Saudi Kayan Petrochemical Co

Petrochemicals –Industrial
KAYAN AB: Saudi Arabia
03 August 2011

الراجحي المالية
Al Rajhi Capital

US$7.04bn	45%	US$50.14mn
Market cap	Free float	Avg. daily volume

Target price	15.70	-10.8% over current
Consensus price	20.58	16.9% over current
Current price	17.60	as at 1/8/2011

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Underweight | Neutral | Overweight

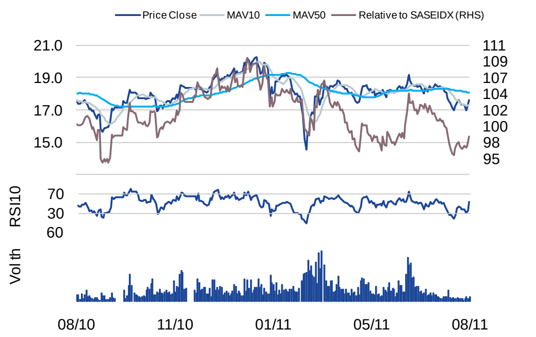
Key themes

We expect the Saudi petrochemicals sector to outperform global peers in the next few years given its feedstock cost advantages and a strong growth in demand from the emerging economies. Saudi Kayan is planning to start commercial production in October, in line with our expectations, after witnessing multiple delays.

Implications

With the launch of commercial production, Saudi Kayan is expected to benefit from the growing demand and product prices in the near term. Additionally, the company is planning to produce some of the speciality chemicals, a first for Saudi Arabia. We reiterate our Underweight rating on Saudi Kayan due to multiple delays faced by the company and await news flow on the actual production commencement.

Performance



Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	-	1,845	12,275	13,628
Revenue Growth			565.3%	11.0%
EBITDA (mn)	(14)	801	5,479	6,269
EBITDA Growth	-15.4%		583.6%	14.4%
EPS	(0.01)	0.00	1.60	2.16
EPS Growth	-13.6%		39197.7%	34.5%

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 profit until 2012.

Saudi Kayan
Commercial production in sight

Saudi Kayan reported a net loss of SAR16mn in Q2, much higher than our estimate of SAR3.6mn due to an increase in zakat expenses. The company announced plans to start commercial production on 1st October 2011, which substantially boosts clarity on production commencement. Hence, we have revised the plant utilization rate for Q4 2011 to 50% versus our earlier estimate of 10%. Further, we have revised estimates for zakat upwards for H2 2011 considering higher zakat expenses in Q2. We remain Underweight on the stock and retain our target price of SAR15.7. It is worth noting that we will be tracking news flow about the commencement of actual production, which was marred by delays in recent times.

Growing inventory levels indicates commercial production: Saudi Kayan has drawn up plans to start commercial production on 1st October 2011, which is in-line with the company's previous guidance as well as our estimates. The jump in the inventory levels (to SAR1.7bn as of Q2 2011 from SAR0.9bn in Q1 2011) also indicates that the commercial production is just around the corner. We have revised the plant utilisation rate for Q4 2011 to 50% from 10% earlier, considering an increased clarity on production commencement. We expect the company to post a small profit of SAR6.0mn in 2011.

Net debt jumps further to SAR27.5bn: The company reported a net debt of SAR27.5bn as of H1 2011 (debt to equity ratio of 1.8x) as compared to net debt of SAR25.1bn as of FY10. The huge debt on its balance sheet and resultant higher interest payout is likely to impact profitability. However, we do not expect any funding/ debt repayment constraints for Saudi Kayan in the near future, as it is nearing the start of commercial production and also has the backing of its parent company SABIC (the largest petrochemical company in the Middle East).

Kayan to benefit from rising petrochemicals prices in the medium term: The average prices for ethylene, propylene and monoethylene glycol (Kayan's major products) rose by 37.8%, 19.1% and 32.1% year-on-year respectively in Q2 2011. We expect prices to remain stable at current levels or improve marginally in the second half of 2011 due to supply concerns on account of annual maintenance season in China and Japan. However, 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. Overall, Kayan is expected to benefit from improved Asian demand for petrochemicals by the time it achieves full capacity utilisation at its plants in 2012.

Valuation and conclusion: We expect Saudi Kayan to benefit from high petrochemicals product prices if the production commences as scheduled. We will keep a track of actual start date for production as the company has suffered multiple delays in project commencement in the last couple of years. With EV/IC ratio of 1.3x and price/book value ratio of 1.7x for 2011, the valuations are not attractive for a company yet to start its business. Hence, we maintain our Underweight rating since our revised target price implies 10.8% downside 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$)			26.40bn / 7.04bn
52-week range			14.55 - 20.25
Daily avg volume (US$)			50.14mn
Shares outstanding			1,500mn
Free float (est)			45%

Performance:	1M	3M	12M
Absolute	-4.6%	-3.3%	1.1%
Relative to index	-3%	-0.1%	-1.4%

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)	-	1,845	12,275	13,628
EBITDA (SARmn)	(14)	801	5,479	6,269
Net Profit (SARmn)	(15)	6	2,407	3,237
EPS (SAR)	(0.01)	0.00	1.60	2.16
DPS (SAR)	-	-	-	-
EPS Growth	-13.6%	na	39197.7%	34.5%
EV/EBITDA (x)	na	67.1	8.7	6.8
P/E (x)	na	4,310.7	11.0	8.2
P/B (x)	1.7	1.7	1.5	1.3
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Q2 results: zakat dents bottom-line

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

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

(SAR mn)	Q2 2010 actual	Q1 2011 actual	Q2 2011 actual	Q2 2011 ARC est	% chg y-y	Q3 2010 actual	Q3 2011 ARC est	% chg y-y
Revenues	**-**	**-**	**-**	**-**	**n/m**	**-**	**-**	**n/m**
Gross profit	-	-	-	-	n/m	-	-	n/m
Gross margin	n/m	n/m	n/m	n/m		n/m	n/m	
EBITDA	**(2)**	**(3)**	**(3)**	**(4)**	**111.3%**	**(5)**	**(4)**	**-29.7%**
EBITDA margin (%)	n/m	n/m	n/m	n/m		n/m	n/m	
Depreciation & amortization					n/m			n/m
Operating Profit	**(2)**	**(3)**	**(3)**	**(4)**	**111.3%**	**(5)**	**(4)**	**-29.7%**
Financing cost					n/m			n/m
Other					n/m			n/m
Net profit before tax after minority	(2)	(3)	(3)	(4)	111.3%	(5)	(4)	-29.7%
Tax	(0)	(5)	(13)	-	6312.2%	(0)	(7)	n/m
Minority	-	-	-	-	n/m	-	-	n/m
Net profit	**(2)**	**(8)**	**(16)**	**(4)**	**791.4%**	**(5)**	**(11)**	**110.0%**
Capex	(2,357)	(364)	(401)	(200)	-83.0%	(1,490)	(300)	-79.9%
Capex / Sales	n/m	n/m	n/m	n/m		n/m	n/m	
Net debt	21,025	26,442	27,487	26,682	30.7%	22,812	27,860	22.1%
Net debt / Annualized EBITDA (x)	n/m	n/m	n/m	n/m		n/m	n/m	

Source: Company data, Al Rajhi Capital

Company expects the launch of commercial production in October 2011

We estimate Saudi Kayan to generate profit in 2011

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**-**	**-**	**1,845**	**12,275**	**13,628**
Cost of Goods Sold	-	-	(959)	(6,125)	(6,678)
Gross Profit	**-**	**-**	**886**	**6,150**	**6,950**
Government Charges					
S.G. & A. Costs	(17)	(14)	(709)	(3,111)	(3,078)
Operating EBIT	**(17)**	**(14)**	**177**	**3,039**	**3,873**
Cash Operating Costs	(17)	(14)	(1,044)	(6,796)	(7,359)
EBITDA	(17)	(14)	801	5,479	6,269
Depreciation and Amortisation	-	-	(624)	(2,440)	(2,396)
Operating Profit	**(17)**	**(14)**	**177**	**3,039**	**3,873**
Net financing income/(costs)	-	-	(142)	(532)	(501)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	**(17)**	**(14)**	**35**	**2,507**	**3,372**
Taxes	(0)	(0)	(29)	(100)	(135)
Minority Interests					
Net profit available to shareholders	**(17)**	**(15)**	**6**	**2,407**	**3,237**
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)	0.420	3.231	3.756
EPS (SAR)	(0.011)	(0.010)	0.004	1.604	2.158
DPS (SAR)	0	0	0	0	0

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth				565.3%	11.0%
Gross Profit Growth				594.4%	13.0%
EBITDA Growth	-90.2%	-15.4%		583.6%	14.4%
Operating Profit Growth	-90.2%	-15.4%		1615.9%	27.5%
Net Profit Growth	-103.4%	-13.6%		39197.7%	34.5%
EPS Growth	-103.4%	-13.6%		39197.7%	34.5%

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin			48.0%	50.1%	51.0%
EBITDA margin			43.4%	44.6%	46.0%
Operating Margin			9.6%	24.8%	28.4%
Pretax profit margin			1.9%	20.4%	24.7%
Net profit margin			0.3%	19.6%	23.8%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	0.0%	0.0%	0.4%	6.5%	8.2%
ROIC	-0.1%	0.0%	0.1%	6.8%	9.5%
ROE	-0.1%	-0.1%	0.0%	14.4%	16.6%
Effective Tax Rate	-0.4%	-2.6%	82.6%	4.0%	4.0%
Capex/Sales			65.8%	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	4,310.7	11.0	8.2
P/CF (x)	na	na	41.9	5.4	4.7
P/B (x)	1.7	1.7	1.7	1.5	1.3
EV/Sales (x)	na	na	29.2	3.9	3.1
EV/EBITDA (x)	na	na	67.1	8.7	6.8
EV/EBIT (x)	na	na	303.9	15.7	11.0
EV/IC (x)	1.3	1.3	1.3	1.2	1.1
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

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	2,472	967	1,451	7,664	10,222
Current Receivables	168	1,417	2,123	4,186	4,339
Inventories	-	498	1,827	1,574	1,363
Other current assets	0	120	251	251	251
Total Current Assets	**2,639**	**2,883**	**5,401**	**13,425**	**15,924**
Fixed Assets	33,147	40,557	41,147	39,935	38,902
Investments	-	-	-	-	-
Goodwill					
Other Intangible Assets	21	34	40	40	40
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**33,168**	**40,591**	**41,187**	**39,975**	**38,941**
Total Assets	**35,808**	**43,474**	**46,588**	**53,400**	**54,865**
Short Term Debt	-	580	348	348	348
Accounts Payable	272	261	497	3,936	4,361
Accrued Expenses	883	1,572	1,658	2,624	2,726
Zakat Payable					
Dividends Payable					
Other Current Liabilities					
Total Current Liabilities	**1,155**	**2,414**	**2,503**	**6,908**	**7,435**
Long-Term Debt	19,113	25,509	28,512	28,512	26,213
Other LT Payables	62	89	105	105	105
Provisions	-	-	-	-	-
Total Non-current Liabilities	**19,175**	**25,598**	**28,617**	**28,617**	**26,317**
Minority interests	-	-	-	-	-
Paid-up share capital	15,000	15,000	15,000	15,000	15,000
Total Reserves	477	463	469	2,875	6,113
Total Shareholders' Equity	**15,477**	**15,463**	**15,469**	**17,875**	**21,113**
Total Equity	**15,477**	**15,463**	**15,469**	**17,875**	**21,113**
Total Liabilities & Shareholders' Equity	**35,808**	**43,474**	**46,588**	**53,400**	**54,865**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	16,642	25,122	27,409	21,196	16,339
Net Debt/EBITDA (x)	(987.93)	(1,763.47)	34.20	3.87	2.61
Net Debt to Equity	107.5%	162.5%	177.2%	118.6%	77.4%
EBITDA Interest Cover (x)			5.7	10.3	12.5
BVPS (SAR)	10.32	10.31	10.31	11.92	14.08

Saudi Kayan will generate positive operating 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)**	**35**	**2,507**	**3,372**
Depreciation & Amortisation	-	-	624	2,440	2,396
Decrease in Working Capital	(938)	(2,771)	(1,731)	2,595	586
Other Operating Cashflow	10	27	4	(100)	(135)
Cashflow from Operations	**(946)**	**(2,758)**	**(1,067)**	**7,441**	**6,219**
Capital Expenditure	(13,410)	(5,710)	(1,214)	(1,227)	(1,363)
New Investments	-	-	-	-	-
Others	6	(13)	(5)	-	-
Cashflow from investing activities	**(13,404)**	**(5,723)**	**(1,220)**	**(1,227)**	**(1,363)**
Net Operating Cashflow	**(14,349)**	**(8,481)**	**(2,287)**	**6,214**	**4,857**
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**	**2,771**	**-**	**(2,299)**
Total cash generated	(1,051)	(1,505)	484	6,214	2,557
Cash at beginning of period	3,522	2,472	967	1,451	7,664
Implied cash at end of year	**2,472**	**967**	**1,451**	**7,664**	**10,222**

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			65.8%	10.0%	10.0%

Source: Company data, Al Rajhi Capital

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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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