



US\$7.30bn Market cap	45% Free float	US\$26.11mn Avg. daily volume
Target price	14.10	-22.7% over current
Consensus price	16.35	-10.9% over current
Current price	18.25	as at 27/11/2010

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Underweight	Neutral	Overweight
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Saudi Kayan

No change in our view

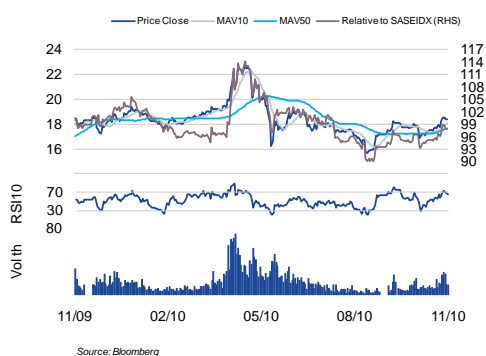
Key themes

We expect the Saudi petrochemicals sector to outperform global peers in the next few years given its feedstock cost advantages and strong demand growth from emerging economies. While local competitors profit from this situation, Saudi Kayan is unable to do so because multiple delays have affected start-up of its massive production capacity.

Implications

Recently Saudi Kayan has started trial production at its plants. However with little visibility about launch of commercial production, we rate Saudi Kayan as Underweight.

Performance



Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (mn)	-	-	-	12,150
Revenue Growth				
EBITDA (mn)	(17)	(17)	(28)	5,346
EBITDA Growth	-90.2%	0.2%	63.4%	
EPS	(0.01)	(0.01)	(0.02)	1.57
EPS Growth	-103.4%	1.6%	60.4%	

Source: Company data, Al Rajhi Capital

Valuation

Note. We have not provided an historical valuation chart here, because we do not expect Saudi Kayan to report revenues or profits until 2012.

We retain our view that it is risky to invest in a “single project” company like Saudi Kayan, considering possible start-up delays. Saudi Kayan’s Q3 2010 results were in line with our estimates. We do not expect Saudi Kayan to record sales till 2012, despite the start of trial operations in Q3. Based on our forecast for higher realised prices, we have raised our revenue estimates by an average of 6% for the period 2012-2014; however, our assumption of higher operating costs has resulted in a decrease in net earnings estimates by an average of 6% for the same period. We have marginally reduced our target price to SAR 14.1, which implies 23% potential downside, and we remain Underweight.

Trial operations started at some units: In Q3 2010, Saudi Kayan started trial operations at its olefins, ethylene glycol and polypropylene plants. Saudi Kayan exported its first shipment of about 5,000 tons of glycol to China (Source: Mubasher.info, 21st September 2010). The company has not provided guidance about the timing of the start of trial operations at its remaining plants. In our view, however, Saudi Kayan is losing the opportunity to tap strong demand from Asian markets due to multiple start up delays. Currently, we estimate launch of commercial production in Q1 2012. We have raised our sales estimates by an average of 6% for the years 2012-2014 due to our assumption of higher realised prices, not of a faster production launch or consequent increase in volumes.

Mounting operational costs: Saudi Kayan reported a net loss of SAR5.1mn for Q3 2010 in line with our estimate of SAR5.4mn as its units are in the pre-operational stage. The net loss increased by 36% from SAR3.7mn in Q3 2009 and by 182% from SAR1.8mn in Q2 2010 due to ongoing operational costs and foreign currency exchange rate fluctuations. In August 2010, the company received a SAR4.5bn loan from National Commercial Bank to part-finance the expected cost escalation of its Jubail petrochemicals plant. The cost over-run is estimated at around SAR9bn.

Weak balance sheet to impact profitability: High debt on the balance sheet is likely to impact profitability due to high interest expenses once Saudi Kayan starts commercial operation. As of Q3 2010, net debt stood at SAR22.81bn, implying a net debt/equity ratio of 148%. Net debt also happens to be equivalent to 1.9x our estimate of 2012 revenues of SAR12.15bn.

Valuation and conclusion: Saudi Kayan expects the launch of commercial production in H2 2011. Conservatively, we estimate that commercial production will be launched from Q1 2012 but await feedback regarding the trial production. We retain our view that it is too risky to invest in a “project company” in view of possible start-up delays, and do not expect major positive triggers for the stock in the near term. The enterprise value/invested capital (EV/IC) ratio of 1.3x suggests that the stock market believes Saudi Kayan will achieve economic profits (i.e. returns above cost of capital) in the future. We agree – but not on a scale sufficient to justify its current share price. Based on our new forecasts, we estimate fair value per share for Saudi Kayan at SAR14.1, marginally below our previous estimate of SAR14.4. Our fair value per share is also our target price, and thus we see 23% downside potential. We remain Underweight. Note: Saudi Kayan has appeared on our Sharia restricted list due to its high debt since the publication of our original Underweight rating.



Corporate summary

Saudi Kayan, launching production at Jubail, will be one of the largest petrochemical plants in the world. SABIC has a 35% stake in the company with the rest being split between the Al Kayan Company (20%) and the general public (45%) after an IPO for the company in 2008. Saudi Kayan has, however, faced delays with its startup. From an initial expected startup date in FY09 which was pushed out to Q3FY10, we think the project now faces a potential delay till Q1 FY12. This delays the revenue stream associated with the company.

Share information

Market cap (SAR/US\$)	27.38bn / 7.30bn		
52-week range	15.65 - 22.75		
Daily avg volume (US\$)	26.11mn		
Shares outstanding	1,500mn		
Free float (est)	45%		
Performance:	1M	3M	12M
Absolute	4.6%	16.6%	16.4%
Relative to index	4.8%	11.1%	1.5%
Major Shareholder:			
SABIC	35%		
Al Kayan	20%		

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	-	-	-	12,150
EBITDA (SARmn)	(17)	(17)	(28)	5,346
Net Profit (SARmn)	(17)	(17)	(28)	2,352
EPS (SAR)	(0.01)	(0.01)	(0.02)	1.57
DPS (SAR)	-	-	-	-
EPS Growth	-103.4%	1.6%	60.4%	na
EV/EBITDA (x)	na	na	na	8.6
P/E (x)	na	na	na	11.7
P/B (x)	1.8	1.8	1.8	1.5
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Q3 2010 results: in line with our estimates

Below we present the key details of Saudi Kayan's Q3 2010 results, together with our comments.

Figure 1. Saudi Kayan: Q3 2010 results

	Q3 2009	Q2 2010	Q3 2010	% chg	Q3 2010	
(SAR mn)	actual	actual	actual	y-y	ARC est	Comment
Revenues	-	-	-	n/m	-	As yet Saudi Kayan is not recording revenues
Gross profit	-	-	-	n/m	-	
Gross margin	n/m	n/m	n/m		n/m	
EBITDA	4	(2)	(5)	-235.5%	(6)	In line with our estimates
EBITDA margin (%)	n/m	n/m	n/m		n/m	
Depreciation & amortization				n/m		
Operating Profit	4	(2)	(5)	-235.5%	(6)	In line with our estimates
Financing cost				n/m		
Other				n/m		
Net profit before tax after minority	4	(2)	(5)	-235.5%	(6)	In line with our estimates
Tax	-	(0)	(0)	n/m	0	
Minority	-	-	-	n/m	-	
Net profit	4	(2)	(5)	-236.1%	(5)	In line with our estimates
Capex	(2,665)	(2,357)	(1,490)	-44.1%	(25)	Well above our forecast, quarterly capex is volatile.
Capex / Sales	n/m	n/m	n/m		n/m	
Net debt	13,587	21,025	22,812	67.9%	22,072	In line with our estimates
Net debt / Annualised EBITDA (x)	n/m	n/m	n/m		n/m	Saudi Kayan does not yet have EBITDA

Source: Company data, Al Rajhi Capital



We expect Saudi Kayan to generate revenues only in 2012

Saudi Kayan will generate positive returns only in 2012

With no revenues or profits, Saudi Kayan is best valued on EV/IC

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	-	-	-	-	12,150
Cost of Goods Sold	-	-	-	-	(6,075)
Gross Profit	-	-	-	-	6,075
Government Charges					
S.G. & A. Costs	(172)	(17)	(17)	(28)	(3,136)
Operating EBIT	(172)	(17)	(17)	(28)	2,939
Cash Operating Costs	(172)	(17)	(17)	(28)	(6,804)
EBITDA	(172)	(17)	(17)	(28)	5,346
Depreciation and Amortisation	-	-	-	-	(2,407)
Operating Profit	(172)	(17)	(17)	(28)	2,939
Net financing income/(costs)	679	-	-	-	(489)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	507	(17)	(17)	(28)	2,450
Taxes	(13)	(0)	(0)	-	(98)
Minority Interests					
Net profit available to shareholders	494	(17)	(17)	(28)	2,352
Dividends	-	-	-	-	-
Transfer to Capital Reserve					
	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	1,500	1,500	1,500	1,500	1,500
CFPS (SAR)	0.329	(0.011)	(0.011)	(0.018)	3.173
EPS (SAR)	0.329	(0.011)	(0.011)	(0.018)	1.568
DPS (SAR)	0	0	0	0	0
Growth	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue Growth					
Gross Profit Growth					
EBITDA Growth	4.8%	-90.2%	0.2%	63.4%	
Operating Profit Growth	4.8%	-90.2%	0.2%	63.4%	
Net Profit Growth	53.2%	-103.4%	1.6%	60.4%	
EPS Growth		-103.4%	1.6%	60.4%	
Margins	12/08A	12/09A	12/10E	12/11E	12/12E
Gross profit margin					50.0%
EBITDA margin					44.0%
Operating Margin					24.2%
Pretax profit margin					20.2%
Net profit margin					19.4%
Other Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
ROCE	-0.8%	0.0%	0.0%	-0.1%	7.0%
ROIC	-1.1%	-0.1%	0.0%	-0.1%	7.0%
ROE	3.2%	-0.1%	-0.1%	-0.2%	14.2%
Effective Tax Rate	2.6%	-0.4%	-1.8%	0.0%	4.0%
Capex/Sales					10.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
Valuation Measures	12/08A	12/09A	12/10E	12/11E	12/12E
P/E (x)	55.7	na	na	na	11.7
P/CF (x)	55.7	na	na	na	5.8
P/B (x)	1.8	1.8	1.8	1.8	1.5
EV/Sales (x)	na	na	na	na	3.8
EV/EBITDA (x)	na	na	na	na	8.6
EV/EBIT (x)	na	na	na	na	15.7
EV/IC (x)	1.4	1.3	1.3	1.3	1.1
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital



The company will steadily increase its asset base

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	3,522	2,472	1,397	1,000	5,972
Current Receivables	88	168	142	142	3,645
Inventories	-	-	440	515	243
Other current assets	(0)	0	-	-	(0)
Total Current Assets	3,610	2,639	1,979	1,657	9,860
Fixed Assets	18,764	33,147	39,616	40,116	38,924
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	27	21	38	38	38
Total Other Assets	-	-	-	-	-
Total Non-current Assets	18,792	33,168	39,654	40,154	38,962
Total Assets	22,402	35,808	41,634	41,811	48,822
Short Term Debt	-	-	399	399	399
Accounts Payable	540	272	230	230	3,888
Accrued Expenses	500	883	1,130	1,130	2,430
Zakat Payable	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	1,041	1,155	1,758	1,758	6,717
Long-Term Debt	5,815	19,113	24,333	24,539	24,239
Other LT Payables	52	62	82	82	82
Provisions	-	-	-	-	-
Total Non-current Liabilities	5,867	19,175	24,415	24,621	24,321
Minority interests	-	-	-	-	-
Paid-up share capital	15,000	15,000	15,000	15,000	15,000
Total Reserves	494	477	460	432	2,785
Total Shareholders' Equity	15,494	15,477	15,460	15,432	17,785
Total Equity	15,494	15,477	15,460	15,432	17,785
Total Liabilities & Shareholders' Equity	22,402	35,808	41,634	41,811	48,822

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	2,293	16,642	23,335	23,937	18,665
Net Debt/EBITDA (x)	(13.33)	(987.93)	(1,382.16)	(867.83)	3.49
Net Debt to Equity	14.8%	107.5%	150.9%	155.1%	105.0%
EBITDA Interest Cover (x)	0.3	-	-	-	10.9
BVPS (SAR)	10.33	10.32	10.31	10.29	11.86

Saudi Kayan will generate positive cash flows only by 2012

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	507	(17)	(17)	(28)	2,450
Depreciation & Amortisation	-	-	-	-	2,407
Decrease in Working Capital	(21)	(938)	(1,403)	(75)	1,728
Other Operating Cashflow	32	10	20	-	(98)
Cashflow from Operations	518	(946)	(1,399)	(102)	6,487
Capital Expenditure	(13,218)	(13,410)	(5,277)	(500)	(1,215)
New Investments	-	-	-	-	-
Others	(27)	6	(17)	-	-
Cashflow from investing activities	(13,245)	(13,404)	(5,294)	(500)	(1,215)
Net Operating Cashflow	(12,727)	(14,349)	(6,693)	(602)	5,272
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(330)	-	-	-	-
Cashflow from financing activities	5,484	13,299	5,619	205	(300)
Total cash generated	(7,243)	(1,051)	(1,075)	(397)	4,972
Cash at beginning of period	10,765	3,522	2,472	1,397	1,000
Implied cash at end of year	3,522	2,472	1,397	1,000	5,972

We project a capex/sales ratio of 10% from 2012 on after high spending prior to launch

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	-	-	-	-	10.0%

Source: Company data, Al Rajhi Capital



Disclaimer and additional disclosures for Equity Research

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

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

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

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

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

2. Definitions

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

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

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

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

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