



WEALTH MANAGEMENT

GCC EQUITIES

INDUSTRIAL

RESEARCH NOTE

Recommendation

BUY

CMP (SAR) (05/11/12) : 42.00

TARGET PRICE (SAR): 46.00

EXPECTED RETURN (%): 10%

STOCK DATA

MCAP (SAR'million)	2,656
52 WEEK HIGH (SAR)	44.60
52 WEEK LOW (SAR)	36.30

QUARTERLY NET PROFIT

SAR'mn	2011	2012
Q1	86	88
Q2	76	87
Q3	47	51
Q4	58	84 (e)

ANALYST

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SAUDI CHEMICAL COMPANY (SSE: 2230)

FY 2012 profitability expected to grow 16% YoY with healthy revenue growth in key product segments supported by firm margins in the pharmaceutical segment.

KEY HIGHLIGHTS

- ✦ **Saudi Chemical Company (Saudi Chemical)** is a Saudi Arabia based company primarily engaged in production & distribution of explosives and derivatives for civil and military uses. The company also has a subsidiary, **Saudi International Trading Company (Sitco Pharma)**, which engages in distribution of pharmaceutical products in the Kingdom. Apart from that, a third subsidiary, **Suez International Nitrates Company (SINCO)** based in Egypt, is involved in production of ammonium nitrate used primarily as raw material for Saudi Chemical's explosives production. The above three units constitute the company's key reportable segments of Explosives (16% of revenues), Pharmaceutical (81% of revenues) and Ammonium Nitrate (3% of revenues).
- ✦ **Explosives and Ammonium Nitrate segments**, while contributing only 19% of revenues in FY 2011, have a much larger 61% contribution to net profit of the company owing to higher margins. This segment manufactures and supplies key explosive products and accessories used for rocks displacement in civil works such as building of roads & tunnels and mining & oil excavation. **Key products** include: **KEMULEX** (emulsion type explosive with high detonation velocity and good waterproof properties), **PRILLEX** (dry blasting agent), **SANEL** (non-electric capsule to control explosion accuracy), and **ENVIROSEIS** (seismic explosive primarily for oil excavations). It also provides explosives for military purposes, ammunition dismantling operations, and other military activities. In October, the company announced that it has added a new Non-Electric Detonators production line at the Company's factory in the eastern district and the commercial operation from the new line has been started
- ✦ **Pharmaceutical segment**, which accounts for a major 81% share of revenues, however contributes a smaller 39% to net profit as margins are lower. Sitco Pharma has agency agreements with thirteen major international pharmaceutical companies and is the **largest national distributor of cooled vaccines and medicines such as insulin and enrichment hormones**, which require special conditions in transport and storage. The company is planning to invest SAR 230 million to build a new pharmaceutical plant in Hail to manufacture drugs under license from major international drug manufacturers.
- ✦ **Saudi Chemical derives 99% of its revenues from within the Kingdom**, with the central and western regions contributing 82% of the revenues and balance divided between eastern and southern regions.

- ✦ The company's **revenues have grown at a CAGR of 10%** for the 5-year period expected through FY 2012, while **net profit has grown at a CAGR of 23%** over the same period. **Return on equity (ROE)** for the 5-year period averaged 22%, while **free cash flows** have remained positive over the past 5 years. The company carries **limited debt leverage** and free cash flows have primarily been used to payout dividends or ploughed back into the business. **Average dividend payout ratio** for the past 3 years has been 40%.
- ✦ Saudi Chemical reported sales of SAR 1.35 billion in 9M 2012, which are 13.2% higher YoY. Net profit during the period rose 7.9% YoY to SAR 226 million. Profitability growth during the period was slightly muted by lower operating margins and a slight increase in financing charges. **We estimate sales of SAR 1.97 billion and net profit of SAR 309 million in FY 2012, implying YoY growth of 9.0% and 15.6% respectively.** Going forward, we expect the company's explosives segment to benefit from the increased investment by the Saudi government in domestic infrastructure and construction, while the non-cyclical pharmaceutical segment is likely continue its steady growth to meet the growing healthcare needs of the population.
- ✦ The stock **currently trades at 8.6x its FY 2012 (e) EPS of SAR 4.89 and offers a reasonable dividend yield of 4.8%.** We estimate a fair value for the stock to be SAR 46, based on a Sum-of-the-Parts valuation (see page 4). This implies a P/E multiple of 9.4x which is in line with the top end of its historical trading band and offers a 10% upside from current levels. **We value the explosives segment as a growth business**, assuming 7% annual operating profit growth from FY 2013 through FY 2015, thereafter moderating to terminal growth of 2% annually. Discount rate of 13% is assumed for this segment considering its cyclical nature. **We have valued the pharmaceutical segment as a mature business** in view of its 2-3% annual growth rate and have excluded any potential impact from the new pharmaceutical facility planned to be setup since details of the investment are not yet available. Discount rate of 9% has been assumed for this segment given its defensive nature.
- ✦ **Downside risks** include a slowdown in government infrastructure spending, government intervention to cut prices of pharmaceutical products, adverse currency fluctuations impacting cost of imported raw materials, and increasing competition.

KEY FINANCIAL HIGHLIGHTS			
(SAR'million)	2010	2011	2012 (E)
Revenue	1,658	1,812	1,975
Operating Profit	316	299	351
Net Profit	303	267	309
EPS (SAR)	4.79	4.23	4.89
P/E (x)	-	9.9	8.6
BVPS (SAR)	21.39	21.62	25.01
DPS (SAR)	2.00	2.00	2.00
Dividend Yield (%)	-	4.8%	4.8%
ROE (%)	23.4%	19.7%	21.5%

Source: Company disclosure, FINCORP Investment Research

9M 2012 RESULT HIGHLIGHTS			
(SAR'million)	9M 2012	9M 2011	YoY (%)
Revenue	1,348	1,191	13.2%
Operating Profit	250	230	8.7%
Net Profit	226	209	7.9%
EPS (SAR)	3.57	3.30	7.9%

Source: Company disclosure, FINCORP Investment Research

INCOME STATEMENT				
(SAR'000)	FY'09	FY'10	FY'11	FY'12 (e)
Total Revenues	1,643,337	1,658,323	1,811,658	1,974,707
Cost of Revenue	(1,297,051)	(1,233,068)	(1,380,376)	(1,463,840)
Gross Profit	346,286	425,255	431,282	510,867
Selling & Marketing Expenses	0	(54,402)	(65,310)	(77,382)
General & Admin Expenses	(67,320)	(54,941)	(66,506)	(82,821)
Operating Profit	278,966	315,912	299,466	350,664
Finance Charges	(6,469)	(3,191)	(4,648)	(5,180)
Other Income	52,815	7,182	930	709
Pre-Tax Income	325,312	319,903	295,748	346,193
Zakat & Taxes	(22,639)	(15,402)	(26,975)	(35,316)
Minority Interest	(1,654)	(1,330)	(1,369)	(1,658)
Net Income	301,019	303,171	267,404	309,219
Wtg. Avg. Shares O/S	63,240	63,240	63,240	63,240
EPS	4.76	4.79	4.23	4.89

Gross Margin (%)	21.1%	25.6%	23.8%	25.9%
Operating Margin (%)	17.0%	19.1%	16.5%	17.8%
EBITDA Margin (%)	17.7%	20.1%	17.6%	18.8%
Net Margin (%)	18.3%	18.3%	14.8%	15.7%

Growth Rates (YoY %)	FY'09	FY'10	FY'11	FY'12 (e)
Total Revenue	6.9%	0.9%	9.2%	9.0%
Gross Profit	30.3%	22.8%	1.4%	18.5%
Operating Profit	22.7%	13.2%	-5.2%	17.1%
Net Income	50.1%	0.7%	-11.8%	15.6%
EPS	50.2%	0.7%	-11.8%	15.6%

BALANCE SHEET	FY'09	FY'10	FY'11	Q3'12
Cash & ST Investments	374,649	122,422	98,976	139,462
Total Assets	2,377,029	2,294,297	2,336,728	2,239,444
Total Debt	50,000	16,978	133,726	81,384
Total Equity	1,239,352	1,352,803	1,367,247	1,497,888

Book Value Per Share (BVPS)	19.60	21.39	21.62	23.69
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Return on Assets	13.7%	13.0%	11.5%	8.9%
Return on Common Equity	25.8%	23.4%	19.7%	13.8%
Return on Capital	26.4%	27.8%	20.5%	15.0%
Debt / Equity Ratio	0.04	0.01	0.10	0.05

CASH FLOWS	FY'09	FY'10	FY'11	9M 2012
Cash From Operations	407,385	151,284	131,333	200,416
Capital Expenditures	(27,767)	(23,319)	(18,809)	(14,053)
Sale Proceeds	193	296	242	358
Free Cash Flows	379,811	128,261	112,766	186,721

Source: Company Disclosure, FINCORP Research

Discounted Cash Flow Valuation - Explosives Segment					
(SAR'000)	FY'12 e	FY'13 e	FY'14 e	FY'15 e	Terminal
EBIT*(1-T)	172,105	184,152	197,043	210,836	215,052
Reinvestment Rate	34%	34%	34%	34%	15%
Reinvested Cash Flows	58,831	62,949	67,355	72,070	33,090
FCFF	113,274	121,203	129,688	138,766	181,963
Discounted FCFF	111,081	105,185	99,601	94,314	-
Terminal Value	1,654,485				
Discounted TV	1,124,495				
Firm Value	1,534,676				
Firm Value / Share (SAR)	24.3				

Source: Company Financials, FINCORP Research

Discounted Cash Flow Valuation - Pharmaceutical Segment		
(SAR'000)	FY'12 e	Terminal
EBIT*(1-T)	123,989	126,469
Reinvestment Rate	10%	10%
Reinvested Cash Flows	12,399	12,647
FCFF	111,590	113,822
Discounted FCFF	110,054	102,941
Terminal Value	1,614,904	
Discounted TV	1,460,526	
Firm Value	1,460,526	
Firm Value / Share (SAR)	23.1	

Source: Company Financials, FINCORP Research

SAUDI CHEMICAL - SUM OF THE PARTS VALUATION	
	SAR'000
Firm Value - Explosives Segment	1,534,676
Firm Value - Pharmaceutical Segment	1,460,526
Total Value of Entity	2,995,202
Net Debt (Q3'12)	(58,078)
Minority Interest (Q3'12)	(7,080)
Equity Value	2,930,044
Equity Value / Share (SAR)	46.3

Source: Company Disclosure, FINCORP Research

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