Saudi Kayan Petrochemical Co
Petrochemicals –Industrial
KAYAN AB: Saudi Arabia
12 November 2011

الراجحي المالية
Al Rajhi Capital

US$7.10bn	40.2%	US$22.94mn
Market cap	Free float	Avg. daily volume

Target price	20.80	17.18% over current
Consensus price	20.50	15.5% over current
Current price	17.75	as at 2/11/2011

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Underweight | Neutral | **Overweight**

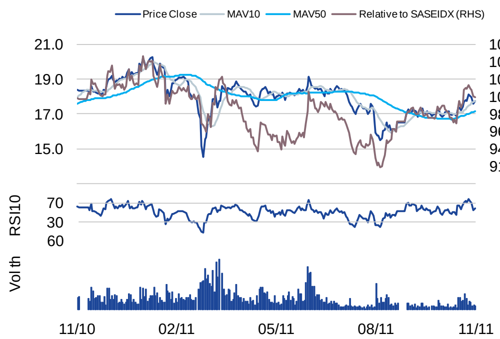
Key themes

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 emerging economies. Saudi Kayan has started 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 medium-term. Additionally, the company is planning to produce some of the speciality chemicals, a first for Saudi Arabia. We assign Overweight rating to Saudi Kayan.

Performance



Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	-	2,285	11,803	12,622
Revenue Growth			416.5%	6.9%
EBITDA (mn)	(14)	1,204	6,632	6,833
EBITDA Growth	-15.4%		450.6%	3.0%
EPS	(0.01)	0.32	2.07	2.32
EPS Growth	-13.6%		538.4%	11.9%

Source: Company data, Al Rajhi Capital

Valuation

Note. We have not provided an historical valuation chart as the company started its operations in October 2011.

Saudi Kayan
Ready for a take-off

Saudi Kayan reported a net loss of SAR35mn in Q3, well above our as well as consensus estimates due to higher zakat expenses. The company announced that it has started commercial production at majority of its plants on October 1st. We expect Saudi Kayan's utilization rate to reach 65% for Q4 with the ramp-up in production over the next 2-3 months. Considering the commencement of production of basic as well as speciality chemicals, we expect the company to record net profit for the full year 2011. We raise our target price to SAR20.8 from SAR15.7 and upgrade our rating on the company to Overweight (previous rating - Underweight).

Launch of commercial operation to be reflected in Q4 results: Saudi Kayan announced that it has started operations at most of its plants including olefins (capacity 1.48mtpa), ethylene glycol (0.57mtpa), propylene (0.63mtpa), HDPE (0.4mtpa), polycarbonate (0.26mtpa) and acetone (0.14mtpa) from October 2011 out of total capacity of 6mtpa. Accordingly, we have revised the cracker utilization rate for Saudi Kayan for Q4 to 65%.

Losses to turn into profits in Q4: Although we don't expect Kayan to achieve an ideal gross margin considering current utilization levels (65%), we still expect the company to report a decent gross margin of 38.5% in Q4 on the back of buoyant MEG prices. That said, even with a ramping-up of utilization in 2012, we expect gross margin to stabilize in 2012 based on our assumption for an increase in ethane prices. We expect Saudi Kayan to post a net profit of SAR546mn in Q4 on revenues of SAR2.3bn and estimate net margin to improve in 2012 on declining net interest expense as a % of revenue and lower zakat.

Debt level expected to fall post commencement: The company reported a net debt of SAR28.4bn as of Q3 2011 (net debt to equity ratio of 1.8x). We expect the company to reduce its net debt to about SAR21bn (net debt to equity ratio of 1.1x) by the end of 2012 on the back of healthy operating cash flows. Although high as compared to peers, we believe that the estimated debt (our expectation for net debt/EBITDA in 2012 is 3x) levels are reasonable for a company which has just started the commercial operations.

Diversification into speciality chemicals, a key catalyst: Apart from basic chemicals, the company's product portfolio includes speciality chemicals such as polycarbonates, phenols, diethanolamine and ethoxylates. Prices of basic petrochemicals are likely to come under pressure due to moderating growth in China and escalating macroeconomic concerns. However, we expect prices of speciality chemicals to improve gradually from current levels in the near term on stable demand outlook. Further, we do not see any demand-supply mismatch in the region as these products will be produced for the first time in Saudi Arabia.

Valuation and conclusion: Since 2009, Saudi Kayan was struggling to commence its production, resulting in depressed valuations. With the launch of production in Q4, the biggest concern of a delay in production commencement has been lifted and hence we upgrade our rating for the stock to Overweight. Based on our revised assumptions for operating rates, price, cost and WACC estimates, we have increased our target price to SAR20.8 per share (previous target SAR15.7), which implies 17.2% upside 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$)			26.63bn / 7.10bn
52-week range			14.55 - 20.25
Daily avg volume (US$)			22.94mn
Shares outstanding			1,500mn
Free float (est)			40.2%

Performance:	1M	3M	12M
Absolute	3.5%	2%	-1.1%
Relative to index	1.8%	5.5%	1.4%

Major Shareholder:	
SABIC	35%
Al Kayan	5.2%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	-	2,285	11,803	12,622
EBITDA (SARmn)	(14)	1,204	6,632	6,833
Net Profit (SARmn)	(15)	486	3,105	3,475
EPS (SAR)	(0.01)	0.32	2.07	2.32
DPS (SAR)	-	-	-	-
EPS Growth	-13.6%	na	538.4%	11.9%
EV/EBITDA (x)	na	45.1	7.2	6.3
P/E (x)	na	54.7	8.6	7.7
P/B (x)	1.7	1.7	1.4	1.2
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Source: Company data, Al Rajhi Capital

Saudi Kayan: Turnaround in Q4

Saudi Kayan reported a net loss of SAR35.2mn in Q3, as compared to net loss of SAR16mn in Q2 2011 (net loss of SAR5.1mn in Q3 2010) mainly due to higher zakat expenses. Zakat expenses in Q3 were SAR31mn, which were well above our as well as consensus estimates. The company reported an operating loss of SAR4mn, in line with our estimates. After commencement of operations, we expect the company to report net profit of SAR546mn in Q4 on revenues of SAR2.3bn. Further, we expect the company to turn profitable in the full year 2011 with a net profit of SAR486mn on the back of strong Q4 results.

Figure 1. Kayan: 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-o-y	Q4 2010 actual	Q4 2011 ARC est	% chg y-o-y
Revenues	-	-	-	-	n/m	-	2,285	n/m
Gross profit	-	-	-	-	n/m	-	880	n/m
Gross margin	n/m	n/m	n/m	n/m	n/m	n/m	38.5%	n/m
EBITDA	(5)	(3)	(4)	(4)	-18.0%	(4)	1,215	n/m
EBITDA margin (%)	n/m	n/m	n/m	n/m	n/m	n/m	53.2%	n/m
Operating Profit	(5)	(3)	(4)	(4)	-18.0%	(4)	811	n/m
Net profit	(5)	(16)	(11)	(35)	593.7%	(4)	546	n/m
Capex	(1,490)	(401)	(300)	(116)	-92.2%	(933)	(150)	-83.9%
Capex / Sales	n/m	n/m	n/m	n/m	n/m	n/m	0.1	n/m
Net debt	22,812	27,487	27,860	28,380	24.4%	25,122	27,656	10.0%
Net debt / Annualized EBITDA (x)	n/m	n/m	n/m	n/m	n/m	n/m	5.7	n/m

Source: Company data, Al Rajhi Capital

Company launched commercial production in October 2011

Income Statement (SARmn)	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Revenue	**-**	**-**	**2,285**	**11,803**	**12,622**
Cost of Goods Sold	-	-	(1,405)	(7,345)	(7,826)
Gross Profit	**-**	**-**	**880**	**4,458**	**4,796**
Government Charges					
S.G. & A. Costs	(17)	(14)	(80)	(322)	(341)
Operating EBIT	**(17)**	**(14)**	**800**	**4,136**	**4,456**
Cash Operating Costs	(17)	(14)	(1,081)	(5,172)	(5,788)
EBITDA	(17)	(14)	1,204	6,632	6,833
Depreciation and Amortisation	-	-	(404)	(2,495)	(2,378)
Operating Profit	**(17)**	**(14)**	**800**	**4,136**	**4,456**
Net financing income/(costs)	-	-	(218)	(833)	(798)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	**(17)**	**(14)**	**582**	**3,303**	**3,658**
Taxes	(0)	(0)	(96)	(198)	(183)
Minority Interests					
Net profit available to shareholders	**(17)**	**(15)**	**486**	**3,105**	**3,475**
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)	0.594	3.734	3.902
EPS (SAR)	(0.011)	(0.010)	0.324	2.070	2.316
DPS (SAR)	0	0	0	0	0

Growth	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Revenue Growth				416.5%	6.9%
Gross Profit Growth				406.7%	7.6%
EBITDA Growth	-90.2%	-15.4%		450.6%	3.0%
Operating Profit Growth	-90.2%	-15.4%		416.8%	7.7%
Net Profit Growth	-103.4%	-13.6%		538.4%	11.9%
EPS Growth	-103.4%	-13.6%		538.4%	11.9%

Margins	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
Gross profit margin			38.5%	37.8%	38.0%
EBITDA margin			52.7%	56.2%	54.1%
Operating Margin			35.0%	35.0%	35.3%
Pretax profit margin			25.5%	28.0%	29.0%
Net profit margin			21.3%	26.3%	27.5%

Other Ratios	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
ROCE	0.0%	0.0%	1.8%	8.6%	9.1%
ROIC	-0.1%	0.0%	1.6%	8.9%	10.6%
ROE	-0.1%	-0.1%	3.1%	17.7%	16.7%
Effective Tax Rate	-0.4%	-2.6%	16.5%	6.0%	5.0%
Capex/Sales			45.1%	8.0%	10.0%
Dividend Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%

The company is currently trading at 2012 P/E multiple of 8.6x

Valuation Measures	**12/09A**	**12/10A**	**12/11E**	**12/12E**	**12/13E**
P/E (x)	na	na	54.7	8.6	7.7
P/CF (x)	na	na	29.9	4.8	4.5
P/B (x)	1.7	1.7	1.7	1.4	1.2
EV/Sales (x)	na	na	23.8	4.0	3.4
EV/EBITDA (x)	na	na	45.1	7.2	6.3
EV/EBIT (x)	na	na	67.8	11.5	9.6
EV/IC (x)	1.3	1.3	1.2	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	1,732	8,361	10,575
Current Receivables	168	1,417	2,850	3,488	3,669
Inventories	-	498	1,741	1,549	1,641
Other current assets	0	120	261	261	261
Total Current Assets	**2,639**	**2,883**	**6,322**	**13,399**	**15,885**
Fixed Assets	33,147	40,557	41,183	39,632	38,516
Investments	-	-	-	-	-
Goodwill					
Other Intangible Assets	21	34	40	40	40
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**33,168**	**40,591**	**41,224**	**39,673**	**38,557**
Total Assets	**35,808**	**43,474**	**47,546**	**53,071**	**54,442**
Short Term Debt	-	580	349	349	349
Accounts Payable	272	261	989	2,582	2,777
Accrued Expenses	883	1,572	1,110	1,936	2,146
Zakat Payable					
Dividends Payable					
Other Current Liabilities					
Total Current Liabilities	**1,155**	**2,414**	**2,447**	**4,867**	**5,271**
Long-Term Debt	19,113	25,509	29,040	29,040	26,531
Other LT Payables	62	89	110	110	110
Provisions	-	-	-	-	-
Total Non-current Liabilities	**19,175**	**25,598**	**29,150**	**29,150**	**26,642**
Minority interests	-	-	-	-	-
Paid-up share capital	15,000	15,000	15,000	15,000	15,000
Total Reserves	477	463	949	4,054	7,529
Total Shareholders' Equity	**15,477**	**15,463**	**15,949**	**19,054**	**22,529**
Total Equity	**15,477**	**15,463**	**15,949**	**19,054**	**22,529**
Total Liabilities & Shareholders' Equity	**35,808**	**43,474**	**47,546**	**53,071**	**54,442**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	16,642	25,122	27,656	21,027	16,305
Net Debt/EBITDA (x)	(987.93)	(1,763.47)	22.96	3.17	2.39
Net Debt to Equity	107.5%	162.5%	173.4%	110.4%	72.4%
EBITDA Interest Cover (x)			5.5	8.0	8.6
BVPS (SAR)	10.32	10.31	10.63	12.70	15.02

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)**	**582**	**3,303**	**3,658**
Depreciation & Amortisation	-	-	404	2,495	2,378
Decrease in Working Capital	(938)	(2,771)	(2,458)	1,973	132
Other Operating Cashflow	10	27	(26)	(198)	(183)
Cashflow from Operations	**(946)**	**(2,758)**	**(1,498)**	**7,573**	**5,985**
Capital Expenditure	(13,410)	(5,710)	(1,030)	(944)	(1,262)
New Investments	-	-	-	-	-
Others	6	(13)	(6)	-	-
Cashflow from investing activities	**(13,404)**	**(5,723)**	**(1,036)**	**(944)**	**(1,262)**
Net Operating Cashflow	**(14,349)**	**(8,481)**	**(2,534)**	**6,629**	**4,722**
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**	**3,299**	**-**	**(2,508)**
Total cash generated	(1,051)	(1,505)	765	6,629	2,214
Cash at beginning of period	3,522	2,472	967	1,732	8,361
Implied cash at end of year	**2,472**	**967**	**1,732**	**8,361**	**10,575**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales			45.1%	8.0%	10.0%

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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