

Saudi Basic Industries Corp.(SABIC)



Recovery in Q3 2020, While Pressures on Margins Remain

11 November 2020

SABIC showed significant recovery on a quarterly basis in Q3 2020 on the back of price improvement as well and an increase in volumes sold. However, despite some business activities' resumption, it is expected that the oversupply in SABIC's key products will further pressure product prices and margins towards the end of 2020e.

During Q3 2020, SABIC posted revenues totaled to SAR29,295mn, representing a Y-o-Y drop of 13% from SAR33,690mn in Q3 2019. The plunge in revenues was a result of the continued challenging demand environment as well as the 19% drop in selling prices Y-o-Y. Despite SABIC's resilient performance in terms of volumetric sales (+8% Y-o-Y & Q-o-Q), the plunge in selling prices out-weighted the volumes sold. However, it is worth noting that the company's performances improved immensely compared to Q2 2020, due to prices recovery during Q3 2020 (+11% Q-o-Q) especially given healthier demand on PP & IS from essential industries.

SABIC is known for its historical cost advantage and conservative financial profile; COGS dropped by 5% Y-o-Y from SAR24,056mn in Q3 2019 to SAR22,775mn in Q3 2020. However, gross margin dropped by 700bps Y-o-Y, from 29% in Q3 2019 to 22.3% in Q3 2020. The squeezed gross margin is mainly attributed to the significant decline (Y-o-Y) in most main product prices such as MEG, MTBE and Methanol.

The company showed cost reduction initiatives; evidently, SG&A dropped by 6% Y-o-Y from SAR4,977mn in Q3 2019 to SAR4,679mn in Q3 2020. That being said, the company reported operating profits of only SAR1,840mn in Q3 2020 compared to SAR4,656mn in Q3 2019, representing a drop of 60%. Similarly, operating profit margin dropped by +50%, from 14% in Q3 2019 to only 6% in Q3 2020.

On a more positive note, the company was able to recover its losses from a share in associates during the quarter. Losses amounted to SAR1,419mn in Q3 2019, however, SABIC reported SAR766mn in profits from share of associates.

SABIC posted a net profit of SAR1,630mn during the quarter, compared to the net profit of SAR1,837mn in Q3 2019. The 12% Y-o-Y drop was driven by the disruption in the supply chain, drop in selling prices, and the impact of decreased oil prices and the overall challenging market conditions. On a quarterly basis, SABIC was able to impressively rebound its SAR2,224mn net losses in Q2 2020. The quarterly improvement is driven by the higher production and sales volume in addition to reversal of impairment provisions in certain financial assets, net of SAR0.69bn.

It is worth noting that in Q2 2020 (on June 17th) Aramco completed the share acquisition of a 70% stake in SABIC from the Public Investment Fund, the sovereign wealth fund of Saudi Arabia, for a total purchase price of SAR259bn. The acquisition of the SABIC stake is part of Aramco's strategy to build its downstream footprint by growing its integrated refining and petrochemicals capacity to add value across the hydrocarbon chain.

Following the acquisition, SABIC announced the deconsolidation of four of its 50%-owned entities namely, "YANPET", "KEMYA", "SHARQ" and "SAMAC". Moreover, the company will retrospectively reassess control over other investments related to "SADAF" and "ARRAZI".

The deconsolidation is bound to impact the company's EBITDA in 2020, especially coupled with the weak market fundamentals.

Going forward, we expect that SABIC's weak performance to have bottomed out in Q2 2020, however, the company's recovery in Q3 is not expected to be maintained going onto Q4 2020 as the company's key products remain in oversupply, further pressuring its margins. Meanwhile going into 2021e, SABIC is expected to benefit from demand recover, given that the global pandemic has brought to the forefront the significant role that plastics play, particularly in safeguarding against Covid-19 on medical frontlines.

It is worth noting that during June, SABIC's board of directors announced a 15% cash dividend (SAR1.5/share) for H1 2020. We expect that SABIC will continue to distribute dividends for H2 2020 with the same amount.

We maintain our **Neutral recommendation with a 52-week target price of SAR90.1/share.**

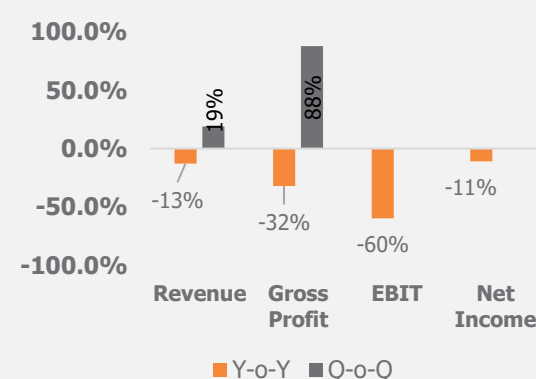
Recommendation **Neutral**

Previous Recommendation	Underweight
Current Price (11-11-2020)	SAR96.0
Target Price (52 Weeks)	SAR90.1
Upside/ (Downside)	-6.1%
Shariah Compliance	Pass

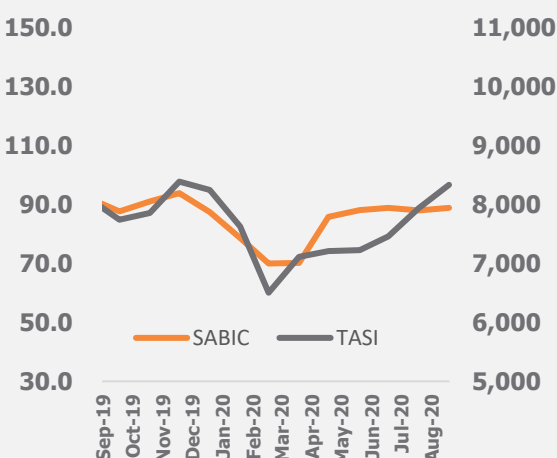
Key Financial Ratios

Ratio	Q3 2020	Q2 2020	Q3 2019
Revenue Growth	19.0%	-20.1%	-6.1%
Gross Margin	22.3%	14.1%	28.6%
EBIT Margin	6.3%	-5.2%	13.8%
Net Margin	5.6%	-9.0%	5.5%

Key Financial Results (Q2 2020)



Share Price Performance



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DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	17,549	26,630	32,333	36,364	40,649
Operating CF	23,430	23,467	30,209	34,804	38,873
Capex	(13,236)	(15,852)	(17,331)	(19,224)	(21,295)
FCFF	10,193	7,615	12,878	15,580	17,577
Stub Period (FCF to be discounted)	2,569	7,615	12,878	15,580	17,577
PV (FCFF)	2,515	6,848	10,634	11,811	12,223
WACC	8.84%	<p>We have valued SABIC using DCF approach, considering a cost of equity is equal to 8.84% (based on a risk-free rate of 3.25%, market risk premium 7.30%, Beta of 0.89).</p> <p>Based on the DCF valuation, the fair price of SABIC share price is SAR90.1, which is lower than the traded value by 6.1%.</p>			
Perpetuity Growth	3.00%				
PV-FCFF	44,030				
PV-TV	212,631				
Net Debt	(15,931)				
Less: End of services benefits	(18,040)				
Add: Investments	47,758				
Intrinsic Values	270,448				
Shares Outstanding	3,000				
Equity value per share	90.1				
CMP (11-11-2020)	96.0				
Upside / (Downside%)	-6.1%				

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Financial Ratios	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Return on Average Assets (%)	6.7%	1.8%	-0.2%	2.1%	3.4%	4.2%	4.9%
Return on Average Equity (%)	12.8%	3.3%	-0.3%	4.0%	6.6%	8.4%	10.2%
Earnings Before Zakat Margin (%)	21.1%	8.4%	1.5%	9.2%	12.6%	14.7%	16.7%
Net Income Margin (%)	12.7%	4.0%	-0.4%	4.7%	6.9%	8.1%	9.2%
Revenue Growth (%)	12.9%	-17.4%	-15.2%	14.6%	9.3%	6.4%	6.4%
EPS	7.2	1.9	-0.2	2.1	3.4	4.3	5.2

Income Statement	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Revenues	169,128	139,737	118,480	135,812	148,484	157,941	168,053
Cost of Revenues	(111,287)	(104,217)	(95,352)	(100,245)	(105,319)	(109,645)	(114,309)
Gross Profit	57,841	35,520	23,128	35,568	43,165	48,296	53,744
SG&A Expenses	(21,561)	(20,687)	(20,170)	(22,320)	(23,812)	(24,455)	(25,109)
Income from Main Operations	36,280	14,833	2,958	13,248	19,352	23,841	28,635
Net Income for The Period	21,521	5,563	(531)	6,347	10,227	12,834	15,472

Balance Sheet	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Total Current Assets	107,588	94,961	83,983	84,431	87,094	89,969	94,491
Total Non-Current Assets	212,123	215,405	215,639	214,972	215,918	218,669	223,279
Total Assets	319,711	310,366	299,622	299,404	303,012	308,638	317,770
Total Current Liabilities	37,881	37,447	33,718	35,809	37,514	39,455	39,052
Total Non-Current Liabilities	60,394	61,667	64,012	62,730	61,368	60,899	62,341
Total Liabilities	98,274	99,114	97,730	98,539	98,882	100,354	101,392
Total Liabilities and Equity	319,711	310,366	299,622	299,404	303,012	308,639	317,770

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

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