

Equity Research – Initiation of Coverage

Sector: Basic Materials & Industrial Products

Country: Lebanon

Date: December 06, 2010

Share Price (USD): 16.50

Fair Value (USD): 17.49

Upside: 6%

Recommendation: HOLD

Initiating coverage with a HOLD Recommendation and a Fair Value of USD 17.49 per share

Sustained market share with challenging growth outlook

Holcim's Lebanese market share has been hovering between 43% and 45% over the past few years. Revenue grew by only 2.5% in 2009 as production capabilities were temporarily reduced while shifting production from old grinders to a new installed one. We expect growth to cool down starting in 2011 on concerns that revenue expansion will be mirroring that of the real estate market which may slightly decline in the next few years.

Revenue reliant on grey cement and weighted towards local sales

Grey cement constituted 84% of revenues in 2009 through sales of 1.98 million tons. Revenue has been traditionally derived from local sales with international revenue driven mainly from markets in Syria and Iraq. In 2010, export sales have been nil as the capacity of the company turns primarily towards the satisfaction of the Lebanese market.

Profitability margins preserved despite spikes in oil prices

Gross margin was maintained between 31% and 33% despite the aggressive fluctuations in energy prices as a result of Holcim's hedging strategy. Profit margin advanced to 15% compared to 10% in 2008 due to the company's belt-tightening policy that led to cuts in its production and operating expenses.

Liquidity supported by limited capital expenditures

At the beginning of the financial crisis, the company limited its capital expenditures to about USD 7 million decreasing new debt issues and thus its Debt-to-Equity from 0.37 in 2007 to 0.19 in 2009. We expect the company to maintain its investing activities around the same levels over the coming few years.

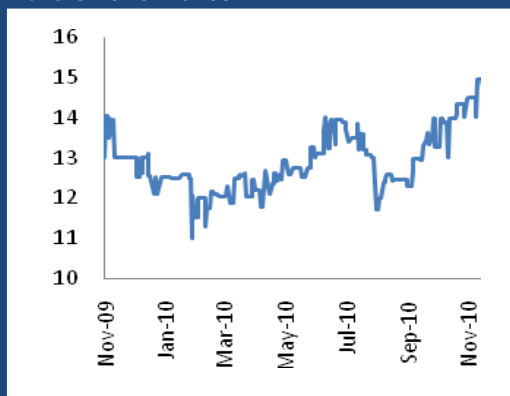
Limited growth prospects deny valuation premium

We valued Holcim USD 17.49 per share with a valuation premium of 6%, using a Discounted Cash Flow (DCF) method and a 15% discount rate. A HOLD recommendation is issued for Holcim's equity based on: 1) the company operating in a country with high political and security risks, 2) reliance on the local real estate market that is expected to slightly decline over the coming few years, 3) the stock trading in an illiquid market with only 18% of outstanding tradable shares and 4) lack of quarterly visibility as the company releases financial reports only on an annual basis.

Share Data

Bloomberg Symbol	HOLC LB
Reuters Symbol	HOLC.BY
Market Cap	322,014,660
Number of Shares	19,516,040
Free Float	17.8%
Price-to-Earnings	10.52
Price-to-Book	1.76

Share Performance



1 Month Return	13.79%
3 Month Return	34.15%
6 Month Return	25.86%
12 Month Return	31.89%
52 Week Range	16.50 – 11.00

Performance and Forecasts

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Year	2009	2010e	2011f	2012f	2013f	2014f
Revenues (USD millions)	207	216	220	222	225	228
Net Income (USD millions)	31	35	35	36	36	38
EPS (USD)	1.57	1.81	1.81	1.85	1.86	1.96
BVPS (USD)	9.38	9.44	9.32	9.28	9.33	9.44
ROA (%)	9.7	11.5	11.7	12.1	12.3	13.2
ROE (%)	14.1	15.8	15.8	16.2	16.2	17.0

FINANCIALS & VALUATION

Year	2009	2010e	2011f	2012f	2013f	2014f		
Profit & Loss Summary								
Revenue (USDm)	207	216	220	222	225	228		
Revenue Growth (%)	2.5	4.6	1.6	1.2	1.2	1.1		
Gross Profit (USDm)	67.9	73.6	74.8	75.6	76.5	77.4		
Gross Margin (%)	32.8	34.0	34.0	34.0	34.0	34.0		
Net Profit (USDm)	30.6	35.3	35.3	36.1	36.3	38.2		
Profit Margin (%)	14.8	16.3	16.1	16.2	16.1	16.8		
Net Profit Growth (%)	48.6	15.2	0.0	2.3	0.5	5.2		
Earnings Per Share (USD)	1.57	1.81	1.81	1.85	1.86	1.96		
Price-to-Earnings (Forward P/E)	10.52	9.12	9.12	8.91	8.87	8.43		
Balance Sheet Summary (USDm)								
Cash & Cash Balances	18	23	27	37	40	47		
Inventories	40	39	41	42	42	41		
Accounts Receivable & Prepayments	17	19	19	18	19	20		
Property, Plant & Equipment	169	164	155	146	138	130		
Other Assets	64	61	58	55	54	51		
Total Assets	307	306	300	298	292	289		
Total Liabilities	84	82	77	74	68	64		
Book Value Per Share (USD)	9.38	9.44	9.32	9.28	9.33	9.44		
Profitability								
ROA (%)	9.7	11.5	11.7	12.1	12.3	13.2		
ROE (%)	14.1	15.8	15.8	16.2	16.2	17.0		
Liquidity								
Cash / Current Liabilities	0.39	0.47	0.61	0.82	0.97	1.18		
Current Assets / Current Liabilities	1.63	1.69	1.93	2.17	2.46	2.74		
Net Working Capital / Current Assets	0.39	0.41	0.48	0.54	0.59	0.64		
Comparables								
	Valuation			Margin Analysis (%)		Profitability (%)		
	P/E	P/Rev	P/BV	Gross	Operat.	Net	ROE	ROA
Holcim (Liban)	10.5	1.6	1.8	32.8	20.3	14.8	14.1	9.7
Average of Peers	12.1	2.4	1.6	31.6	22.6	22.8	18.6	14.1
Valuation								
		2010e	2011f	2012f	2013f	2014f		
Net Income (USDm)		35.3	35.3	36.1	36.3	38.2		
Free Cash Flow to Equity (USDm)		42.4	39.4	37.9	40.4	39.7		
Terminal Value (USDm)								361.1
Discounted Cash-flows (USDm)		42.4	34.2	28.6	26.6	22.7		
Holcim (Liban) Value (USDm)								341.2
Number of shares (in millions)								19.52
Fair Value								17.49

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INVESTMENT SUMMARY

We are initiating a HOLD recommendation on Holcim (Liban)'s shares after carefully analyzing the essential factors we consider when investing in an equity.

Macroeconomic Environment

The cement market has been growing over the past ten years at a Compounded Annual Growth Rate (CAGR) of 10.3% reaching 5.10 million tons per year in 2010. This growth was accelerated in 2007 following the reconstruction activity to restore the bridges and regions that were ruined during the July 2006 war. From 2008 on, the main driver of the demand for cement in Lebanon has been real estate caused by the increase in capital inflows mainly from expatriates and Arab businessmen who wanted to diversify away from markets impacted by the financial crisis. Moreover, with the continuous growth of tourist activity and the need for higher capacity in hotels and resorts, investments in the tourism sector also have a tangible effect on construction. Concerns about potential growth in real estate construction activity rise with the risk of oversupply in the upscale and luxurious residential segment that is inaccessible for a large fraction of the population. Accordingly, we expect the cement market to slightly downsize through the coming few years unless the development of Lebanon's infrastructure, through the potential public private partnership, boosts demand for cement.

Business Model

Revenue at Holcim Liban (HL) is dominated by grey cement sales which constituted 84% of revenues in 2009. White cement sales are much less common with 100,000 tons sold in 2009 compared to 1.98 million tons for grey cement. Revenue has been traditionally weighted towards local sales with international revenue driven mainly from markets in Syria, Iraq and Cyprus where the company's grinding facility is located. In 2010, export sales have been nil as the capacity of the company turns primarily towards the satisfaction of the Lebanese market's growing demand. HL has purposely limited exports as falling prices in Syria presented a less attractive market. Moreover, new cement producers have started to operate in Syria allowing buyers to avoid expensive shipping costs from Lebanon.

Profitability

Between 2007 and 2009, HL's gross margin was maintained between 31% and 33% despite the aggressive fluctuations in energy prices as HL managed to hedge against spikes in oil prices. Net Income witnessed an aggressive y-o-y growth of 49% in 2009 reaching USD 31 million with profit margin advancing to 15% compared to 10% in 2008. This net income growth is a result of improvements in its sales figures following a strong market demand and capacity expansion in addition to the company's strategy of controlling its production and operating costs infused by its parent Holcim Ltd.

Over the past three years, Return-on-Assets (ROA), that measures how well the company manages its assets in generating the maximum return to its shareholders, almost doubled from 5.5% in 2007 to 9.7% in 2009. Return-on-Equity (ROE), an indicator of how well the company is managing stakeholders' capital also increased from 8.6% to 14.1% over the same period. Earnings-Per-Share (EPS) have grown almost 50% from USD 0.96 in 2007 to USD 1.57 in 2009 reflecting the improvement in the company's bottom line.

Growth

HL's revenues grew by only 2.5% in 2009 compared with the 16.5% expansion recorded a year earlier. Top line growth in 2009 was impeded mostly from reduced production during the second and third quarters of the year, due to the installation of a new grinder that would improve the operations' efficiency. We estimate the company's sales to expand at an annualized rate of around 4.6% in 2010 before starting a downward trend in 2011, following a decline in the demand for cement, as growth in the Lebanese real estate sector may have already peaked. In terms of

market share, HL's share of the Lebanese market has been hovering between 43% and 45% over the past few years, however the company is implementing a strategy to maintain a target of 45%. It plans to do so by offering client-specific services to ensure repeat purchases by its customers, while also targeting customers in growing cement markets such as Mount Lebanon.

Financial Position

HL has been enjoying a strong financial position backed by satisfactory liquidity levels whereby its current assets are normally around 1.5 times its current liabilities. In 2007 however, this ratio reached 1.1 due to the company's cash balance declining remarkably from USD 30 million down to USD 12.8 million with HL using some of its cash to complete a 12-to-1 reverse stock split. Controlled debt levels have also contributed to HL's financial health. At the beginning of the financial crisis the company limited its capital expenditures to about USD 7 million, decreasing new debt issues and thus its Debt-to-Equity from 0.37 in 2007 to 0.19 in 2009. We expect the company to maintain its investing activities around the same levels over the next few years.

Valuation

We valued HL's share at USD 17.49 using a Discounted Cash Flow (DCF) method based on a 5 years forecast and a discount rate of 15%. We assumed that revenue would increase by an annualized 2% over the 5-year period and determined the terminal growth rate at 4% taking into consideration the outlook of the company.

When comparing HL to its regional peers, we find that with a P/E ratio of 10.5, the cement producer may be undervalued against its peers which hold an average P/E of 12.1. However, we issue a HOLD recommendation on the company's equity as it operates in a country with high political and security risks and only has 18% of its outstanding shares tradable in an illiquid market such as the Beirut Stock Exchange.

Dividends

HL has been distributing all of its earnings to shareholders over the past six years, resulting in a dividend payout ratio of 80%-90%. In 2009, the company gave out USD 17.5 million or a dividend yield of 7.2%. We expect the company to continue having a high payout ratio with similar dividend yields in the future.

	2007	2008	2009
Price / Share	20.75	15.93	12.52
Dividend Paid / Share	0.908	0.698	0.898
Dividend Yield	4.4%	4.4%	7.2%

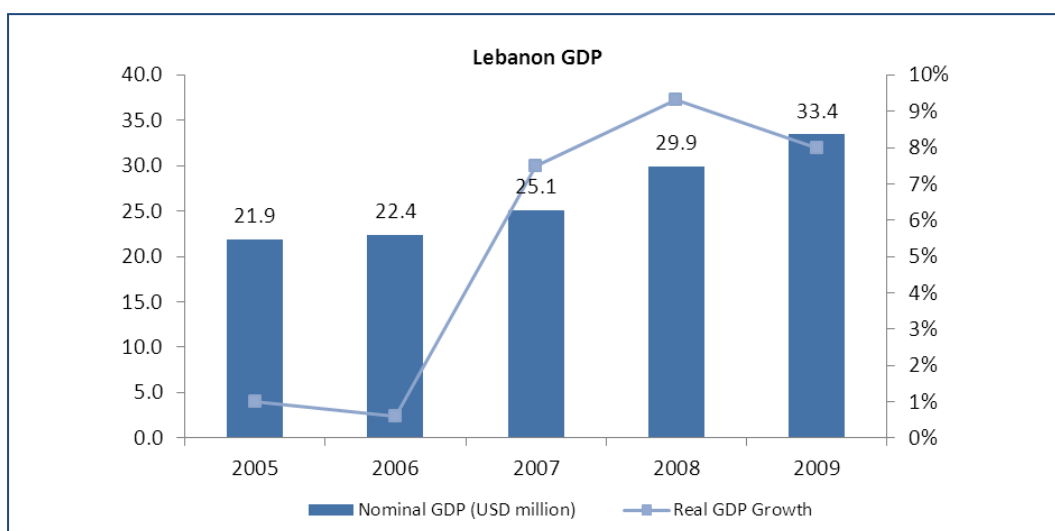
Risks

We have three major concerns related to investing in HL with the most significant being a potential slowdown in the Lebanese real estate market that drives demand for cement and related products. This may be partially or totally offset by Government infrastructure investments. However, since the Government is limited to finance large projects, the private-public partnership scheme to develop Lebanon's juvenile infrastructure is seen as a potential growth driver to the cement market. If this scheme fails to birth, the cement producers will find themselves operating in a shrinking market. One last concern goes to the cement imports' banning, as it shields local producers against foreign competition. As long as the government is imposing high tariffs on cement imports which restrain foreign competition, Lebanese cement producers would still enjoy a price advantage in their local market.

ECONOMIC OVERVIEW

Strong Economic Growth Resilient Despite Political Tensions

The Lebanese economy continued to flourish in the first half of 2010, following the trend that has been prevailing over the last few years. Nominal Gross Domestic Product (GDP) is projected to expand by 7% throughout 2010, a shy decline from the 8% growth recorded in 2009. The boom in most economic sectors resulted, as expected, in a noticeable increase in inflation as Consumer Price Index (CPI) averaged 3.93% during the first six months of 2010 compared to the 2.60% during the same period last year. Massive capital inflows coupled with expatriate remittances continue to soar, allowing local consumption and demand to sustain their rise in the first half of 2010. Moreover, the number of tourists visiting Lebanon has grown by 22.12% y-o-y during the first seven months of 2010 to reach 1.32 million tourists.

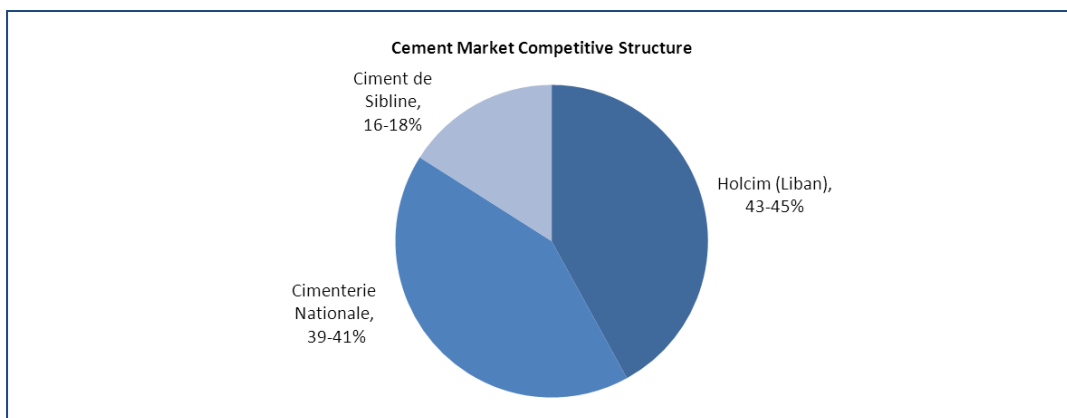


Source: Ministry of Economy & Trade, IMF, Blominvest

Sustained economic growth has been supported by the political stability in the country beginning with the Doha agreement in May 2008 that led to the election of a new president and a new parliament. While consumption and investment in the country continue to soar, political tensions grew in June 2010 due to the unexpected turn of events in the Special Tribunal for Lebanon. These concerns, along with fears of a slow global recovery, applied considerable downward pressure on the Beirut Stock Exchange. Solidere shares, which mirror political tensions in the country, declined by 18% between June and October 2010 to reach USD 18.55 per share at the end of October. Consumer confidence that is measured through the Consumer Confidence Index (CCI) also lost 19.38% by the end of June y-o-y.

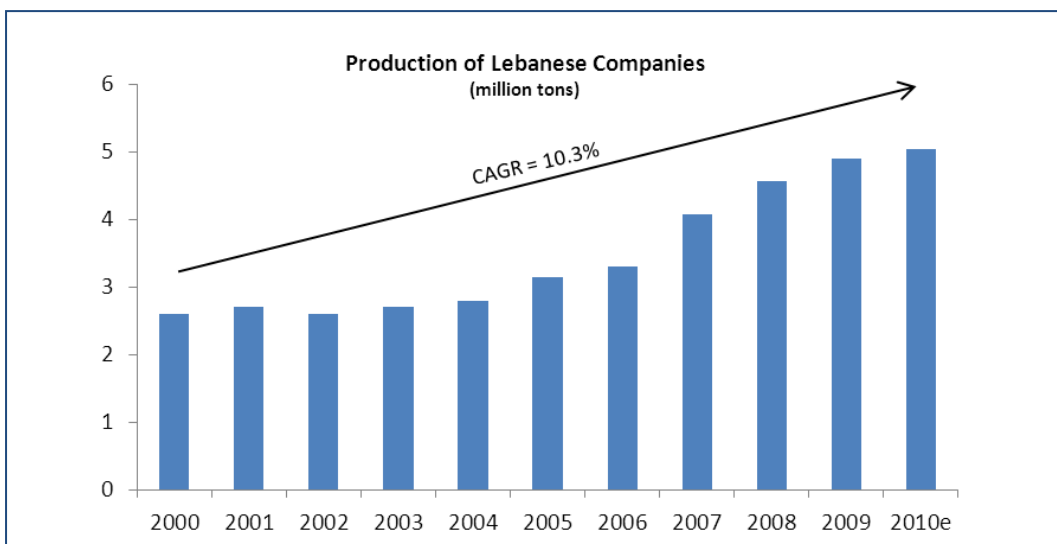
Cement Market Dynamics

The cement market in Lebanon takes the form of an oligopoly where only three companies form the market with the following shares:



Source: Blominvest

The Lebanese cement market has been growing over the past ten years at a CAGR of 10.3% to reach 5.04 million tons per year in 2010 as compared to the 2.6 million tons in 2000. Record growth was registered in 2007 estimated at 23% following the July 2006 war. In fact, after the July war that left massive destruction in infrastructure, reconstruction efforts resulted in higher than expected growth for the cement market. From 2008 on, the main driver of cement demand in Lebanon has been real estate, caused by the surge in demand for properties along with the increase in capital inflows from expatriates and other Arab investors diversifying away from markets impacted by the financial crisis.



Source: Holcim

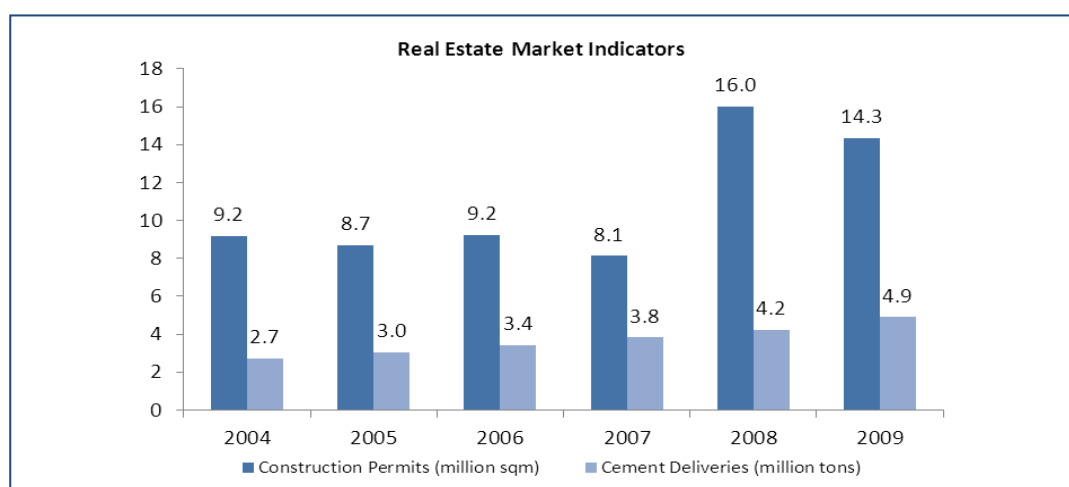
The following are the main types of cement and related construction products:

- Grey cement is the most common type of cement in general use worldwide and represents the biggest share of the Lebanese market for construction materials.
- White cement is very similar to grey cement in terms of texture but endures substantial modification to the manufacturing process including much higher temperatures (i.e. more energy) making it more expensive than the ordinary grey cement. It is used for specialized and aesthetic purposes from architectural projects and decorative works, to bright coloring and finishing.

- Clinker is the solid material generated by the cement kiln to which other additives and small quantities of gypsum are combined to produce ordinary grey cement.
The production process of cement is available in the appendix.
- Concrete is produced combining cement with water and other additives. It is used for architectural structures and foundations, and is mostly popular for binding construction components together.

Demand for Cement and Construction Driven by Real Estate

Most of the demand for cement and construction activity in Lebanon relies on the real estate market which continues to disappoint those advocating the presence of a real estate bubble that is about to burst. Construction permits, measured by surface, surged 33.33% up until June 2010 to reach 8.53 million square meters with cement deliveries estimated at 2.59 million tons, a 9.2% y-o-y increase.



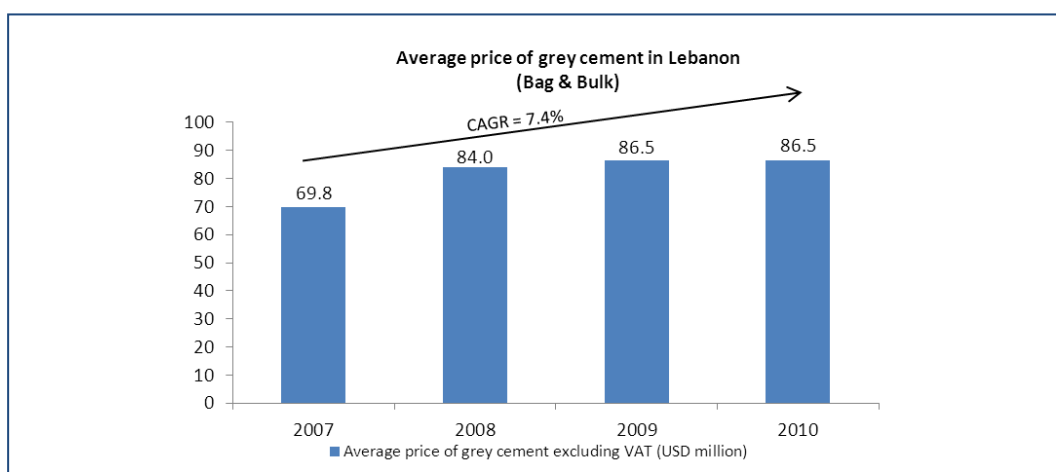
Source: Order of Engineers

Increased cash inflows to the country have induced the real estate market either by funding direct investments in the sector or by increasing housing loans as deposits are providing banks with a large cushion of liquidity. The non-resident private sector deposits rose 26% during the first four months of 2010 compared to the same period last year. These were backed by robust remittances and Foreign Direct Investments (FDI) that followed the 11% growth rate recorded in 2009. Investments in real estate are quite attractive for investors as capital gains on this sector are not subject to taxes and foreigners are allowed to acquire lands and properties.

On the hospitality front, with the continuous growth of the tourism sector and the need for higher capacity in hotels and resorts, investments in the tourism sector are also affecting construction activity. In fact, 17 new hotels and resorts will be inaugurated between 2010 and 2013 increasing capacity by 2,386 rooms.

A Localized Industry with Limited Imports/Exports

Foreign cement producers can only import cement into Lebanon through a license that can be granted by the Ministry of Industry. There is currently a "gentleman's understanding" stating that the ministry will not issue new licenses as long as the local producers do not exceed a certain ceiling for cement prices in the country (currently USD 86.5 per ton excluding taxes).



Source: Holcim

Assuming the ministry issues licenses, import tariffs can reach up to 75% for grey cement, clinker and related products and 25% for white cement. These terms have been in effect since 2005 before which imports were completely prohibited by a law decree issued with a duration of 5 years from October 1999 until the end of 2004.

Cement Type	Custom Duties
Cement clinkers	75%
Portland white cement	25%
Other Portland cement	75%
Aluminous cement	30%
Other hydraulic cement	35%

Source: www.customs.gov.lb

In case the agreement with the ministry dissolves, it would still be challenging to import cement due to its high shipping costs that range between USD 23 and USD 44 per ton of cement depending on the country of import and on the shipping routes adopted. Egypt and Turkey are the main cement exporters in the region as they have an overcapacity and are able to produce cement at competitive prices. Thus, if Lebanon were to import cement from one of these two countries, the total price per ton would stand at USD 109 for Egyptian cement and USD 98 for Turkish cement. This is higher than the USD 86.5 price that Lebanese producers are selling at, assuming Egyptian and Turkish exporters would want to generate a similar level of profit as when selling in their local market. It is important to note at this point, that cement exports from Egypt have been banned since 2009 to ensure domestic needs are secured. In fact, prior to the ban, Egyptian cement producers turned primarily to satisfy foreign markets, positioning the country among the world's largest cement exporters. This ban was imposed in 2009 after surging demand drove prices higher, and is expected to expire in October 2010 without being renewed. Thus the scenario above applies in case Egypt lifts its ban on cement exports.

From	Shipping Method	Shipping costs per container (USD)	Tons per container	Shipping costs per ton	Selling Price of cement per ton (USD)	Total cost of cement per ton (USD)
Egypt	Land	680	24	28.33	86.00	114.33
Egypt	Sea	540	24	22.50	86.00	108.50
Turkey	Land	1,050	24	43.75	54.00	97.75

Source: CMA-CGM, Suez Cement Company

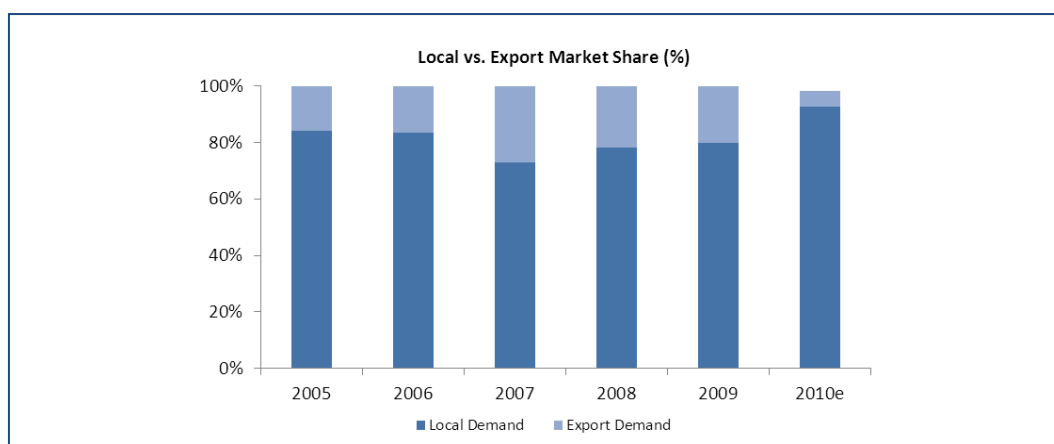
On the export side, Lebanese producers would have to export cement at lower prices in order to be competitive in Syria or Iraq. Cement would have to be sold to Syria at around USD 60 per ton, much lower than the USD 86.5 per ton of cement sold in its local market, in order for the total price including shipment costs and customs to be USD 120 which is the current market price in Syria. In addition, very expensive shipping costs to Iraq of USD 143 per ton of cement exported to Iraq makes the Iraqi market less attractive to the Lebanese producers.

To	Shipping Method	Shipping costs per container (USD)	Tons per container	Shipping costs per ton	Selling Price of cement per ton (USD)	Total cost of cement per ton (USD)
Syria	Land	1,200	23.5	51.06	120.00	120.00
Iraq	Land	3,350	23.5	142.55	N/A	N/A

Source: CMA-CGM, Holcim

Between 2005 and 2009, exports to Syria have contributed to demand for Lebanese produced cement to hover between 16 – 27% of the total demand for Lebanese cement. In 2010 however, exports to Syria are expected to decline to around 6% due to the following:

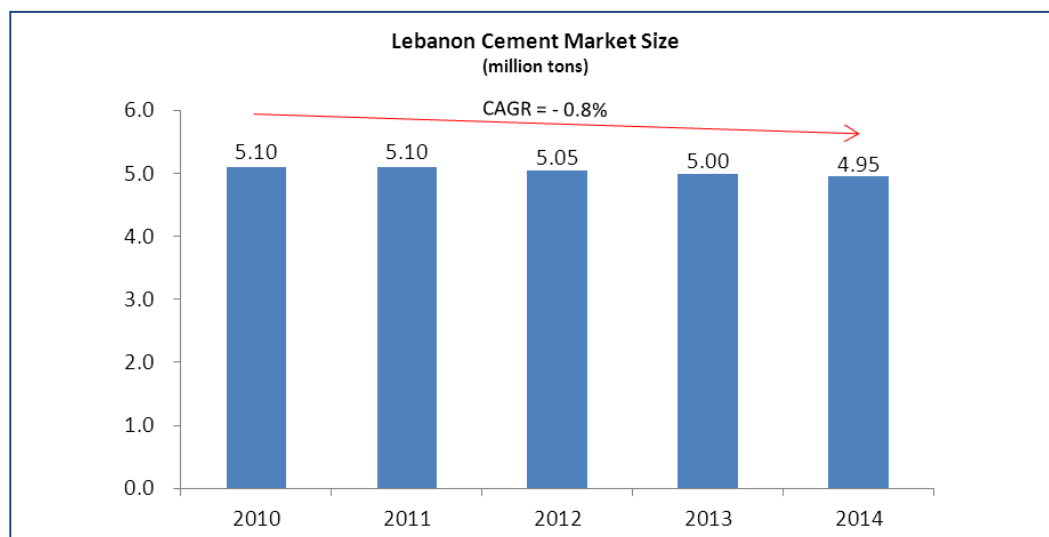
- The Lebanese market size has grown enough to exhaust almost all of the capacity of local producers that aim primarily to protect and enhance their market positions locally.
- The Syrian market has become self-sufficient as new cement producers have started to operate in the country. Lafarge, a French producer that is a major player in the global cement market, has expanded its operations in Syria with an estimated annual capacity of about 3 million tons, which will suffice at least a third of the Syrian market's demand. As a result, demand for Lebanese cement in Syria has retreated as Syrian buyers can now acquire locally produced cement and avoid the shipping costs from Lebanon.



Source: Holcim, Blominvest

Taking a look at the Horizon

Concerns surrounding the real estate construction activity rise with the risk of oversupply in the upscale and luxurious residential segments that are inaccessible to a large fraction of the population. Consequently, we expect the cement market to stagnate, declining at an estimated annual average rate of 0.8% throughout the coming four years. If the local demand slows, Lebanese producers will likely export their cement to Syria at lower prices in order to cover for their fixed costs and utilize their full capacity.



Source: Blominvest

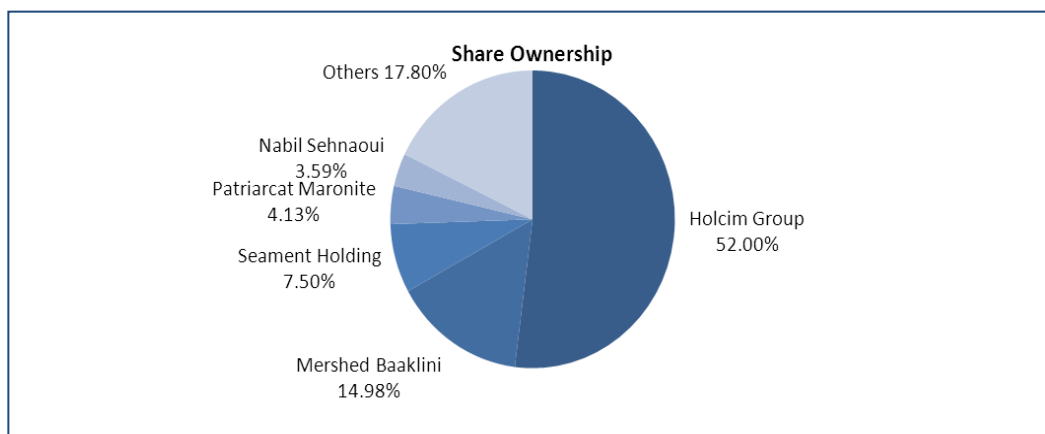
The upcoming need for the development of Lebanon's faltering infrastructure is expected to boost demand for cement as real estate activity in Lebanon may possibly stabilize in 2011. As Lebanon is suffering from under-developed infrastructure constrained by the government's inability to fully fund potential projects, the suggestion of a public-private partnership scheme is emerging. This partnership that consists of building the country's infrastructure through a joint funding from the Lebanese government and the private sector is still being debated with ideas and plans to be yet agreed upon. Whatever the scheme that will be used to upgrade the infrastructure, it will boost the demand for cement, which may partly compensate for the future slight decline of the real estate market.

COMPANY PROFILE

Holcim Liban S.A.L. (HL) was incorporated in Lebanon in 1929 as a subsidiary of Switzerland-based Holcim Ltd., one of the largest cement producers in the world. It is engaged in the production and sale of grey and white cement along with other related concrete products needed for construction. HL's main production facility is located in Chekka with its headquarters in Antelias, Lebanon. It currently grasps 42.5% of the Lebanese cement market and is the largest cement company in Lebanon measured by sales and annual cement production capacity with 2.2 million tons per year. HL is also the sole producer of white cement in the country through its majority owned subsidiary Société Libanaise des Ciments Blancs (SLCB) with a capacity of 100,000 tons in 2010 and owns a grinding facility in Cyprus.

Ownership

HL is the fifth largest company on the Beirut Stock Exchange (BSE) with 52% of its shares owned by Holcim Ltd. Most of its remaining stock is held by individuals and organizations that are tied to the company, leaving a mere 18% of stocks tradable on the BSE.



Source: Zawya

Management

Name	Position
Urs Spillmann	CEO
Bruno Pitzini	CFO
Jamil Bouharoun	Development Manager
Marlene El Khazen	Human Resources Manager
Jacques Fayad	Sales Director
Jacques Thooris	Cement Exploitation Manager

Subsidiaries

Societe Libanaise des Ciments Blancs (SLCB)

Through the intermediary of SLCB in which it holds 67% of ownership, HL is the sole producer of white cement in Lebanon with a capacity of 100,000 tons.

Holcim Beton (HB)

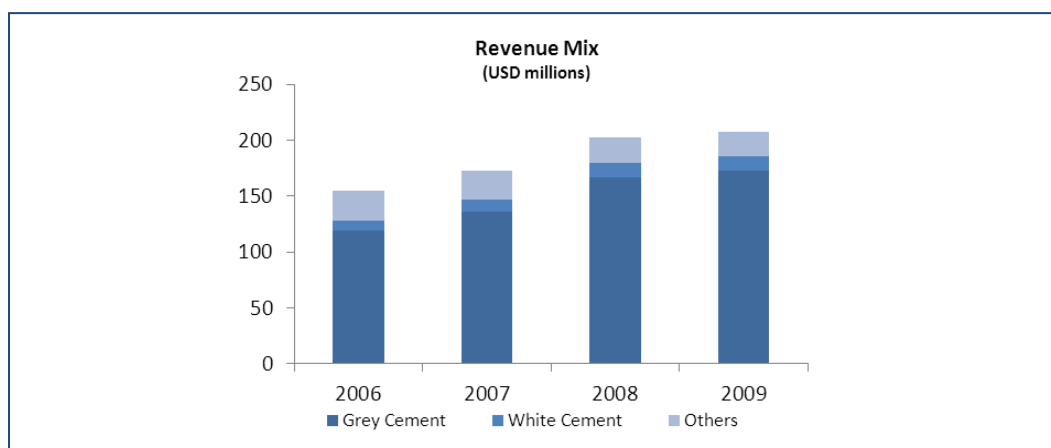
HL owns 100% of Holcim Beton S.A.L. that constitutes its distribution channel for selling concrete products to the Lebanese market. The subsidiary's facilities are located in Chekka, Tyre, Nahr el Mott, Kfarshima and Beirut Port for the duration of an ongoing project. In addition, HB has launched a new facility in Halba earlier in 2010.

Bogaz Industri Ve Madencilik Ltd. (BEM)

BEM is a grinding station in Cyprus, 100% owned by HL. It buys Clinker from its parent company and simultaneously constitutes an export channel to Cyprus.

BUSINESS MODEL

HL's raw materials are mainly procured from its quarry in Chekka, Lebanon, which can yield a supply for at least 30 years assuming a slight growth in HL's annual capacity. HL has three different revenue sources: revenue from grey cement, from white cement and from other related products such as concrete and clinker with the grey cement dominating the sales pool.



Source: Holcim

Revenue Mix

Holcim (Liban)'s revenue is dictated by grey cement sales. Out of the 2.2M tons produced yearly by the Company, grey cement sales constituted in 2009 84% of revenues and this trend is expected to continue.

White cement sales are much less common with roughly 100,000 tons sold in 2009, divided between 57,000 tons for the Lebanese market and around 41,000 tons for the export market with a focus on Syrian customers. This kind of cement is used for prestige construction projects and decorative work in apartments, as compared to grey cement used for most construction works and buildings.

Local vs. Export Sales

HL's revenue has been traditionally generated from local and export sales although the latter has been nil in 2010. Export revenues are driven mainly from sales to Syria, Iraq and Cyprus where the company's grinding facility is located.

Local sales continue to form the majority of HL's revenue as the company aims primarily to satisfy the local demand that has climbed during 2010, due to the surge in residential properties. Simultaneously, exports decreased sharply compared to 2008 as the capacity of the company turned primarily towards satisfying local demand. Previously, exports to Syria were driven by a surge in local demand faced by a limited production capacity, rendering cement imports from Lebanon a necessity. However, competitors such as Lafarge have recently launched operations in Syria by building a facility in Aleppo with a capacity of approximately 3 million tons of cement satisfying by itself almost a third of local needs.

Reasonable Margins

Holcim has been maintaining adequate Gross margins as upward sales growth is coupled with increasingly production efficiency. In fact, the company has been successful in operating at full capacity through the use of innovative technologies that allow it to produce at a lower cost.

STRATEGY

Through its “Value Creation in Competitive Environment” initiative, HL focuses on offering high quality products and enhancing its image to its customers as an environmentally responsible firm. The company achieves this by leveraging its relationship with its parent company and utilizing the renowned studies surrounding quality and process improvement that it offers. In addition, HL follows simple risk management methods by not relying heavily on a few customers or limiting its geographical focus to one area. We expand on these ideas below:

Qualitative Production

The constant update of equipment and plants, using the most innovative technologies in production, enables HL to produce high quality cement earning it the ISO 9001 for its quality management system. So far in 2010, the company has invested USD 4 million in a new filter that will improve both the quality of its products and the efficiency of the production process by lowering maintenance frequency and expenses, and hence slightly improving its profit margin.

Environmental Awareness

Producing in an environmentally friendly manner is a major consideration for HL as it always works for sustainable development. The company has earned the ISO 14001 for its environmental management system and focuses on:

- 1) Water management: the company uses a closed circuit cooling system to reduce water use and effluents, in addition to a metering system to monitor water consumption.
- 2) Treatment of waste water: a physical treatment of wastewater is conducted in a sedimentation pool before discharge into the sea.
- 3) Energy consumption and efficiency: the company is planning to invest in the near future in a waste heat recovery plant that will enable it to recycle the heat used in the kilns for the production of clinker, an essential element in the production of cement. As a result, energy costs and CO₂ emissions in the atmosphere will be reduced. In addition, HL is studying the use of industrial by-products as alternative fuels and raw materials for clinker production, to reduce the consumption of fossil fuels.

Diversified Customer Base

By maintaining a diversified customer base of more than 200 clients, HL ensures optimal market reach and product availability.

Geographical Diversification

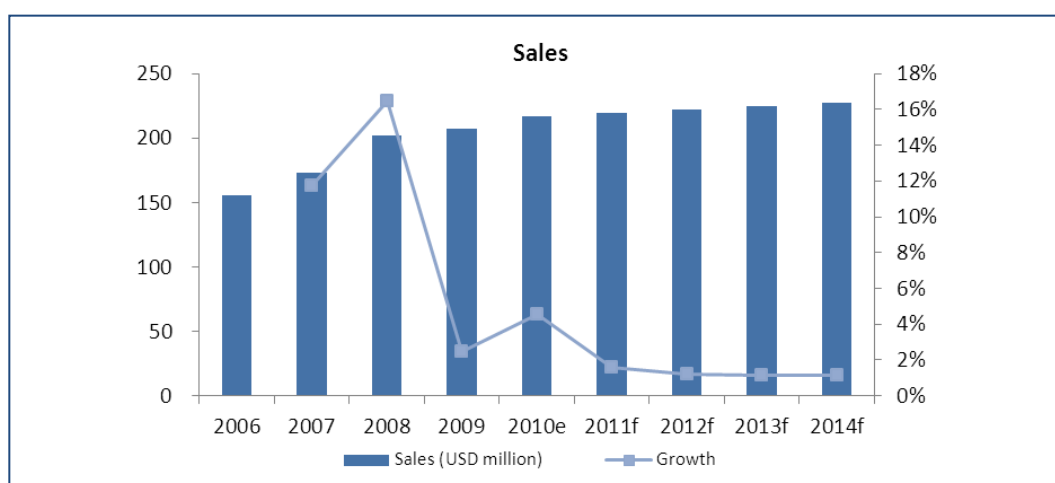
HL stresses on geographical location covering all the Lebanese regions with a demand that varies across the regions: Beirut, North and South Lebanon grasp the major portion followed by Mount Lebanon and Bekaa. The weight of demand is expected to move towards Mount Lebanon where construction activity is peaking as Beirut is becoming saturated.

HL, through its facilities located in different Lebanese regions, is able to satisfy the demand for its cement related products all over the country. Although the market share per geographical location is the highest for the north and south regions of Lebanon, the company covers also Beirut, Mount Lebanon and the Bekaa regions.

FINANCIAL ANALYSIS

Revenues

HL' revenue has been growing continuously at a CAGR of 10% between 2006 and 2009 driven by a boom in the Lebanese real estate sector during the past 4 years. In 2009 however, sales grew by only 2.5% as cement production at HL retreated due to the replacement of three old grinders with a new one to improve its operational efficiency. As a result, the production of the company was temporarily reduced between April and July 2009. As for 2010, sales are expected to be around USD 216 million, a 4.6% annual growth, as the real estate construction activity continues to flourish. We expect that revenue will grow at a slower pace starting in 2011, mirroring the decline in the demand for cement as growth in the Lebanese real estate sector may have already peaked.

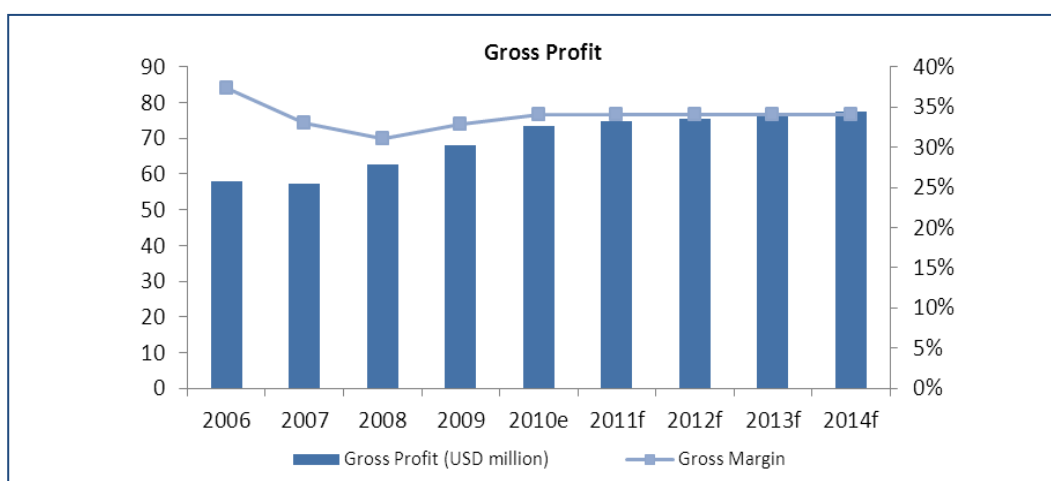


Source: Blominvest

Gross Margins

Between 2007 and 2009, HL's Gross Margin was maintained between 31% and 33% despite the aggressive fluctuations in energy prices as HL managed to hedge its positions against spikes in oil prices.

We expect a slight improvement to this margin during the coming years as the company installed a new filter in 2010 that would improve production efficiency by reducing its clinker factor which constitutes 80% of production costs.

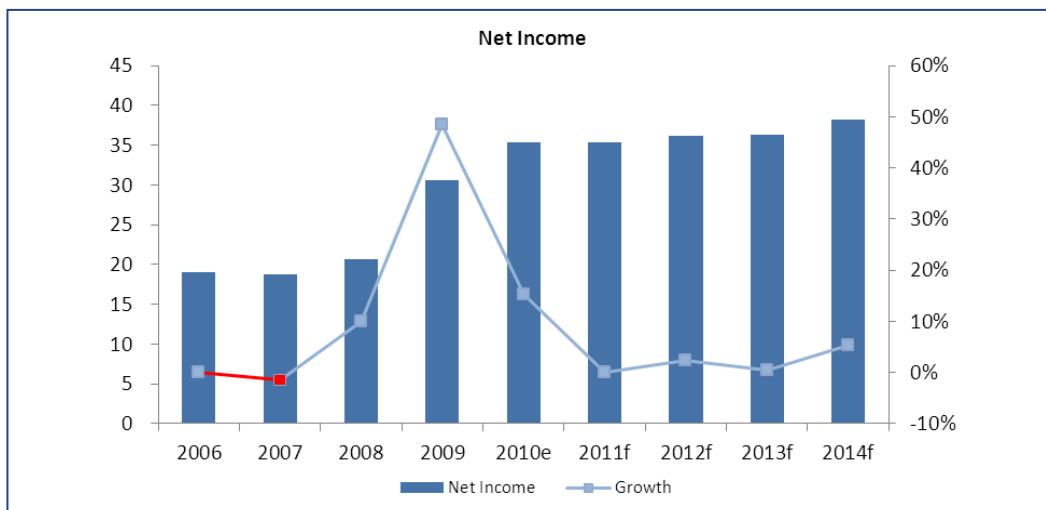


Source: Blominvest

Earnings

In 2009, Holcim's Net Income grew a remarkable 49% reaching USD 30.6M due to a control of selling, general and administrative expenses. In fact, Holcim Ltd. imposed a cost-cutting strategy on all its subsidiaries in response to the global financial crisis. For 2010, we expect net income to increase 15% to reach USD 35 million driven by revenue growth and the belt-tightening policy.

Due to the cost structure of cement companies that is weighing towards variable costs, fixed costs constitute a small portion of production expenses, which in HL's case represent a mere 10%. With a stagnant revenue growth in the next few years and the dominant share of variable costs, Net income is likely to sustain its current levels on the condition that energy costs do not dramatically change.



Source: Blominvest

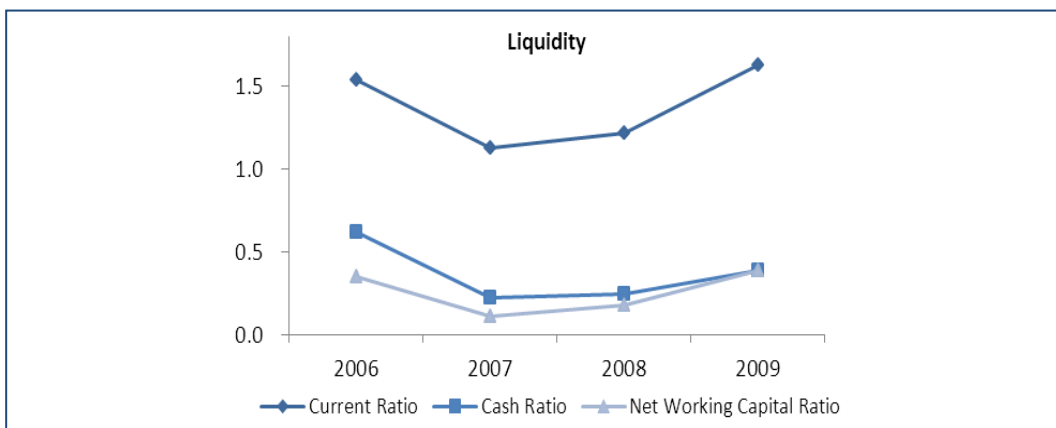
Liquidity

Since 2007, HL's liquidity ratios have been experiencing an upward trend as the company focuses on repaying its current borrowings before maturity. Its current assets have always been greater than its current liabilities despite the major drop in its liquidity ratios in 2007, when current assets reached 1.1 times its current liabilities. Between 2006 and 2007, the cash balance of the company declined remarkably from USD 30 million down to USD 12.8 million. HL used some of its cash to complete a 12-to-1 reverse stock split in 2007, reducing its number of shares from 234 million to 19.5 million.

Current Ratio = Current Assets / Current Liabilities

Cash Ratio = Cash / Current Liabilities

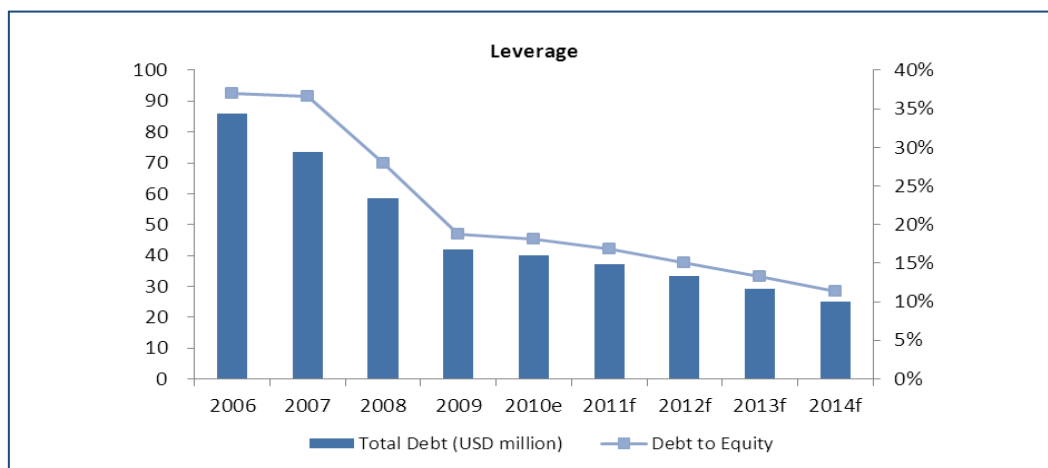
Net Working Capital Ratio = (Current Assets – Current Liabilities) / Current Assets



Source: Blominvest

Leverage

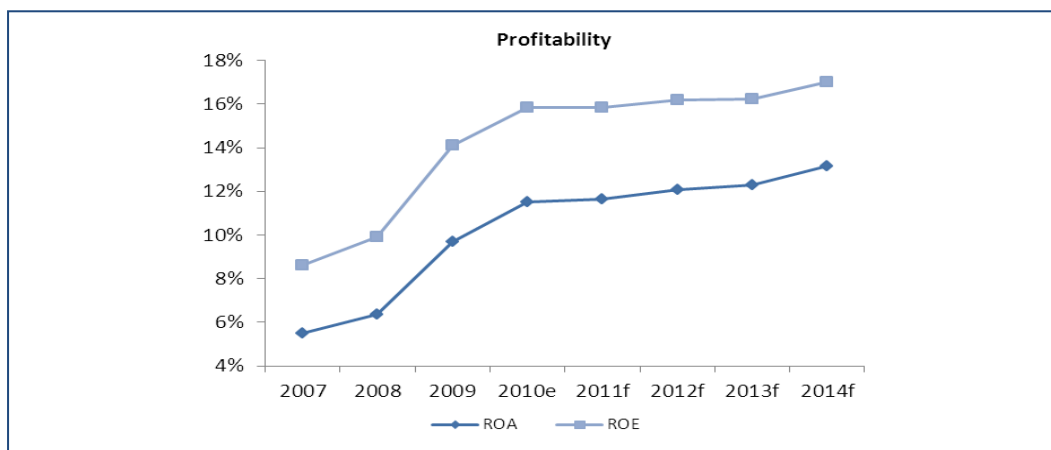
Competing in a capital-intensive industry, Holcim relies moderately on debt to finance its operations with debt to equity topping 39% through 2006 and 2007 but being reduced to 19% in 2009. Although the company is planning to maintain its capital expenditures at an annual average of USD 7 million through 2014, we expect the leverage ratio to slightly decline, floating between 14% and 18% in the near future as it is paying back its borrowings in a timely manner.



Source: Blominvest

Profitability

HL has been witnessing an upward trend in its ROA and ROE reaching 9.7% and 14.1% respectively in 2009. These ratios indicate how efficiently the company is managing its assets and its capital to generate earnings. We expect these ratios to slightly improve in 2010 before maintaining a status-quo through 2014 pressured by a declining cement market and increased challenges to maintain its market share.



Source: Blominvest

Dividends

Over the past five to six years, HL has followed an 80%-90% payout ratio where all earnings are distributed to shareholders after deducting legal reserves requirements. In 2009, USD 17.5 million was distributed resulting in a dividend yield of 7.2%. We expect this trend to continue in the near future as there are no signs of any changes in its parent's policy in relation to this matter.

COMPARABLE ANALYSIS

In order to assess HL's performance in comparison to peers, we compare it against four different categories:

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

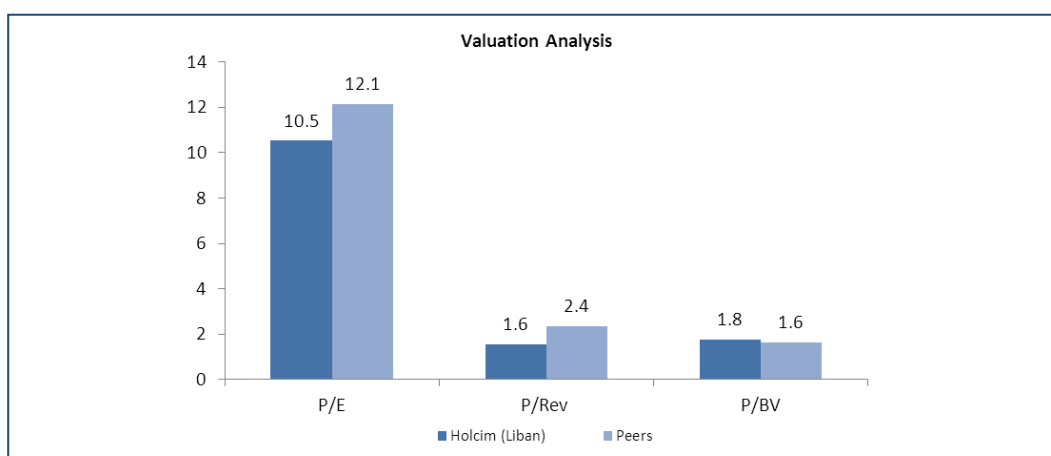
Comparable Firms

We compiled a list of 15 companies operating in the Middle East that are comparable to HL with regards to its operations. Analyzing the average of the industry in the region provides insight and exposes some strengths and weaknesses for the company we are studying. Our selection consists of cement producers in the Middle East with a market cap ranging between USD 100 million and USD 600 million and an average of USD 364 million (versus USD 322 million for HL).

The complete list of comparables is available in the appendix.

Relative Valuation

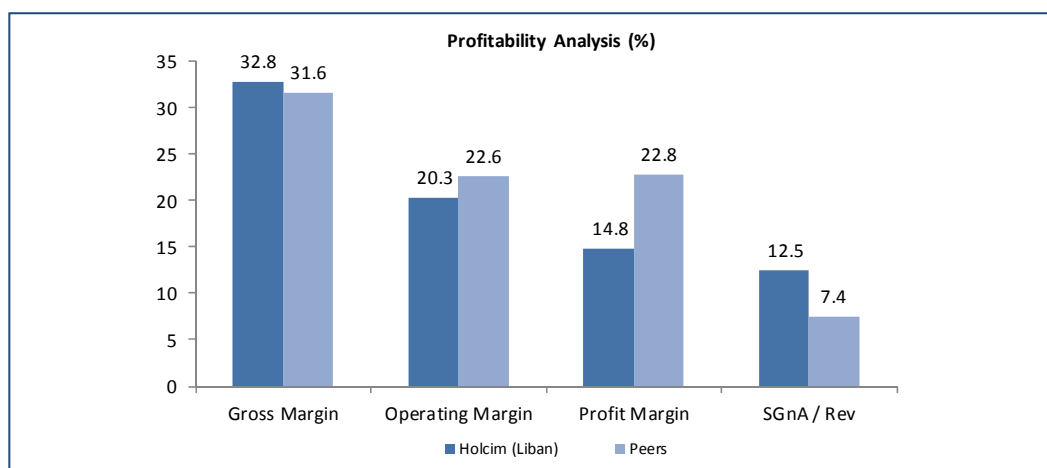
In order to get a sense of how HL is valued compared to its peers, we studied the stock price against earnings, revenue and book value. These three ratios portray HL as being undervalued compared to the average of the industry in the Middle East. In fact, HL's Price-to-Earnings (P/E) of 10.5 is much lower than its peers' 12.1 even after the stock's recent 25% rise in the last six months. We believe HL is underpriced due to the country's security and political risks in which it operates. In addition, investors view Lebanon's cement market as a smaller market that offers limited growth potential for a cement producer. Finally, HL's shares are much less liquid than those of its counterparts with only 18% tradable by the public, and it does not release financial reports on a quarterly basis like other listed companies. This supports our view for a HOLD recommendation for HL's stock.



Source: Blominvest

Profitability Comparison

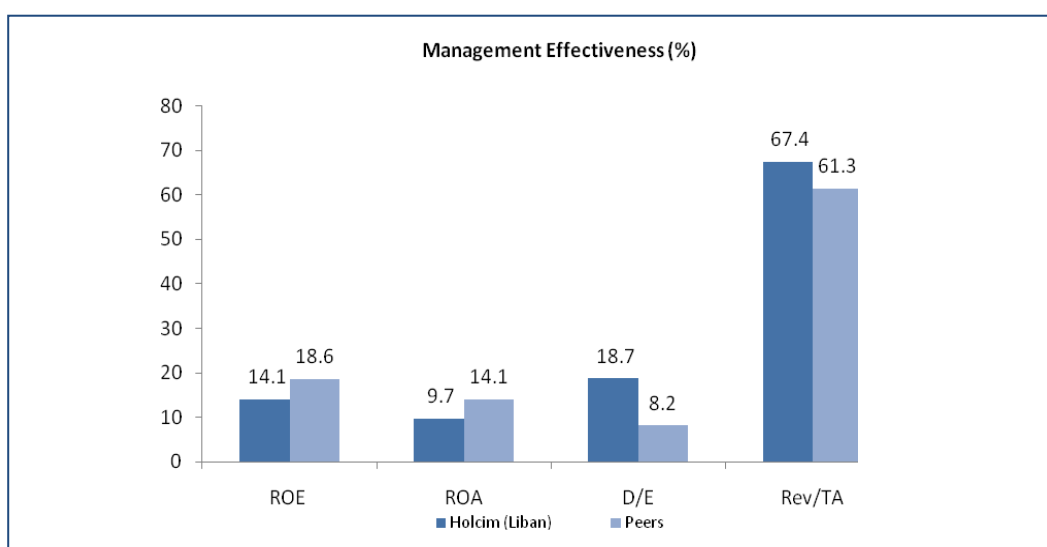
We compared gross margin, operating margin and net income as a percentage of revenues in order to understand how the company is managing its expenses compared to peers. HL's gross margin at 32.8% is slightly higher than the average cement producer in the region, driven by efficiencies in production achieved through a constant update of equipment. Both operating and net profit margins appear to be lower than the industry. In fact, selling, general and administrative expenses-to-revenue is considerably higher at HL even though the company has been constantly lowering its SG&A over the past three years. Moreover, HL's Debt-to-Equity ratio is more than double that of its peers. This results in increased finance costs and exercises a downward pressure on HL's net profit margin.



Source: Blominvest

Management Effectiveness

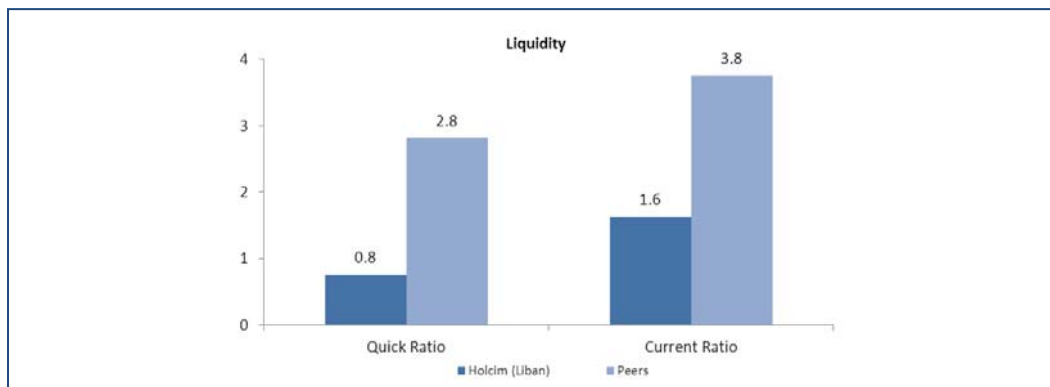
To measure how well the company is managing its capital and assets, we compared the ROE and ROA ratios to the industry average. HL significantly underperforms its peers with an ROE of 14.4% and an ROA of 9.7% when benchmarked to peers' 18.6% and 14.1% respectively. Debt-to-Equity ratio at HL is more than double the industry average confirming that the company relies more on debt to finance its operations compared to peers. Partially as a consequence to the above, HL is able to utilize its assets more effectively thus generating more revenue from its total assets than its peers do with a Revenue-to-Total Assets ratio of 0.7, topping the industry's average of 0.6.



Source: Blominvest

Liquidity

Taking a look at the quick and current Ratios, HL appears to be less liquid than the average in the market with ratios of 0.8 and 1.6 benchmarked to 2.8 and 3.8 respectively. We believe this is a result of the company's dividend policy to distribute annually 100% of its earnings from its cash balance.



Source: Blominvest

VALUATION

We valued HL's share at USD 17.49 using a Discounted Cash Flow (DCF) method based on a 5-year forecast with the following assumptions:

Discount Rate

A discount rate of 15% was deemed appropriate for the purpose of valuing HL's equity derived as follows:

$$\begin{aligned} &\text{Risk-Free Rate} + (\text{Beta} * \text{Market Risk Premium}) + \text{Country Risk Premium} + \text{Liquidity Risk} \\ &= 5.0\% + (1.0 * 3.92\%) + 3.0\% + 2.8\% \\ &= 14.72\% \text{ rounded up to } 15\% \end{aligned}$$

We used:

- A Risk-Free Rate of 5% represented by the yield on the 5-year Eurobond issued by the Lebanese government. This is calculated using the sum of the 5-year US Treasury yielding 2% and the Credit Default Swap issued on Lebanon yielding 3%.
- A weekly Beta of 1.00 estimated during the past 4 years. This is a measure of HL's volatility against the BLOM Stock Index that represents the Beirut Stock Exchange (BSE).
- A Market Risk Premium of 3.92% is the difference between the average 4 year return of BSI estimated at 8.92% and the Risk-Free Rate of 5.0%. This represents the premium investors expect to gain for realizing the additional risk of investing in securities.
- A Country Risk Premium of 3% is used to capture the additional risk of investing in a politically unstable country such as Lebanon. This was added because we believe that the Credit Default Swap is not enough to capture the high probability of external shocks that may occur in the country.
- A Liquidity Risk Premium of 2.8% calculated using the Bid/Ask Spread and the share price. We attribute this premium to HL having only 18% of its shares tradable by the public along with being traded in a fairly illiquid market such as the BSE.

Revenue Growth

We derive forecasted revenues by estimating the underlying factors such as the number of tons sold and price/ton based on the market size, its future trend, HL's market share, and cement prices in Lebanon.

We estimate the number of tons sold by HL in 2010 to be 2.17 million and expect this to remain still due to the following:

- Studies indicate that the cement market is peaking in Lebanon at 5.10 million tons in 2010. In our forecasts, we maintain the market size at its current level for 2011 before reducing it by the annual rate of 1% through 2014.
- HL's current market share is 42.5%; the company's goal revolves around it reaching 45% in the next few years.

Currently, the grey cement price/ton in Lebanon is approximately USD 86.5 and we raised prices by an average of USD 1.00 each year, as a conservative measure over the next few years.

	2010e	2011f	2012f	2013f	2014f
Cement Deliveries in Lebanon (in million tons)	5.10	5.10	5.05	5.00	4.95
Market Size Growth		0.0%	-1.0%	-1.0%	-1.0%
Holcim Market Share	42.5%	43.0%	43.5%	44.0%	44.5%
Demand satisfied by HL (in million tons)	2.17	2.19	2.20	2.20	2.20
Expected price per ton (in USD)	86.5	87.0	88.0	89.0	90.0
Price Growth		0.6%	1.1%	1.1%	1.1%
* Expected Net Sales from Grey Cement (in USD m)	187.5	190.8	193.3	185.7	198.2

* This represents the majority of HL's revenue. The rest is derived from white cement and other construction materials which we did not grow in our forecasts.

Production and Operating Costs

- Based on historic figures, the average Cost of Goods Sold (COGS) as a percentage of revenue is estimated at 66.4%. In our forecasts, we held COGS at 66% of revenue as HL continues to focus on improving its production efficiency.
- As for Selling, General and Administrative (SG&A), they have been declining constantly from 17% of revenue in 2006 to 12% in 2009. As a conservative measure, we used 13% in our forecasts even though HL continues to apply a belt-tightening policy imposed by its parent company.
- In accordance with Lebanese law, we used a 15% income tax that is imposed on corporations operating in the country.

Determining Free Cash Flow to Equity

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

FCFE = Net Income + Depreciation – Capital Expenditures (CAPEX) – Change in Net Working Capital – New Debt + Loan Repayments

<i>in USD million</i>	2010	2011	2012	2013	2014
Net income	35.3	35.3	36.1	36.3	38.2
Add: Depreciation	16.8	15.8	14.9	14.1	13.3
Less: CAPEX	(7.0)	(6.0)	(6.0)	(6.0)	(6.0)
Less: Change in Net Working Capital	(4.5)	(8.7)	(10.4)	(7.3)	(9.1)
Less: New Debt & Add: Loan Repayment	1.8	3.0	3.2	3.3	3.4
FCFE	42.4	39.4	37.9	40.4	39.7

Source: Blominvest

As for the Terminal Growth Rate, we assumed a 4% growth rate for FCFE beyond 2014.

Sensitivity Analysis

Discount Rate	Terminal Growth	Fair Value/Share	Upside
20%	2%	11.85	-28.17%
20%	4%	12.53	-24.04%
20%	6%	13.41	-18.73%
15%	2%	15.71	-4.81%
15%	4%	17.49	6.00%
15%	6%	19.68	19.30%
10%	2%	24.54	48.74%
10%	4%	30.33	83.85 %
10%	6%	41.92	154.06%

Source: Blominvest

PROJECTED INCOME STATEMENT

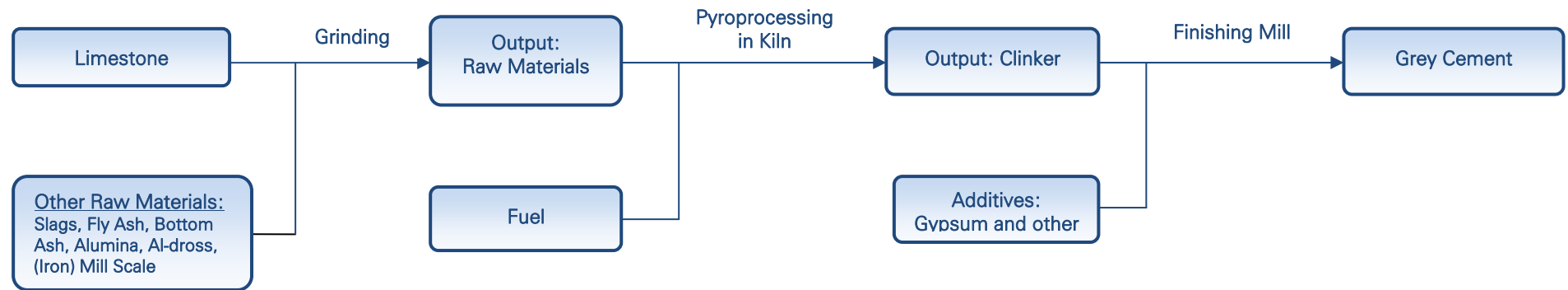
<i>In USD million</i>	2006	2007	2008	2009	2010e	2011f	2012f	2013f
Sales of Goods	155	173	202	207	216	220	222	225
Production Cost of Goods Sold	(97)	(116)	(139)	(139)	(143)	(145)	(147)	(149)
Gross Profit	58	57	63	68	74	75	76	77
Distribution & Selling expenses	(16)	(18)	(21)	(20)	(21)	(22)	(21)	(23)
Administrative Expenses	(10)	(9)	(9)	(6)	(6)	(6)	(7)	(7)
Other Income	1	2	1	0	1	1	1	1
Other Expenses	(3)	(4)	(5)	(4)	(4)	(4)	(4)	(4)
Interest Income	1	1	1	1	1	1	1	1
Finance Costs	(8)	(6)	(5)	(3)	(3)	(3)	(2)	(2)
Profit Before Tax	23	23	24	37	42	42	43	43
Income Tax Expense	(4)	(4)	(4)	(6)	(6)	(6)	(6)	(6)
Profit for the Year	19	19	21	31	35	35	36	36

PROJECTED BALANCE SHEET

<i>In USD million</i>	2006	2007	2008	2009	2010e	2011f	2012f	2013f
Current Assets								
Cash & Cash Balances	30	13	14	18	23	27	37	40
Inventories	31	37	38	40	39	41	42	41
Accounts Receivables & Prepayments	14	15	19	17	19	19	18	19
Total Current Assets	75	65	71	74	81	87	97	100
Non-Current Assets								
Property, plant & equipment	202	190	184	169	164	155	146	138
Investment Properties	12	12	11	11	11	11	11	10
Goodwill	12	12	12	12	12	12	12	12
Intangible assets	46	41	39	35	33	30	28	25
Other Financial Assets	11	6	6	5	5	5	5	6
Total Non-Current Assets	282	262	253	233	225	213	201	191
Total Assets	357	327	324	307	306	300	298	292
Current Liabilities								
Bank Overdraft	0	1	0	0	0	1	0	0
Loans & Borrowings	18	18	11	10	11	11	10	10
Accounts Payable & Accruals	27	33	43	29	31	29	28	27
Taxes Payable	4	4	4	6	4	4	5	4
Provision for Risks & Charges	1	1	1	1	1	1	1	1
Total Current Liabilities	49	58	59	46	48	45	45	41
Non-Current Liabilities								
Loans & Borrowings	68	56	48	32	29	26	23	21
Provision for employees end of service benefits	7	7	5	5	5	5	5	5
Provision for risks & Charges	1	1	1	1	1	1	1	1
Deferred Tax Liability	0	0	1	1	0	0	0	1
Total Non-Current Liabilities	76	64	55	38	35	33	30	27
Shareholders' Equity								
Share Capital	155	129	129	129	129	129	129	129
Statutory Reserve	11	13	15	17	19	21	23	25
Revaluation Reserve	37	37	37	37	37	37	37	37
Dividends Declared	22	20	24	34	32	30	28	26
Retained Earnings	6	5	5	5	6	5	5	5
Total Equity	232	205	211	223	223	222	223	224
Total Liabilities & Equity	357	327	324	307	306	300	298	292

APPENDIX

I - Cement Production Process



II - List of Comparable Peers

Company	Country	Mkt Cap USD (m)	P/E	P/Rev	P/BV	Gross Profit Margin (%)	Operating Margin (%)	Profit Margin (%)	SG&A / Rev (%)	ROE (%)	ROA (%)	D/E (%)	Rev/A (%)
Oman Cement Company SAOG	Oman	593	8.55	3.34	1.68	45.11	34.77	35.49	3.04	19.09	16.92	2.96	0.48
Jordan Cement Factories	Jordan	519	9.50	1.29	1.92	31.90	19.65	16.27	6.09	24.24	15.98	1.74	0.98
Mardin Cimento Sanayii ve Ticaret A.S.	Turkey	519	11.56	3.46	3.25	49.52	39.40	37.5	10.09	37.61	33.56	2.52	0.89
Cimentas Izmir Cimento Fabrikasi Turk AS	Turkey	462	10.05	1.64	1.26	19.06	4.02	12.05	15.04	8.13	5.24	16.87	0.44
Amreyah Cement Company	Egypt	461	4.71	2.02	2.23	41.71	37.72	35.96	1.68	38.23	28.04	6.02	0.78
Tabuk Cement Company	KSA	444	13.69	6.24	1.58	50.47	44.41	45.38	6.06	11.56	9.68	0.00	0.21
Konya Cimento Sanayii A.S.	Turkey	369	25.83	3.26	1.72	23.65	7.63	12.98	16.02	6.99	6.1	0.15	0.47
Gulf Cement Company P.S.C.	UAE	369	12.88	1.82	0.92	22.52	21.04	4.87	1.52	2.38	2.09	5.67	0.43
National Cement Company	Egypt	363	6.17	1.58	2.78	27.27	20.02	20.78	2.58	37.84	23.41	1.04	1.13
Torah Portland Cement Company	Egypt	355	5.99	1.38	2.12	32.23	25.79	23.29	4.43	39.34	27.7	0.00	1.19
Fujairah Cement Industries PSC	UAE	291	34.34	2.35	1.08	21.46	17.23	17.76	3.21	8.34	4.92	59.48	0.28
Unye Cimento Sanayi ve Ticaret A.S.	Turkey	287	9.33	2.71	1.79	36.30	27.60	29.52	11.72	19.34	16.36	5.43	0.55
Sharjah Cement & Industrial Development	UAE	151	7.48	0.61	0.39	14.94	12.12	11.11	2.82	7.08	5.2	16.45	0.47
Bolu Cimento Sanayii A.S.	Turkey	148	15.64	1.99	1.23	23.18	8.87	14.72	14.22	8.76	8.09	0.11	0.55
Ras Al Khaimah Co. for White Cem.&Const.	UAE	134	6.26	1.67	0.68	35.01	18.82	23.89	13.13	9.85	8.44	3.86	0.35
Peer Average		364	12.1	2.4	1.6	31.6	22.6	22.8	7.4	18.6	14.1	8.2	61.3
Holcim (Liban)	Lebanon	322	10.52	1.6	1.8	32.8	20.3	14.8	12.5	14.1	9.7	18.7	67.4

Sources: Thomson Reuters, Blominvest

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Buy: A recommendation with a potential return greater than 10% based on our current 12-month view of total shareholder return*.

Hold: A recommendation with a potential return between -10% and 10% based on our current 12-month view of total shareholder return.

Sell: A recommendation with a potential return of less than -10% based on our current 12-month view of total shareholder return.

* Total Shareholder Return is calculated by the potential price growth over a 12-month period along with the expected dividend yield.

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