

August 10, 2017

Rating Buy
12- Month Target Price SAR 21.00

SAUDI INDUSTRIAL INVESTMENT GROUP (SIIG)
2Q2017 First Look

Expected Total Return

| | |
|--------------------------|-----------|
| Price as on Aug-09, 2017 | SAR 18.93 |
| Upside to Target Price | 10.9% |
| Expected Dividend Yield | 5.3% |
| Expected Total Return | 16.2% |

Market Data

| | |
|-----------------------|----------------|
| 52 Week H/L | SAR 23.5/11.4 |
| Market Capitalization | SAR 8,518 mln |
| Enterprise Value | SAR 22,157 mln |
| Shares Outstanding | 450.0 mln |
| Free Float | 80.4% |
| 12-Month ADTV (000's) | 661.1 |
| Bloomberg Code | SIIG AB |

1-Year Price Performance



Source: Bloomberg



| Fig in SAR mln | RC. Est | Actuals |
|----------------|---------|---------|
| Revenue | 1,584 | 1,754 |
| Gross Profit | 412 | 421 |
| EBIT | 367 | 255 |
| Net Income | 174 | 70 |
| EPS (SAR) | 0.39 | 0.16 |

Earnings Falter

Saudi Industrial Investment Group (SIIG) reported bleak set of numbers with its 2Q2017 results broadly missing RC and consensus expectations as shutdown impact from associates weighed on earnings. Despite its key subsidiary Petrochem reporting slightly in-line earnings, the subdued income trend from associates has led to a disappointment in this quarter following its 35-day shutdown, the impact came higher than our expectations. Management attributes the lower volume sales from associates and lower contribution from Petrochem to be the key reasons. Unlike a stellar earnings in 1Q2017 for SIIG, EPS of SAR 0.16 in this quarter declined by -54% Y/Y and -77% Q/Q missed our SAR 0.39 estimate and street's SAR 0.35, as associates fail to deliver. We revise our estimate for 2017-19 (mainly 2017) and revise our target price to SAR 21.00 (earlier SAR 22.00). Despite revision, valuations are supportive with its 2017E P/E of 10.8x cheaper to TASI's 14.2x and Petrochem's 11.7x.

Revenue trumps expectations on higher volumes

SIIG recorded revenue of SAR 1.75 billion (Petrochem revenue), beat our SAR 1.58 billion estimate, despite the impact of unplanned shutdown due to sudden outage of nitrogen supply in SPC for 2-weeks. Revenue increased by +4% Q/Q and +7% Y/Y but stood firm on volume play despite falling product prices. SIIG's major product prices fell in 2Q, with PP on a Q/Q basis falling by -2%, PE by -6% and PS by -9%. However, the higher sales volume is the key element of surprise aided by its strong inventories. As of 2Q, Petrochem's inventories of SAR 965 million declined from SAR 1,125 million in 1Q2017, suggests better inventory turnover ratio to have offset the fall in utilization. The strategy has paid-off, as Petrochem adopted similar trends in 4Q2016.

Margins contract significantly

Despite its higher volume growth, SIIG failed to create any margin expansion due to lower realization; with gross margins shrinking 580 bps to 24% from 30% in 1Q2017. Gross profit of SAR 421 million came in-line with our estimate of SAR 412 million, declined by -27% Y/Y and -16% Q/Q. Additionally, SIIG was unable to expand margins despite a fall in feedstock prices and barely monetized the higher fall in feedstock prices. We believe the impact of higher inventory mark-up in 1Q has led to a minimal cost decline and led to a fall in margins. In 2Q, propane prices fell by -11% Q/Q but was up by +27% Q/Q in 1Q2017, while ethylene was down by -10% in this quarter, went up by +14% Q/Q in the last quarter. In addition, spreads improvement in PP barely aided any growth in margins, as PE spread contraction offset the improved PP spreads. Operating profit of SAR 255 million declined -47% Y/Y and -57% Q/Q, as SG&A costs remained high at 9% of sales.

Earnings miss, but long-term outlook continues with a Buy rating

With few details divulged, share of associate income is expected to be in the range of SAR 10-15 million in 2Q2017 from SAR 200 million in 1Q2017. Earnings of SAR 70 million (share of Petrochem >90%) missed estimates of SAR 174 million and consensus of SAR 152 million, with margins at 4.0% in 2Q2017 from 18% in 1Q2017. We revise our 2017-19 estimates but maintain our long-term outlook with a Buy, expect DPS of SAR 1.00 for 2017, yields 5.3%.

Key Financial Figures

| FY Dec31 (SAR mln) | 2016A | 2017E | 2018E |
|--------------------|-------|-------|-------|
| Revenue | 6,065 | 6,875 | 6,957 |
| EBITDA | 1,826 | 2,104 | 1,976 |
| Net Profit | 486 | 791 | 854 |
| EPS (SAR) | 1.08 | 1.76 | 1.90 |
| DPS (SAR) | 0.50 | 1.00 | 1.00 |
| BVPS (SAR) | 12.20 | 12.96 | 13.86 |

Key Financial Ratios

| FY Dec31 | 2016A | 2017E | 2018E |
|-----------|-------|-------|-------|
| ROAA | 6% | 5% | 6% |
| ROAE | 9% | 14% | 14% |
| P/E | 17.5x | 10.8x | 10.0x |
| P/B | 1.6x | 1.5x | 1.4x |
| EV/EBITDA | 12.2x | 10.6x | 11.3x |
| EV/Sales | 3.7x | 3.2x | 3.2x |

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Stock Rating

| Buy | Neutral | Sell | Not Rated |
|--|---|--------------------------------------|--------------------------|
| Expected Total Return Greater than 15% | Expected Total Return between -15% and +15% | Expected Total Return less than -15% | Under Review/ Restricted |

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

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