الجزيرة كابيتال

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

August 2024

شركة مجموعة كابلات الرياض

Riyadh Cables Group Company

Riyadh Cables Group Company

Healthy Demand, Consistent Capacity Expansions and Pricing Power to Deliver Growth and Improved Profitability

Initiation Report I August 2024

Ahmed AlMutawah

+966 11 2256250

a.almutawah@aljaziracapital.com.sa

Saud F. Alrajhi

+966 11 225 6156

s.Alrajhi@Aljaziracapital.com.sa

Table of contents:

Healthy Demand, Consistent Capacity Expansions and Pricing Power to Deliver Robust Growth: We Initiate our coverage with an "Overweight" rating

Riyadh Cables is a leading power and telecommunication cables producers in the Middle East, with production facilities in 3 markets and sales centers across 9 regional markets. The company also exports its products into other countries and aims to increase its footprint internationally. The company's market has the potential to grow at a CAGR of 5.3% over the period FY23-FY28. To tap this opportunity, the company has laid out an extensive plan to increase its production capacity by 10% by FY24. The company's topline growth is expected to be robust in coming years driven by its expansion plan and growing demand supported by macroeconomic trends. The company has financial strength and sector expertise to execute the expansion plans, and benefit from the market potential. After expanding by around 300bps in FY23, we expect gross margin to reach 13.4% in FY24; on account of strong demand and the pricing power of the group, and we expect it to normalize between 13.2-13.8% during FY25-28. Thus, we are positive about the prospects of the company. We initiate our coverage on the stock with an "Overweight" rating and a TP of SAR 115.9/share.

Strong presence in the strategic sector: Riyadh Cables Group Co. is one of the biggest 15 cables producers globally, and the biggest in the Kingdom with almost 2X the capacity as its closest regional competitor. The company has a local market share of 38.0% and a strong presence in the UAE with a market share above 20% and the most advanced producer in Iraq. Additionally, the company is planning to enter the Kuwaiti market as a producer soon. The size of the combined markets of KSA, GCC and Iraq is assumed to stand around SAR 30.1bn by the end of FY23 and is expected to grow to SAR 39.1bn by FY28. The economic trends in the region such as infrastructure development, urbanization and power transition projects indicate a good growth potential. Moreover, the group's products portfolio and its leadership in HV and EHV cables gives an edge over other competitors. Riyadh cables, with the leading market share and large production capacity, is placed well to make most of this growth opportunity.

Robust topline growth led by expansions and healthy demand: Riyadh Cables has started an expansion plan in 2022 to add 6-7% more capacity annually until 2027. The strong utilization rates of the company indicate the immediate benefit and financial impact of the expansion, added to the healthy and growing demand. We forecast revenue to record a CAGR of 6.7% during FY23-28E. The company's topline is anticipated to be boosted by an increase in volumetric sales across its segments supported by the favorable economic trends.

Improved margins are expected to sustain going forward: The company protects its GP margin by using "Cost +" pricing model, where it adds absolute profit-per-KM on top of all costs. This model hedges the company against fluctuations in raw material prices and acts as a shield for the margins. GP margin is expected to reach 13.4% in FY24 compared to FY23 level of 12.4%, and we expect it to normalize between 13.2-13.8% during FY25-28. We believe that, amid the healthy demand and favorable market conditions, the company will benefit from its economies of scale, in addition to its pricing model. Thus, we expect current margins are sustainable for the company in the long run. Consequentially, profits are expected to grow by a CAGR of 15.2% between FY23-28, reaching to more than SAR 1.0bn by FY28.

AJC View and Valuation: Riyadh Cables' expansion strategy is the backbone of the company's growth story. The expansion plan is supported by the company's current market position, financial ability to invest in new production facilities and industry growth potential. The company has a well-established operating model, which is vertically integrated. Thus, Riyadh Cables has the potential to record robust growth in the top line as well as bottom line over the next few years. We value the stock with 50% weightage each to DCF (WACC=7.66%, terminal growth rate=2.5%), and P/E (22x) multiple applied to our FY25 estimates. Based on the combined valuation, we arrived at a TP of SAR 115.9/share. The TP indicates a 25.9% upside potential from the current market price. Thus, we assign an "Overweight" rating to the stock.

Recommendation	**Overweight**
Target Price (SAR)	**115.9**
Upside / (Downside)*	**25.9%**

Source: Tadawul *prices as of 5th of Aug 2024

Key Financials

SARmn (unless specified)	FY22	FY23	FY24E	FY25E
Revenue	**6,852**	**7,825**	**8,417**	**9,014**
Growth %	40.3%	14.2%	7.6%	6.6%
Gross Profit	647	973	1,125	1,194
EBITDA	522	728	926	1,009
Net Income	**352**	**519**	**697**	**792**
Growth %	46.6%	47.6%	34.2%	13.6%
EPS	2.35	3.46	4.65	5.28
DPS	1.50	2.50	2.75	350

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	9.4%	12.4%	13.4%	13.2%
EBITDA Margin	7.6%	9.3%	11.0%	11.2%
Net Margin	5.1%	6.6%	8.3%	8.8%
ROE	16.9%	23.7%	29.2%	29.7%
ROA	8.2%	11.0%	13.9%	14.6%
P/E (x)	15.5	26.8	19.8	17.4
P/B (x)	2.6	6.2	5.5	4.9
EV/EBITDA (x)	13.0	19.8	15.6	14.4

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	13.80
YTD %	-0.60%
52-week (High)/(Low)	122.0/60.3
Share Outstanding (mn)	150.0

Source: Company reports, Aljazira Capital

Ownership Structure

Name	Shares (mn)	Holding
Abdulqader Al Muhaidib & Sons Co.	28.58	19.05%
AL-AKAF DEV LTD CO	20.0	13.33%
Ahmed Samer Al-Zaim	13.98	9.32%
Almi Company Ltd.	13.97	9.31%
AFAK ALHIKMA DEV CO	10.01	6.67%
Foreigners	19.47	12.98%
Public	43.99	29.34%

Sources: Argaam, AlJazira Capital

Company Overview

Riyadh Cables Group Co. produces, markets and sells cables, electric wires, conductors and optic fibers. It also manufactures electrical connections, wire extension channels made of plastic and other materials, electrical sockets and outlets, as well as insulated wires and cables made of steel, copper or aluminum. The company is also engaged in the contracting projects for high voltage cable, retail sale and installation of factory machinery, equipment and cables, and installation, repair and maintenance of lightning conductors. The Group is the biggest manufacturer of cables in the KSA and ranks among the fifteen (15) largest cable manufacturers globally in terms of production. The Group's total design production ca-pacity is approximately 264,000 tons of metals, with an estimated market share of 37.5% in the KSA. The Group's operation-al extend to GCC countries, Iraq and Egypt.

Market and Industry Overview

Globally, the power cables market is expected to grow in accordance with a post-pandemic economic rebound and ambitious energy transition plans of advanced economies. The power cables market is driven by key factors like growth in the construction sector and promoting large-scale development projects worldwide, urbanization in emerging economies, transition to green energy and electrification. The global power cable market is forecasted to grow at a CAGR of 4.4% to reach SAR 894bn by FY27, from SAR 690bn in FY21. The power cable market in the company's main geographical areas, the Kingdom, GCC countries and Iraq, is expected to exceed global growth rates, as a result of the national development plans of those areas and supported by favorable macroeconomic and demographic factors. The power cables market in these geographies is expected to accelerate to a CAGR of 5.3%, with the total market value ranging from SAR 37.3-40.8bn in the next five (5) years. The power cables market relevant to the Kingdom is expected to grow at a CAGR of 5.9% between FY23-28, reaching SAR 17.6-19.4bn.

Fig 1. Riyadh Cables revenue segments (SAR mn)

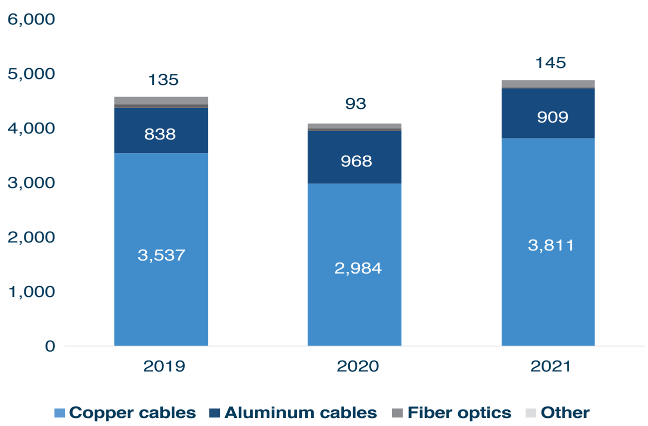
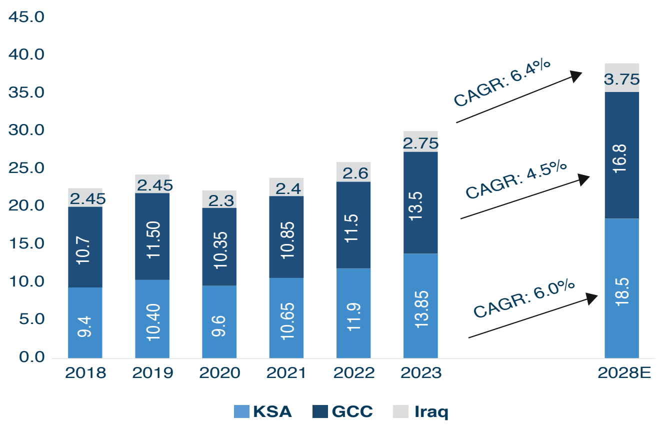


Fig 2. Average power cables market size in the region (SAR bn)



Source: Company's report, Aljazira Capital

Regional economic trends favourable for the company's growth

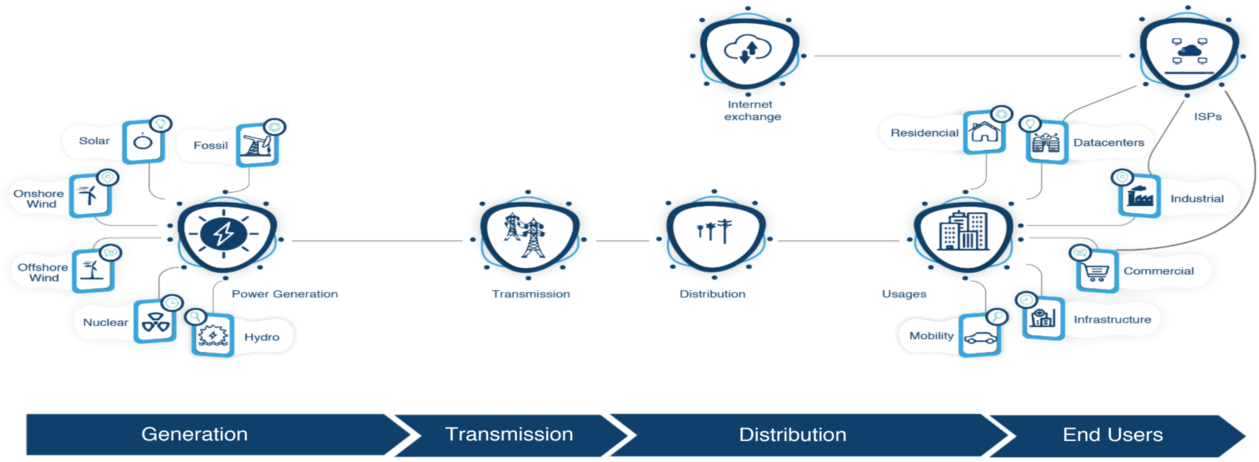
Global Demand Drivers

The global economy is witnessing a strong recovery, post-pandemic, and is expected to have steady, real GDP growth between 2022 and 2027. The IMF expects the World GDP to grow by 3.2% each year in 2024 and 2025. The growth in the global power cables market is driven by the following key factors:

- **Construction:** Spending in the construction sector is expected to grow at a CAGR of 4.4% between 2022 and 2027.
- **Urbanization:** The world population is projected to reach 9.7bn by 2050. Moreover, urbanization rate is estimated to reach 68% of world population by 2050, compared to 57% in 2021, creating more demand for cables for infrastructure and improving access to electricity.
- **Energy transition:** Countries have started their energy transition plans to renewable sources; as part of the efforts to reduce carbon emission. Within the next two years, 425 GW of renewable energy capacity is expected to be added globally. The transition to renewables and modernization of power grids is expected to drive the revamp of power infrastructure.
- **Electrification:** Countries are actively looking at adoption of carbon-free energy at the consumption end of the energy value chain. To achieve this objective, countries are electrifying buildings, industries and transportation, which is driving demand for both electricity and electrical products.

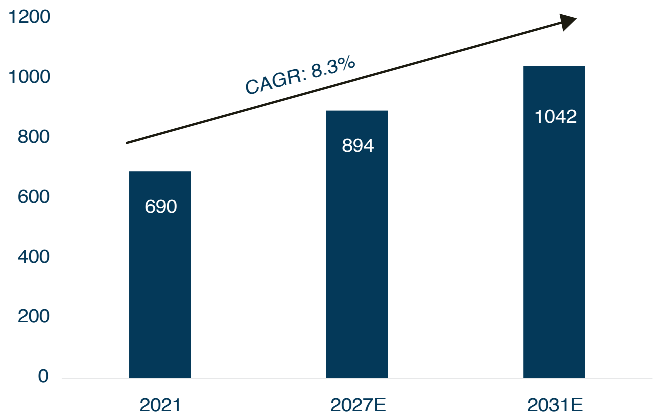
Aided by these trends, the global power cables market is forecasted to grow at a CAGR of 6.4% from 2022 and 2031, reaching SAR 894 bn by 2027, and SAR 1,042 bn from SAR 690 bn in 2021.

Fig 3. Power cables value chain



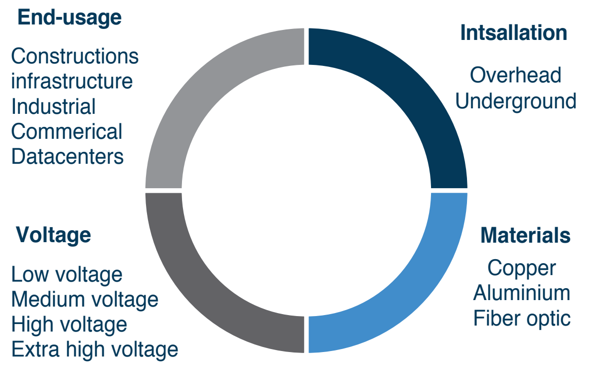
Source: Company's reports, Aljazira Capital

Fig 4. Global power cables market outlook (SAR bn)



Source: Allied Market Research, Company's reports, Aljazira

Fig 5. Power cables market segmentations



Source: Company's reports, Aljazira

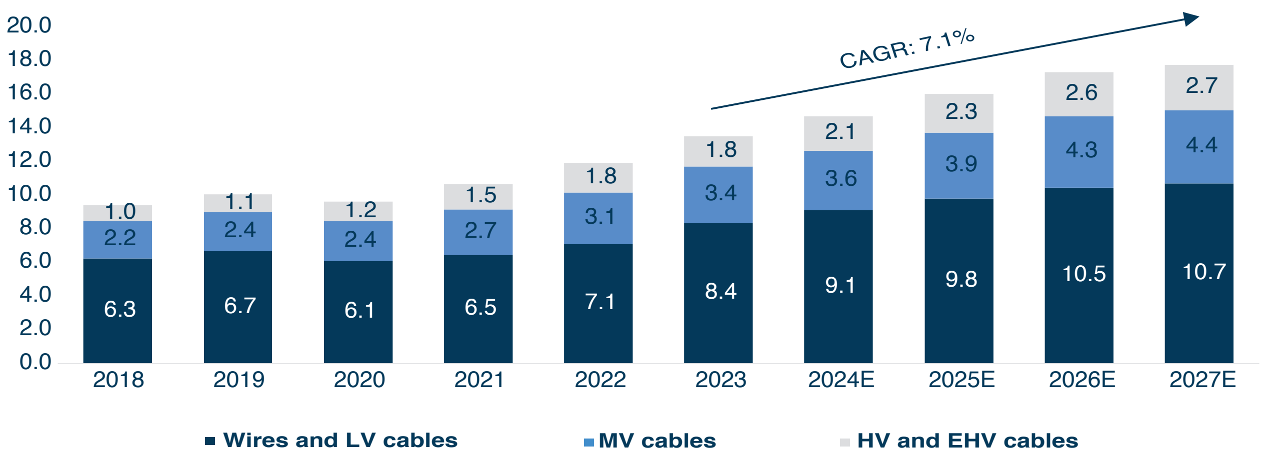
KSA's economic trends to stimulate demand for power cables:

Riyadh Cables Group Co (RCGC) is a leading regional player and has manufacturing facilities in KSA, UAE and Iraq, and expected to add another facility in Kuwait, as soon as the regulatory issues are resolved. The company had a market share of 38.0% in KSA by the end of H1-24, and more than 20% in UAE and is the sole local manufacturer of medium voltage cables in Iraq. Moreover, the company's position as one of the top 15 manufacturers in the world and the biggest in the GCC, enables it to export its products to a wider geography, and leverage large manufacturing capacity. The company's exports reached SAR 1.71bn in FY23, stable on yearly basis. The company aims to reach more regional and international markets like Jordan, Belgium and Australia.

The power cables market is expected to register a healthy growth in the Kingdom in the upcoming years through various channels, such as constructions, industrial and infrastructure. This multi-sector growth is driven mainly by two factors, Vision 2030, and the Kingdom's power transformation program. The effect of Vison 2030 includes both its projects (like NEOM and The Line) and its programs to transform the country's infrastructure, industrial base and quality of life. The KSA is planning to develop infrastructure across the Kingdom to keep it in par with new mega developments. Riyadh is set to be transformed into one of the largest and most advanced cities globally. Projects totaling more than SAR 180bn have been announced, primarily through the King Salman Park, Al Qiddiya and the Diriyah Gate projects. These projects aim to build the infrastructure and real estate necessary to reach a population of 10mn people by 2030. Alongside infrastructural development, the KSA is also expanding the industrial sector through industrial projects such as the industrial complex in Ras Al Khair, RCJY LED factory, Waad Al Shamal Phosphate City, etc. and oil and gas projects such as Marjan offshore oil field expansion. Among them, the following flagship projects will drastically transform the Kingdom:

- **Public infrastructure:** Mecca public transport, Riyadh Airport, Saudi Landbridge Rail, Kingdom National Schools Program, King Hamad and King Fahd causeways.
- **Smart cities and Economic cities:** NEOM, Jeddah Economic City, Medina Knowledge Economic City.
- Mega-projects: Red Sea Project, Qiddiya, AlUla tourism region, King Salman Park, Diriyah Gate, Roshn real estate development.

Fig 6. KSA average power cable market (SAR bn)



Source: Company's reports, Aljazira Capital research

Saudi's Power Transformation Offers another Opportunity for Growth

Saudi Arabia has initiated an ambitious green energy program, leading to a major transformation of the power infrastructure. To realize this program, the Kingdom is targeting to build 58.7 GW of renewable energy capacity by 2030, allowing production of 50% of its electricity with zero carbon emissions. The new capacity will mainly come from photovoltaic solar parks and onshore wind farms (68% and 27% of the new capacity, respectively), but also from innovative concentrated solar power plants (5% of the new capacity). This objective will be further expanded as most of the mega-projects have the objective of sustainably producing their own energy with low carbon emissions. In order to support this transition, Saudi Arabia will also have to take grid modernization initiatives. Saudi Electricity Company (SEC) and the Saudi National Grid are also aiming to add 5,400 circuit-kilometers of transmission lines and 86 transformer substations by 2030G. The KSA is also continuing its grid interconnection efforts to ensure a resilient grid and is expected to become an exporter of green electricity. Renewable energy projects:

- **35 renewable energy parks** are planned across the Kingdom, aiming to build 9 GW per year between 2025G-2030G.
- **4 photovoltaic projects** are planned to start by 2023G, totaling 3 GW capacity from Sudair (1.5 GW), Shuaibah (0.6 GW), Jeddah (0.3 GW), and Rabigh (0.25 GW).

Considering these favorable demand conditions, the power cables market relevant to RCGC is expected to exhibit a high growth with a CAGR of around 6.0% between 2023 and 2028, with a value of SAR 17.6-19.4bn by 2028. These conditions are also favorable for the growth in markets of other products proposed by RCGC in the KSA such as telecom cables, special cables, engineering services, etc. . RCGC had a market share of 38.0% in the kingdom, as of H1 2024, the company should be on the top beneficiaries of the potentials and growth in the Saudi market.

Other Regional Markets also Displaying Growth Drivers Similar to KSA

The GCC countries & Iraq have been undergoing similar developments as the KSA, albeit at different rates. All GCC countries have laid out their vision for the next 10-15 years and share the common themes of economic diversification and sustainable development. Meanwhile, Iraq is undergoing a major economic development plan, and has over SAR 1.4tn of major projects which are planned or underway. The UAE, where RCGC is a key approved supplier and contractor with Dubai Electricity and Water Authority, constitutes the most significant share in the overall Gulf economy after the KSA. We expect the company also to benefit from the power transitions projects like:

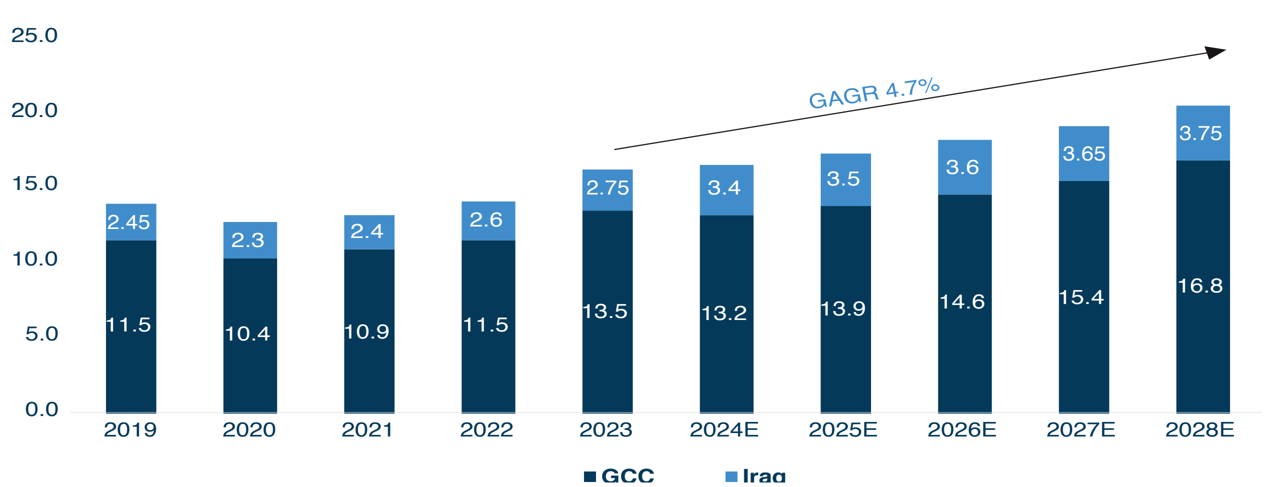
- **The UAE** has 7.3GW of upcoming projects planned – Fujairah 3, a waste-to-energy project of 2.4GW, Al Dhafra, a solar energy project of 2GW in Abu Dhabi, and SP IV and V, solar energy projects of 2GW and 0.9GW in Dubai.
- **Kuwait** has a plan for 2.9GW of projects under separate phases of the Shagaya project. The project is a mix of CSP and photovoltaic solar energy.

Table 1. RCGC and competitors' manufacturing presence by geography

Company	KSA	UAE	Oman	Kuwait*	Qatar	Bahrain	Iraq
RCGC	√	√		√			√
Al Fanar Group	√						
Bahra Electric	√						
Ducab		√					
Elsewedy Electric	√				√		
Gulf Cables				√			
Jeddah Cables	√						
Oman Cables			√				

Source: Company's reports. *From 2023 onwards

Fig 7. GCC & Iraq average power cable market



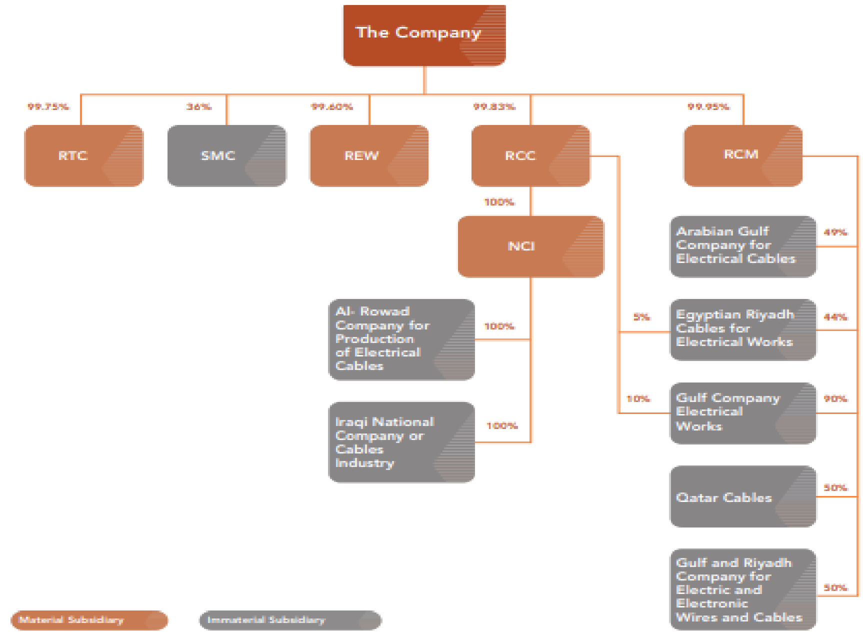
Source: Company's reports, Aljazira Capital Research

Beside these internal energy projects, there are grid interconnection efforts in the region. Kuwait has signed an interconnection deal with Iraq. The GCC Interconnection Authority aims to expand the GCC inter-connection grid towards Iraq, Egypt, and Jordan. RCGC is already a key supplier of power cables for the implementation of different phases of this regional-scale grid interconnection program.

RCGC's vertically integrated operations give it an edge over competitors

RCGC has 13 subsidiaries owned directly and/or indirectly by the company, of which 5 are considered material and 8 are considered non-material. The Group owns six supporting factories to the ten main cable factories in the KSA, the UAE and Iraq, with a total production capacity of 264,000 tons of metal, as of 2022 (without the additions in 2023 and 2024), almost 2X capacity of its closest regional competitor. The Group is considered a leading company specialized in the production of cables, electrical wires, communication cables and electrical conductors of various types in the Middle East and globally. It is also considered a leading supplier of cables used in infrastructure developments in the Kingdom, GCC countries and the Republic of Iraq. The Group aims to keep its manufacturing facilities up to date with technical developments in the electrical cable and wire manufacturing sector. The Group's operations are vertically integrated in terms of manufacturing, administrative and marketing, and other technical aspects.

Fig 8. RCGC's organizational structure

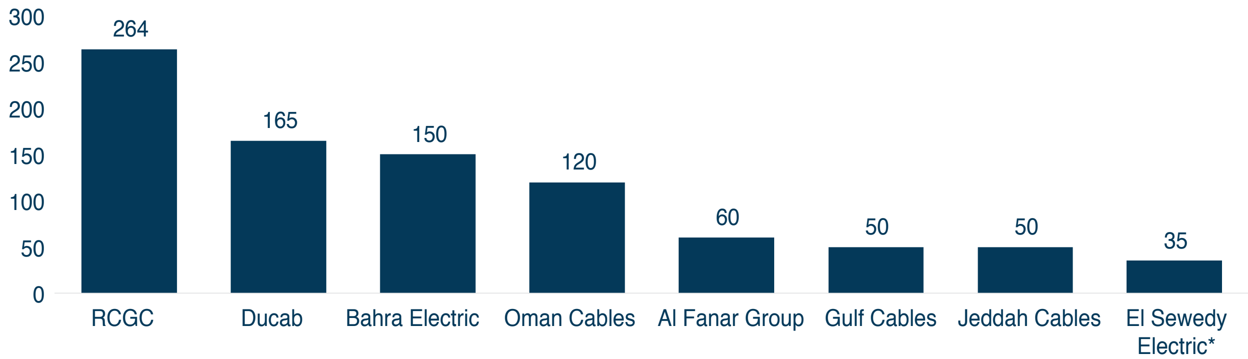


Source: Company's reports

The Group's business is divided into four segments:

1. **Manufacturing activities:** The Group produces low, medium, high and extra-high voltage electrical cables, wires manufactured from copper or aluminum, household electrical cables and wires, copper communication cables, fiber optic cables, specialized cables and cables and overhead line (OHL) conductors. In addition, the Group produces its own raw materials used in manufacturing its products, including copper and aluminum rods (which are the main components of cable conductors), compounding polymers necessary for cable manufacturing such as medium-density polyethylene (MDPE) compound, fire-retardant low-smoke emission halogen-free polymer compound (LSHF), polyvinyl chloride (PVC) compound, cross-linked polyethylene (XLPE) compound and polypropylene yarn (PP). The Group also manufactures wooden and steel drums used in spooling electrical cables and wires. This manufacturing process is vertically integrated, has provided the Group with competitive advantages in terms of production speed, cost-effectiveness and quality maintenance.

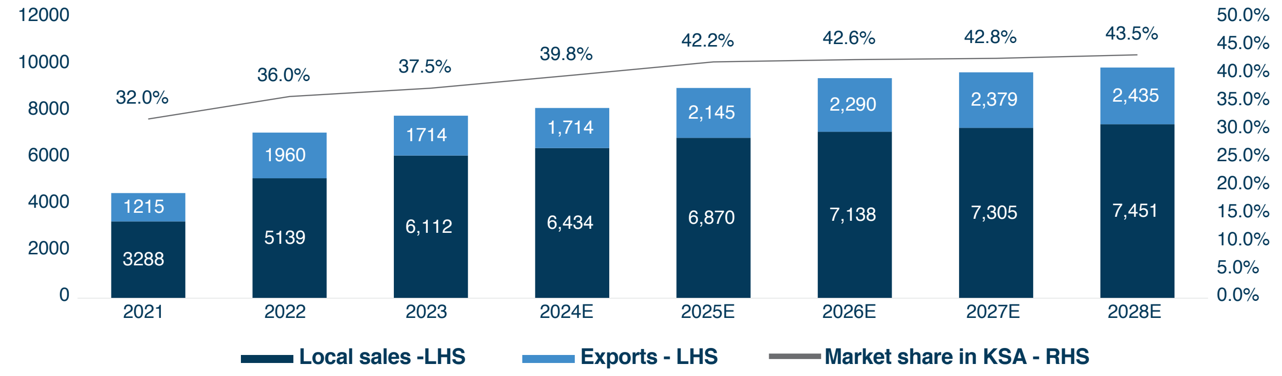
Fig 9. RCGC's and competitors' production capacities (000, metal tons)



Source: Company's reports. *In the GCC. Not including RCGC's added capacity by FY23 end.

2. **Sales activities:** The Group sells its products through multiple sales channels including direct sales to Group customers and more than 20 sales and distribution partners in the Kingdom and the GCC. The group's size gave it an advantage of a wider geographic presence in the region. In addition to 4 manufacturing facilities in KSA, UAE, Iraq and Kuwait (by the end of 2023) the company has also spread into regional countries like Qatar, Jordan, and Egypt. As per management guidance; the group is also expanding into the Libyan market, driven by regional tendency toward regional suppliers instead of international (especially European) suppliers. By the end of 2023, export sales contributed 22% of the group's revenue.

Fig 10. Riyadh Cables revenues and market share in KSA



Source: Company's reports, Aljazira Capital Research

3. **Electrical contracting project:** The Group undertakes electrical contracting projects for high voltage (HV) cables inside and outside the Kingdom. Which include the design and construction of electricity distribution networks, excavation, installation and connection works related to electrical cables and wires.

4. **Maintenance activities:** Backed by a specialized team of engineers, the Group engages through a subsidiary in construction and maintenance of industrial buildings and production lines. The company also offers industrial services, including maintenance, repair and operation of industrial, electrical, telephone and computer machinery, as well as installation and operation of laboratory equipment.

Products portfolio gives the group a strong competitive advantage

The Group is distinguished in its ability to produce a variety of products with more than 3,000 high-quality cable and wire items (of various specifications and sizes) that are used in the energy, contracting, oil, gas, transportation, industry and communications sectors, giving it a significant competitive advantage in providing turnkey solutions.

Table 2. RCGC and competitors' product portfolio

Competitor	Wires	LV Cables	MV Cables	HV Cables	EHV Cables	Over-head lines	Spe-cial and Con-trol cables	Commu-ni-cation cables	Rods	Fiber optics
RCGC	√	√	√	√	√	√	√	√	√	√
Al Fanar Group	√	√	√	√						
Bahra Electric	√	√	√	√		√	√			
Ducab	√	√	√	√	√	√	√		√	
Elsewedy Elec-tric	√	√	√	√		√				
Gulf Cables	√	√	√			√	√	√		
Jeddah Cables	√	√	√	√	√	√	√		√	

Source: Company's reports.

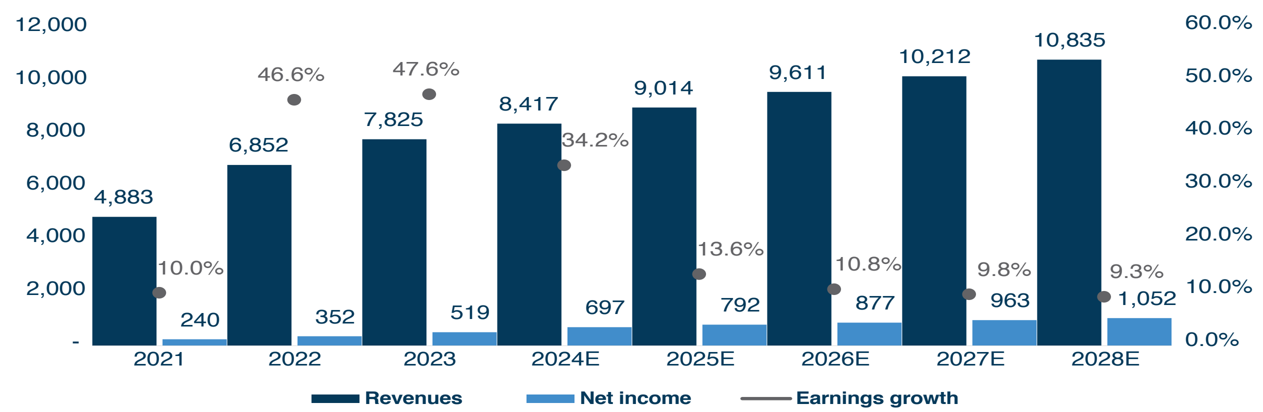
RCGC's expansion plans and the healthy demand to drive the growth story

RCGC's revenues grew at a CAGR of 12.7% in the period (2018-2023) reaching SAR 7.83bn by the end of FY23, and the CAGR of net income in the same period has been 30.9% reaching SAR 518.49mn. In FY23, the company's earnings grew by 47.4% compared to FY22, and the management's guidance for FY24 growth is between 20%-30%. The company's market share grew from 30.0% in FY21 to reach around 37.5% in FY23, as it benefited from its wide range portfolio of products to meet the healthy demand.

Meanwhile, the company plans to spend around SAR 200mn in FY24, after spending SAR 156mn in FY23, and expected to stabilize between SAR 175-200mn annually going forward. Moreover, the company is increasing its footprint in the region. In addition to its exports, and the manufacturing facilities in UAE and Iraq, the company is also planning to start a joint project with a local produced in Kuwait, in order to compete for the High Voltage cables (HVC) in the country. Moreover, the company's management announced that the company accepted new customers in The Middle East and Africa recently, which we expect to pave the way for the company to increase its regional presence in the future.

We expect the company to record a healthy growth in the coming years, and to post a revenue growth CAGR of 6.7% from 2023 to 2028, and a CAGR of 15.2% in earnings during the same period.

Fig 11. RCGC's revenues and earnings growth (SAR mn)

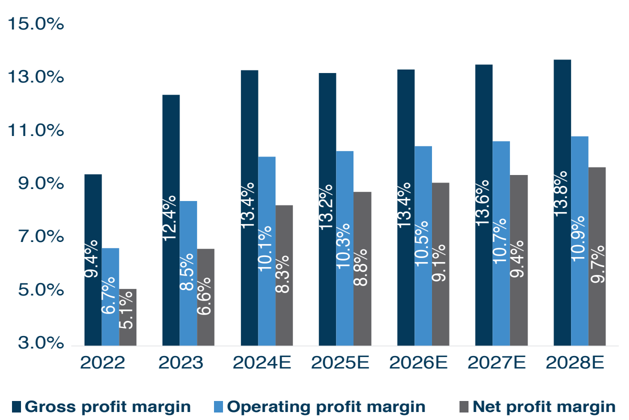


Source: Company reports, Aljazira Capital Research

"Cost +" pricing model and growth to support the margins, while providing a shield against prices volatility

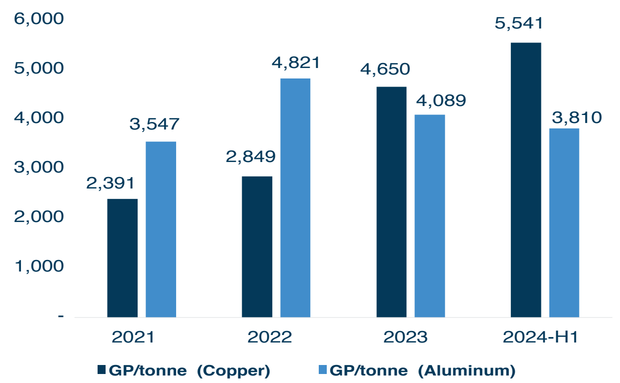
The company uses a pricing model (Cost +), where it adds an absolute profit/KM on top of all costs. This model provides the company's margins with protection against fluctuation in prices of the raw materials. On top of that, the pricing model gives a strong competitive advantage as the company has the ability to increase prices as demand peaks. This led GP margin to reach 13.56% in H1-24 compared to 12.4% in 2023. In addition to the pricing power, the company will also benefit from the economies of scale amid the healthy demand and favorable market conditions. We expect GP margin to reach 13.4% during FY24 on the back of the better product pricing, while net profit margin is expected to reach 8.3% in FY24 compared to 6.6% in FY23. We expect GP margin to normalize between 13.2-13.8% between FY25 and FY28. Meanwhile, we expect NP margin to be preserved in the coming years, supported by higher operational efficiency and lower interest expenses.

Fig 12. RCGC's margins



Source: Allied Market Research, Company's reports, Aljazira

Fig 13. RCGC's GP/tonne (SAR)



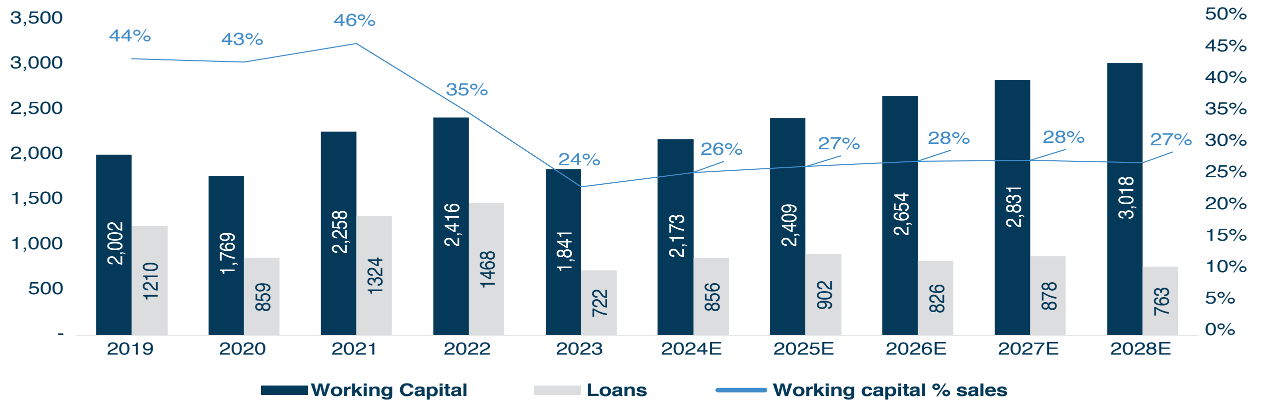
Source: Company's reports, Aljazira

Business requires external financing for working capital

Increasing loans due to a high working capital, but cash cycle is improving

RCGC's working capital has increased significantly in the last two years due to business growth (backlog of confirmed orders= SAR 5.2bn, as of June 2024). This growth in backlog has driven the increase in the working capital to reach SAR 2.4bn by the end of FY22, before decreasing to SAR 1.84 by December-23 as the company had an excellent working capital management. However, we expect the working capital to stay at high levels going forward due to the nature of the company's operations, which will attract external financing. On the other hand, accounts receivables' collection days have improved along with the increase in working capital reaching to 61 days in December-23, compared to 87 days in 2019. Trade payables days have been increasing in the same period to reach 64 days in FY23 compared to only 8 days in 2019, which supported the cash flows of the company.

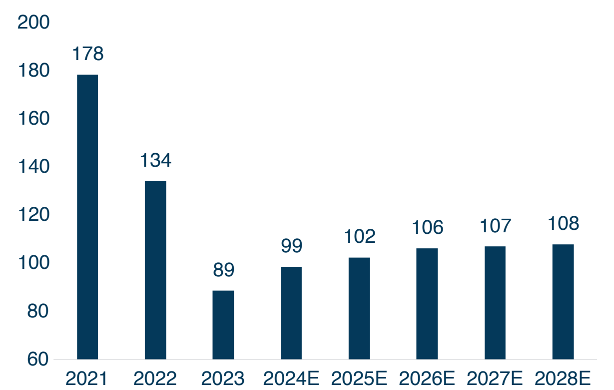
Fig 14. Working capital and borrowings trends (SAR mn)



Source: Company reports, Aljazira Capital Research

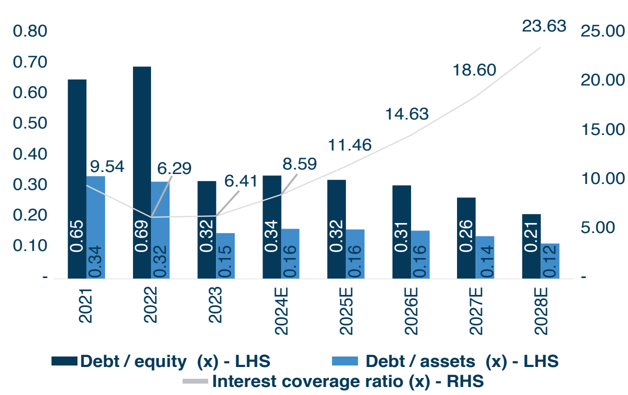
As of June 2024, RCGC's debt stood at SAR 916mn and the company held net cash position of SAR 169.1mn, implying a debt to eaquity ratio of 0.38x (up from 0.32x in December 2023), which we expect to normalize to around 0.34x-0.32x during FY24 and FY25, given the working capital and Capex needs. Interest expense is expected to come around the level of SAR 100mn in FY24, and to decline to around SAR 80mn in FY25, supported by lower interest rates. The company has healthy interest coverage ratio of 8.4x in H1 2024 (6.4x in FY23), implying the manageable level of the interest expenses.

Fig 15. Cash cycle (days)



Source: Company reports, Aljazira Capital Research

Fig 16. Solvency ratios

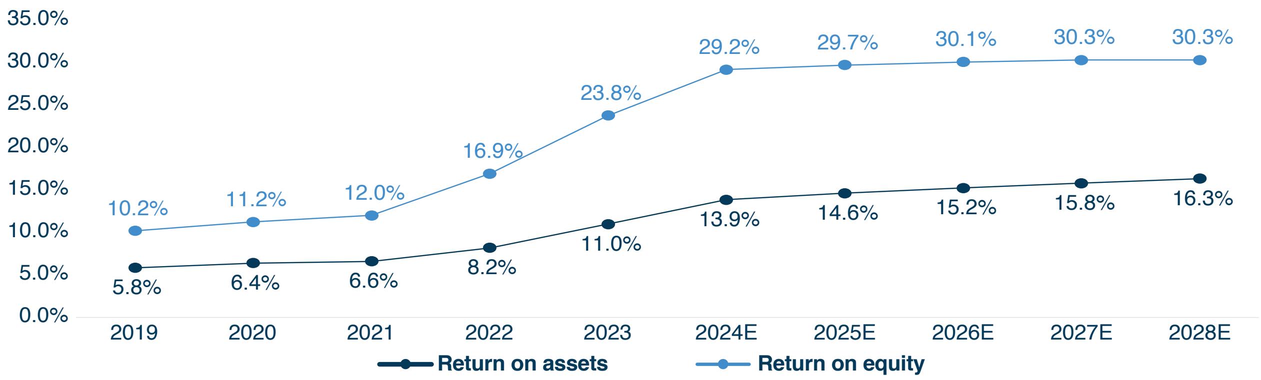


Source: Company reports, Aljazira Capital Research

Healthy ROE and ROA

RCGC has delivered heathly returns with an ROA of 11.0% and ROE of 23.7% in FY23. We forecast ROA to increase further to 13.9% in FY24 to grow steady in the following year to reach 16.3% by FY28; as profitability is expected to increase with the excellent utilization rates of the assets. ROE is also expected grow at a higher rate to reach 29.2% in FY24 and stablize at around the level of 30% in the upcoming years, given the growth expected for the company's earings.

Fig 17. ROE and ROA

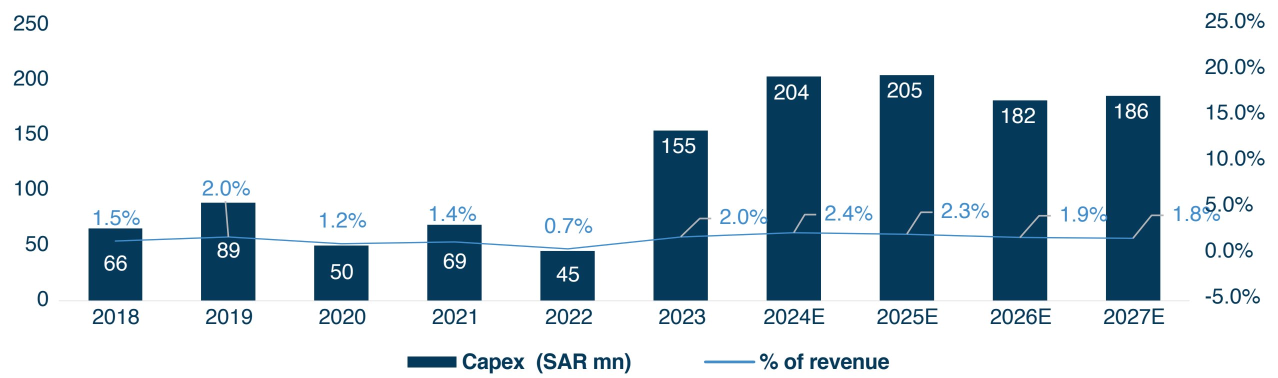


Source: Company reports, Aljazira Capital Research

Capex to further increase to SAR 200mn in 2024 and 2025, and to stay above SAR 180mn afterwards due to the ambitious expanion plans

The company is planning to spend around SAR 200mn in FY24 and FY25, each, after spending more than SAR 150mn in FY23, amid its expansion plan to benefit from the growing local market and to increase its footprint regionally. Accordingly, We expect this level of CAPEX to normalized going froward, as we expect the company to spend more than SAR 180mn annually between 2026 and 2028 to meet its expanionary goals. Assets turnover improved in FY23 reaching to 162% compared to 148.2% in FY22, which we expect to stay at the level of 161%-164% between FY24-28. This heathtly ratio, added to the the pricing model which protects the margins, and given the heathly utilzation rates and the good demand in the market, indicates that the expansion plans will translate into favorable returns for the shareholders.

Fig 18. Capex intensity

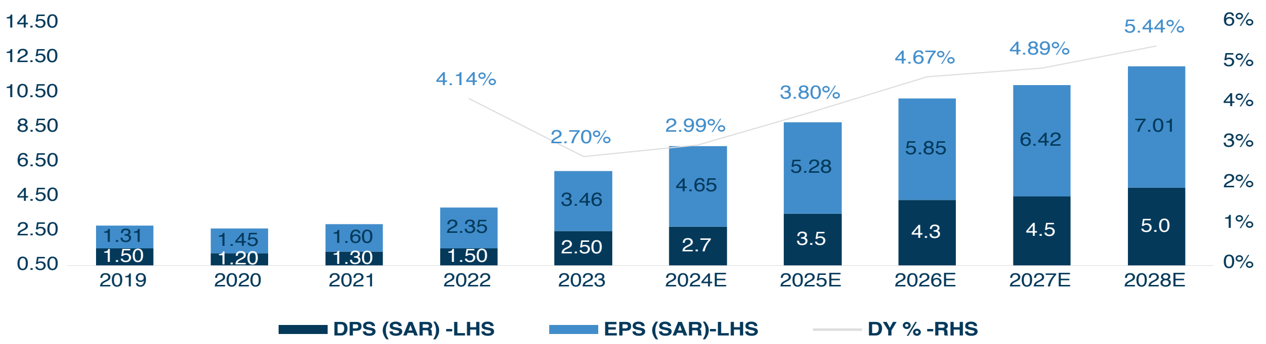


Source: Company reports, Aljazira Capital Research

Dividend payout to decline to around 60% in FY24 amid high Capex, before improving gradually to 70% level

The company has been paying dividends to its shareholders. Payout ratio decreased in the last two years reaching to 72% in FY23 and 64% in FY22, compared to 82% in FY21, as the company tightend the built a little to finance its expansion plans and related CAPEX. However, we believe the company is in a stroing financial position to keep its payput ratio between 60-70% during the period FY2024-28. We expect the company to pay SAR 2.75 per share in FY24 and SAR 3.50 in FY25 yielding 3.0% and 3.8% on the stock, repectively. We believe the company is still in its growth phase, hence we expect dividends payout to be curbed at the mentioned level.

Fig 19. RCGC's dividends trend



Source: Company reports, Aljazira Capital Research

Key Risks

- The Group's operations depend on certain key raw materials (mainly copper and aluminium) in manufacturing its final products, the unavailability of any such raw materials will hinder the Group's manufacturing operations and negatively affect its financial position.
- Any increase in raw material prices may require the company to obtain bank facilities to finance working capital and to grant higher credit ceilings to its customers. Additionally, prices increase might result in an increase in the value of the Group's inventory, leading to increased financing of working capital, and impacting the cash flow negatively.
- The hedging agreements the group has entered into do not cover around 17% of the raw materials in its inventories. Any extreme fluctuations in raw material prices may impact on the profitability of those unhedged materials.
- In case of any inventory surplus exceeding the Group's needs, management of such inventory will cause the Group to incur additional costs and to use a portion of the Company's liquidity to finance such surplus. In contrast, any shortage in raw material inventory would have an impact on the Group's ability to maintain the required level of production and meet the needs of some customers as quickly as required, which may have an adverse and material impact on the Group's operations.
- Any future changes to the accounting policies for the slow-moving inventories adopted by the Group may force it to increase the value of provisions it has to set aside in order to cover slow-moving inventory, which will have an adverse effect on the Group's business, results of operations, financial position and future prospects.
- The Group's manufacturing operations depend on electricity, industrial water, diesel, gas and gasoline. The Group's inability to procure its needs for such resources in a timely manner or at adequate prices will have an adverse effect on financial projections and actual financial results.
- The Group is subject to the risk of industrial accidents, which in turn may lead to damage to the environment and negatively affect the health and safety of workers and facilities and may cause interruption of production.
- Some of the Group's manufacturing facilities are constructed on land leased from (Modon). Any failure to obtain or maintain or renew those leases, will result in hindering manufacturing operations of the plants and incurring unexpected capital expenses, and adverse affecting the Group's operations, financial position and future prospects.
- If the Group is not able to manage its working capital efficiently, this will lead to increased utilization of facilities and increased financing costs, which will have a material adverse effect on the Group's profitability, cash flows, operations and financial position
- The group is subject to risk of concentration and dependence on major clients representing around 17% of total revenues (namely the Saudi Electricity Company).

Valuation Methodologies

DCF Valuation

We performed a DCF valuation based on our forecasts for the next five years. We assumed risk free rate of 4.25%, market risk premium of 6.25% and beta of 0.67 to arrive at a WACC of 7.66%. Terminal growth rate is assumed at 2.5%. Our valuation of Riyadh Cables based on DCF yielded an enterprise value of SAR 17.85bn and fair value to equity shareholders of SAR 17.3bn, which translated into a TP of **SAR 115.6 per share**.

	FY23E	FY24E	FY25E	FY26E	FY27E
NOPAT	860	931	1,027	1,092	1,180
Depreciation & Amortization	74	78	72	82	86
Change in working capital	(275)	(172)	(174)	(101)	(104)
Capex	(204)	(204)	(182)	(186)	(188)
FCFF	**455**	**633**	**743**	**887**	**974**
Discounting factor	0.98	0.91	0.85	0.79	0.73
Present value of FCFF	**444**	**576**	**629**	**699**	**755**
Sum of the PV					3,062
Terminal Value					14,790
Enterprise Value					17,852
Cash and cash equivalents					161
Debt					-579
FV to common shareholders					17,334
No outstanding shares (mn)					150.0
Fair value per share					**115.6**

Terminal growth rate	WACC				
	6.3%	**7.0%**	**7.7%**	**8.4%**	**8.9%**
2.0%	106.09	106.08	106.07	106.07	106.06
2.3%	110.60	110.60	110.59	110.58	110.58
2.5%	115.57	115.57	115.56	115.56	115.55
2.8%	121.08	121.07	121.06	121.06	121.05
3.0%	127.19	127.19	127.18	127.18	127.17

Above is an illustration of sensitivity of our DCF valuation to the change assumptions of terminal growth rate (range: 2.0%-3.0%) and WACC (6.3%-8.9%). The sensitivity analysis indicates valuation in the range between a minimum of SAR 106.06 (at terminal growth rate of 2.0% and WACC of 8.9%) and SAR 127.19 per share (at a terminal growth rate of 3.0% and WACC of 6.3%).

Relative valuation

For our relative valuation, we have valued Riyadh Cables using a P/E multiple of 22.0x based on FY25 estimates. We assigned a high multiple for the company taking in consideration its growth trajectory, as we estimate growth rates of Riyadh Cables' earnings of 34.2% and 13.6% for FY24 and FY25, respectively. Consequently, we arrived to a TP of SAR 116.1 per share.

P/E Valuation:

All figures in SAR mn, unless specified	
RCGC P/E (Multiple)	22.0x
FY25 EPS	5.28
Market value (SAR mn)	17,421
Shares (mn)	150.0
Relative value (SAR/share)	**116.1**

Blended Valuation

Valuation Summary	Fair Value	Weight	Weighted Average
DCF	**115.6**	50.0%	57.8
P/E	**116.1**	50.0%	58.1
Weighted Avg. 12-month TP			**115.9**
Current Market Price (SAR /share)			92.0
Expected Capital Gain			**25.9%**

We assigned 50% weightage each to DCF, and P/E multiples. Based on the combined valuation, we arrived at a TP of **SAR 115.9/share**. The TP indicates 25.9% upside potential from the current market price. **Upside risks** for our valuation include: 1) Faster than expected execution of expansion plans. 2) Higher than expected acceleration of constructions activities. 3) Lower than expected raw material prices. 4) Better than expected collection of receivables. 5) Lower than expected finance expenses amid interest rate cuts. While **downside risks** include: 1) Delay in the execution of expansion plans. 2) Lower than expected acceleration of constructions activities. 3) Extreme fluctuation in raw material prices impacting working capital. 4) Less than expected collection of receivables. 5) Higher than expected finance expenses amid high interest rate.

Key Financial Data

Amount in SARmn, unless otherwise specified	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement										
Revenues	4,566	4,087	4,883	6,852	7,825	8,417	9,014	9,611	10,212	10,835
Y/Y	**6.1%**	**-10.5%**	**19.5%**	**40.3%**	**14.2%**	**7.6%**	**7.1%**	**6.6%**	**6.3%**	**6.1%**
COGS	(4,086)	(3,650)	(4,420)	(6,205)	(6,853)	(7,291)	(7,820)	(8,323)	(8,826)	(9,344)
Gross profit	**480**	**436**	**463**	**647**	**973**	**1,125**	**1,194**	**1,288**	**1,386**	**1,491**
Selling and distribution expenses	(98.0)	(87.0)	(91.8)	(102.8)	(111.9)	(117.7)	(124.0)	(132.9)	(142.3)	(152.5)
General and administrative expenses	(85.1)	(84.5)	(79.5)	(100.2)	(135.3)	(131.0)	(134.2)	(140.3)	(146.6)	(153.2)
Credit provision	(33.5)	12.1	8.7	3.1	(42.9)	(15.5)	(13.8)	(12.0)	(12.7)	(13.5)
Other revenue	15.0	8.6	2.6	10.5	(20.7)	(9.2)	8.6	7.4	7.5	7.3
Operating profit	**278**	**286**	**303**	**458**	**662**	**852**	**931**	**1,010**	**1,091**	**1,179**
Y/Y	**36.1%**	**2.6%**	**6.1%**	**51.0%**	**44.6%**	**28.7%**	**9.2%**	**8.5%**	**8.1%**	**8.0%**
Financing Expense (net)	(49.6)	(35.4)	(31.8)	(72.8)	(103.3)	(99.2)	(81.2)	(69.0)	(58.7)	(49.9)
Income before zakat	**229**	**250**	**271**	**385**	**559**	**753**	**850**	**941**	**1,033**	**1,129**
Zakat	(31.9)	(32.1)	(31.4)	(33.1)	(39.1)	(55.5)	(57.7)	(63.9)	(70.2)	(76.7)
Net income	**197**	**218**	**240**	**352**	**519**	**697**	**792**	**877**	**963**	**1,052**
Y/Y	**45.5%**	**10.7%**	**10.0%**	**46.6%**	**47.6%**	**34.2%**	**13.6%**	**10.8%**	**9.8%**	**9.3%**
EPS (SAR)	**1.31**	**1.45**	**1.60**	**2.35**	**3.46**	**4.60**	**5.30**	**5.8**	**6.4**	**7.0**
DPS (SAR)	**1.53**	**1.19**	**1.31**	**1.50**	**2.50**	**2.70**	**3.50**	**4.30**	**4.50**	**5.0**
Balance sheet										
Assets										
Cash & equivalent	54	64	50	107	150	172	187	177	212	194
Other current assets	2,204	2,004	2,620	3,226	3,339	3,589	3,817	4,035	4,267	4,507
Total current assets	2,258	2,069	2,670	3,333	3,489	3,761	4,004	4,212	4,479	4,701
Property plant & equipment	1,229	1,144	1,155	1,120	1,207	1,337	1,463	1,564	1,668	1,770
Other non-current assets	17	89	128	171	135	134	133	132	131	130
Total assets	**3,503**	**3,302**	**3,953**	**4,624**	**4,831**	**5,232**	**5,600**	**5,908**	**6,277**	**6,601**
Liabilities & owners' equity										
Other current liabilities	266	377	476	913	1,728	1,703	1,759	1,803	1,933	2,070
Short term loans	1,210	859	1,324	1,468	722	856	902	926	878	763
Total current liablities	1,476	1,236	1,800	2,381	2,450	2,559	2,661	2,729	2,811	2,833
Total non current liablities	109	107	116	123	135	141	141	148	147	147
Paid -up capital	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500	1,500
Statutory reserves	207	229	253	288	288	288	288	288	288	288
Retained earnings	189	208	218	306	448	733	1,000	1,233	1,521	1,823
Other reserve	23	22	65	26	31	31	31	31	31	31
Treasure shares					(21)	(21)	(21)	(21)	(21)	(21)
Total owners' equity	1,919	1,959	2,036	2,121	2,246	2,531	2,798	3,031	3,318	3,620
Total equity & liabilities	**3,503**	**3,302**	**3,953**	**4,624**	**4,831**	**5,232**	**5,600**	**5,908**	**6,277**	**6,601**
Cashflow statement										
Operating activities	(27)	594	(208)	185	1,342	658	838	925	1,073	1,162
Investing activities	(88)	(52)	(72)	(37)	(156)	(204)	(205)	(182)	(186)	(188)
Financing activities	124	(532)	267	(91)	(1,144)	(433)	(618)	(753)	(852)	(992)
Change in cash	8	10	(13)	56	43	22	15	(10)	35	(18)
Ending cash balance	**54**	**64**	**50**	**107**	**150**	**172**	**187**	**177**	**212**	**194**
Key fundamental ratios										
Liquidity ratios										
Current ratio (x)	1.53	1.67	1.48	1.40	1.42	1.47	1.50	1.54	1.59	1.66
Quick ratio (x)	0.77	0.71	0.56	0.59	0.59	0.62	0.64	0.65	0.68	0.71
Profitability ratios										
Gross profit margin	10.5%	10.7%	9.5%	9.4%	12.4%	13.4%	13.2%	13.4%	13.6%	13.8%
Operating margin	6.1%	7.0%	6.2%	6.7%	8.5%	10.1%	10.3%	10.5%	10.7%	10.9%
EBITDA margin	7.6%	8.6%	7.5%	7.6%	9.3%	11.0%	11.2%	11.4%	11.5%	11.7%
Net profit margin	4.3%	5.3%	4.9%	5.1%	6.6%	8.3%	8.8%	9.1%	9.4%	9.7%
Return on assets	5.8%	6.4%	6.6%	8.2%	11.0%	13.9%	14.6%	15.2%	15.8%	16.3%
Return on equity	10.2%	11.2%	12.0%	16.9%	23.8%	29.2%	29.7%	30.1%	30.3%	30.3%
Assets turnover	130.3%	123.8%	123.5%	148.2%	162.0%	160.9%	161.0%	162.7%	162.7%	164.1%
Leverage ratio										
Debt / equity (x)	0.63	0.44	0.65	0.69	0.32	0.34	0.32	0.31	0.26	0.21
Debt / assets (x)	0.35	0.26	0.34	0.32	0.15	0.16	0.16	0.16	0.14	0.12
Interest coverage ratio (x)	5.61	8.08	9.54	6.29	6.41	8.59	11.46	14.63	18.60	23.63
Market/valuation ratios										
EV/sales (x)	NA	NA	NA	0.99	1.85	1.72	1.61	1.51	1.42	1.33
EV/EBITDA (x)	NA	NA	NA	13.0	19.8	15.6	14.4	13.3	12.3	11.4
EPS (SAR)	1.31	1.45	1.60	2.35	3.46	4.65	5.28	5.85	6.42	7.01
BVPS (SAR)	12.8	13.1	13.6	14.1	15.0	16.9	18.7	20.2	22.1	24.1
Market price (SAR)*	NA	NA	NA	36.3	92.6	92.0	92.0	92.0	92.0	92.0
Market-Cap (SAR mn)	NA	NA	NA	5,438	13,890	13,800	13,800	13,800	13,800	13,800
DPS (SAR)	1.5	1.2	1.3	1.50	2.5	2.75	3.50	4.30	4.50	5.00
Dividend yield	NA	NA	NA	4.1%	2.7%	3.0%	3.8%	4.7%	4.9%	5.4%
P/E ratio (x)	NA	NA	NA	15.5	26.8	19.8	17.4	15.7	14.3	13.1
P/BV ratio (x)	NA	NA	NA	2.6	6.2	5.5	4.9	4.6	4.2	3.8

Source: the company's report, Bloomberg, Argaam, AJC Research

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

RESEARCH DIVISION

Head of Sell-Side Research - AGM
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer