Saudi Basic Industries Corp

Petrochemicals – Industrial
SABIC AB: Saudi Arabia
26 October 2020

الراجحي المالية
Al Rajhi Capital

US$74.56bn	21%	US$40.79mn
Market cap	Free float	Avg. daily volume

Target price	73.00	-21.7% over current
Current price	93.20	as at 25/10/2020

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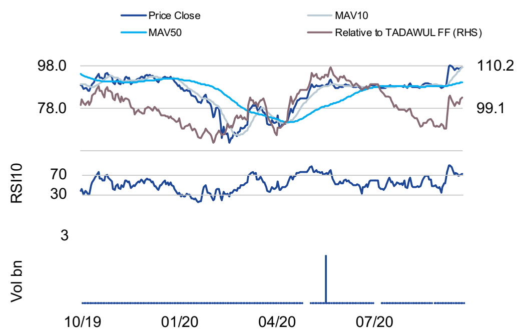
Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

(SARbn)	2019	2020e*	2021e*
Revenue	139.7	115.4	139.8
Revenue growth	-17.3%	-17.4%	21.2%
Gross profit	35.7	22.9	38.5
Gross margin	25.5%	19.8%	27.5%
EBITDA	35.7	20.6	32.8
EBITDA margin	25.5%	17.9%	23.4%
Net profit	5.6	0.0	13.5
Net margin	4.0%	0.0%	9.7%
EPS	1.9	0.0	4.5
DPS	4.4	3.0	3.3
Payout ratio	234%	NM	73%
EV/EBITDA	8.1x	14.0x	8.8x
P/E	49.6x	NM	20.6x

Source: Company data, Al Rajhi Capital. * Adjusted the financials to reflect the latest accounting change post-Aramco deal and hence the data is not comparable with the earlier period.

SABIC

Q3: Earnings beat; No change in outlook

SABIC reported a good set of numbers in Q3. Petchem sales volume was up 7% q-o-q and petchem prices continued to improve with a 13% q-o-q increase. In Q4, the average polymer prices are up 5-10% q-o-q, so far, based on our calculations. This is expected to result in continued recovery in earnings. However, the stock price has already run up ahead of earnings recovery seen from Figure 2 (2020 earnings estimates vs. stock performance). SABIC has also reiterated its outlook - an oversupply in its key products, which is likely to keep product prices and margins under pressure. For 2021, we expect SABIC to continue benefit from i) improving product spreads aided by improved polymer prices, ii) firm utilization rates backed by a recovery in demand, mainly for polymer products, iii) the absence of any further impairments, and iv) its continuous focus on costs. We keep our dividend outlook unchanged (dividend of SAR3.0/sh. vs. SAR4.4/sh. in 2019, before slightly improving to SAR3.3/sh. in 2021) which drives valuations in our view. Based on a 4.5% implied dividend yield, our target price stands at unchanged SAR73/share with an Underweight rating on the stock.

Figure 1 Q3 2020 results summary

(SAR mn)	Q3 2020	Q3 2019	Y-o-Y	Q2 2020	Q-o-Q	ARC est	vs ARC
Revenue	**29.3**	**32.8**	**-10.7%**	**24.6**	**19.0%**	**28.1**	**4.3%**
Gross profit	6.5	8.0	-18.3%	3.5	87.9%	6.5	-0.2%
Gross margin	22.3%	24.3%		14.1%		23.3%	
Operating profit	2.1	3.8	-44.6%	(1.3)	-266.7%	1.9	11.5%
Operating margin	7.2%	11.6%		-5.1%		6.7%	
Net profit	**1.1**	**0.7**	**47.3%**	**(2.2)**	-149.1%	**0.9**	17.9%
Net margin	3.7%	2.3%		-9.0%		3.3%	

Source: Company data, Al Rajhi Capital

Q3 results. Q3 top-line came in slightly higher than our estimate, mainly due to higher-than-expected petchem sales volume (+7% q-o-q vs. +0.3% expected). However, gross profit reported largely in-line with our estimate. During the quarter, the company reversed SAR0.69bn worth net impairment provisions, which was primarily associated with Clariant. Overall, net profit of SAR1.1bn beat our estimate of SAR0.9bn (consensus: SAR0.7bn)

OTC project update: Back toward the end of 2017, SABIC had announced the signing of MoU with Aramco to study the feasibility of developing an industrial complex to convert crude Oil to Chemicals (OTC). This was estimated to have a significant capex of around USD20bn and was earlier expected to be a material event. While the details are not clear, we believe that SABIC may have re-scoped the project to mainly using existing infrastructure and work on the integration of existing refineries in Yanbu. Hence no material changes to valuations because of this announcement.

Valuation and risks: If we are to go by the DCF method of valuing, the company could be valued at around SAR100/share, which is the inherent value in the stock for a long-term investor. However, given the current situation and looking at how petchem companies in Saudi have been valued, it may be more reasonable to look at dividend yields.

Figure 2 Bloomberg consensus earnings 2021 vs. Stock price

Source: Bloomberg, Al Rajhi Capital

Based on 2021 DPS of SAR3.3 and an average historical dividend yield of ~4.5%, our TP is unchanged at SAR73/share. Supply of new capacity globally, unexpected fall in oil price and petchem product prices, and unplanned plant shutdowns are key downside risks. Key upside risks include higher-than-expected spreads, faster than expected successful commercial launch of its future expansion projects, and recovery in global demand. Overall based on our ratings methodology, we remain Underweight on SABIC.

Figure 3 Spot prices started showing a sustainable improvement

	2019	5Y Avg. price	2020 YTD	2020E	2021E	Current spot price
Average oil prices						
Brent (US$/bbl)	64	58	42	43	54	42
WTI (US$/bbl)	57	53	39	39	51	40
Feedstock prices (US$/t)						
Naphtha	525	505	380	376	478	382
Propane	435	437	387	393	459	375
Butane	442	455	394	401	466	380
Product prices (US$/t)						
HDPE	975	1,154	861	863	1,058	940
PP	1,082	1,119	925	928	1,108	985
Polycarbonates	2,047	2,553	1,759	1,773	2,109	2,300
MEG	741	921	623	627	720	640
Urea	259	251	245	250	281	265
Spreads (US$/t)*						
HDPE-Naphtha	450	649	481	487	580	558
PP-Propane	648	682	538	535	649	610

Source: Bloomberg, Al Rajhi Capital. * Spreads may be misleading given that feedstock costs are much lesser than product revenues. As of 25 Oct 2020

SABIC concall with analysts:- Quick summary

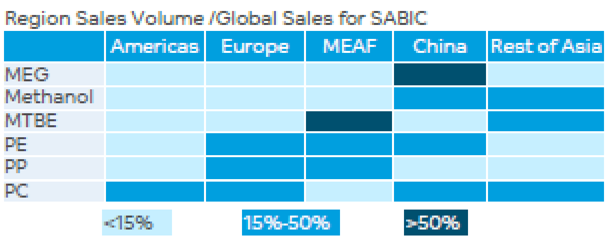
Capex: Globally, companies have become more disciplined about their capex plans and have postponed/cancelled their capex programs. However, SABIC is committed to continue funding its existing 'under construction' plants and continues to focus on capex discipline for 2020 ($3.8-3.9bn) and 2021. Amid the challenging market conditions, the company aims to maintain a healthy cash position and credit ratings, and continue its stable and growing dividend policy.

Operating performance

- The third quarter of 2020 benefited from higher product prices and sales volumes aided by an increase in oil price and improvement in economic activity post the opening of global economies, leading to better margins.
- SABIC's performance remained resilient in 9M 2020 despite the COVID-19 outbreak, which is positive.
- Total sales volume was up marginally up by 1% y-o-y during the 9M 2020. In Q3, it was up by 8% (both q-o-q and y-o-y), mainly driven by increased petchem sales volume (7% q-o-q and 6% y-o-y).
- Europe, Asia, and Middle East regions accounted for around 80% of Q3 sales.
- Operating costs declined by ~2% q-o-q in Q3 2020, reflecting the company's commitment to cost control.
- The company recorded non-recurring gains of SAR0.69bn in Q3 2020 as compared to non-recurring charges of SAR 1.18bn in Q2 2020. The reversal of impairment provisions associated with Clariant, which offset certain impairments in other financial assets.

SABIC's key markets

- Over 50% of MEG sales in China
- Middle East is the biggest market (+50% of volume) for MTBE
- Europe and the Middle East are the biggest markets for PE and PP, while the rest of Asia is the significant market for Methanol and MTBE, and PC.



Source: SABIC Q3 2020 Presentation, Al Rajhi Capital

Polymer prices were up sequentially in Q3, aided by rising oil prices and improvement in economic activities; however, on y-o-y basis, most product prices were lower in Q3. Nonetheless, PE prices in China and the US (being exceptional) were higher than Q3 2019.

Urea market dynamics

- Urea price increased significantly in Q3 driven by tightness in supply/demand balance and favourable farm conditions.
- Urea demand improved in India (aided by healthy monsoon), South East Asia, and South America.
- <u>Q4 outlook:</u> Stable fertilizer demand expected in Q4.

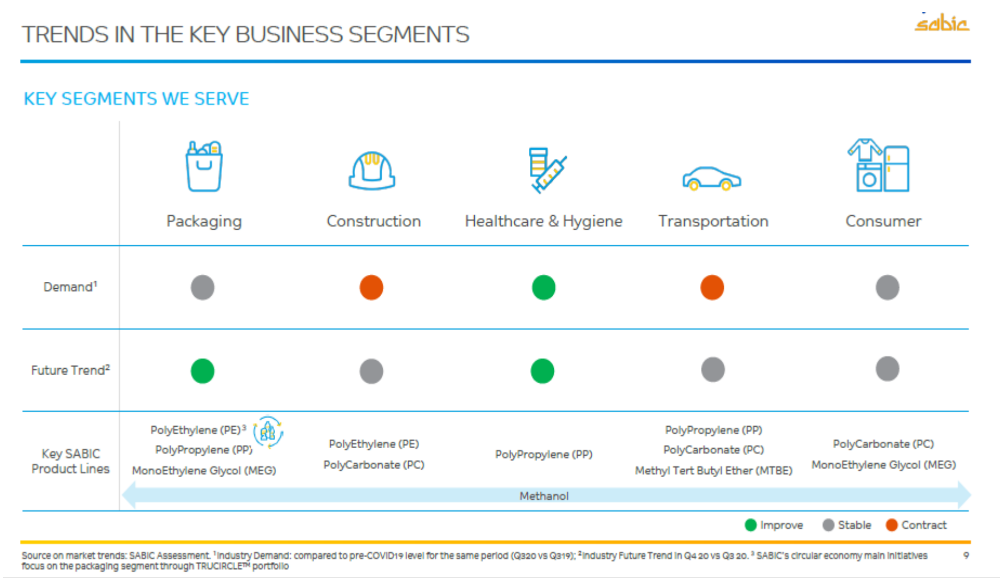
Overall outlook – SABIC maintains its earlier outlook.

- Global economic growth to contract this year before rebounding next year.
- Still expects the market to remain challenging as the supply-demand condition remains bad (supply to remain above the demand) at least till the foreseeable future, which may keep the product prices and margins under pressure.

- <u>Polycarbonate prices:</u> The company said that prices were impacted in Q2 2020 due to weakness in the automobile industry demand. Prices are recently going up as the company has seen some improvement in the demand from the automotive sector; however, it is still below the 2019 levels.
- <u>Q4 outlook:</u> The company indicated that Q4 financial performance would be similar to Q3 results.

Al Rajhi Capital

Trend in key business segments



OTC project update: The company is leveraging its existing infrastructure assets and hence it's difficult to access the total project investment costs. This project will remain the JV with both SABIC and Aramco are committed for the project. We note that SABIC had announced the signing of MoU with Aramco to study the feasibility of developing an industrial complex to convert crude oil to Chemicals (US$20bn capex estimated) at the end of 2017.

Bond issuance

- The success of the bond issuance demonstrated the strength of the SABIC brand and strong interest by a diverse group of global investors. The company issued two bonds - $500mn each for 10Y and 30Y tenure, respectively.
- First-ever dual listing from a Saudi entity; listed 30Y bond on both Ireland and Taiwan stock exchanges.

Subsidized feedstock prices: Regulators are keen to maintain the competitive advantage which Saudi producers are currently enjoying, signalling no change in feedstock prices in the near-term, in our view.

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"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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