



Saudi Steel Pipes Co

Overweight

Unrecognized Growth Story

Price (SR) **33.2**

12M target price (SR) **40.5**

Potential upside (%) $\uparrow$ 22

Stock details

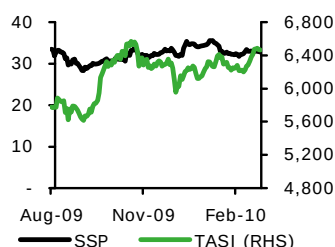
52-week range H/L (SR)	28.3/35.6		
Market cap (\$mn)	449		
Shares outstanding (mn)	51		
Listed on exchanges	TADAWUL		
Price perf. (%)	1M	3M	12M[^]
Absolute	0.9	(0.9)	(2.1)
Rel. to market	(1.5)	(3.5)	(14.0)
Avg daily turn.(mn)	SR	US\$	
3M	20.2	5.4	
12M [^]	44.8	12.0	
Reuters code	1320.SE		
Bloomberg code	SSP AB		
Website	www.sspipe.com		

Valuation multiples

	09	10E	11E
P/E (x)	13.6	16.8	13.9
P/B (x)	1.8	2.1	2.1
EV/EBITDA (%)	10.3	10.6	8.6
Div yield (%)	6.0	6.0	6.0

Source: NCBC Research estimates

Share price performance [^]



Source: Bloomberg

[^] performance after first day of listing (Aug 04, 2009)

Ahmed Al Qahtani
ah.alqahtani@ncbc.com
Tel. +966 2 6907784

Please refer to the last page for important disclaimer

Demand improvement, coupled with capacity expansion in higher-margin segments, should lead to significant top and bottom line growth. That has not yet been factored in by the market, in our view. We initiate coverage on Saudi Steel Pipes Co (SSP) with an Overweight rating and a price target of SR40.5, implying upside of 22%.

- **Improving demand to increase utilization rates:** We expect demand for steel pipes to increase over the next few years as major oil and gas projects come back on stream, supported by continued government spending on large construction and infrastructure projects. We believe this will lead to increased capacity utilization and ultimately higher revenues for SSP.
- **Expanding capacity in higher-margin segments:** SSP doubled its capacity of medium-size pipes at the end of 2009 and is a partner in a new large diameter pipes plant that will begin operations in 2012e. This will change SSP's sales mix towards larger and higher-margin pipes, with proportionate EBITDA margin expected to increase from 19.0% in 2008 to 23.2% in 2012e.
- **Robust earnings growth over 2010-16e:** We expect the decline in steel prices in 2009 to flow through and lead to a decline in earnings in 2010e. However, we believe meaningful growth will return from 2011e onwards. We forecast net income growth of 11.8% annually over 2009-16e driven by robust revenue growth and improved profit margins.
- **Strong balance sheet supports high dividends:** Given the SR363mn raised in the IPO in Jun 09, low gross debt and sustainable earning growth, we believe SSP will be able to invest in expansion projects and maintain good dividends. In 2009, SSP announced dividends of SR2.0/share, implying a 6.0% yield and we expect the company to maintain the same level in 2010e.
- **Unrealized growth potential:** Despite conservative assumptions in our model (30% utilization of the new Jubail plant in 2012e and 50% in 2013e), the stock appears undervalued. The stock is trading at 2011e P/E of 13.9 and a 2012e P/E of 10.4x. Considering its attractive price, we initiate coverage on SSP with an **Overweight** rating and a 12-month price target of **SR40.5**

Financials (Based on proportionate consolidation, see pages 16 and 17)

		2008	2009	2010E	2011E	2012E
Revenues	SR mn	817	539	613	737	943
EBITDA	SR mn	155	131	127	158	219
EBITDA margin	%	19.0	24.4	20.8	21.4	23.2
Reported net income	SR mn	141	113	107	129	174
Adjusted net income	SR mn	132	105	101	122	162
Total debt	SR mn	50.0	-	79	122	131
ROE	%	31.4	17.2	12.7	15.2	19.3
Reported EPS	SR	NA	2.6	2.1	2.5	3.4

Source: Company, NCBC Research estimates

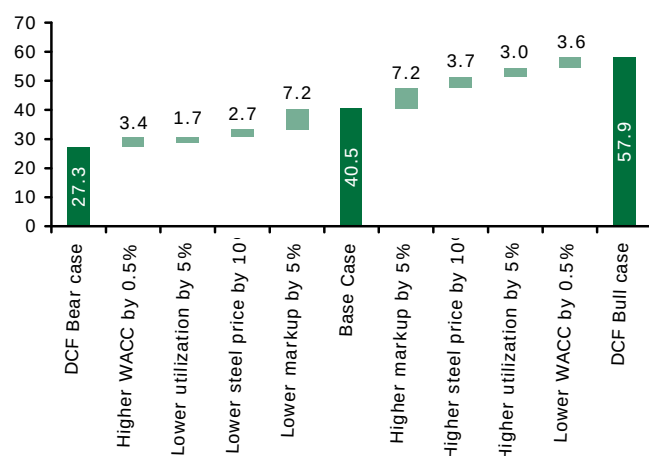
Note: Reported net income and reported EPS are before Zakat and tax. See page 16 for explanation

Contents

INVESTMENT SCENARIOS.....	3
INVESTMENT VIEW	4
VALUATION	7
Methodology	7
Sum-of-the-parts	7
BUSINESS ANALYSIS.....	9
Product mix	9
Demand growth	11
Selling price	13
EARNINGS OUTLOOK.....	15
Revenue and margins	15
Accounting issues.....	16
FINANCIALS	17

Investment Scenarios

Valuations is most sensitive to pricing assumption



Source: NCBC Research estimates

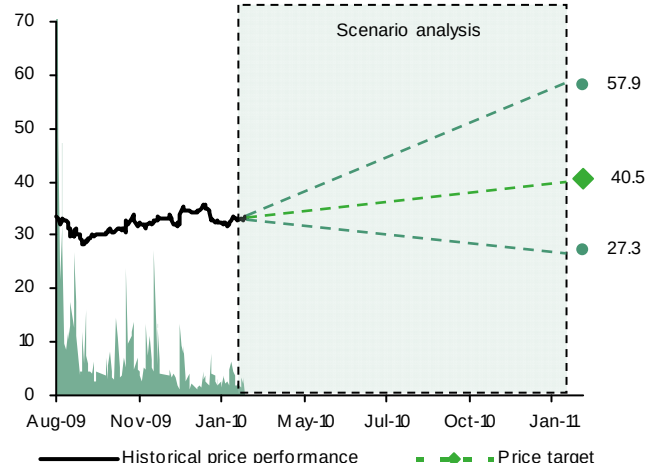
Investment view

- **Large projects fuel future demand:** Large oil and gas projects and massive capital expenditure by the Saudi government are expected to boost demand for steel pipes. We expect the impact of these projects to start flowing from 2011e onwards and result in higher overall utilization rates
- **SSP increases capacity:** the company doubled the production capacity of medium size pipes from 80,000 tons to 160,000 tons at the end of 2009. This should result in significant top line growth as demand picks up in 2011e
- **New large diameter plant in Jubail:** SSP owns 35% of the large diameter plant that is currently under construction. The plant will have a capacity of 200,000 tons and is expected to start production in 2012e. In our view, the market has not priced in the impact of the project based on the company's valuation
- **Changing sale mix support margins:** Following the capacity increases in the larger diameter pipes which offers higher margin; we expect the company's sales mix to shift towards higher margin segments. We expect the company's overall margin to improve over our forecast period.
- **Strong balance sheet:** SSP had no debt on the balance sheet as of December 31, 2009. This coupled with growing earnings and improving free cash flows over our forecast period should lead to dividends growth. In 2009, the company proposed SR2/share resulting in a 6.0% yield

Potential catalysts

- **Progress in the large diameter plant:** News flow from the company regarding progress in the construction of the new plant in Jubail could trigger positive market reaction
- **Announcement of project awards:** Announcements of projects being awarded to the company would indicate a pick up in demand. We expect this to attract investors' attention to the potential growth
- **Higher steel prices:** Higher steel prices driven by global demand growth would result in higher selling price for the company which would support revenue growth over our forecast horizon. We expect this to positively impact the company's top and bottom lines.

Historical and expected price performance



Source: NCBC Research estimates

DCF scenarios

Price target: We value SSP's Enterprise Value (EV) based on the sum-of-the-parts approach using DCF to value each part. SSP parts include the existing business and the new Joint Venture in Jubail. We adjust the EV for cash, debt and debt-like items in order to arrive at the fair equity value.

DCF bull case: A rapid pick up in demand would lead to higher revenues and margins. A higher utilization rate and selling price would lead to higher valuations relative to our base case scenario. We discount future cash flows at 10.4%

DCF base case: We assume demand to stabilize in 2010e before picking up again in 2011e onwards. We assume a moderate improvement in utilization rates and a marginal, but steady increase in selling price over our forecast horizon. We discount future cash flows at 10.9%

DCF bear case: Slower than expected recovery in demand would result in lower utilization rate and selling price assumption. This would negatively impact valuation. We discount future cash flows at 11.4%

Investment risks

- **Project delays:** Cancellation or even delays of announced large oil and gas projects could lead to lower growth in demand relative to our assumptions. This could lead to pressure on utilization rate
- **Decline in steel price:** As an important driver of selling price, decline in steel price would lead to lower than expected revenues. In our view, this would lead to lower valuations
- **Competitive pressure:** Currently, government related companies (e.g. Aramco) give Saudi-based contractors and suppliers priority which effectively shields them from import competition. Should this change in the future, increased competition could lead to margin pressures.

Investment View

We initiate coverage on Saudi Steel Pipes Company (SSP) with an **Overweight** rating and a price target of SR40.5, implying potential upside of 22%. Given the capacity expansion plans and the current low utilization levels due to the economic crisis, we see significant room for top-line growth. Improving margins, driven by a changing sales mix toward higher-margin products, would result in higher bottom line growth

Production capacity of the medium diameter plant doubled from 80,000 tons/year to 160,000 tons/year by end-2009

The bulk of growth in production of existing products is expected to come from medium diameter pipes

SSP will start producing large diameter pipes in 2012e with a capacity of 200,000 tons/year

PRODUCTION OF EXISTING LINES TO GROW 61% OVER 2009-12E

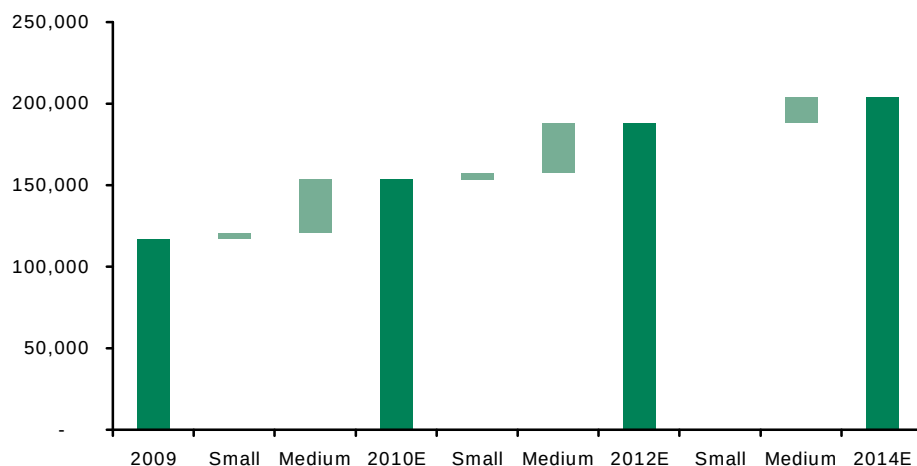
Until recently, SSP produced small and medium diameter pipes with a capacity of 80,000 tons/year each (total of 160,000 tons/year). By end-2009, SSP doubled its medium diameter capacity to 160,000 tons/year (total capacity 240,000 tons/year).

Over 2006-08, SSP's capacity utilization was high. However, it declined sharply in 2009 due to the global economic crisis. Nevertheless, we expect government spending and progress in construction in the economic cities, coupled with large oil and gas projects coming back on track to positively impact demand for small and medium diameter pipes, resulting in higher capacity utilization going forward.

We estimate production to grow by 12.0% annually over 2009-14e, mainly driven by the medium diameter segment, which we believe will account for 91% of the expected increase in production over 2009-14e.

Exhibit 1: Medium diameter pipes to lead growth of existing lines

Production in tons



Source: Company, NCBC Research estimates

SSP IS EXPANDING INTO LARGE DIAMETER PIPES

In addition to the expansion of medium diameter pipes, SSP is building a presence in large diameter pipes. SSP has a 35% stake in a plant in Jubail that is currently under construction. This plant will have a capacity of 200,000 tons/year and will start production in 2012e. The plant will produce pipes with diameters between 20" and 60" and a wall thickness of up to 50mm.

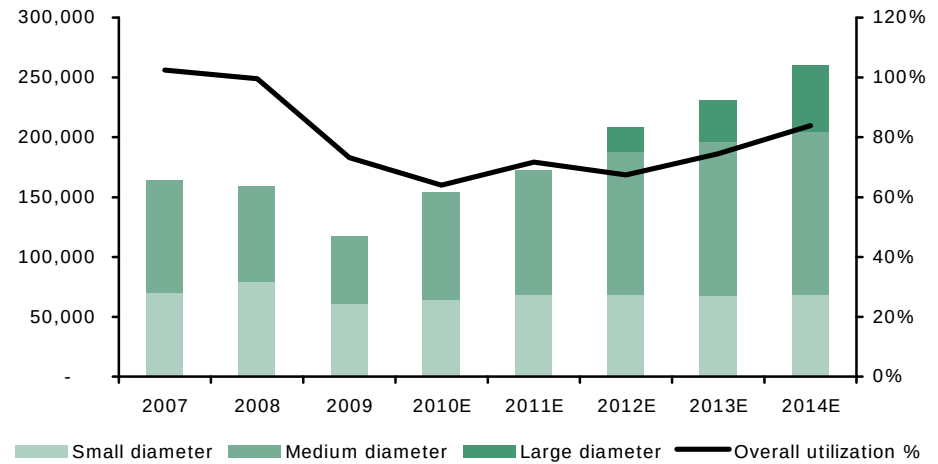
The plant is scheduled to be commissioned in 2012e and is expected to significantly impact the company's production levels and top-line growth. We estimate sales of

Substantial growth in top line is expected to be driven by the large diameter plant that is scheduled to be commissioned in 2012e

large diameter pipes (proportion attributable to SSP) at SR118.5mn in 2012e and SR342.34mn in 2014e, accounting for 27% of total sales.

Exhibit 2: Total production and overall capacity utilization levels

Production in tons (LHS), capacity utilization in % (RHS)



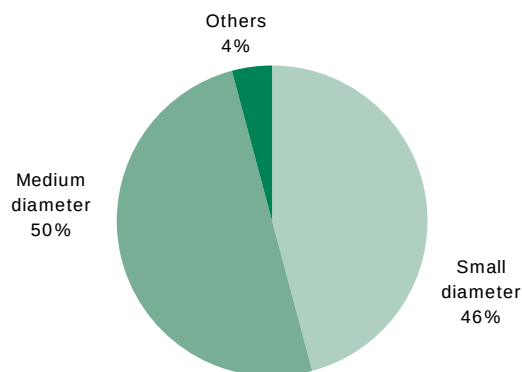
Source: Company, NCBC Research estimates

Note: SSP owns 35% stake in the large diameter project. The chart presents the proportion attributable to SSP.

CHANGING SALES MIX WILL LEAD TO HIGHER MARGINS

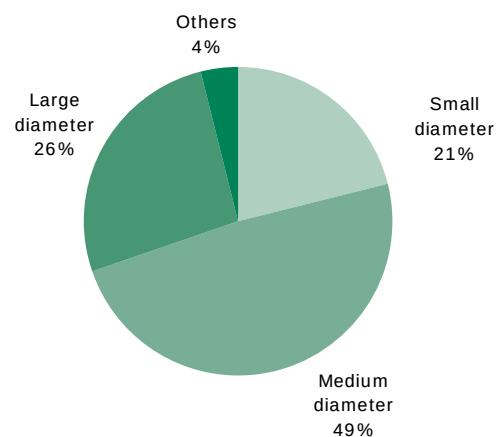
Expansion of medium diameter capacity and commissioning of the large diameter plant will shift the company's sales mix towards higher-margin products that should ultimately improve overall profit margins.

Exhibit 3: Revenue mix in 2009



Source: Company, NCBC Research estimates

Exhibit 4: Revenue mix in 2014E



Company, NCBC Research estimates

Note: large diameter sales represents the 35% proportion attributable to SSP

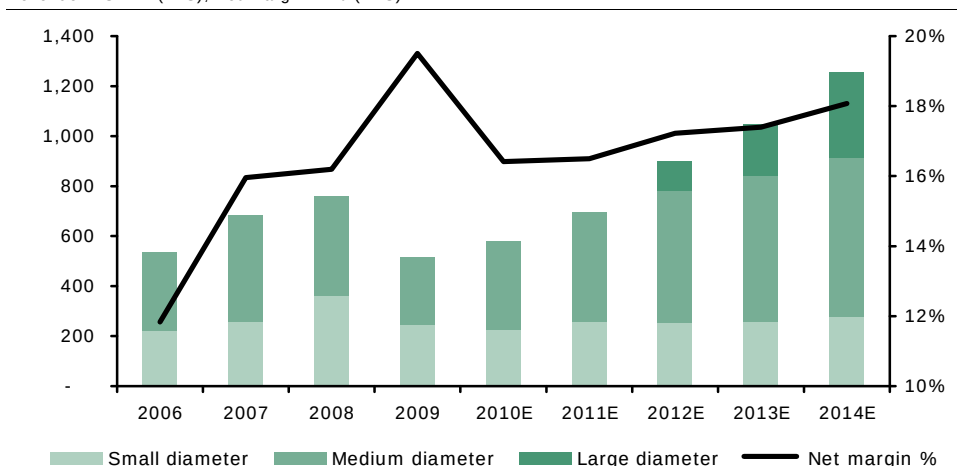
We estimate long-term gross margin for the small diameter and medium diameter businesses to stabilize at 15% and 20% respectively and SSP management estimates 30% in gross margin for the large diameter business.

The shift in sales mix towards higher-margin products (medium and large diameter pipes) should increase net margin by 200bps between 2008 and 2014e, from 16% to 18%. Since the change in sales mix is due to capacity expansion, we believe that improving margins will help net income growth outpace growth in revenue. We estimate net income to grow from SR105.1mn in 2009 to SR236.7mn in 2014e.

We expect net margin to grow from 16% in 2008 to 18% in 2014e, driven by changing sales mix

Exhibit 5: Expected revenue growth and improving margins

Revenue in SRmn (LHS), Net margin in % (RHS)



Source: Company, NCBC Research estimates

MARKET IS NOT PRICING IN THE NEW EXPANSION PROJECT

Although we believe the company is an attractive growth story, the market does not seem to have fully factored in this potential yet. Based on our valuation, the market is currently attaching a small value to the company's new JV in Jubail. *(Please see page 9 for more details)*

Even though our valuation model is based on conservative utilization and pricing assumptions, the stock appears inexpensive. Our fair value estimate of SR40.5, implies a 2012e P/E of 12.7 while the current market price implies a 2012e P/E of 10.4, indicating that the stock is trading at a steep discount.

Our valuation and recommendation for SSP are based on expected revenue growth and improved margins from the steel pipes business. However, there are other growth opportunities that we have not yet factored into our valuation, which could potentially offer further upside.

SSP is planning to enter the pipes coating business. This will allow the company to deliver a more integrated product offering. Besides generating revenue by itself, the pipes coating business would improve utilization rates of pipe production by increasing the company's competitiveness. In February 2010, the company announced the purchase of land that will be used for the coating business and other expansionary projects in the future.

Additionally, SSP is studying the feasibility of building offshore oil and gas platforms and indicated in the IPO prospectus the potential of acquisitions in the region. We also do not include these plans in our valuation.

Valuation

Methodology

We value SSP using sum-of-the-parts (SOTP) methodology and value the parts using DCF. The parts are the company's existing business and the new 35%-owned JV that will start operations in 2012e. We forecast SSP's free cash flows over 2010-16e and assume terminal growth of 2% thereafter. We discount future cash flows using a weighted average cost of capital (WACC) of 10.9%.

Exhibit 6: Weighted Average Cost of Capital

Risk-free rate (%)	3.5
Long-term Beta	1.1
Market risk premium (%)	8.5
Cost of equity (%)	12.8
Cost of debt, net (%)	3.2
Long term debt-to-capital (%)	20.0
Weighted Average Cost of Capital (WACC) (%)	10.9

Source: NCBC Research estimates

Sum-of-the-parts

We value SSP's existing business (small and medium diameter pipes) at SR1.2bn and estimate the value of the new JV at SR601mn, resulting in a total enterprise value (EV) of SR1.78bn. We adjust the EV to arrive at an equity value of SR2.1bn or SR40.5 per share, implying a 22% potential upside from the current level.

Exhibit 7: Sum-of-the-parts valuation

SRmn, unless otherwise stated

	Total EV	% ownership	EV attributable to SSP
Existing business	1,180	100.0	1,180
LSAW pipe mill (New JV)	1,717	35.0	601
Enterprise value			1,781
Cash & Short term investments			392
Total debt			(79)
End of service benefits			(29)
Equity value			2,064
Shares outstanding (mn)			51
Fair value per share			40.5
Upside potential (%)			22.0

Source: NCBC Research estimates

We run a sensitivity analysis of the DCF valuation to our WACC and terminal growth rate assumptions, as summarized in the table below.

Exhibit 8: Discount rate and terminal growth sensitivity analysis

		Weighted Average Cost of Capital (WACC) %				
		9.0	10.0	10.9	12.0	13.0
Terminal growth %	1.5	49.8	43.4	39.0	34.4	31.3
	2.0	52.4	45.3	40.5	35.5	32.2
	2.5	55.4	47.5	42.1	36.8	33.1
	3.0	58.9	49.9	44.0	38.1	34.2
	3.5	63.0	52.8	46.1	39.7	35.4

Source: NCBC Research estimates

What is the market implying?

As already highlighted, our valuation considers both the company's existing business and the new JV in Jubail. However, we believe that the market is considering only the current operations and is attaching a small value to the new JV in Jubail. This offers major upside potential to the share price and progress in the project would be an important trigger.

The table below highlights two valuation scenarios: including and excluding the new JV in Jubail. Not factoring in the Jubail plant results in a low 2012 P/E indicating that excluding the Jubail JV undermines the company's growth potential.

Exhibit 9: Value of SSP with and without the new JV in Jubail

SRmn, unless otherwise stated

Including the new JV		Excluding the new JV	
Enterprise value	1,781	Enterprise value	1,180
Equity value	2,064	Equity value	1,464
Fair value per share (SR)	40.5	Fair value per share (SR)	29
Upside potential %	22	Upside potential %	(14)
Valuation multiples		Valuation multiples	
Implied P/E-10	20.5	Implied P/E-10	14.5
Implied P/E-12	12.7	Implied P/E-12	9.0

Source: NCBC Research estimates

Moreover, given our conservative assumptions for utilization rates and steel prices, we believe the likelihood of further upside beyond our price target is strong. We assumed utilization rates to increase for current levels slowly before stabilizing at 85% over the long term.

For the new JV in Jubail, we assume the plant to start production with 30% utilization in 2012e and 50% in 2013e and a sustainable long term rate at 85%. We do think these assumptions are conservative and upside potential beyond our price target is not unlikely.

The table below presents a sensitivity analysis of our price target to changes in utilization rate and the Hot rolled coil – steel price.

Exhibit 10: Valuation sensitivity to steel price and utilization rate

		Hot Rolled Coil price (USD/ton)				
		-10.0	-5.0	Base case	+5.0	+10.0
Utilization rate %	- 10.0	19.1	19.9	20.7	21.5	22.2
	- 5.0	28.2	29.4	30.6	31.8	33.0
	Base case	37.3	38.9	40.5	42.1	43.7
	+ 5.0	46.3	48.4	50.4	52.4	54.4
	+ 10.0	55.4	57.8	60.3	62.7	65.2

Source: NCBC Research estimates

Business Analysis

Saudi Steel Pipes Company (SSP) was established in 1980 as a limited liability company with a paid-up capital of SR24.1mn. Since then, the company has been increasing its capital which reached SR350mn in 2008. In 2009, SSP increased its total capital, by issuing shares in a public offering, to SR712.7mn (SR510mn capital and SR219mn additional paid-in capital less employees' stock program SR16.3mn)

Small, medium and large pipes are the company's main focus. SSP will enter the coating business in 2011e. It is also assessing the feasibility of production of oil and gas offshore platforms. Currently, our analysis only focused on pipes manufacturing. We will update our note as we gain more visibility into the other businesses.

Product mix

SSP produces small and medium diameter steel pipes. It is expanding capacity in the higher-margin medium diameter business and building capacity to produce large diameter pipes that will mainly serve the oil and gas sector.

Exhibit 11: Summary of product segments

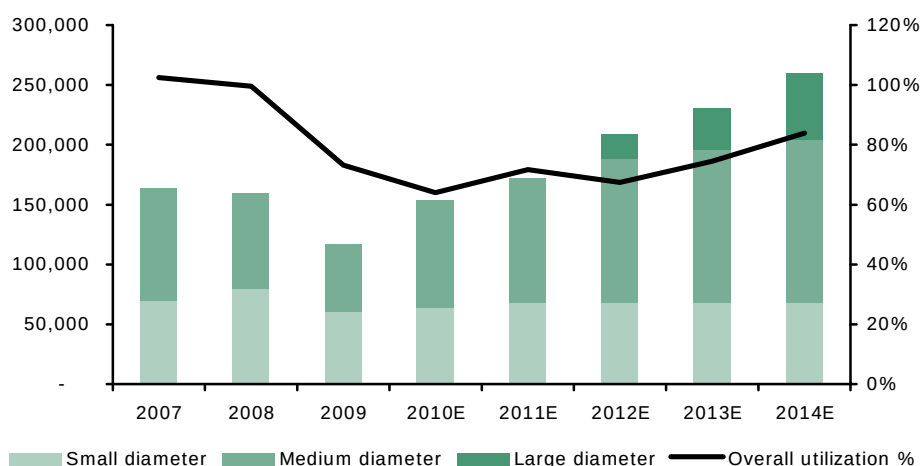
Segment	Stake (%)	Capacity (tons)			Demand driver	Margin	Volatility
		2009	2010	2012E			
Small diameter (0.5"-4")	100	80,000	80,000	80,000	Construction & RE	Modest	Steady demand
Medium diameter (4"-20")	100	80,000	160,000	160,000	Oil and gas	High	Volatile demand
Large diameter (20"-60")	35	-	-	200,000	Oil and gas	Highest	Volatile demand

Source: Company, NCBC Research estimates

We expect this capacity expansion over the next few years to drive substantial revenue growth. The shift towards medium and larger diameter pipes will result in margin expansion and strong net income growth.

Exhibit 12: Total production level and overall capacity utilization

Production in tons (LHS), capacity utilization in % (RHS)



Source: Company, NCBC Research estimates

Note: SSP owns 35% of the large diameter project. The chart presents the proportion attributable to SSP

Small diameter

SSP started as a producer of small diameter pipes and currently has a production capacity of 80,000 tons per annum. Based on our discussions with management, we do not expect any increase in capacity in this segment and estimate revenue growth to come from improved capacity utilization and increasing selling prices.

Exhibit 13: Basic drivers of the small diameter segment

	2006	2007	2008	2009	2010E	2011E	2012E
Capacity (tons)	80,000	80,000	80,000	80,000	80,000	80,000	80,000
Utilization (%)	88.4	87.4	99.1	75.3	80.0	85.0	85.0
Production (tons)	70,691	69,923	79,303	60,274	64,000	68,000	68,000

Source: Company, NCBC Research estimates

After reaching a high of near 100% utilization in 2008, the utilization rate declined significantly in 2009 as a result of the global economic crisis, which had a negative impact on construction activities in Saudi Arabia. We expect a steady recovery from 2010e and assume the long-term utilization rate at 85%.

Medium diameter

SSP used part of the 2009 IPO proceeds to expand production capacity in this segment. Utilization rates, which had averaged over 100% between 2006-08 declined materially in 2009 due to the effects of the global downturn on the local market. Given the recent capacity expansion and our assumption of weak demand in 2010, we expect the utilization rate to decline further in 2010e before picking up in 2011e.

Although demand is expected to grow substantially over our forecast period, driven by oil and gas projects, our assumptions for future utilization levels are conservative as we assume a long-term utilization rate at 85%.

Exhibit 14: Basic drivers of the medium diameter segment

	2006	2007	2008	2009	2010E	2011E	2012E
Capacity (tons)	80,000	80,000	80,000	80,000	160,000	160,000	160,000
Utilization (%)	97.3	117.6	100.1	71.1	56.0	65.0	75.0
Production (tons)	77,815	94,111	80,097	56,858	89,000	104,000	120,000

Source: Company, NCBC Research estimates

Large diameter

SSP has entered into a JV to produce large diameter (20"-60") pipes at a plant in Jubail in which it has a 35% stake. The JV will start production in 2012e. These pipes are mostly used in oil, gas and petrochemical projects.

We expect this segment to reach 30% gross margins, versus 15% to 20% for the small and medium diameter segments.

Exhibit 15: Basic drivers of the large diameter segment

	2006	2007	2008	2009	2010E	2011E	2012E
Capacity (tons)	-	-	200,000	200,000	200,000	200,000	200,000
Utilization (%)	-	-	30.0	50.0	80.0	85.0	85.0
Production (tons)	-	-	60.00	100.00	160.00	170.00	170.00

Source: Company, NCBC Research estimates

Demand growth

As illustrated in Exhibit 11 on page 9, demand for small diameter pipes depends on real estate and construction projects and demand for medium and large diameter pipes is driven by oil and gas projects.

Small diameter pipes

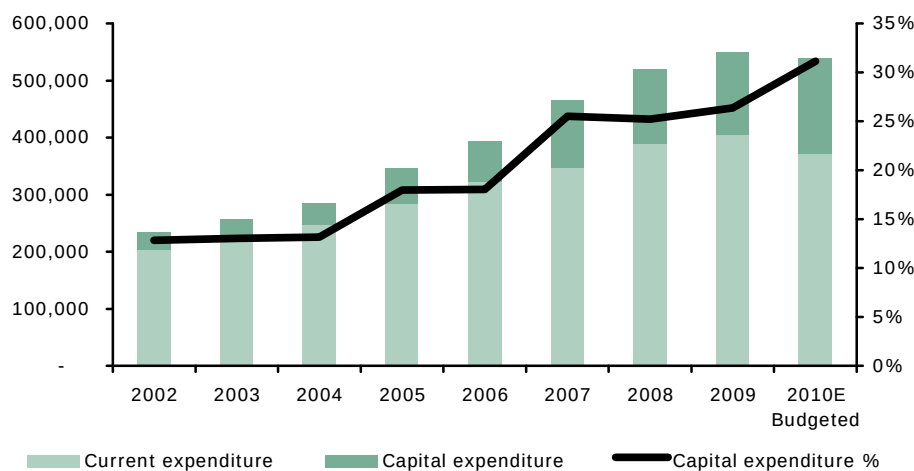
The decline in construction activity and delays in major projects resulted in a lower demand for this segment in 2009. However, we expect demand for small diameter pipes to resume growth in 2010e, resulting in a gradual increase in utilization rates. This should be driven by high government investments and increasing construction activity in Saudi Arabia.

Expenditure by the Saudi government has grown substantially over the past decade and is expected to maintain healthy growth levels in 2010-2011. Moreover, capital expenditure has been growing at a faster rate relative to total expenditure, with its contribution to total expenditure increasing from 13% in 2002 to 26% in 2009.

Based on the announced budget for 2010e, we expect this growth to continue as the government focuses on fiscal expansion; it is part of the government's plan of a massive infrastructure build-out that includes schools, universities, hospitals, roads, sea ports, railways, and airports.

Exhibit 16: Saudi government expenditure

Expenditure in SRmn (LHS), % (RHS)



Source: Ministry of Finance, SAMA, NCBC Research

SSP's capacity utilization of small pipes increased from 87% in 2007 to 100% in 2008 before declining to 75% in 2009. We expect the utilization rate to increase in 2010 and stabilize at 85% from 2011e onwards.

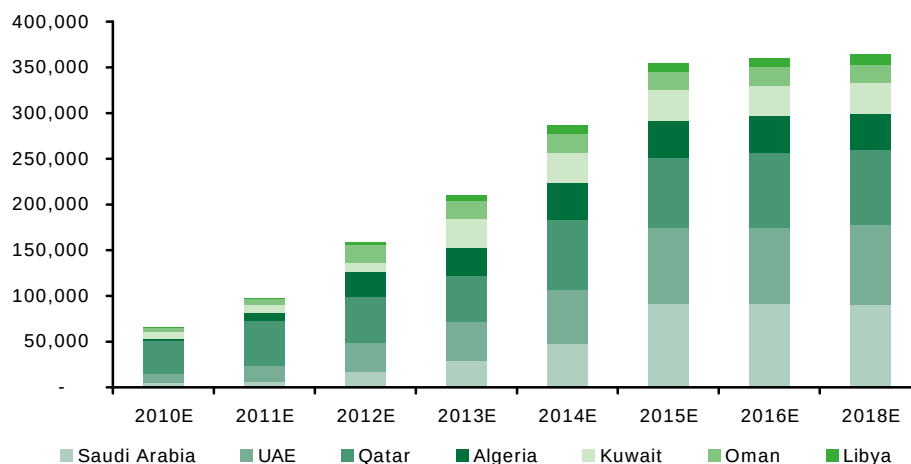
Medium and large diameter pipes

Medium and large diameter pipes are mainly used in oil and gas projects. Over 2006-08, SSP had been able to maintain utilization rates above 100% due to high capital expenditure on oil, gas and petrochemical projects. However, as many of these projects were put on hold due to the global economic crisis, demand for medium diameter pipes declined sharply in 2009 with the utilization rate falling to 71%. We expect this segment to perform poorly in 2010 as well.

With oil (Brent) having nearly doubled to the \$75 per barrel range from its lows in early 2009, we expect many of these projects to be put back on track, which would boost demand for steel pipes. Although we do not expect a pick-up in demand in 2010, we see upside potential from 2011 onwards.

Exhibit 17: Cumulative announced oil and gas capital expenditure 2010-18e

USDmn (As of Feb 2010)



Source: Zawya Projects, NCBC Research estimates

Based on announced projects in the region, and even assuming many of these projects continue to suffer from delays, we expect demand for pipes in the oil and gas sector, which form 30-35% of the build-out cost of a project, to grow substantially over 2011-2018.

SSP depends heavily on Saudi Aramco for its medium diameter pipe business. This client concentration results in higher business risk and volatile utilization rates. From our discussions with management, we understand that the company is planning to diversify its customer base by expanding into other regional markets.

The main markets the company will target are other GCC markets (mainly Qatar and the UAE) and North African markets (mainly Libya and Algeria). Although we understand that the Saudi market remains the largest single market and accounts for 25% of total oil and gas projects announced in the region, entering other GCC and MENA markets in addition to Libya and Algeria will expand the company's addressable market by 4x. Given its strong track record, we believe SSP is in a good position to increase market share in the new regions. This would lead to the company having higher and less volatile utilization rates.

Selling price

SSP's average selling price (ASP) is based on the cost of production plus a mark-up. Changes in raw material costs primarily drive cost of production as raw material costs comprise 75-80% of the cost of sales while the mark-up depends on the supply-demand scenarios.

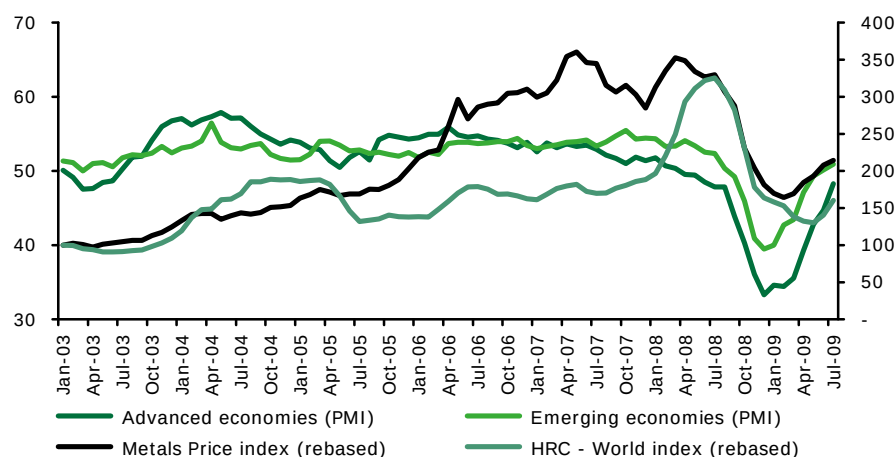
RAW MATERIAL COST

Based on our analysis of historical selling prices and our discussions with management, we believe that the main driver which will influence ASP is the change in cost of raw materials. The two main raw materials which are used in the production of steel pipes include Hot Rolled Coil steel and Zink.

Generally, changes in steel prices and metal prices are largely due to changes in the global supply/demand balance, which is heavily influenced by economic cycles. The Manufacturing Purchasing Managers Index (PMI) serves as a good leading indicator and a proxy to future price changes of raw material cost.

Exhibit 18: Manufacturing Purchasing Managers Index (PMI) vs. metal prices

PMI (LHS), Metal Price Index and HRC World Index (2003=100) (RHS)



Source: IMF, NCBC Research estimates

SSP's selling price increased over 2006-08 mainly due to the increase in raw material costs and then decreased in 2009 as raw material prices declined because of the global economic crisis. Consensus estimates and forward prices indicate that all metal prices are expected to rise over the next few years. Going forward, we assume a steady increase in raw material prices driven by global economic recovery.

Although the pricing structure is based on cost plus a markup, it is interesting to note that the change in selling price is less than proportionate to the change in raw material prices in both the growth and the decline periods. In our view, this reflects the lag in pricing owing to the difference between the contract date and the delivery time. This affects the markup segment of the selling price.

MARKUP FACTOR

The markup represents the company's gross profit. This portion is mainly influenced by the product itself and any differentiating factors the product may have.

Due to the time lag between contract and delivery, markup can change from year to year. In 2008, the company received orders and priced them according to raw material prices at the time (which were high); however, the raw materials were actually ordered in 2009 at lower than anticipated prices due to the global crisis. This worked well for the company in 2009 and resulted in higher margins relative to 2006-08. Additionally, the recorded impairment on inventory by the end of 2008 actually increased markups in 2009. However, we expect markup and margins to normalize in 2010e resulting in lower margins for the year relative to 2009.

Different product segments have different markups. As the diameter increases, the markup, everything else is equal, increases given the higher technical know-how necessary for production of these larger pipes. Hence, we expect the overall markup to improve on the back of the change in sales mix towards larger diameter segments, leading to higher profit margins.

In our view, the potential impact of competition on markup is negligible in SSP's case for two key reasons:

- First, most of the additional industry capacity that is planned to be built will be in the small diameter segments and the company is currently moving away from small diameter towards larger diameter, higher margin segments.
- Second, government related contracts (ie. Aramco) give priority to Saudi based firms over non-Saudi suppliers, which effectively shields them from import competition.

The below table summarizes the major drivers and assumptions of SSP's selling prices for the different product segments. We try to remain conservative on our estimates and assume a small increase in HRC prices and a decline in markup over our forecast horizon

Exhibit 19: Average selling price (historical and future assumptions)

USD per ton

	2008	2009	2010E	2011E	2012E	2013E ...	2016E
Hot Rolled Coil (HRC)	887	528	600	630	662	695	729
Small diameter (0.5"-4")							
Cost of sales (USD/ton)	1,024	791	779	837	846	868	948
Markup %	118	138	121	120	119	118	115
Avg selling price (USD/ton)	1,211	1,095	940	1,001	1,004	1,021	1,255
Medium diameter (4"-20")							
Cost of sales (USD/ton)	1,080	950	819	881	918	957	1,019
Markup %	123	132	128	128	127	126	123
Avg selling price (USD/ton)	1,328	1,259	1,050	1,129	1,168	1,208	1,086
Large diameter (20"-60")							
Cost of sales (USD/ton)	-	-	-	-	1,060	1,103	1,148
Markup %	-	-	-	-	142	142	142
Avg selling price (USD/ton)	-	-	-	-	1,505	1,566	1,630

Source: Bloomberg, NCBC Research estimates

Earnings Outlook

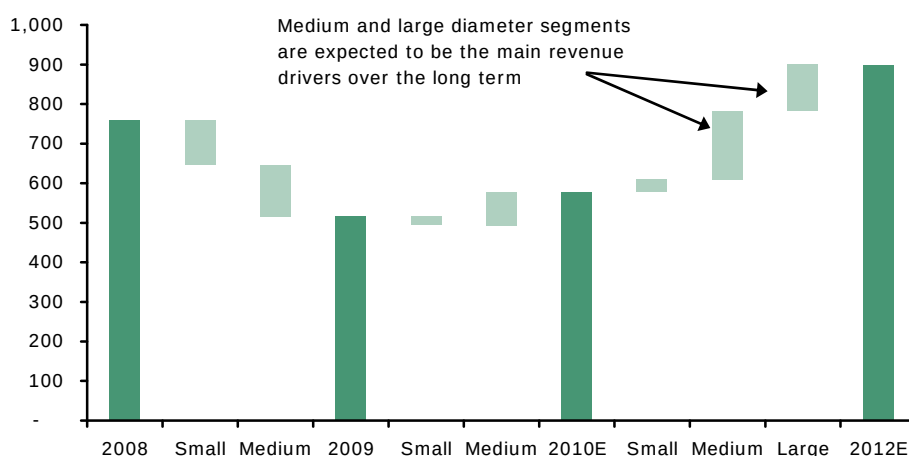
Revenue and margins

In 2009, revenue declined significantly due to pressure on utilization levels and reduction in ASP of small and medium diameter pipes.

We expect revenue to grow marginally in 2010, driven by a small increase in sales volume, but partially offset by reduction in ASP. Although we expect many real estate, oil & gas and petrochemical projects to be back on track in 2010e, we believe SSP's performance will lag by a year and will start to show meaningful growth from 2011e.

Exhibit 20: Revenue growth will resume from 2011E

Revenues, in SRmn

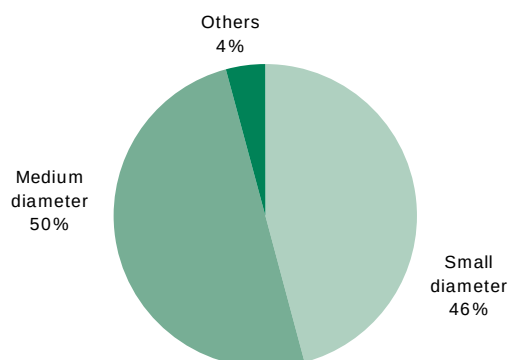


Company, NCBC Research estimates

Note: SSP owns 35% of the large diameter project. The chart presents the proportion attributable to SSP

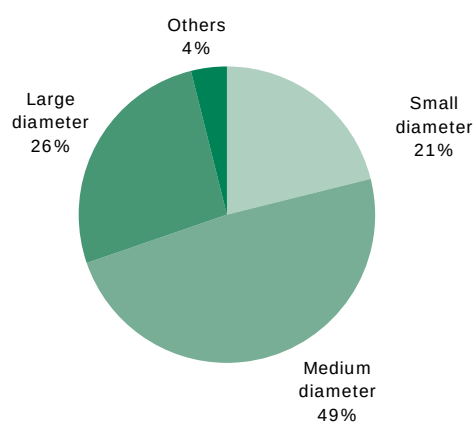
From 2011e, we expect demand for medium diameter pipes to pick up; we also expect the large diameter plant to go on stream in 2012. This, accompanied by higher ASPs, will lead to significant revenue growth over the long term, we believe.

Exhibit 21: Revenue mix 2009



Source: Company, NCBC Research estimates

Exhibit 22: Revenue mix 2014E



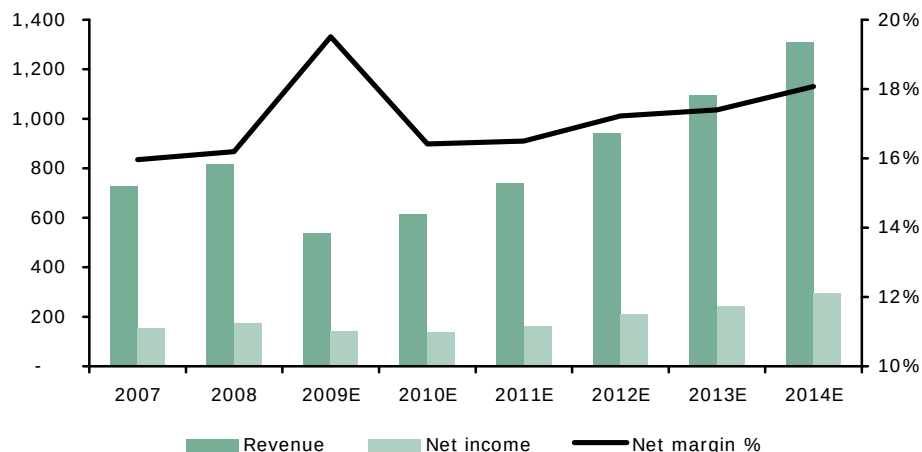
Source: Company, NCBC Research estimates

As a result of the expected increase in contribution of medium and large diameter pipes relative to small diameter pipes, we expect margins to grow significantly. Our estimates indicate that over the long term, gross margins in small diameter pipes

will be around 15% and that in medium diameter pipes will be around 20%. Large diameter pipes, however, will have significantly higher margins of an estimated 30%, resulting in a positive impact on overall margins.

Exhibit 23: Proportionate revenue and gross profit

Revenue and gross profit in SRmn (LHS), gross margin in % (RHS)



Source: Company, NCBC Research estimates

Accounting issues

ISSUE 1: TAX AND ZAKAT EXPENSE

Under the Saudi Accounting Standard, a company with mixed ownership (Saudi and foreign ownership) does not report net income after Zakat and tax. However, the reported income is pre Zakat and tax and the charge will directly hit equity. SSP falls under this category given its 16.3% ownership by Husteel Co. However, in our model, we deduct Zakat and tax from income to arrive at a post Zakat and tax income in order to be able to compare SSP with other companies which report net income in a similar manner.

ISSUE 2: LARGE DIAMETER PLANT

SSP owns a 35% stake in the large diameter plant that is currently under construction; it will use the equity method to account for the subsidiary. Under this method, revenue, costs and the balance sheet items will not be consolidated in SSP's financials. Instead, 35% of net income of the subsidiary will be reported below operating income and an investment account will appear on the balance sheet. The investment account will increase by income and decrease by dividends paid by the subsidiary.

In the financials section, we produce two income statements. The first uses the correct accounting treatment using the equity method and the second uses proportionate consolidation to show the economic impact of the new JV on revenue and operating margins. For the balance sheet, we only use the equity method.

Financials

Exhibit 24: Income statement using Equity method

In SR millions, unless otherwise stated

	2008	2009	2010E	2011E	2012E	2013E
Net sales	817	539	613	737	824	889
% change	12	(34)	14	20	12	8
COGS	(644)	(399)	(477)	(576)	(649)	(707)
Gross Profit	173	140	136	161	175	182
Operating expenses	(31)	(26)	(27)	(30)	(32)	(33)
Operating profit	142	114	108	131	143	149
EBITDA	155	131	127	158	177	189
Depreciation & amort	(14)	(18)	(19)	(27)	(34)	(40)
Financing cost, net	(3)	(3)	(1)	(1)	(2)	(2)
Other income (expense)	2	2	-	-	-	-
Income from associates					31	55
Reported net income	141	113	107	129	173	203
Zakat and Tax	(9)	(8)	(6)	(8)	(10)	(12)
Adjusted net income	132	105	101	122	162	190
% change	14	(21)	(4)	21	33	17
Net income margin (%)	16.2	19.5	16.4	16.5	19.7	21.4
Shares outstanding	35,000	43,000	51,000	51,000	51,000	51,000
Reported EPS	4.0	2.6	2.1	2.5	3.4	4.0
Adjusted EPS	7.3	2.4	2.0	2.4	3.2	3.7

Exhibit 25: Income statement using proportionate consolidation

In SR millions, unless otherwise stated

	2008	2009	2010E	2011E	2012E	2013E
Net sales	817	539	613	737	943	1,094
% change	12	(34)	14	20	28	16
COGS	(644)	(399)	(477)	(576)	(733)	(852)
Gross Profit	173	140	136	161	210	243
Operating expenses	(31)	(26)	(27)	(30)	(33)	(36)
Operating profit	142	114	108	131	176	207
EBITDA	155	131	127	158	219	256
Depreciation & amort	(14)	(18)	(19)	(27)	(42)	(49)
Financing cost, net	(3)	(3)	(1)	(1)	(3)	(3)
Other income (expense)	2	2	-	-	-	-
Reported net income	141	113	107	129	174	204
Zakat and Tax	(9)	(8)	(6)	(8)	(11)	(14)
Adjusted net income	132	105	101	122	162	190
% change	14	(21)	(4)	21	33	17
Net income margin (%)	16.2	19.5	16.4	16.5	17.7	18.1
Shares outstanding	35,000	43,000	51,000	51,000	51,000	51,000
Reported EPS	4.0	2.6	2.1	2.5	3.4	4.0
Adjusted EPS	7.3	2.4	2.0	2.4	3.2	3.7

Source: Company, NCBC Research estimates

Note 1: Equity method (income statement on the top) is the correct accounting treatment for the new JV in Jubail given the company's ownership of 35%. However, the proportionate income statement presents the economic impact of the JV more accurately; hence we produce the proportionate income statement for illustrative purposes.

Note 2: Company reports income before Zakat and tax as net income and charges Zakat and tax directly to equity

Exhibit 26: Balance sheet (Equity method only)

In SR millions, unless otherwise stated

	2008	2009	2010E	2011E	2012E	2013E
Cash & short term investments	82	369	392	327	258	261
Accounts receivable	122	95	106	127	142	154
Inventory	262	239	201	243	273	298
Prepayments	6	8	6	8	10	10
Current assets	473	712	705	706	684	722
Investment in associates	-	45	45	45	73	101
Net fixed assets	191	224	315	398	475	469
Deferred expenses	3	-	-	-	-	-
Total assets	666	981	1,066	1,149	1,232	1,291
Accounts payables & accruals	96	60	64	82	93	101
Dividends payable ^	70	102	102	102	102	153
Current liabilities	190	188	195	216	230	292
End of service indemnity	24	26	29	32	35	38
Total debt	50	-	79	122	131	91
Total liabilities	240	188	274	338	361	382
Share capital	350	510	510	510	510	510
Additional paid in capital	-	219	219	219	219	219
Employees' stock program	-	(16)	(16)	(16)	(16)	(16)
Reserves	14	25	35	48	64	83
Retained earnings	63	55	43	51	95	113
Shareholder's equity	427	793	791	811	872	909
Total equity & liab	667	981	1,066	1,149	1,232	1,291

Source: Company, NCBC Research estimates

^ In 2009, the company did not have dividend payable since the proposed dividends has not been approved yet. However, we add this account to 2009 balance sheet in order to show dividends impact on equity.

Exhibit 27: Cash flow statement (Equity method only)

In SR millions, unless otherwise stated

	2008	2009	2010E	2011E	2012E	2013E
EBIT	144	115	108	131	174	204
Depreciation & amortization	14	18	19	27	34	40
Income from associates	-	-	-	-	(31)	(55)
Other non-cash items	(0)	-	-	-	-	-
Zakat and tax payment	(9)	(8)	(6)	(8)	(10)	(12)
Change in working capital	48	12	33	(47)	(37)	(27)
Other assets/liab	3	2	3	3	3	3
Operating cash flows	200	140	157	106	132	153
Capital expenditure	(52)	(48)	(110)	(110)	(110)	(34)
Investment in associates	-	(45)	-	-	-	-
Dividends received	-	-	-	-	3	28
Proceeds from sale of fixed assets	0	-	-	-	-	-
Investing cash flows	(52)	(93)	(110)	(110)	(107)	(6)
IPO proceeds	-	363	-	-	-	-
dividends paid	(52)	(70)	(102)	(102)	(102)	(102)
Debt issuance/repayment	(26)	(50)	79	43	9	(40)
Financing cost	(3)	(3)	(1)	(1)	(2)	(2)
Financing cash flows	(80)	240	(24)	(61)	(95)	(144)
Net cash flows for the year	67	286	23	(65)	(69)	3
Beginning cash balance	15	82	369	392	327	258
Ending cash balance	82	369	392	327	258	261

Source: Company, NCBC Research estimates

Exhibit 28: Key ratios

In SR millions, unless otherwise stated

	2008	2009	2010E	2011E	2012E	2013E
Per share ratios (SR)						
Reported EPS	4.0	2.6	2.1	2.5	3.4	4.0
Adjusted EPS	3.8	2.4	2.0	2.4	3.2	3.7
Cash EPS	4.2	2.9	2.3	2.9	3.8	4.5
FCF per share	148	46	47	(4)	25	146
Div per share	3.4	2.0	2.0	2.0	2.0	3.0
Book value per share	12.2	18.4	15.5	15.9	17.1	17.8
Valuation ratios (x)						
Adjusted P/E	NA	13.6	16.8	13.9	10.4	8.9
Implied adjusted P/E	NA	16.6	20.5	17.0	12.7	10.8
P/FCF	NA	0.7	0.7	(7.9)	1.3	0.2
P/BV	NA	1.8	2.1	2.1	1.9	1.9
EV/sales	NA	2.5	2.2	1.8	1.6	1.5
EV/EBITDA	NA	10.3	10.6	8.6	7.6	7.1
Div yield (%)	NA	6.0	6.0	6.0	6.0	9.0
Profitability ratios (%) (using equity method income statement)						
Gross margins	21.2	25.9	22.1	21.8	21.2	20.5
Operating margin	17.3	21.1	17.7	17.8	17.4	16.8
EBITDA margins	19.0	24.4	20.8	21.4	21.4	21.3
Net profit margins	16.2	19.5	16.4	16.5	19.7	21.4
ROE	31.4	17.2	12.7	15.2	19.3	21.4
ROA	21.2	12.8	9.8	11.0	13.6	15.1
Liquidity ratios						
Current ratio	2.5	3.8	3.6	3.3	3.0	2.5
Quick Ratio	1.1	2.5	2.6	2.1	1.8	1.5
Operating ratios (days)						
Inventory	147	216	152	152	152	152
Receivables	54	63	62	62	62	62
Payables	54	54	48	51	51	51
Operating cycle	200	279	214	214	214	214
Cash cycle	147	225	166	163	162	162
Production capacity(thousand tons)						
Small diameter capacity	80	80	80	80	80	80
Utilization (%)	99.1	75.3	80.0	85.0	85.0	85.0
Medium diameter capacity	80.0	80.0	160.0	160.0	160.0	160.0
Utilization (%)	100.1	71.1	56.0	65.0	75.0	80.0
Large diameter capacity	-	-	-	-	200	200
Utilization (%)	-	-	-	-	30.0	50.0

Source: Company, NCBC Research estimates



Kindly send all mailing list requests to research@ncbc.com

Brokerage website www.alahlitadawul.com / www.alahlibrokerage.com

Corporate website www.ncbc.com

NCBC INVESTMENT RATINGS

Overweight:	Target price represents expected returns in excess of 15% in the next 12 months
Neutral:	Target price represents expected returns between -10% and +15% in the next 12 months
Underweight:	Target price represents a fall in share price exceeding 10% in the next 12 months
Price Target:	Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

OTHER DEFINITIONS

NR:	Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations
CS:	Coverage Suspended. NCBC has suspended coverage of this company
NC:	Not Covered. NCBC does not cover this company

IMPORTANT INFORMATION

The authors of this document hereby certify that the views expressed in this document accurately reflect their personal views regarding the securities and companies that are the subject of this document. The authors also certify that neither they nor their respective spouses or dependants (if relevant) hold a beneficial interest in the securities that are the subject of this document. Funds managed by NCB Capital and its subsidiaries for third parties may own the securities that are the subject of this document. NCB Capital or its subsidiaries may own securities in one or more of the aforementioned companies, or funds or in funds managed by third parties. The authors of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. The Investment Banking division of NCB Capital may be in the process of soliciting or executing fee earning mandates for companies that are either the subject of this document or are mentioned in this document.

This document is issued to the person to whom NCB Capital has issued it. This document is intended for general information purposes only, and may not be reproduced or redistributed to any other person. This document is not intended as an offer or solicitation with respect to the purchase or sale of any security. This document is not intended to take into account any investment suitability needs of the recipient. In particular, this document is not customized to the specific investment objectives, financial situation, risk appetite or other needs of any person who may receive this document. NCB Capital strongly advises every potential investor to seek professional legal, accounting and financial guidance when determining whether an investment in a security is appropriate to his or her needs. Any investment recommendations contained in this document take into account both risk and expected return. Information and opinions contained in this document have been compiled or arrived at by NCB Capital from sources believed to be reliable, but NCB Capital has not independently verified the contents of this document and such information may be condensed or incomplete. Accordingly, no representation or warranty, express or implied, is made as to, and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this document. To the maximum extent permitted by applicable law and regulation, NCB Capital shall not be liable for any loss that may arise from the use of this document or its contents or otherwise arising in connection therewith. Any financial projections, fair value estimates and statements regarding future prospects contained in this document may not be realized. All opinions and estimates included in this document constitute NCB Capital's judgment as of the date of production of this document, and are subject to change without notice. Past performance of any investment is not indicative of future results. The value of securities, the income from them, the prices and currencies of securities, can go down as well as up. An investor may get back less than he or she originally invested. Additionally, fees may apply on investments in securities. Changes in currency rates may have an adverse effect on the value, price or income of a security. No part of this document may be reproduced without the written permission of NCB Capital. Neither this document nor any copy hereof may be distributed in any jurisdiction outside the Kingdom of Saudi Arabia where its distribution may be restricted by law. Persons who receive this document should make themselves aware of, and adhere to, any such restrictions. By accepting this document, the recipient agrees to be bound by the foregoing limitations.

NCB Capital is authorised by the Capital Market Authority of the Kingdom of Saudi Arabia to carry out dealing, as principal and agent, and underwriting, managing, arranging, advising and custody, with respect to securities under licence number 37-06046. NCB Capital's registered office is at 25th Floor, Al-Faisaliyah Tower, King Fahad Road, P.O. Box 22216, Riyadh 11495, Kingdom of Saudi Arabia.