Saudi International Petrochemical Co

Petrochemicals –Industrial
SIPCHEM AB: Saudi Arabia
06 February 2011

الراجحي المالية
Al Rajhi Capital

US$2.050bn	68.3%	US$9.07mn
Market cap	Free float	Avg. daily volume

Target price	29.90	29.7.% over current
Consensus price	30.50	32.3% over current
Current price	23.05	as at 5/2/2011

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Underweight | Neutral | **Overweight**

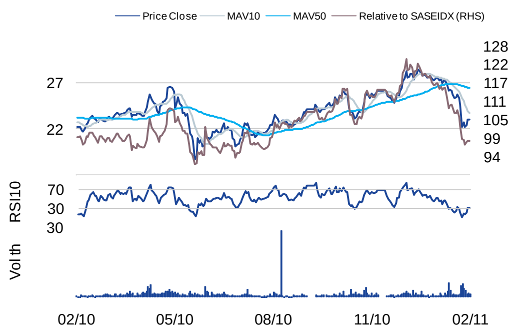
Key themes

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 a few years is expected to broaden its product portfolio. We are Overweight on the stock.

Performance

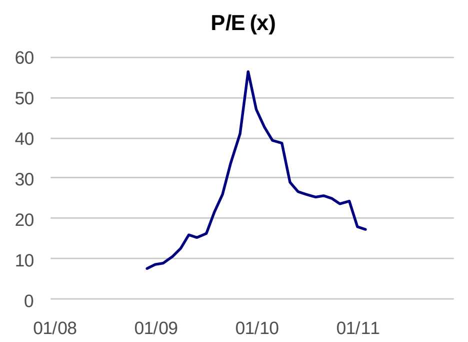


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	1,987	3,249	3,381	3,449
Revenue Growth	139.2%	63.6%	4.1%	2.0%
EBITDA (mn)	1,005	1,723	1,860	1,931
EBITDA Growth	199.5%	71.4%	8.0%	3.9%
EPS	1.13	2.28	2.29	2.36
EPS Growth	168.4%	101.2%	0.4%	2.9%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Sipchem
Subdued Q4 profitability

While Sipchem's Q4 revenues were above our estimate reflecting both capacity expansion and the recent pick-up in prices, profit margins were below our forecasts due to the change in product mix. Factoring in the weaker than expected Q4 results, we have increased our operating cost estimates, resulting in a reduction of profit estimates of about 5% over 2011-2013. Our new target price of SAR29.9 implies 35% upside and we remain Overweight.

Strong sales growth: Sipchem reported Q4 sales of SAR801mn, up by 169% year-on-year and by 57% quarter-on-quarter. Q4 sales exceeded our estimate of SAR770mn by 4%. The growth in revenues reflected higher production of the company's two core products, methanol and butanediol, as well as higher pricing for the majority of the company's petrochemicals products. We have marginally revised our revenue estimates downwards, and now assume a compound annual growth rate of 20% compared to 22% previously for the period 2010-2013.

Profits below our forecast: Net profit was SAR125mn in Q4, up by 122% year-on-year and by 49% quarter-on-quarter, well below our estimate of SAR174mn. Compared to Q3, the net profit margin declined from 16.5% to 15.6%. We believe that change in product mix and lower operating rates in the new product lines impacted the net profit. Higher zakat charges also impacted the bottom line.

Investing for a brighter future: Sipchem launched its Phase 2 production facilities (carbon monoxide, vinyl acetate monomer (VAM) and acetic acid) in the middle of 2010. Currently Sipchem is planning to spend around US$100mn to build the first ethyl acetate plant in the Gulf with the help of the French chemical group, Rhodia. It has also awarded a contract to South Korea's GS Engineering and Construction (GS) to build a petrochemicals plant as part its Phase 3 expansion. GS will build a plant to produce ethylene vinyl acetate and low density polyethylene in Jubail with a capacity of 200,000 tons per year. We think this expansion will enable Sipchem to capitalise on strong demand for petrochemicals in Asia while moving up the petrochemicals value chain.

Expanding share capital by 10% bonus issue: Sipchem announced a plan to increase its share capital from SAR3.3bn to SAR3.7bn (333.3mn shares) by making a 10% bonus share issue. The Capital Market Authority has approved this bonus issue. We will revise our valuation model to reflect the impact of this issue once the company announces the exact issue date.

Valuation and conclusion: While sales in Q4 benefited from higher volume and realised prices, margins contracted significantly, primarily due to a shift in product mix. Based on this trend we have increased our assumptions for operating costs in our long-run valuation model. This has resulted in a 9% decline in our fair value per share (which is also our target price) from SAR32.8 to SAR29.9. Our valuation reflects a three year compound annual growth rate in net profit of 28% mainly driven by recovery in prices and volume growth from capacity expansion. While the reduction in our fair value is substantial, it has arguably been more than reflected in the 15% decline – driven by both weak results and the impact of the current political crisis in Egypt – in Sipchem's share price since its results announcement on 16th January. Our new target price implies 35% upside potential and 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$)	7.68bn / 2.050bn
52-week range	18.70 - 28.50
Daily avg volume (US$)	9.07mn
Shares outstanding	333.3mn
Free float (est)	68.3%

Performance:	1M	3M	12M
Absolute	-16.5%	-9.3%	1.5%
Relative to index	-14%	-12.3%	-2.5%

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)	1,987	3,249	3,381	3,449
EBITDA (SARmn)	1,005	1,723	1,860	1,931
Net Profit (SARmn)	378	761	764	786
EPS (SAR)	1.13	2.28	2.29	2.36
DPS (SAR)	1.00	1.00	1.00	1.00
EPS Growth	168.4%	101.2%	0.4%	2.9%
EV/EBITDA (x)	12.8	8.3	8.2	8.1
P/E (x)	20.3	10.1	10.1	9.8
P/B (x)	1.6	1.4	1.3	1.2
Dividend Yield	4.3%	4.3%	4.3%	4.3%

Source: Company data, Al Rajhi Capital

Q4 results: product mix change leads to margin contraction

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

Figure 1. Sipchem: Q4 2010 results

(SAR mn)	Q4 2009 actual	Q3 2010 actual	Q4 2010 actual	% chg y-y	Q4 2010 ARC est	Comment
Revenues	**298**	**509**	**801**	**168.5%**	**770**	Healthy revenue growth due to higher production volumes (methanol and butanediol) and improved prices for most petrochemicals products on a year-on-year basis
Gross profit	194	309	362	86.5%	469	Well below our forecast, mainly due to change in product mix
Gross margin	65.1%	60.7%	45.2%	(19.9)pp	61.0%	Change in product mix contributed to significant margin contraction in Q4 versus Q3
EBITDA	**178**	**283**	**331**	**85.8%**	**431**	Well below our forecast
EBITDA margin (%)	59.7%	55.7%	41.3%	(18.4)pp	56.0%	Margin affected due to lower productivity
Depreciation & amortization	(55)	(108)	(48)	-12.4%	(102)	Well below our forecast
Operating Profit	**123**	**176**	**282**	**129.9%**	**329**	We believe that lower operating rates and productivity from new product lines reflected in lower operating profit
Financing cost	(7)	(36)	ND	n/a	(39)	
Other	(2)	0	3	n/m	-	
Net profit before tax after minority	114	140	ND	n/a	291	
Tax	(20)	(6)	(28)	36.7%	(12)	Higher than our estimates
Minority	(38)	(50)	ND	n/a	(105)	
Net profit	**55**	**84**	**125**	**125.5%**	**174**	Lower operating profit and higher taxes affected net earnings
Capex	(229)	(104)	(120)	-47.4%	(616)	Well below our forecast, quarterly capex is very volatile.
Capex / Sales	76.7%	20.5%	15.0%	n/m	80.0%	As above
Net debt	3,094	3,471	ND	n/m	3,831	
Net debt / Annualized EBITDA (x)	4.3	3.1	n/m	n/m	2.2	

Source: Company data, Al Rajhi Capital

Phase 2 expansion is driving strong revenue growth

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**830**	**1,987**	**3,249**	**3,381**	**3,449**
Cost of Goods Sold	(424)	(894)	(1,364)	(1,353)	(1,345)
Gross Profit	**407**	**1,093**	**1,885**	**2,029**	**2,104**
Government Charges					
S.G. & A. Costs	(238)	(328)	(462)	(576)	(610)
Operating EBIT	**168**	**765**	**1,423**	**1,452**	**1,494**
Cash Operating Costs	(495)	(982)	(1,527)	(1,522)	(1,518)
EBITDA	336	1,005	1,723	1,860	1,931
Depreciation and Amortisation	(167)	(240)	(300)	(407)	(437)
Operating Profit	**168**	**765**	**1,423**	**1,452**	**1,494**
Net financing income/(costs)	42	(95)	(155)	(180)	(184)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	-	(3)	-	-	-
Other Expenses					
Net Profit Before Taxes	**210**	**667**	**1,268**	**1,273**	**1,310**
Taxes	(40)	(42)	(51)	(51)	(52)
Minority Interests	(29)	(247)	(456)	(458)	(472)
Net profit available to shareholders	**141**	**378**	**761**	**764**	**786**
Dividends	(333)	(333)	(333)	(333)	(333)
Transfer to Capital Reserve					

We expect EPS to grow at a CAGR of 28% over 2010-13

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	333.3	333.3	333.3	333.3	333.3
CFPS (SAR)	1.01	2.60	4.55	4.89	5.08
EPS (SAR)	0.423	1.134	2.282	2.291	2.358
DPS (SAR)	1.000	1.000	1.000	1.000	1.000

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	-51.4%	139.2%	63.6%	4.1%	2.0%
Gross Profit Growth	-65.1%	168.6%	72.5%	7.6%	3.7%
EBITDA Growth	-69.4%	199.5%	71.4%	8.0%	3.9%
Operating Profit Growth	-82.2%	354.5%	86.0%	2.1%	2.9%
Net Profit Growth	-73.8%	168.4%	101.2%	0.4%	2.9%
EPS Growth	-79.0%	168.4%	101.2%	0.4%	2.9%

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%	55.0%	58.0%	60.0%	61.0%
EBITDA margin	40.4%	50.6%	53.0%	55.0%	56.0%
Operating Margin	20.3%	38.5%	43.8%	43.0%	43.3%
Pretax profit margin	25.3%	33.6%	39.0%	37.6%	38.0%
Net profit margin	17.0%	19.0%	23.4%	22.6%	22.8%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	1.5%	6.9%	11.7%	10.7%	10.4%
ROIC	1.4%	6.7%	12.4%	11.6%	10.6%
ROE	2.8%	7.7%	14.9%	13.8%	13.2%
Effective Tax Rate	19.2%	6.3%	4.0%	4.0%	4.0%
Capex/Sales	188.4%	16.0%	57.7%	55.5%	40.0%
Dividend Payout Ratio	236.6%	88.2%	43.8%	43.7%	42.4%

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Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	54.5	20.3	10.1	10.1	9.8
P/CF (x)	22.8	8.9	5.1	4.7	4.5
P/B (x)	1.6	1.6	1.4	1.3	1.2
EV/Sales (x)	14.7	6.5	4.4	4.5	4.5
EV/EBITDA (x)	36.3	12.8	8.3	8.2	8.1
EV/EBIT (x)	72.5	16.8	10.0	10.5	10.5
EV/IC (x)	1.1	1.2	1.2	1.1	1.1
Dividend Yield	4.3%	4.3%	4.3%	4.3%	4.3%

Source: Company data, Al Rajhi Capital

Phase 2 & Phase 3 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	717	721	569
Current Receivables	308	591	890	927	931
Inventories	79	209	330	343	345
Other current assets	0	0	-	-	-
Total Current Assets	**2,218**	**2,420**	**1,938**	**1,991**	**1,845**
Fixed Assets	9,569	9,570	11,145	12,613	13,555
Investments	-	-	-	-	-
Goodwill	31	28	28	28	28
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**9,601**	**9,598**	**11,173**	**12,641**	**13,583**
Total Assets	**11,818**	**12,018**	**13,111**	**14,632**	**15,428**
Short Term Debt	283	432	432	432	432
Accounts Payable	620	401	495	515	517
Accrued Expenses	-	-	-	-	-
Zakat Payable					
Dividends Payable	-	-	-	-	-
Other Current Liabilities					
Total Current Liabilities	**903**	**833**	**927**	**947**	**949**
Long-Term Debt	4,642	4,587	5,022	5,955	6,155
Other LT Payables	401	530	530	530	530
Provisions	40	49	49	49	49
Total Non-current Liabilities	**5,083**	**5,166**	**5,601**	**6,535**	**6,735**
Minority interests	910	1,133	1,270	1,408	1,549
Paid-up share capital	3,333	3,333	3,333	3,333	3,333
Total Reserves	1,589	1,552	1,979	2,409	2,862
Total Shareholders' Equity	**4,922**	**4,885**	**5,313**	**5,743**	**6,195**
Total Equity	**5,832**	**6,018**	**6,583**	**7,151**	**7,744**
Total Liabilities & Shareholders' Equity	**11,818**	**12,018**	**13,111**	**14,632**	**15,428**

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

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	3,094	3,399	4,737	5,666	6,018
Net Debt/EBITDA (x)	9.22	3.38	2.75	3.05	3.12
Net Debt to Equity	53.0%	56.5%	72.0%	79.2%	77.7%
EBITDA Interest Cover (x)	(8.0)	10.6	11.1	10.3	10.5
BVPS (SAR)	14.77	14.66	15.94	17.23	18.59

While much capex has been finished, we expect capex to remain heavy over 2011-2012

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	**210**	**667**	**1,268**	**1,273**	**1,310**
Depreciation & Amortisation	167	240	300	407	437
Decrease in Working Capital	(283)	(546)	(327)	(29)	(4)
Other Operating Cashflow	(269)	(549)	(51)	(51)	(52)
Cashflow from Operations	**(175)**	**(187)**	**1,190**	**1,600**	**1,691**
Capital Expenditure	(1,565)	(317)	(1,875)	(1,875)	(1,380)
New Investments	238	79	-	-	-
Others	-	(22)	-	-	-
Cashflow from investing activities	**(1,327)**	**(260)**	**(1,875)**	**(1,875)**	**(1,380)**
Net Operating Cashflow	**(1,502)**	**(447)**	**(685)**	**(275)**	**311**
Dividends paid to ordinary shareholders	(333)	(336)	(333)	(333)	(333)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash					
Other Financing Cashflow	(216)	428	(320)	(321)	(330)
Cashflow from financing activities	**752**	**237**	**(218)**	**279**	**(463)**
Total cash generated	(750)	(211)	(903)	4	(152)
Cash at beginning of period	2,581	1,831	1,621	717	721
Implied cash at end of year	**1,831**	**1,621**	**717**	**721**	**569**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	188.4%	16.0%	57.7%	55.5%	40.0%

Source: Company data, Al Rajhi Capital

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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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