



US\$7.38bn Market cap	45% Free float	US\$78.14mn Avg. daily volume
Target price	15.70	-14.9% over current
Consensus price	18.60	0.8% over current
Current price	18.45	as at 26/4/2011

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▼
Underweight **Neutral** **Overweight**

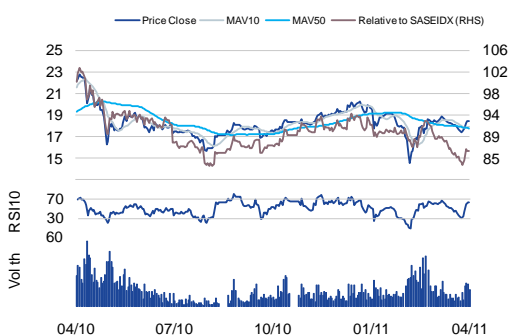
Key themes

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 a little confidence in scheduled launch of commercial production in 2H 2011, we rate Saudi Kayan as underweight.

Performance



Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	-	369	12,275	13,628
Revenue Growth			3226.5%	11.0%
EBITDA (mn)	(14)	144	5,479	6,269
EBITDA Growth	-15.4%		3702.8%	14.4%
EPS	(0.01)	(0.40)	1.63	2.18
EPS Growth	-13.6%	3956.2%		34.0%

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 profit until 2012.

Saudi Kayan Clouded by mounting debt

This report follows our Flash View of 13th April. Saudi Kayan's production facilities are currently in the pre-operational stage. The company reported a net loss of SAR8.3mn in Q1, significantly above our estimate of a loss of SAR4.1mn. Despite the start of trial operations in Q3 2010, we do not expect Saudi Kayan to record significant revenues till 2012. In our view, high & rising debt and uncertainties related to timely start of operations make the stock unattractive. Nonetheless, we have raised our revenue forecast by an average of about 2.5% for 2012- 2015 period on the back of improving product prices. Consequently, our target price increased from SAR15.5 to SAR15.7 but remain Underweight.

Increased inventory level signifying pick up in trial operations: Saudi Kayan continued its trial operations during the first quarter. The Company started trial operations at its polycarbonate plant in mid-March. The plant has the capacity to produce 26,000 tons a year of polycarbonate resins. In addition, Kayan reportedly sent initial shipment of acetone (about 1,600 metric tonnes) to India in the middle of January this year (Source: Zawya dated 17 Jan 2011). Further, a sharp jump in the inventory level to SAR947.1mn at the end of current quarter versus SAR498.3mn in the previous quarter shows the increased activity at the company's plants.

Net debt vaults further to SAR26.4bn: Net debt increased from SAR25.1bn at the end of Q4 2010 to SAR26.4bn at the end of Q1 2011. During the quarter, Kayan utilised about SAR1.8bn in additional loan facilities (note - in late March 2011, the Company signed a SAR2bn murabaha facility agreement with Banque Saudi Fransi) to cover the escalated construction costs. In addition, total accounts receivables expanded significantly to SAR1.8bn at the end of Q1 2011 compared to SAR1.4bn at the end of Q4 2010.

We expect Kayan to generate economic profit only from 2014: 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 9.5% to 10.0%. We estimate that Kayan will generate an economic profit, i.e. a return on invested capital higher than WACC, only from 2014.

Valuation and conclusion: We estimate the launch of commercial production in Q4 2011 as against the Company's guidance for a launch in 2H2011, principally due to the continued delays the Company has experienced in its commercial operations. However, we will keep a track of the news from the Company and will update our assumptions accordingly. A launch of commercial production before our expectations remains an upside risk to the stock. We also expect the company's share price to benefit from higher oil prices that should provide boost to Petro product prices thereby improving the overall sentiments of the Petrochemicals companies. However, the EV/IC ratio of 1.3x and price/book value ratio of 1.8x for 2011 (for a company yet to start its business) looks high suggesting that the stock is expensive. We maintain our Underweight rating since our revised target price implies 15% downside potential from the current share price.



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 2H FY11, thus delaying the revenue stream associated with the company.

Share information

Market cap (SAR/US\$)	27.68bn / 7.38bn		
52-week range	14.55 - 22.75		
Daily avg volume (US\$)	78.14mn		
Shares outstanding	1,500mn		
Free float (est)	45%		
Performance:	1M	3M	12M
Absolute	-0.3%	-5.9%	-17.6%
Relative to index	-3.1%	-5.7%	-14.1%
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)	-	369	12,275	13,628
EBITDA (SARmn)	(14)	144	5,479	6,269
Net Profit (SARmn)	(15)	(593)	2,438	3,266
EPS (SAR)	(0.01)	(0.40)	1.63	2.18
DPS (SAR)	-	-	-	-
EPS Growth	-13.6%	3956.2%	na	34.0%
EV/EBITDA (x)	na	379.3	8.9	7.0
P/E (x)	na	na	11.4	8.5
P/B (x)	1.8	1.9	1.6	1.3
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Q1 2011 results: zakat weighs on bottom-line

Below we present the key details of Saudi Kayan's Q1 2011 results, together with our comments.

Figure 1. Kayan: Q1 2011 results

(SAR mn)	Q1 2010 actual	Q4 2010 actual	Q1 2011 actual	% chg y-y	Q1 2011 ARC est	Comment
Revenues	-	-	-	n/m	-	
Gross profit	-	-	-	n/m	-	
Gross margin	n/m	n/m	n/m	n/m	n/m	
EBITDA	(4)	(4)	(3)	-5.8%	(4)	Marginally above our estimates
EBITDA margin (%)	n/m	n/m	n/m	n/m	n/m	
Depreciation & amortization				n/m		
Operating Profit	(4)	(4)	(3)	-5.8%	(4)	Marginally above our estimates
Financing cost				n/m		
Other				n/m		
Net profit before tax after minority	(4)	(4)	(3)	-5.8%	(4)	Marginally above our estimates
Tax	(0)	(0)	(5)	n/m	-	Significantly higher than Q3 numbers
Minority	-	-	-	n/m	-	
Net profit	(4)	(4)	(8)	121.1%	(4)	Well below our estimates due to increased zakat
Capex	(929)	(933)	(364)	-60.9%	(200)	Well above our forecast, quarterly capex is volatile
Capex / Sales	n/m	n/m	n/m	n/m	n/m	
Net debt	18,591	25,122	26,442	51.1%	25,373	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	n/m	

Source: Company data, Al Rajhi Capital



We expect Saudi Kayan to generate revenues only in Q4 2011

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	-	-	369	12,275	13,628
Cost of Goods Sold	-	-	(192)	(6,125)	(6,678)
Gross Profit	-	-	177	6,150	6,950
Government Charges					
S.G. & A. Costs	(17)	(14)	(652)	(3,088)	(3,055)
Operating EBIT	(17)	(14)	(475)	3,062	3,895
Cash Operating Costs	(17)	(14)	(225)	(6,796)	(7,359)
EBITDA	(17)	(14)	144	5,479	6,269
Depreciation and Amortisation	-	-	(619)	(2,417)	(2,374)
Operating Profit	(17)	(14)	(475)	3,062	3,895
Net financing income/(costs)	-	-	(137)	(523)	(493)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	(17)	(14)	(612)	2,539	3,402
Taxes	(0)	(0)	19	(102)	(136)
Minority Interests					
Net profit available to shareholders	(17)	(15)	(593)	2,438	3,266
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)	0.018	3.236	3.760
EPS (SAR)	(0.011)	(0.010)	(0.395)	1.625	2.178
DPS (SAR)	0	0	0	0	0
Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth				3226.5%	11.0%
Gross Profit Growth				3372.2%	13.0%
EBITDA Growth	-90.2%	-15.4%		3702.8%	14.4%
Operating Profit Growth	-90.2%	-15.4%	3234.2%		27.2%
Net Profit Growth	-103.4%	-13.6%	3956.2%		34.0%
EPS Growth	-103.4%	-13.6%	3956.2%		34.0%
Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin			48.0%	50.1%	51.0%
EBITDA margin			39.0%	44.6%	46.0%
Operating Margin			-128.7%	24.9%	28.6%
Pretax profit margin			-165.8%	20.7%	25.0%
Net profit margin			-160.6%	19.9%	24.0%
Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	0.0%	0.0%	-1.1%	6.8%	8.5%
ROIC	-0.1%	0.0%	-1.1%	7.0%	9.7%
ROE	-0.1%	-0.1%	-3.9%	15.2%	17.2%
Effective Tax Rate	-0.4%	-2.6%	3.1%	4.0%	4.0%
Capex/Sales			220.5%	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	11.4	8.5
P/CF (x)	na	na	1,049.6	5.7	4.9
P/B (x)	1.8	1.8	1.9	1.6	1.3
EV/Sales (x)	na	na	148.1	4.0	3.2
EV/EBITDA (x)	na	na	379.3	8.9	7.0
EV/EBIT (x)	na	na	na	16.0	11.3
EV/IC (x)	1.4	1.3	1.3	1.3	1.2
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital



The company's debt has increased substantially over the years

Saudi Kayan will generate positive operating cash flows only by 2012

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

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	2,472	967	1,000	6,656	9,523
Current Receivables	168	1,417	1,917	4,094	4,246
Inventories	-	498	1,065	1,574	1,363
Other current assets	0	120	158	158	158
Total Current Assets	2,639	2,883	3,982	12,324	15,132
Fixed Assets	33,147	40,557	40,752	39,563	38,552
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	21	34	41	41	41
Total Other Assets	-	-	-	-	-
Total Non-current Assets	33,168	40,591	40,793	39,604	38,593
Total Assets	35,808	43,474	44,775	51,928	53,725
Short Term Debt	-	580	587	587	587
Accounts Payable	272	261	529	3,936	4,361
Accrued Expenses	883	1,572	1,315	2,624	2,726
Zakat Payable	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	1,155	2,414	2,431	7,146	7,673
Long-Term Debt	19,113	25,509	27,384	27,384	25,387
Other LT Payables	62	89	91	91	91
Provisions	-	-	-	-	-
Total Non-current Liabilities	19,175	25,598	27,475	27,475	25,478
Minority interests	-	-	-	-	-
Paid-up share capital	15,000	15,000	15,000	15,000	15,000
Total Reserves	477	463	(130)	2,308	5,574
Total Shareholders' Equity	15,477	15,463	14,870	17,308	20,574
Total Equity	15,477	15,463	14,870	17,308	20,574
Total Liabilities & Shareholders' Equity	35,808	43,474	44,775	51,928	53,725
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	16,642	25,122	26,971	21,314	16,451
Net Debt/EBITDA (x)	(987.93)	(1,763.47)	187.21	3.89	2.62
Net Debt to Equity	107.5%	162.5%	181.4%	123.1%	80.0%
EBITDA Interest Cover (x)	-	-	1.1	10.5	12.7
BVPS (SAR)	10.32	10.31	9.91	11.54	13.72
Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	(17)	(14)	(612)	2,539	3,402
Depreciation & Amortisation	-	-	619	2,417	2,374
Decrease in Working Capital	(938)	(2,771)	(1,061)	2,030	586
Other Operating Cashflow	10	27	26	(102)	(136)
Cashflow from Operations	(946)	(2,758)	(1,027)	6,884	6,226
Capital Expenditure	(13,410)	(5,710)	(814)	(1,227)	(1,363)
New Investments	-	-	-	-	-
Others	6	(13)	(7)	-	-
Cashflow from investing activities	(13,404)	(5,723)	(821)	(1,227)	(1,363)
Net Operating Cashflow	(14,349)	(8,481)	(1,848)	5,656	4,863
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	6,976	1,881	-	(1,997)
Total cash generated	(1,051)	(1,505)	33	5,656	2,866
Cash at beginning of period	3,522	2,472	967	1,000	6,656
Implied cash at end of year	2,472	967	1,000	6,656	9,523
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	-	-	220.5%	10.0%	10.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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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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