Saudi International Petrochemical Co

Petrochemicals –Industrial
SIPCHEM AB: Saudi Arabia
10 August 2011

Al Rajhi Capital الراجحي المالية

US$1.833bn	68.8%	US$12.17mn
Market cap	Free float	Avg. daily volume

Target price	24.50	30.67% over current
Consensus price	26.00	38.7% over current
Current price	18.75	as at 9/9/2011

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Underweight | Neutral | **Overweight**

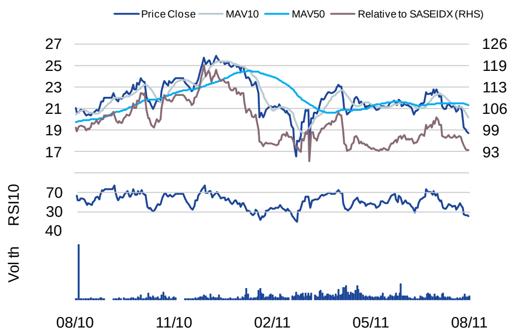
Key themes

We expect Saudi petrochemicals suppliers to outperform global rivals with margins driven by cheap feedstock costs and strong demand coming from Asia. Sipchem's production is currently focused on methanol and its derivatives with a heavy concentration towards Chinese demand.

Implications

Sipchem has commissioned its Phase 2 expansion. Phase 3 facility, which will come on board in 2013, is expected to broaden its product portfolio. We are Overweight on the stock

Performance

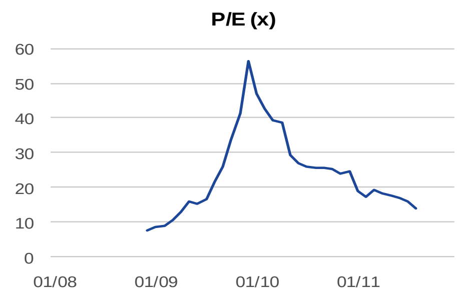


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	1,993	3,099	3,270	3,335
Revenue Growth	139.9%	55.5%	5.5%	2.0%
EBITDA (mn)	1,069	1,548	1,596	1,661
EBITDA Growth	218.6%	44.7%	3.1%	4.1%
EPS	1.03	1.53	1.47	1.46
EPS Growth	168.4%	48.0%	-3.4%	-0.8%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Sipchem
positive outlook

Driven by higher sales volume and a rise in company's key product prices, Sipchem reported a solid sequential growth of 36.8% in earnings in Q2 2011, beating consensus as well as our estimates. We are conservative about the petrochemical prices for the remainder of the year, considering the recent global economic concerns (US rating downgrade and escalating European sovereign debt crisis). However, we believe that Sipchem will continue to benefit from its feedstock advantage, focus on methanol products and gearing to high growth in Asian markets. We remain Overweight on the stock with a revised target price of SAR24.5.

Robust top-line performance: Sipchem posted Q2 2011 revenues of SAR832mn, up by 123.6% year-on-year due to additional production from its Phase II expansion and improved product prices. On a sequential basis, the company recorded a jump of 20% in revenues beating our estimate of SAR811mn and consensus of SAR787mn. It may be worth noting that the company's Q1 performance was subdued due to a maintenance shutdown at the IAC complex (which produces acetic acid and acetic anhydride). Further, the company benefitted from postponement of a 20-day maintenance shutdown at vinyl acetate monomer (VAM) in Q2. We do not expect a maintenance shutdown at the VAM plant in H2 2011, in absence of the company guidance.

Clean beat at both operating and net level: Robust top-line growth trickled down to the income statement. Sipchem reported a strong operating profit of SAR288mn in Q2, up by 19.9% sequentially, beating our estimate of SAR262mn. Benefitting from higher operating earnings and lower zakat expenses, the company posted a net income of SAR165mn (vs. our estimate of SAR136mn).

H2 2011 performance expected to moderate: Sipchem's methanol plant utilization is around 120% level, while the company expects utilization to go upto 125% level in the near term as it sees a positive outlook for demand for methanol and its derivatives. Nevertheless, we expect utilization rate at the company's plants to remain stable in Q3 and decline marginally in Q4 2011 considering the recent global economic concerns. Further, we expect methanol prices to witness a sequential decline of 3% and 4% in Q3 & Q4 2011 respectively (in line with the recent drop in oil prices), even though prices of methanol registered a jump of 4% in July versus Q2 average price. Consequently, we estimate revenue of SAR815mn and SAR759mn for Q3 & Q4 2011 respectively. We might have to revise our price estimates in the event of major negative macroeconomic developments in the US or Europe, affecting oil prices severely.

Valuation and conclusion: Sipchem reported a better-than-expected Q2 results benefitting from higher volumes as well as an increase in product prices. However, we expect the company's performance to moderate in H2 2011 considering the global macroeconomic concerns and lower oil prices. Consequently, we have raised the market risk premium, which resulted in an increase in WACC to 8.9% from 8.7% earlier. Further, our revenue estimates increased by 1.1% and EBITDA estimates declined by 3.5% for the year 2011, on revision of estimates for utilization rate, prices and cost assumptions for H2 2011. We retain our Overweight rating with a revised target price of SAR24.5 (old target of SAR25.5), implying a 30.7% upside from the current level.

Corporate summary

Sipchem is something of a rarity in the Saudi petrochemicals sector. While the other big players like SABIC and PetroRabigh are owned directly or indirectly by the government, Sipchem is a company promoted by a private sector enterprise, the Zamil Industrial Group (the government owns only 8% through the Public Investment Fund).

Share information

Market cap (SAR/US$)	6.88bn / 1.833bn
52-week range	16.55 - 25.91
Daily avg volume (US$)	12.17mn
Shares outstanding	366.7mn
Free float (est)	68.8%

Performance:	1M	3M	12M
Absolute	-17.6%	-11.6%	-11.3%
Relative to index	-8.2%	-1.6%	-6.4%

Major Shareholder:	
Al-Zamil Group Holding Co.	9.6%
National Industries Group Holding.	8.3%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	1,993	3,099	3,270	3,335
EBITDA (SARmn)	1,069	1,548	1,596	1,661
Net Profit (SARmn)	378	560	541	536
EPS (SAR)	1.03	1.53	1.47	1.46
DPS (SAR)	-	1.00	1.00	0.80
EPS Growth	168.4%	48.0%	-3.4%	-0.8%
EV/EBITDA (x)	11.0	7.6	8.1	8.0
P/E (x)	18.2	12.3	12.7	12.8
P/B (x)	1.4	1.3	1.2	1.2
Dividend Yield	0.0%	5.3%	5.3%	4.3%

Source: Company data, Al Rajhi Capital

Sipchem: better times ahead

Phase III will push Sipchem up in the petrochemicals value chain

Moving up in the petrochemicals value chain: The company recently issued Sukuk worth SAR1.8bn to fund its Phase III expansion plans. We believe that the company's phase III expansion plans appear firmly on track for commercial production in H2 2013. Further, in late April 2011, the company signed a JV agreement to build a plant to produce special resin grades. Currently, the company does not have plans to raise additional funds. We believe that additional funding requirements for the company's expansion plan will be met through cash generated from its operations. These expansions will help the company to move up in the petrochemicals value chain by focusing on specialty chemicals.

Diversification through developing downstream sector and focusing on polymer products

Focusing on knowledge hub: On July 25th, the company announced plan to invest SAR150mn to build corporate research and product & application center under a MoU with the Ministry of Petroleum & Minerals and King Fahd University of Petroleum & Minerals. The center, with the objective of developing the usage of polymer products and downstream industries in the Kingdom, is expected to begin operations by mid 2012. According to the company, the center will focus its research on the basic usage of films which are used in the production of solar cells and thin sheets for agricultural usages, flexible pipes necessary for wooden & paper industries, dyes, and fiber optic cables.

We expect product prices to decline marginally in H2 2011, in line with the decline in oil prices

Methanol prices to decline moderately in the short term: Despite a weak demand from China in the last couple of months, the average prices of the company's phase II key products- Acetic acid and VAM- were sequentially higher during Q2 as major Chinese acetic acid producers had shut their plants for maintenance. In July, average prices of methanol increased by 4% (at US$363/mt) as compared to average price in Q2 mainly due to supply concerns as a result of technical issues at Saudi Methanol's Ar-Razi 5 plant and maintenance at Zagros Petrochemical's methanol plant in Iran.

Despite a rise in methanol prices in July 2011, we lower our estimates for product prices (mainly methanol and its derivatives) for H2 2011 considering the recent global events (negative macro-economic developments and a sharp drop of more than 11% in Brent oil prices to US$104 per barrel). We assume that the Brent crude prices to be stable at the level of US$100-105 per barrel for the rest of the year (a decline of 8% over average Q2 prices). Consequently, we expect the average price of methanol to decline sequentially by 3% and 4%, respectively in Q3 & Q4 2011. We expect the company's fixed price contracts (renewed every three months), which constitute 40-70% of the total sales volumes to provide a partial cushion against a decline in spot prices.

Below we present the key details of Sipchem's Q2 2011 results, and our estimates for Q3 2011.

Figure 1. Sipchem: Q2 and Q3 results (actual and our estimates)

(SAR mn)	Q2 2010 actual	Q1 2011 actual	Q2 2011 ARC est	Q2 2011 actual	% chg y-y	Q3 2010 actual	Q3 2011 ARC est	% chg y-y
Revenues	372	693	810	832	123.6%	509	815	60.3%
Gross profit	237	381	470	429	81.1%	309	440	42.6%
Gross margin	63.6%	55.0%	58.0%	51.5%	-1212 bps	60.7%	54.0%	-673 bps
EBITDA	220	354	429	400	82.0%	283	412	45.3%
EBITDA margin (%)	59.1%	51.1%	53.0%	48.1%	-1101 bps	55.7%	50.5%	-524 bps
Operating Profit	172	240	262	288	67.2%	176	295	68.0%
Net profit	88	121	136	165	88.7%	84	152	81.2%
Capex	54	(142)	(313)	(220)	-507.7%	(104)	(250)	139.3%
Capex / Sales	-14.5%	20.5%	38.6%	26.5%	n/m	20.5%	30.7%	n/m
Net debt	3,519	3,142	4,017	2,945	-16.3%	3,471	3,423	-1.4%
Net debt / Annualized EBITDA (x)	4.0	2.2	2.3	1.8	n/m	3.1	2.1	n/m

Source: Company data, Al Rajhi Capital

Phase II expansion is driving strong revenue growth

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**830**	**1,993**	**3,099**	**3,270**	**3,335**
Cost of Goods Sold	(424)	(826)	(1,439)	(1,553)	(1,551)
Gross Profit	**407**	**1,167**	**1,660**	**1,717**	**1,784**
Government Charges					
S.G. & A. Costs	(238)	(402)	(572)	(621)	(715)
Operating EBIT	**168**	**764**	**1,088**	**1,095**	**1,069**
Cash Operating Costs	(495)	(923)	(1,552)	(1,674)	(1,674)
EBITDA	336	1,069	1,548	1,596	1,661
Depreciation and Amortisation	(167)	(305)	(460)	(500)	(592)
Operating Profit	**168**	**764**	**1,088**	**1,095**	**1,069**
Net financing income/(costs)	42	(100)	(177)	(194)	(175)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	-	(4)	-	-	-
Other Expenses					
Net Profit Before Taxes	**210**	**660**	**910**	**901**	**894**
Taxes	(40)	(44)	(27)	(36)	(36)
Minority Interests	(29)	(238)	(323)	(324)	(322)
Net profit available to shareholders	**141**	**378**	**560**	**541**	**536**
Dividends	(333)	-	(367)	(367)	(295)
Transfer to Capital Reserve					

We expect EPS to grow at a CAGR of 14% over 2010-13

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	366.7	366.7	366.7	366.7	366.7
CFPS (SAR)	0.920	2.513	3.664	3.724	3.955
EPS (SAR)	0.384	1.031	1.527	1.475	1.463
DPS (SAR)	0.909	0.000	1.000	1.000	0.805

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	-51.4%	139.9%	55.5%	5.5%	2.0%
Gross Profit Growth	-65.1%	186.8%	42.3%	3.4%	3.9%
EBITDA Growth	-69.4%	218.6%	44.7%	3.1%	4.1%
Operating Profit Growth	-82.2%	354.0%	42.3%	0.7%	-2.4%
Net Profit Growth	-73.8%	168.4%	48.0%	-3.4%	-0.8%
EPS Growth	-79.0%	168.4%	48.0%	-3.4%	-0.8%

Sipchem has one of the lowest cost structures in the world, supporting margins

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	49.0%	58.5%	53.6%	52.5%	53.5%
EBITDA margin	40.4%	53.7%	49.9%	48.8%	49.8%
Operating Margin	20.3%	38.4%	35.1%	33.5%	32.1%
Pretax profit margin	25.3%	33.1%	29.4%	27.6%	26.8%
Net profit margin	17.0%	19.0%	18.1%	16.5%	16.1%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	1.5%	6.9%	8.1%	8.0%	7.6%
ROIC	1.9%	8.0%	11.3%	10.4%	9.1%
ROE	2.8%	7.7%	10.8%	9.7%	9.3%
Effective Tax Rate	19.2%	6.7%	3.0%	4.0%	4.0%
Capex/Sales	188.4%	18.9%	27.8%	52.0%	35.0%
Dividend Payout Ratio	236.6%	0.0%	65.5%	67.8%	55.0%

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	48.8	18.2	12.3	12.7	12.8
P/CF (x)	20.4	7.5	5.1	5.0	4.7
P/B (x)	1.4	1.4	1.3	1.2	1.2
EV/Sales (x)	13.5	5.9	3.8	3.9	4.0
EV/EBITDA (x)	33.5	11.0	7.6	8.1	8.0
EV/EBIT (x)	66.8	15.4	10.8	11.7	12.4
EV/IC (x)	1.3	1.3	1.2	1.1	1.1
Dividend Yield	4.8%	0.0%	5.3%	5.3%	4.3%

Source: Company data, Al Rajhi Capital

Phase II & Phase III programmes are expanding the balance sheet

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	1,831	1,621	3,217	2,229	2,114
Current Receivables	308	596	820	894	900
Inventories	79	209	304	331	333
Other current assets	0	-	-	-	-
Total Current Assets	**2,218**	**2,426**	**4,341**	**3,453**	**3,348**
Fixed Assets	9,569	9,568	9,965	11,165	11,740
Investments	-	-	-	-	-
Goodwill	31	33	38	38	38
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**9,601**	**9,601**	**10,003**	**11,203**	**11,779**
Total Assets	**11,818**	**12,027**	**14,344**	**14,656**	**15,126**
Short Term Debt	283	410	440	440	440
Accounts Payable	620	447	456	496	500
Accrued Expenses	-	-	-	-	-
Zakat Payable					
Dividends Payable	-	-	-	-	-
Other Current Liabilities					
Total Current Liabilities	**903**	**857**	**895**	**936**	**940**
Long-Term Debt	4,642	4,561	6,132	6,132	6,332
Other LT Payables	401	543	536	536	536
Provisions	40	53	57	57	57
Total Non-current Liabilities	**5,083**	**5,156**	**6,726**	**6,726**	**6,926**
Minority interests	910	1,092	1,233	1,330	1,426
Paid-up share capital	3,333	3,333	3,667	3,667	3,667
Total Reserves	1,589	1,588	1,823	1,997	2,167
Total Shareholders' Equity	**4,922**	**4,921**	**5,490**	**5,664**	**5,834**
Total Equity	**5,832**	**6,014**	**6,722**	**6,994**	**7,260**
Total Liabilities & Shareholders' Equity	**11,818**	**12,027**	**14,344**	**14,656**	**15,126**

Higher net debt results from the Phase II and Phase III expansion plans

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	3,094	3,350	3,355	4,344	4,658
Net Debt/EBITDA (x)	9.22	3.13	2.17	2.72	2.80
Net Debt to Equity	53.0%	55.7%	49.9%	62.1%	64.2%
EBITDA Interest Cover (x)	(8.0)	10.7	8.7	8.2	9.5
BVPS (SAR)	13.42	13.42	14.97	15.45	15.91

We expect capex to remain heavy over 2011-2013

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	**210**	**660**	**910**	**901**	**894**
Depreciation & Amortisation	167	305	460	500	592
Decrease in Working Capital	(283)	(535)	(248)	(60)	(5)
Other Operating Cashflow	(269)	(55)	(66)	(36)	(36)
Cashflow from Operations	**(175)**	**375**	**1,056**	**1,305**	**1,445**
Capital Expenditure	(1,565)	(376)	(863)	(1,700)	(1,167)
New Investments	238	79	-	-	-
Others	-	(9)	-	-	-
Cashflow from investing activities	**(1,327)**	**(306)**	**(863)**	**(1,700)**	**(1,167)**
Net Operating Cashflow	**(1,502)**	**69**	**194**	**(395)**	**277**
Dividends paid to ordinary shareholders	(333)	(336)	-	(367)	(367)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash					
Other Financing Cashflow	(216)	(48)	(199)	(227)	(225)
Cashflow from financing activities	**752**	**(280)**	**1,403**	**(594)**	**(392)**
Total cash generated	(750)	(211)	1,596	(988)	(115)
Cash at beginning of period	2,581	1,831	1,621	3,217	2,229
Implied cash at end of year	**1,831**	**1,621**	**3,217**	**2,229**	**2,114**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	188.4%	18.9%	27.8%	52.0%	35.0%

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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