Saudi International Petrochemical Co

Petrochemicals –Industrial
SIPCHEM AB: Saudi Arabia
29 November 2010

الراجحي المالية
Al Rajhi Capital

US$2.21bn	68.3%	US$4.398mn
Market cap	Free float	Avg. daily volume

Target price	**31.00**	24.5% over current
Consensus price	**28.70**	15.3% over current
Current price	**24.90**	as at 27/11/2010

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Underweight | **Neutral** | **Overweight**

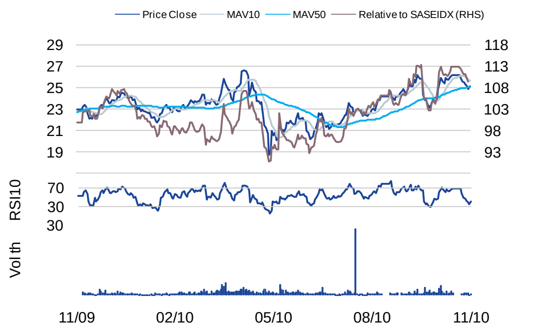
Key themes

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 recently commissioned its Phase 2 expansion. Phase 3 facility, which will come on board in a few years,is expected to broaden its product portfolio. We are Overweight on the stock.

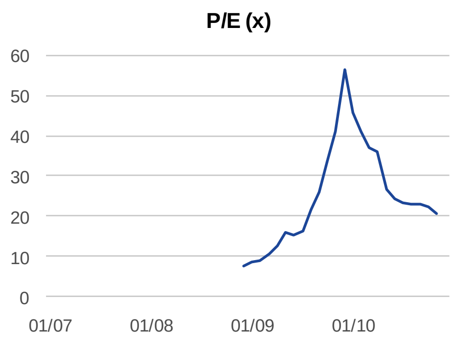
Performance



Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (mn)	830	1,956	3,195	3,419
Revenue Growth	-51.4%	135.5%	63.4%	7.0%
EBITDA (mn)	336	1,105	1,837	2,017
EBITDA Growth	-69.4%	229.4%	66.2%	9.8%
EPS	0.42	1.28	2.18	2.54
EPS Growth	-79.0%	203.3%	70.4%	16.2%

Valuation



Sipchem
Capex-led growth continues

Sipchem's Q3 results were below our estimates, but with its enhanced product line Sipchem looks well-placed to benefit from firm Asian demand. Reflecting both capacity expansion and the recent pick-up in prices, we have raised our sales and profit estimates for the years 2011 to 2013 by about 20%. Our new target price of SAR31.0 implies 24% upside and we remain Overweight.

Growth through expansion: Sipchem is predominantly a methanol supplier. However, so far in 2010 Sipchem has progressively launched production of the new products included in its Phase 2 expansion plan: carbon monoxide, vinyl acetate monomer (VAM) and acetic acid. The most recent stage came in August, when Sipchem announced commercial start-up of its VAM plant with capacity of 330,000mpta. Sipchem's Phase 3 facilities, which will further expand its product range, are due to be built and launched by 2014. We think this expansion will help Sipchem both to move further up the value chain of petrochemicals production and to win business in markets with robust demand, notably in Asia.

Q3 2010 – strong growth y-on-y but not q-on-q: In Q3, Sipchem posted sales of SAR509mn for Q3 2010, up 158% year-on-year and 37% quarter-on-quarter. This growth primarily reflected the contribution from its Phase 2 expansion; growth was augmented by higher prices for butanediol and a recovery in methanol prices. Higher prices for these products were offset by declines in prices of other petrochemicals products on a quarter-on-quarter basis. We had underestimated the impact of these declines, so our sales forecast proved too high. Operating profit jumped from SAR32mn in Q3 2009 to SAR176mn in Q3 2010, but this was only just above the level of Q2 and below our forecast.

Higher financing cost impacted net profit: Net financing costs were SAR36mn in Q3, up sharply from SAR7mn in Q3 2009 and from SAR14mn in Q2. The reason for this is that interest costs on the debt related to construction of the new production facilities launched in Q3 were capitalised prior to their commercial launch, but charged fully to the income statement afterwards. While net profit rose 53% year-on-year, the higher financing costs helped push net profit down versus Q2 from SAR88mn to SAR84mn. We expect Sipchem to post slightly higher interest costs in Q4 and have adjusted our forecasts accordingly.

Outlook for prices good: According to Bloomberg data, methanol prices rose by about 22% over October mainly due to supply issues in the US and China and to low Chinese inventory levels (reflecting the impact of emissions controls). Despite this price increase, Chinese methanol demand remains firm. Moreover, China's decision not to impose duties on imports of methanol from Saudi Arabia is a clear positive for the company (source: *Zawya*, 30th October, 2010). Note that Sipchem is unaffected by India's decision to impose duties on polypropylene imports from Saudi Arabia (source: *The Hindi*, 23rd November, 2010).

Valuation and conclusion: Despite the weak Q3 results, we are optimistic about future prospects for Sipchem. We have reviewed our assumptions for the company and have raised our sales and profit estimates for the years 2011 to 2013 by about 20%. We have raised our fair value per share (which is also our target price) by only 4%, from SAR29.7 to SAR31.0, mainly because we have increased depreciation forecasts in our long-run valuation model. However, our new target still implies 24% upside and so we remain Overweight.

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$)	8.30bn / 2.21bn
52-week range	18.70 - 26.60
Daily avg volume (US$)	4.398mn
Shares outstanding	333.3mn
Free float (est)	68.3%

Performance:	1M	3M	12M
Absolute	4.8%	10.8%	9.4%
Relative to index	5%	6.8%	10.3%

Major Shareholder:	
Al-Zamil Group Holding Co.	10.1%
National Industries Group Holding.	8.3%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	830	1,956	3,195	3,419
EBITDA (SARmn)	336	1,105	1,837	2,017
Net Profit (SARmn)	141	427	728	846
EPS (SAR)	0.42	1.28	2.18	2.54
DPS (SAR)	1.00	1.00	1.00	1.00
EPS Growth	-79.0%	203.3%	70.4%	16.2%
EV/EBITDA (x)	38.8	12.6	8.1	7.8
P/E (x)	59.4	19.6	11.5	9.9
P/B (x)	1.7	1.7	1.6	1.4
Dividend Yield	4.0%	4.0%	4.0%	4.0%

Q3 results: earnings affected by high financing costs

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

Figure 1. Sipchem: Q3 2010 results

(SAR mn)	Q3 2009 actual	Q2 2010 actual	Q3 2010 actual	% chg y-y	Q3 2010 ARC est	Comment
Revenues	**197**	**372**	**509**	**158.5%**	**689**	Phase 2 expansion which came on stream in Q1 2010 was the key reason for revenue growth
Gross profit	68	237	309	356.0%	416	Decline in some petrochemical prices compared to Q2 2010 impacted gross profit
Gross margin	34.4%	63.6%	60.7%	26.3pp	60.4%	In line with our estimate
EBITDA	**50**	**220**	**283**	**462.6%**	**390**	Volume growth from new capacity resulted in strong growth in EBITDA
EBITDA margin (%)	25.6%	59.1%	55.7%	30.1pp	56.7%	Close to our estimate
Depreciation & amortisation	(19)	(48)	(108)	471.9%	(142)	Well below our forecast
Operating Profit	**32**	**172**	**176**	**457.1%**	**248**	Close to Q2 2010 numbers
Financing cost	(7)	(14)	(36)	413.8%	9	Financing cost much higher than our estimates as well as Q2 2010 number
Other	50	(4)	0	-99.6%	2	Close to our estimate
Net profit before tax after minority	75	154	140	87.4%	258	Higher financing cost affected earnings
Tax	(18)	(4)	(5)	-68.9%	(12)	Close to Q2 2010 numbers
Minority	(2)	(62)	(50)	n/m	(132)	Well below our forecast
Net profit	**55**	**88**	**84**	**53.9%**	**115**	Higher financing cost affected net earnings
Capex	(416)	54	(104)	-74.9%	(856)	Well below our forecast; quarterly capex is very volatile
Capex / Sales	211.4%	-14.5%	20.5%	n/m	124.2%	As above
Net debt	4,940	3,519	3,471	-29.7%	3,692	Close to our estimate
Net debt / Annualised EBITDA (x)	24.5	4.0	3.1	n/m	2.4	

Source: Company data, Al Rajhi Capital

Phase 2 expansion is driving strong revenue growth

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	**1,709**	**830**	**1,956**	**3,195**	**3,419**
Cost of Goods Sold	(541)	(424)	(755)	(1,198)	(1,231)
Gross Profit	**1,167**	**407**	**1,200**	**1,997**	**2,188**
Government Charges					
S.G. & A. Costs	(223)	(238)	(388)	(634)	(620)
Operating EBIT	**944**	**168**	**812**	**1,363**	**1,569**
Cash Operating Costs	(612)	(495)	(850)	(1,358)	(1,402)
EBITDA	1,096	336	1,105	1,837	2,017
Depreciation and Amortisation	(152)	(167)	(293)	(474)	(449)
Operating Profit	**944**	**168**	**812**	**1,363**	**1,569**
Net financing income/(costs)	(93)	42	(96)	(159)	(158)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	-	-	(3)	-	-
Other Expenses					
Net Profit Before Taxes	**851**	**210**	**712**	**1,204**	**1,410**
Taxes	(30)	(40)	(25)	(42)	(56)
Minority Interests	(284)	(29)	(260)	(433)	(508)
Net profit available to shareholders	**537**	**141**	**427**	**728**	**846**
Dividends	(333)	(333)	(333)	(333)	(333)
Transfer to Capital Reserve					

We expect EPS to grow at a CAGR of 43% in 2010-12

	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	333.3	333.3	333.3	333.3	333.3
CFPS (SAR)	3.65	1.01	2.94	4.91	5.41
EPS (SAR)	2.013	0.423	1.282	2.185	2.539
DPS (SAR)	1.000	1.000	1.000	1.000	1.000

Growth	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue Growth	11.8%	-51.4%	135.5%	63.4%	7.0%
Gross Profit Growth	5.6%	-65.1%	195.1%	66.4%	9.6%
EBITDA Growth	4.6%	-69.4%	229.4%	66.2%	9.8%
Operating Profit Growth	5.4%	-82.2%	382.4%	67.9%	15.1%
Net Profit Growth	-9.6%	-73.8%	203.3%	70.4%	16.2%
EPS Growth		-79.0%	203.3%	70.4%	16.2%

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

Margins	12/08A	12/09A	12/10E	12/11E	12/12E
Gross profit margin	68.3%	49.0%	61.4%	62.5%	64.0%
EBITDA margin	64.2%	40.4%	56.5%	57.5%	59.0%
Operating Margin	55.3%	20.3%	41.5%	42.7%	45.9%
Pretax profit margin	49.8%	25.3%	36.4%	37.7%	41.3%
Net profit margin	31.4%	17.0%	21.9%	22.8%	24.8%

Other Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
ROCE	9.6%	1.5%	7.3%	11.2%	11.5%
ROIC	14.0%	1.4%	7.3%	11.9%	12.5%
ROE	13.5%	2.8%	8.7%	14.2%	15.1%
Effective Tax Rate	3.6%	19.2%	3.6%	3.5%	4.0%
Capex/Sales	159.4%	188.4%	41.5%	58.7%	54.8%
Dividend Payout Ratio	62.1%	236.6%	78.0%	45.8%	39.4%

Sipchem's premium valuation is justified by strong growth prospects

Valuation Measures	12/08A	12/09A	12/10E	12/11E	12/12E
P/E (x)	12.5	59.4	19.6	11.5	9.9
P/CF (x)	6.9	24.8	8.5	5.1	4.6
P/B (x)	1.7	1.7	1.7	1.6	1.4
EV/Sales (x)	5.2	15.7	7.1	4.7	4.6
EV/EBITDA (x)	8.1	38.8	12.6	8.1	7.8
EV/EBIT (x)	9.4	77.3	17.2	11.0	10.0
EV/IC (x)	1.1	1.2	1.3	1.2	1.2
Dividend Yield	4.0%	4.0%	4.0%	4.0%	4.0%

Source: Company data, Al Rajhi Capital

Phase 2 & Phase 3 programmes are expanding balance sheet

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	2,581	1,831	1,215	824	835
Current Receivables	154	308	770	980	1,060
Inventories	107	79	308	327	342
Other current assets	0	0	-	-	-
Total Current Assets	**2,842**	**2,218**	**2,292**	**2,131**	**2,236**
Fixed Assets	7,792	9,569	10,091	11,492	12,918
Investments	-	-	-	-	-
Goodwill	200	31	28	28	28
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**7,992**	**9,601**	**10,120**	**11,520**	**12,947**
Total Assets	**10,833**	**11,818**	**12,411**	**13,651**	**15,183**
Short Term Debt	176	283	407	407	407
Accounts Payable	804	620	770	980	1,094
Accrued Expenses	-	-	-	-	-
Zakat Payable					
Dividends Payable	-	-	-	-	-
Other Current Liabilities					
Total Current Liabilities	**979**	**903**	**1,177**	**1,388**	**1,501**
Long-Term Debt	3,581	4,642	4,638	5,142	5,895
Other LT Payables	382	401	572	572	572
Provisions	34	40	49	49	49
Total Non-current Liabilities	**3,996**	**5,083**	**5,260**	**5,764**	**6,516**
Minority interests	894	910	1,041	1,171	1,323
Paid-up share capital	3,333	3,333	3,333	3,333	3,333
Total Reserves	1,631	1,589	1,601	1,996	2,509
Total Shareholders' Equity	**4,965**	**4,922**	**4,934**	**5,329**	**5,842**
Total Equity	**5,858**	**5,832**	**5,975**	**6,500**	**7,165**
Total Liabilities & Shareholders' Equity	**10,833**	**11,818**	**12,411**	**13,651**	**15,183**

Higher net debt results from the Phase 2 andPhase 3 expansion plans

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	1,175	3,094	3,831	4,725	5,468
Net Debt/EBITDA (x)	1.07	9.22	3.47	2.57	2.71
Net Debt to Equity	20.1%	53.0%	64.1%	72.7%	76.3%
EBITDA Interest Cover (x)	11.7	(8.0)	11.5	11.5	12.7
BVPS (SAR)	14.90	14.77	14.80	15.99	17.53

While much capex has been finished, we expect capex to remain heavy over 2010-2012

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	**851**	**210**	**712**	**1,204**	**1,410**
Depreciation & Amortisation	152	167	293	474	449
Decrease in Working Capital	119	(283)	(523)	(19)	19
Other Operating Cashflow	92	(269)	(58)	(42)	(56)
Cashflow from Operations	**1,214**	**(175)**	**425**	**1,617**	**1,821**
Capital Expenditure	(2,723)	(1,565)	(812)	(1,875)	(1,875)
New Investments	1	238	79	-	-
Others	(85)	-	(9)	-	-
Cashflow from investing activities	**(2,807)**	**(1,327)**	**(743)**	**(1,875)**	**(1,875)**
Net Operating Cashflow	**(1,593)**	**(1,502)**	**(318)**	**(258)**	**(54)**
Dividends paid to ordinary shareholders	(333)	(333)	(336)	(333)	(333)
Proceeds from issue of shares	1,967	-	-	-	-
Effects of Exchange Rates on Cash					
Other Financing Cashflow	(1,036)	(216)	(158)	(303)	(355)
Cashflow from financing activities	**2,612**	**752**	**(299)**	**(132)**	**64**
Total cash generated	1,019	(750)	(617)	(390)	10
Cash at beginning of period	1,562	2,581	1,831	1,215	824
Implied cash at end of year	**2,581**	**1,831**	**1,215**	**824**	**835**

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	159.4%	188.4%	41.5%	58.7%	54.8%

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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