CONSTRUCTION | 02 August 2010

COMPANY UPDATE

Saudi Steel Pipes

Attractive entry point

Overweight

Target Price (SR) 37.4

Current price (SR) 26.1

Stock details

52-week range H/L (SR)	36.7/25.5
Market cap ($mn)	1,331
Shares outstanding (mn)	51
Listed on exchanges	TADAWUL

Price perf. (%)	1M	3M	12M
Absolute	(3.7)	(14.7)	(22.1)
Rel. to market	(6.8)	(6.2)	(30.8)

Avg daily turn.(mn)	SR	US$
3M	5.0	1.3
12M	29.4	7.9

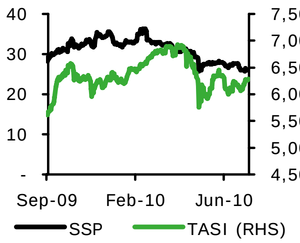
Reuters code	1320.SE
Bloomberg code	SSP AB
Website	www.sspipe.com

Valuation multiples

	09	10E	11E
P/E (x)	10.7	15.4	12.5
P/B (x)	1.4	1.7	1.6
EV/EBITDA (%)	7.5	8.8	7.0
Div yield (%)	7.7	7.7	7.7

Source: NCBC Research estimates

Share price performance



Source: Bloomberg

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We maintain our Overweight rating but reduce our PT to SR37.4 due to gross margin pressure. Our key themes remain intact with continued sales volume growth of medium diameter pipes, coupled with good progress in the new large diameter plant. We believe the stock is trading below its fair value, which in turn has created a more compelling entry point.

- **Continued top line growth:** Revenue reached SR168.7mn in 2Q10; a growth of 16.2% YoY and 10.1% QoQ. This was driven by growing sales volume and, to a lesser extent, the increase in average selling prices. Total sales volume increased 14.7% YoY to 37,273 tons in 2Q10. This volume-driven growth is an indicator that demand is heading in the right direction.
- **Medium diameter is key to top line growth:** Revenue from sales of medium diameter pipes has increased 141% since 4Q09. This was driven by sales volume growth from 9,016 tons in 4Q09 to 17,428 tons in 2Q10 with the selling price increasing 25% over the period. The medium diameter pipes' contribution to revenue has increased from 31% in 4Q09 to 47% in 2Q10.
- **Margin pressure is a key risk:** Gross margin for 1H10 came in at 19.5% versus our estimate of 22.0%. This was due to the company's inability to pass the entire rise in cost of raw materials to customers. We revise our markup estimates downwards, resulting in lower revenue and margin estimates, and a net income revision from SR107mn to SR92mn for 2010e
- **Maintain Overweight, but reduce our price target:** We revise our PT to SR37.4/share from SR40.5/share on the back of lower markups. Our revised EPS implies that the stock is currently trading at 15.4x 2010e earnings, although this falls significantly to an attractive 9.3x for 2012e, when the large diameter pipe plant should be operational. Additionally, we note the company has a net cash balance of SR3.14/share and we estimate this to be around SR5.9/share by the end of 2010e; implying a P/E 2010e of 11.13.

Financials (based on proportionate consolidation method)

		2008	2009	2010E	2011E	2012E
Revenues	SR mn	817	539	597	720	922
EBITDA	SR mn	155	131	112	141	199
Net income	SR mn	141	113	92	113	153
Total debt	SR mn	50	-	-	-	-
Div per share	SR	3.4	2.0	2.0	2.0	2.0
EBITDA margin	%	19.0	24.4	18.8	19.6	19.5
Net margin	%	16.2	19.5	14.5	14.8	17.9
ROE	%	31.4	17.2	11.0	13.6	17.9
EPS*	SR	4.0	2.6	1.8	2.2	3.0
Cash EPS*	SR	4.2	2.9	2.1	2.6	3.5

Source: Company, NCBC Research estimates
^ Company reports net income, pre Zakat and Tax due to the mixed ownership (Saudi and non-Saudi owners)
* SSP issued new shares in June 2009 (for the IPO) resulting in EPS dilution in 2009 and a full dilution in 2010

Earnings analysis

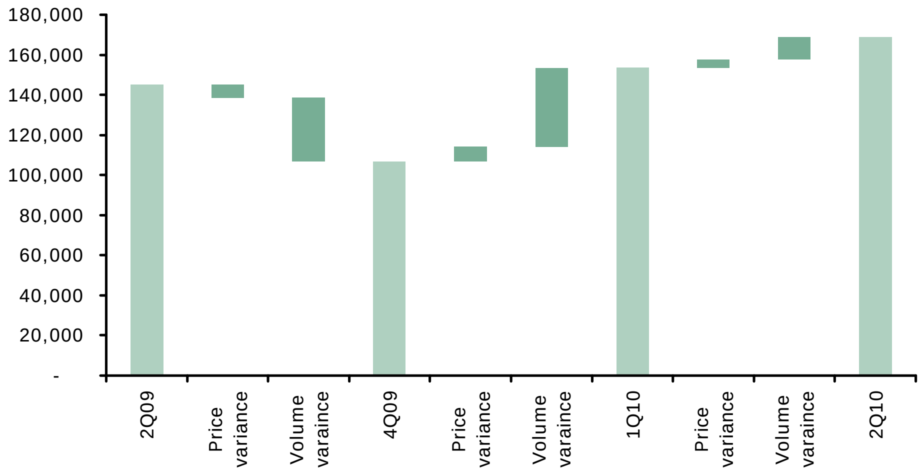
SSP's 2Q10 earnings came in above our estimates mainly driven by higher than expected revenue, which recorded 16.2% increase YoY and 10.2% QoQ. Despite the continued growth in revenue, margins are under pressure as the company was not able to pass the entire rise in cost of raw materials to customers. On the back of these results, we maintain our sales volume estimate but reduce our markup assumptions resulting in lower revenues and margins.

Revenue continues to grow...

SSP's revenue has grown at an acceptable rate on a quarterly and annual basis. In 2009, revenue dropped sharply from the highs of 2008, as a result of the global economic crisis and bottomed in 4Q09. Since then, revenue recovered as a result of both higher average selling price and increased sales volume. In 2Q10, revenues were higher than both 2Q09 and 1Q10.

Exhibit 1: Growing sales volume and higher selling price drive revenue growth

In SR'000



Source: Company, NCBC research analysis

...but margins are under pressure

Comparing margins in 2010 with those in 2009 is not meaningful. SSP's reported margins were above the "normal" level in 2009 despite the revenue drop. This was on the back of 1) an inventory write-down in 2008 that resulted in lower cost of sales in 2009, and 2) lag in pricing.

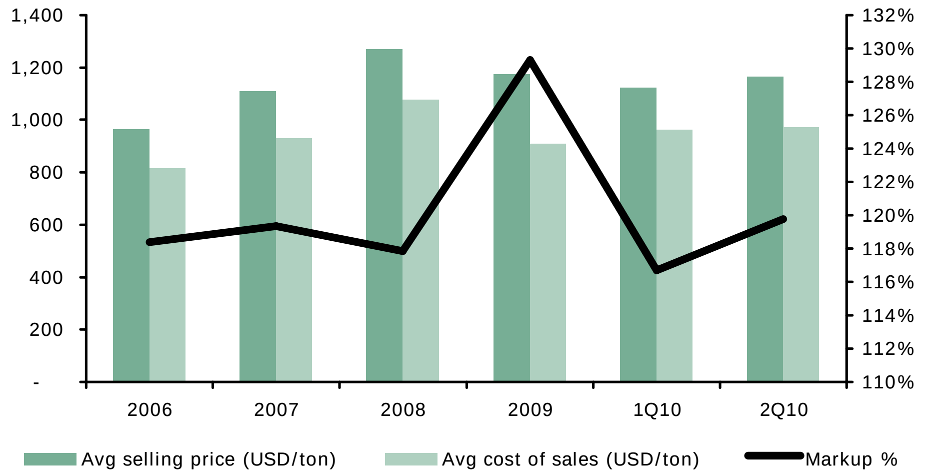
However, margins in 2010 came in lower than 2007 and 2008, but around 2006 levels. Our estimate of gross margin for 2010 was 22.0% (vs. 25.9% in 2009); whereas H1 2010 actual gross margin was 19.5%.

Management attributes the decline in margin to the rising cost of raw material which the company was not able to pass to customers (SSP currently purchases Hot Rolled Coil "HRC" from HADEED). This was due to the "wait and see" approach that customers were taking in anticipation of a potential price softness given the decline in iron ore prices in May 2010. However, we think this is not likely to happen as iron ore prices recovered from the lows of last quarter.

From our discussion with SSP's management we understand that they are trying to reduce the cost of production by looking for other steel suppliers (mainly Chinese suppliers) which charge less than HADEED. This should allow the company to mitigate additional margin losses.

Exhibit 2: Markup is below 2007 and 2008 levels

USD/ton (LHS), % (RHS)



Source: Company, NCBC Research analysis

Downward margin revision results in lower valuation

We revise our estimate of markup downwards implying 20.2% gross margin (down 180bps from our previous estimate). This results in a downward revision of revenue, gross profit and net income in 2010 by 2.5%, 11.2%, 13.9%; respectively.

Exhibit 3: We revise markup assumptions resulting in lower revenues and margins

In SRmn, unless otherwise stated

		2010E	2011E	2012E	2013E	2014E
Revenue	Current	597	720	922	1,071	1,283
	Previous	613	737	943	1,094	1,310
	Chg %	(2.5)	(2.3)	(2.2)	(2.2)	(2.0)
Gross profit	Current	120	144	189	220	271
	Previous	136	161	210	243	296
	Chg %	(11.2)	(10.4)	(9.7)	(9.4)	(8.6)
Net income	Current	92	113	153	180	227
	Previous	107	129	174	204	254
	Chg %	(13.9)	(12.7)	(12.1)	(11.7)	(10.8)
Valuation	Current	37.4				
	Previous	40.5				
	Chg %	(7.6)				

Source: NCBC Research estimates

^ We use proportionate consolidation to present revenue & gross profit in this table. However, SSP will use equity method which we present in the financial section on page 4.

NCB CAPITAL

Financials

Exhibit 4: Income statement (Using Equity Method)

In SR millions, unless otherwise stated

	2009	2010E	2011E	2012E	2013E	2014E
Net sales	539	597	720	803	865	941
% change	(34.1)	10.9	20.6	11.5	7.7	8.8
COGS	(399)	(477)	(576)	(649)	(706)	(771)
Gross profit	**140**	**120**	**144**	**154**	**159**	**170**
Operating expenses	(26)	(27)	(30)	(31)	(32)	(34)
Operating profit	**114**	**93**	**114**	**123**	**127**	**136**
EBITDA	**131**	**112**	**141**	**157**	**167**	**174**
% change	(15.5)	(14.6)	25.7	11.0	6.5	4.1
Dep. & Amortization	(18)	(19)	(27)	(34)	(40)	(37)
Financing cost, net	(3)	(1)	(1)	(2)	(2)	(2)
Other income (expense)	2	-	-	-	-	-
Non-recurring expenses	-	-	-	-	-	-
Income from associates	-	-	-	31	55	93
Reported net income	**113**	**92**	**113**	**153**	**180**	**227**
Tax (Zakat)	(8)	(6)	(7)	(9)	(11)	(14)
Adjusted net income	**105**	**87**	**106**	**143**	**169**	**213**
% change	(20.6)	(17.6)	22.7	35.0	17.9	25.9
EBT Excl Jubail	**113**	**92**	**113**	**121**	**125**	**134**
Tax (Zakat)	(8)	(6)	(7)	(7)	(7)	(8)
Net income excl Jubail	**105**	**87**	**106**	**114**	**117**	**126**

Source: Company, NCBC Research estimates

Exhibit 5: Balance sheet

In SR millions, unless otherwise stated

	2009	2010E	2011E	2012E	2013E	2014E
Cash & short term investments	369	301	172	81	110	122
Accounts receivable	95	103	125	139	150	163
Inventory	239	201	248	273	290	309
Prepayments	8	6	8	10	10	11
Current assets	**712**	**611**	**553**	**503**	**560**	**605**
Investment in associates	45	45	45	73	101	138
Net fixed assets	224	315	398	475	469	463
Deferred expenses	-	-	-	-	-	-
Total assets	**981**	**971**	**997**	**1,051**	**1,129**	**1,206**
Accounts payables & accruals	60	62	81	91	99	113
End of service indemnity	26	29	32	35	38	41
Dividends payable	102	102	102	102	153	204
Current liabilities	**188**	**194**	**215**	**228**	**290**	**357**
Total debt	-	-	-	-	-	-
Total liabilities	**188**	**194**	**215**	**228**	**290**	**357**
Share capital	510	510	510	510	510	510
Additional paid-in capital	219	219	219	219	219	219
Employees' stock program	(16)	(16)	(16)	(16)	(16)	(16)
Reserves	25	34	45	59	76	97
Retained earnings	55	31	24	51	51	38
Shareholder's equity	**793**	**777**	**782**	**823**	**839**	**849**
Total equity & liab	**981**	**971**	**997**	**1,051**	**1,129**	**1,206**

Source: Company, NCBC Research estimates

Exhibit 6: Cash flow statement

In SR millions, unless otherwise stated

	2009	2010E	2011E	2012E	2013E	2014E
EBIT	**115**	**93**	**114**	**154**	**182**	**229**
Depreciation & amortization	18	19	27	34	40	37
Income from associates	-	-	-	(31)	(55)	(93)
Other non-cash items	-	-	-	-	-	-
Zakat and tax payment	(8)	(6)	(7)	(9)	(11)	(14)
Change in working capital	12	35	(53)	(31)	(20)	(20)
Other assets/liab	2	3	3	3	3	3
Operating cash flows	**140**	**145**	**85**	**119**	**139**	**143**
Capital expenditure	(48)	(110)	(110)	(110)	(34)	(32)
Investment in associates	(45)	-	-	-	-	-
Dividends received	-	-	-	3	28	56
Proceeds from sale of fixed assets	-	-	-	-	-	-
Investing cash flows	**(93)**	**(110)**	**(110)**	**(107)**	**(6)**	**23**
IPO proceeds	363	-	-	-	-	-
dividends paid	(70)	(102)	(102)	(102)	(102)	(153)
Debt issuance/repayment	(50)	-	-	-	-	-
Financing cost	(3)	(1)	(1)	(2)	(2)	(2)
Financing cash flows	**240**	**(103)**	**(103)**	**(104)**	**(104)**	**(155)**
Net cash flows for the year	**286**	**(68)**	**(129)**	**(91)**	**29**	**12**
Beginning cash balance	82	369	300	172	81	110
Ending cash balance	**369**	**300**	**172**	**81**	**110**	**121**

Source: Company, NCBC Research estimates

Exhibit 7: Key ratios

	2009	2010E	2011E	2012E	2013E	2014E
Per share ratios (SR)						
Reported EPS	2.6	1.8	2.2	3.0	3.5	4.4
Adjusted EPS	2.4	1.7	2.1	2.8	3.3	4.2
Cash EPS	2.9	2.1	2.6	3.5	4.1	4.9
FCF per share	1.1	0.7	(0.5)	0.2	2.6	3.3
Div per share	2.0	2.0	2.0	2.0	3.0	4.0
Book value per share	18.4	15.7	16.3	17.1	17.5	17.6
Valuation ratios (x)						
Adjusted P/E	10.7	15.4	12.5	9.3	7.9	6.2
P/FCF	0.6	0.7	(1.0)	2.1	0.2	0.2
P/BV	1.4	1.7	1.6	1.5	1.5	1.5
EV/sales	1.8	1.7	1.4	1.2	1.1	1.0
EV/EBITDA	7.5	8.8	7.0	6.3	5.9	5.7
Div yield (%)	7.7	7.7	7.7	7.7	11.5	15.3
Profitability ratios (%) (using equity method income statement)						
Gross margins	25.9	20.2	20.0	19.2	18.4	18.0
Operating margin	21.1	15.6	15.9	15.3	14.6	14.5
EBITDA margins	24.4	18.8	19.6	19.5	19.3	18.4
Net profit margins	19.5	14.5	14.8	17.9	19.6	22.6
ROE	17.2	10.8	13.0	16.8	19.2	23.8
ROA	12.8	8.9	10.7	13.5	14.8	17.5
Liquidity ratios						
Current ratio	3.8	3.6	3.1	2.4	2.1	1.8
Quick Ratio	2.5	2.4	1.7	1.2	1.1	1.0
Operating ratios (days)						
Inventory	216	152	155	152	148	144
Receivables	63	62	62	62	62	62
Payables	54	47	50	51	51	53
Operating cycle	279	214	217	214	210	207
Cash cycle	225	167	167	163	160	154
Production capacity(thousand tons)						
Small diameter capacity	80	80	80	80	80	80
Utilization (%)	75.3	80.0	85.0	85.0	85.0	85.0
Medium diameter capacity	80.0	160.0	160.0	160.0	160.0	160.0
Utilization (%)	71.1	56.0	65.0	75.0	80.0	85.0
Large diameter capacity	-	-	-	200	200	200
Utilization (%)	-	-	-	30.0	50.0	80.0

Source: Company, NCBC Research estimates

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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