



US\$1.921bn Market cap
68.8% Free float
US\$6.56mn Avg. daily volume

Target price **24.50** 24.68% over current
Consensus price **24.40** 24.2% over current
Current price **19.65** as at 26/10/2011

Research Department

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Underweight

Neutral

Overweight

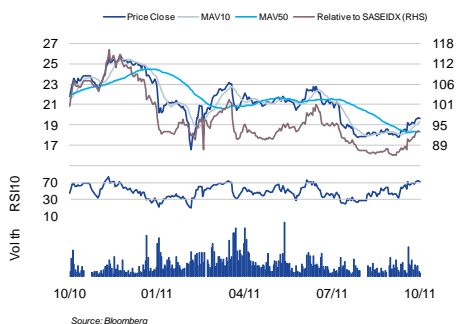
Key themes

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

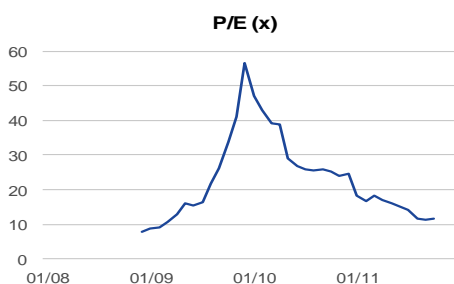


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	1,993	3,236	3,381	3,543
Revenue Growth	139.9%	62.4%	4.5%	4.8%
EBITDA (mn)	1,069	1,749	1,915	1,999
EBITDA Growth	218.6%	63.5%	9.5%	4.4%
EPS	1.03	1.82	2.00	2.13
EPS Growth	168.4%	76.8%	9.9%	6.3%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Sipchem

Robust Q3 performance

Sipchem reported a net profit of SAR208mn, a 26% growth sequentially, beating consensus as well as our estimates on the back of higher product prices. Prices of methanol (~ 50% revenue contribution in Q3 as per our estimate) have increased sharply in Q3 (+10% q-o-q), driven by a strong demand from China (inventory build-up ahead of an introduction of methanol futures) and supply constraints. We expect the average prices of methanol to continue the upward trend in Q4, before moderating in 2012. We estimate the company to post another solid performance in Q4; however, lower utilization levels due to maintenance shutdown at the company's VAM facility can marginally impact earnings. We remain Overweight on the stock, with a target price of SAR24.5.

Healthy Q3 results, decline in utilization rate expected in Q4: Sipchem posted Q3 revenues of SAR865mn, up by 70% y-o-y with an improvement in the net profit margins of 756 bps y-o-y, on the back of improved product prices and higher plant utilization. Sequentially, revenues grew by 4%, beating our estimate of SAR815mn. We believe that utilization rates at the company's facilities were close to 120% in Q3 due to improvement in operational performance. Considering a 20-day scheduled maintenance shutdown at the VAM plant, we have reduced our estimates for operating rates for the VAM plant from 120% in Q3 to 93% in Q4. Accordingly, we expect overall utilization rate at 115% in Q4.

Improving methanol prices to fuel growth: Although most of major petrochemical prices declined q-o-q in Q3, average price of methanol jumped by around 10%. Methanol supplies were affected by shutdowns in Asia, especially in Japan. Furthermore, demand from China remained robust, driven by speculations that methanol will trade in future contracts on the Zhengzhou Commodity Exchange from November 2011. Considering a 9% rise in prices in the first two weeks of October compared to average price in Q3, we expect average methanol prices to increase by 5% q-o-q. We expect product prices to start moderating in 2012, once the Chinese methanol futures start trading. We might have to revise our price estimates in the event of major macroeconomic developments in the US or Europe.

VAM maintenance shutdown and higher zakat to impact Q4 performance: We estimate the company to report a 2% q-o-q decline in revenues to SAR847mn, with a 70bps drop in gross margin to 47.5% in Q4 due to VAM maintenance shutdown. Moreover, higher zakat expenses, historically high in Q4 for the company, may impact Q4 performance further, which would result in a 320bps q-o-q decline in the net margin. For Q4, we estimate zakat rate of 10%, but we lack clarity on zakat calculations.

Valuation and conclusion: We have raised our revenue estimates by 4% for both 2011 and 2012, following strong Q3 results. However, considering the global macroeconomic concerns, we have raised the market risk premium and beta resulting in an increase in WACC, which offsets the upside from our increased earnings estimates. We retain our Overweight rating with a target price of SAR24.5, implying a 25% upside from the current levels. We expect the company to declare a dividend of SAR1 per share for 2011, which implies an attractive dividend yield of 5.1%.



Corporate summary	Share information			Valuation					
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).	Market cap (SAR/US\$)	7.21bn / 1.921bn		Period End	12/10A	12/11E	12/12E	12/13E	
	52-week range	16.55 - 25.91		Revenue (SARmn)	1,993	3,236	3,381	3,543	
	Daily avg volume (US\$)	6.56mn		EBITDA (SARmn)	1,069	1,749	1,915	1,999	
	Shares outstanding	366.7mn		Net Profit (SARmn)	378	669	735	781	
	Free float (est)	68.8%		EPS (SAR)	1.03	1.82	2.00	2.13	
	Performance:	1M	3M	12M	DPS (SAR)	-	1.00	1.00	1.17
	Absolute	8.6%	-7.3%	-9.4%	EPS Growth	168.4%	76.8%	9.9%	6.3%
	Relative to index	7.8%	-2.3%	-6.6%	EV/EBITDA (x)	11.4	6.6	6.5	6.3
	P/E (x)	19.1	10.8	9.8	P/B (x)	1.5	1.3	1.2	1.1
	Dividend Yield	0.0%	5.1%	5.1%	6.0%	Source: Company data, Al Rajhi Capital			
Major Shareholder:				Source: Bloomberg, Al Rajhi Capital					
Al-Zamil Group Holding Co.			9.6%						
National Industries Group Holding.			8.3%						

Expansion plans on track

In early October, Sipchem started construction of phase III plants

Phase III construction begins: As per its expansion strategy, Sipchem has started the construction of its phase III plants in Jubail industrial city in early October. These facilities will produce speciality chemicals such as Ethylene Vinyl Acetate & LDPE (annual capacity of 0.2mtpa, estimated project cost SAR3bn) and Ethyl Acetate (0.1 mtpa, cost SAR350mn). These products will diversify the company's portfolio, which is currently focused on methanol and its derivatives. In Q3 2011, the company issued Sukuk worth SAR1.8bn to fund these expansion plans. We believe that the company's phase III expansion plans are firmly on track for commercial production from the second half of 2013.

Net income estimates are highly sensitive to zakat expenses.

Higher zakat expenses may dent Q4 net earnings: Historically the company has reported higher zakat expenses in the last quarter of the year. Currently, we estimate zakat rate of 10% for Q4 2011 based on zakat rates for Q4 2010; however, we lack clarity on zakat calculations. It's worth noting that our earnings estimate is highly sensitive to zakat assumptions as every 1% increase in zakat (as a % of profit before tax) leads to a decrease in net profit estimate by about 2%.

We estimate dividend yield of 5.1% for 2011

Attractive dividend yield compared to peers: Sipchem has maintained stable dividend policy (SAR1 per share per year during the period 2007-09) despite the financial crisis in 2008-09. In 2010, the company issued 10% bonus shares for 2010. Considering the strong operating performance so far in 2011, we estimate dividend pay-out to be more than 50% for 2011. Our dividend estimate of SAR1 per share for 2011 implies a 5.1% yield at current market price, which is attractive as compared to its major peers (Yansab: no dividend payout and Advanced Petrochemical Co.: 6.3% yield for 2011 as per Bloomberg consensus).

Figure 1. Sipchem: Q3 and Q4 results (actual and our estimates)

(SAR mn)	Q3 2010 actual	Q2 2011 actual	Q3 2011 ARC est	Q3 2011 actual	% chg y-y	Q4 2010 actual	Q4 2011 ARC est	% chg y-y
Revenues	509	832	815	865	70.1%	806	847	5.0%
Gross profit	201	316	324	417	107.3%	322	402	24.8%
Gross margin	39.6%	38.1%	39.7%	48.2%	867 bps	40.0%	47.5%	755 bps
EBITDA	283	400	412	505	78.2%	395	489	24.0%
EBITDA margin (%)	55.7%	48.1%	50.5%	58.4%	265 bps	49.0%	57.8%	886 bps
Operating Profit	176	288	295	393	123.3%	281	377	33.8%
Net profit	84	165	152	208	147.8%	125	182	45.2%
Capex	(104)	(220)	(250)	(112)	7.6%	(179)	(200)	11.8%
Capex / Sales	20.5%	26.5%	30.7%	13.0%	n/m	22.2%	23.6%	n/m
Net debt	3,471	2,945	3,423	2,679	-22.8%	3,350	2,564	-23.5%
Net debt / Annualized EBITDA (x)	3.1	1.8	2.1	1.3	n/m	2.1	1.3	n/m

Source: Company data, Al Rajhi Capital



Phase II expansion is driving strong revenue growth

We expect EPS to grow at a CAGR of 27% over 2010-13

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

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	830	1,993	3,236	3,381	3,543
Cost of Goods Sold	(591)	(1,131)	(1,833)	(1,826)	(1,931)
Gross Profit	239	861	1,403	1,555	1,612
Government Charges					
S.G. & A. Costs	(71)	(97)	(105)	(101)	(106)
Operating EBIT	168	764	1,298	1,454	1,506
Cash Operating Costs	(495)	(923)	(1,488)	(1,466)	(1,544)
EBITDA	336	1,069	1,749	1,915	1,999
Depreciation and Amortisation	(167)	(305)	(451)	(461)	(493)
Operating Profit	168	764	1,298	1,454	1,506
Net financing income/(costs)	42	(100)	(174)	(198)	(182)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	-	(4)	-	-	-
Other Expenses					
Net Profit Before Taxes	210	660	1,123	1,256	1,323
Taxes	(40)	(44)	(52)	(69)	(66)
Minority Interests	(29)	(238)	(403)	(452)	(476)
Net profit available to shareholders	141	378	669	735	781
Dividends	(333)	-	(367)	(367)	(429)
Transfer to Capital Reserve					
	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	4.153	4.494	4.773
EPS (SAR)	0.384	1.031	1.823	2.004	2.130
DPS (SAR)	0.909	0.000	1.000	1.000	1.171
	12/09A	12/10A	12/11E	12/12E	12/13E
Growth					
Revenue Growth	-51.4%	139.9%	62.4%	4.5%	4.8%
Gross Profit Growth	-76.4%	259.7%	62.9%	10.9%	3.6%
EBITDA Growth	-69.4%	218.6%	63.5%	9.5%	4.4%
Operating Profit Growth	-82.2%	354.0%	69.8%	12.0%	3.6%
Net Profit Growth	-73.8%	168.4%	76.8%	9.9%	6.3%
EPS Growth	-79.0%	168.4%	76.8%	9.9%	6.3%
	12/09A	12/10A	12/11E	12/12E	12/13E
Margins					
Gross profit margin	28.8%	43.2%	43.4%	46.0%	45.5%
EBITDA margin	40.4%	53.7%	54.0%	56.6%	56.4%
Operating Margin	20.3%	38.4%	40.1%	43.0%	42.5%
Pretax profit margin	25.3%	33.1%	34.7%	37.2%	37.4%
Net profit margin	17.0%	19.0%	20.7%	21.7%	22.0%
	12/09A	12/10A	12/11E	12/12E	12/13E
Other Ratios					
ROCE	1.5%	6.9%	9.6%	10.4%	10.2%
ROIC	1.9%	8.0%	13.2%	14.5%	13.2%
ROE	2.8%	7.7%	12.7%	12.7%	12.7%
Effective Tax Rate	19.2%	6.7%	4.6%	5.5%	5.0%
Capex/Sales	188.4%	18.9%	23.2%	53.2%	33.0%
Dividend Payout Ratio	236.6%	0.0%	54.8%	49.9%	55.0%
	12/09A	12/10A	12/11E	12/12E	12/13E
Valuation Measures					
P/E (x)	51.1	19.1	10.8	9.8	9.2
P/CF (x)	21.4	7.8	4.7	4.4	4.1
P/B (x)	1.5	1.5	1.3	1.2	1.1
EV/Sales (x)	14.0	6.1	3.6	3.7	3.6
EV/EBITDA (x)	34.7	11.4	6.6	6.5	6.3
EV/EBIT (x)	69.1	15.9	8.9	8.5	8.4
EV/IC (x)	1.3	1.3	1.2	1.1	1.1
Dividend Yield	4.6%	0.0%	5.1%	5.1%	6.0%

Source: Company data, Al Rajhi Capital



Phase II & Phase III programmes are expanding the balance sheet

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

We expect capex to remain heavy over 2011-2013

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	1,831	1,621	3,838	3,000	2,967
Current Receivables	308	596	609	617	673
Inventories	79	209	271	274	354
Other current assets	0	-	-	-	-
Total Current Assets	2,218	2,426	4,719	3,891	3,994
Fixed Assets	9,569	9,568	9,864	11,203	11,879
Investments	-	-	17	17	17
Goodwill	31	33	36	36	36
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	9,601	9,601	9,917	11,256	11,932
Total Assets	11,818	12,027	14,636	15,147	15,926
Short Term Debt	283	410	455	455	455
Accounts Payable	620	447	643	651	673
Accrued Expenses	-	-	-	-	-
Zakat Payable	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	903	857	1,098	1,106	1,128
Long-Term Debt	4,642	4,561	5,976	5,976	6,176
Other LT Payables	401	543	593	593	593
Provisions	40	53	60	60	60
Total Non-current Liabilities	5,083	5,156	6,629	6,629	6,829
Minority interests	910	1,092	1,327	1,463	1,605
Paid-up share capital	3,333	3,333	3,667	3,667	3,667
Total Reserves	1,589	1,588	1,915	2,283	2,697
Total Shareholders' Equity	4,922	4,921	5,582	5,950	6,364
Total Equity	5,832	6,014	6,909	7,412	7,969
Total Liabilities & Shareholders' Equity	11,818	12,027	14,636	15,147	15,926
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	3,094	3,350	2,593	3,431	3,665
Net Debt/EBITDA (x)	9.22	3.13	1.48	1.79	1.83
Net Debt to Equity	53.0%	55.7%	37.5%	46.3%	46.0%
EBITDA Interest Cover (x)	(8.0)	10.7	10.0	9.7	11.0
BVPS (SAR)	13.42	13.42	15.22	16.23	17.36
Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	210	660	1,123	1,256	1,323
Depreciation & Amortisation	167	305	451	461	493
Decrease in Working Capital	(283)	(535)	192	(3)	(115)
Other Operating Cashflow	(269)	(55)	(93)	(69)	(66)
Cashflow from Operations	(175)	375	1,673	1,645	1,636
Capital Expenditure	(1,565)	(376)	(750)	(1,800)	(1,169)
New Investments	238	79	(17)	-	-
Others	-	(9)	-	-	-
Cashflow from investing activities	(1,327)	(306)	(767)	(1,800)	(1,169)
Net Operating Cashflow	(1,502)	69	906	(155)	467
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)	(189)	(317)	(334)
Cashflow from financing activities	752	(280)	1,311	(683)	(500)
Total cash generated	(750)	(211)	2,218	(838)	(34)
Cash at beginning of period	2,581	1,831	1,621	3,838	3,000
Implied cash at end of year	1,831	1,621	3,838	3,000	2,967
Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	188.4%	18.9%	23.2%	53.2%	33.0%

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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