Saudi Kayan Petrochemical Co

Petrochemicals –Industrial
KAYAN AB: Saudi Arabia
09 February 2011

الراجحي المالية
Al Rajhi Capital

US$7.56bn	45%	US$55.60mn
Market cap	Free float	Avg. daily volume

Target price	15.50	-18.0% over current
Consensus price	17.65	-6.6% over current
Current price	18.90	as at 6/2/2011

Research Department
ARC Research Team
Tel +966 1 211 9233, research@alrajhi-capital.com

Underweight | Neutral | Overweight

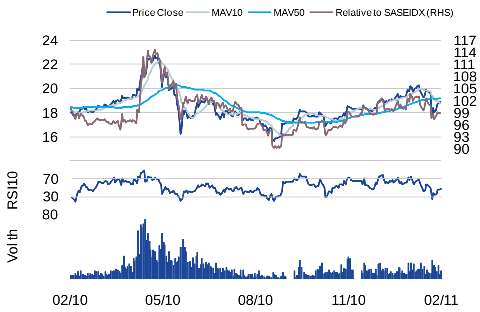
Key themes

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

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

Performance



Source: Bloomberg

Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	-	-	11,776	13,441
Revenue Growth				14.1%
EBITDA (mn)	(14)	(18)	5,256	5,914
EBITDA Growth	-15.4%	24.7%		12.5%
EPS	(0.01)	(0.01)	1.49	1.96
EPS Growth	-12.9%	20.5%		31.5%

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.

Saudi Kayan
High debt rising further

This report follows our Flash View of 17th January. Saudi Kayan's production facilities are currently in the pre-operational stage. The company reported a net loss of SAR4mn in Q4, marginally above our estimate of a loss of SAR6mn. We do not expect Saudi Kayan to record revenues till 2012, despite the start of trial operations in Q3 and Q4 2010. In our view, high and rising debt and uncertainties related to timely completion of the project make the stock unattractive. Using long-run discounted economic profit valuation, we revise our target price from SAR14.1 to SAR15.5 but remain Underweight.

Started trial operations in few more units: Saudi Kayan started trial operations at its phenolics plant and high density polyethylene plant in December 2010 and January 2011 respectively; the latter has production capacity of 0.4mn tonnes per annum (mtpa). In addition, Kayan recently signed an equal tripartite agreement with the Dow-Aramco joint venture entity and Saudi Acrylic Acid Co. to build and operate an SAR1.8bn N-butanol plant in Jubail Industrial City with planned capacity of 0.3mtpa.

Net debt jumps to SAR25.1bn: Net debt increased from SAR22.8bn at the end of Q3 to SAR25.1bn at the end of Q4 2010. To cover its project construction and start-up costs, Kayan utilised around SAR1.5bn in additional loan facilities in Q4. Furthermore, a portion of cash is now tied up in accounts receivable, which have greatly expanded following the start of trial operations: at the end of Q4, total accounts receivable stood at SAR1.42bn versus SAR0.14bn at the end of Q3. The net debt/equity ratio increased significantly to 163% at the end of Q4 versus 148% at the end of Q3 and 108% at the end of Q4 2009. More significantly, perhaps, net debt amounts to 2.1x our estimate of 2012 revenues.

We expect Kayan to generate economic profit only after 2015: We use a long-run discounted economic profit (DEP) model to value Saudi Kayan. Based on updated assumptions for risk-free rate, beta and market risk premium from Bloomberg, we have increased the weighted average cost of capital (WACC) used in our model from 8.3% to 8.8%. We estimate that Kayan will generate an economic profit, i.e. a return on invested capital higher than WACC, only from 2015. The EV/IC ratio of 1.3x and price/book value ratio of 1.8x for 2011 suggest that the stock market believes Saudi Kayan will generate economic profits in the future. We agree – but not on a scale sufficient to justify its current share price.

Valuation and conclusion: We estimate that commercial production will be launched from Q1 2012, but await more guidance from the company. Based on our DEP model and revisions to our model, which include rolling our model forward to start in 2011 (with the result that one year of losses and high investment falls into the past), we have increased our fair value per share from SAR14.14 to SAR 15.5. This is also our target price. High debt on the company's balance sheet and uncertainties related to the timely completion of its investment project make the stock unattractive, in our view. We remain Underweight since our revised target price implies 18% downside potential from the current share price. Note: Saudi Kayan has appeared on our Sharia restricted list due to its high debt since the publication of our original Underweight rating.

Al Rajhi Capital الراجحي المالية

Corporate summary

Saudi Kayan, coming on board 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 start-up. From an initial expected start-up date in FY09 which further got pushed to Q2FY10, the project now faces a potential delay till Q1 FY12, thus delaying the revenue stream associated with the company.

Share information

Market cap (SAR/US$)	28.35bn / 7.56bn
52-week range	15.65 - 22.75
Daily avg volume (US$)	55.60mn
Shares outstanding	1,500mn
Free float (est)	45%

Performance:	1M	3M	12M
Absolute	-4.3%	3.8%	5.0%
Relative to index	-2.6%	1.9%	-0.9%

Major Shareholder:	
SABIC	35%
Al Kayan	20%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	-	-	11,776	13,441
EBITDA (SARmn)	(14)	(18)	5,256	5,914
Net Profit (SARmn)	(15)	(18)	2,231	2,934
EPS (SAR)	(0.01)	(0.01)	1.49	1.96
DPS (SAR)	-	-	-	-
EPS Growth	-12.9%	20.5%	na	31.5%
EV/EBITDA (x)	na	na	9.3	7.5
P/E (x)	na	na	12.7	9.7
P/B (x)	1.8	1.8	1.6	1.4
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Q4 2010 results: no earnings surprises

Below we present the key details of Saudi Kayan's Q4 2010 results, together with our comments.

Figure 1. Kayan: Q4 2010 results

(SAR mn)	Q4 2009 actual	Q3 2010 actual	Q4 2010 actual	% chg y-y	Q4 2010 ARC est	Comment
Revenues	**-**	**-**	**-**	**n/m**	**-**	
Gross profit	-	-	-	n/m	-	
Gross margin	n/m	n/m	n/m		n/m	
EBITDA	**(0)**	**(5)**	**(4)**	**1165.8%**	**(7)**	In line with our estimates
EBITDA margin (%)	n/m	n/m	n/m		n/m	
Depreciation & amortization				n/m		
Operating Profit	**(0)**	**(5)**	**(4)**	**1165.8%**	**(7)**	In line with our estimates
Financing cost				n/m		
Other				n/m		
Net profit before tax after minority	(0)	(5)	(4)	1165.8%	(7)	In line with our estimates
Tax	(0)	(0)	(0)	n/m	-	
Minority	-	-	-	n/m	-	
Net profit	**(0)**	**(5)**	**(4)**	**1022.7%**	**(7)**	In line with our estimates
Capex	(2,225)	(1,490)	(959)	-56.9%	(500)	Well above our forecast, quarterly capex is volatile
Capex / Sales	n/m	n/m	n/m		n/m	
Net debt	16,644	22,812	25,149	51.1%	23,335	Net debt increased due to cost escalations and higher than estimated working capital
Net debt / Annualized EBITDA (x)	n/m	n/m	n/m		n/m	

Source: Company data, Al Rajhi Capital

We expect Saudi Kayan to generate revenues only in 2012

Saudi Kayan will generate profits only in 2012

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

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**-**	**-**	**-**	**11,776**	**13,441**
Cost of Goods Sold	-	-	-	(5,876)	(6,720)
Gross Profit	**-**	**-**	**-**	**5,900**	**6,720**
Government Charges					
S.G. & A. Costs	(17)	(14)	(18)	(3,076)	(3,193)
Operating EBIT	**(17)**	**(14)**	**(18)**	**2,824**	**3,528**
Cash Operating Costs	(17)	(14)	(18)	(6,520)	(7,527)
EBITDA	(17)	(14)	(18)	5,256	5,914
Depreciation and Amortisation	-	-	-	(2,432)	(2,386)
Operating Profit	**(17)**	**(14)**	**(18)**	**2,824**	**3,528**
Net financing income/(costs)	-	-	-	(500)	(472)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	**(17)**	**(14)**	**(18)**	**2,324**	**3,056**
Taxes	(0)	(0)	-	(93)	(122)
Minority Interests					
Net profit available to shareholders	**(17)**	**(15)**	**(18)**	**2,231**	**2,934**
Dividends	-	-	-	-	-
Transfer to Capital Reserve					

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	1,500	1,500	1,500	1,500	1,500
CFPS (SAR)	(0.011)	(0.010)	(0.012)	3.108	3.547
EPS (SAR)	(0.011)	(0.010)	(0.012)	1.487	1.956
DPS (SAR)	0	0	0	0	0

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth					14.1%
Gross Profit Growth					13.9%
EBITDA Growth	-90.2%	-15.4%	24.7%		12.5%
Operating Profit Growth	-90.2%	-15.4%	24.7%		24.9%
Net Profit Growth	-103.4%	-12.9%	20.5%		31.5%
EPS Growth	-103.4%	-12.9%	20.5%		31.5%

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin				50.1%	50.0%
EBITDA margin				44.6%	44.0%
Operating Margin				24.0%	26.2%
Pretax profit margin				19.7%	22.7%
Net profit margin				18.9%	21.8%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	0.0%	0.0%	0.0%	6.4%	7.8%
ROIC	-0.1%	0.0%	0.0%	6.4%	7.6%
ROE	-0.1%	-0.1%	-0.1%	13.5%	15.3%
Effective Tax Rate	-0.4%	-3.5%	0.0%	4.0%	4.0%
Capex/Sales				10.0%	10.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	na	na	na	12.7	9.7
P/CF (x)	na	na	na	6.1	5.3
P/B (x)	1.8	1.8	1.8	1.6	1.4
EV/Sales (x)	na	na	na	4.1	3.3
EV/EBITDA (x)	na	na	na	9.3	7.5
EV/EBIT (x)	na	na	na	17.3	12.6
EV/IC (x)	1.3	1.3	1.3	1.1	1.0
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)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	2,472	967	1,000	6,349	8,675
Current Receivables	168	1,417	1,417	3,895	4,152
Inventories	-	498	583	755	941
Other current assets	0	120	120	120	120
Total Current Assets	**2,639**	**2,883**	**3,000**	**10,999**	**13,767**
Fixed Assets	33,147	40,528	41,028	39,774	38,732
Investments	-	-	-	-	-
Goodwill					
Other Intangible Assets	21	34	34	34	34
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**33,168**	**40,563**	**41,063**	**39,808**	**38,766**
Total Assets	**35,808**	**43,445**	**44,063**	**50,808**	**52,533**
Short Term Debt	-	580	580	580	580
Accounts Payable	272	261	261	3,776	4,301
Accrued Expenses	883	1,517	1,517	2,517	2,688
Zakat Payable					
Dividends Payable					
Other Current Liabilities					
Total Current Liabilities	**1,155**	**2,359**	**2,359**	**6,873**	**7,570**
Long-Term Debt	19,113	25,535	26,171	26,171	24,266
Other LT Payables	62	89	89	89	89
Provisions	-	-	-	-	-
Total Non-current Liabilities	**19,175**	**25,624**	**26,259**	**26,259**	**24,355**
Minority interests	-	-	-	-	-
Paid-up share capital	15,000	15,000	15,000	15,000	15,000
Total Reserves	477	462	445	2,675	5,609
Total Shareholders' Equity	**15,477**	**15,462**	**15,445**	**17,675**	**20,609**
Total Equity	**15,477**	**15,462**	**15,445**	**17,675**	**20,609**
Total Liabilities & Shareholders' Equity	**35,808**	**43,445**	**44,063**	**50,808**	**52,533**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	16,642	25,149	25,751	20,402	16,172
Net Debt/EBITDA (x)	(987.93)	(1,765.31)	(1,450.06)	3.88	2.73
Net Debt to Equity	107.5%	162.6%	166.7%	115.4%	78.5%
EBITDA Interest Cover (x)				10.5	12.5
BVPS (SAR)	10.32	10.31	10.30	11.78	13.74

Saudi Kayan will generate positive cash flows only by 2012

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	**(17)**	**(14)**	**(18)**	**2,324**	**3,056**
Depreciation & Amortisation	-	-	-	2,432	2,386
Decrease in Working Capital	(938)	(2,771)	(85)	1,864	254
Other Operating Cashflow	10	27	-	(93)	(122)
Cashflow from Operations	**(946)**	**(2,758)**	**(102)**	**6,527**	**5,574**
Capital Expenditure	(13,410)	(5,736)	(500)	(1,178)	(1,344)
New Investments	-	-	-	-	-
Others	6	(13)	-	-	-
Cashflow from investing activities	**(13,404)**	**(5,749)**	**(500)**	**(1,178)**	**(1,344)**
Net Operating Cashflow	**(14,349)**	**(8,507)**	**(602)**	**5,349**	**4,230**
Dividends paid to ordinary shareholders	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash					
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	**13,299**	**7,002**	**635**	**-**	**(1,905)**
Total cash generated	(1,051)	(1,505)	33	5,349	2,326
Cash at beginning of period	3,522	2,472	967	1,000	6,349
Implied cash at end of year	**2,472**	**967**	**1,000**	**6,349**	**8,675**

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

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales				10.0%	10.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

Disclaimer

This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

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.

Contact us

Dr. Saleh Alsuhaibani
Head of Research
Tel : +966 1 2119434
alsuhaibanis@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561
Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

Al Rajhi Capital, a subsidiary of Al Rajhi Bank, is licensed by the Saudi Arabian Capital Market Authority, License No. 07068/37.