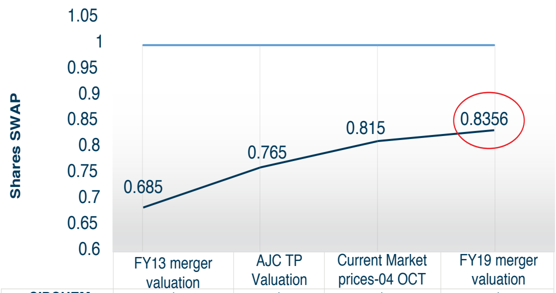
SIPCHEM- SAHARA Merger Synergies

Sipchem's valuation of proposed merger for Sahara stock at 0.8356 is providing 22% higher offer to Sahara's shareholders compared with previous valuation in FY13, while the merged entity could have a combined market cap of SAR 16bn. Proposed merger would provide diversified feedstock, lowering the impact from subsidy reforms after FY19. The proposed merger will support Sipchem to increase its self-sufficiency in basic olefin chemicals by getting access to ethylene feedstock via Sahara's associate (SEPC). Sahara is expected to benefits from Sipchem logistics and marketing arms in Asia and Europe. The consolidation will increase the weight of equity in the combined capital due to Sahara low leveraged balance sheet compared to Sipchem total debt of SAR 7.3bn.

Sipchem, Sahara sign a non-binding MOU on planned merger with 22% higher valuation for Sahara's stock compared to FY13 proposed merger valuation: Saudi International Petrochemical Co. and Sahara Petrochemical Co. signed on 3rd of Oct a non-binding memorandum of understanding (MoU) to carry out a merger, as both firms have reached a preliminary agreement on the valuation, where Sipchem will fully acquire Sahara through shares Swap, issuing 0.8356 new shares for every share held by Sahara's shareholders. Sipchem will increase its shares from 366.67mn to 733.33mn shares, each owning 50% of the combined entity. This means that Sipchem will issue 366.67mn new shares for 438.8mn shares of Sahara. The two firms agreed on Feb. 28, 2019 as the deadline for finalizing the deal. The proposed merger valuation of Sahara share swap Vs. Sipchem at (0.8356:1) is providing 22% higher offer for the Sahara's shareholders compared with previously proposed merger valuation in FY13 at (0.685:1), higher than the current stock market prices ratio of (0.815:1), and AJC TP valuation ratio of (0.765:1). Thus, the preliminarily agreed valuation, along with the tangible positive benefits for both entities to successfully support the completion of the proposed merger during FY19.

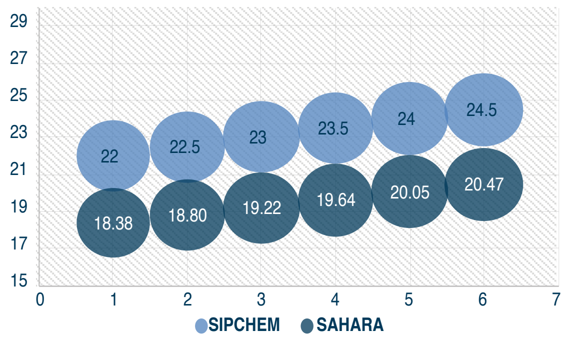
Figure1: The valuation of proposed merger



	FY13 merger valuation	AJC TP Valuation	Current Market prices-04 OCT	FY19 merger valuation
SIPCHEM	1	1	1	1
SAHARA	0.685	0.765	0.815	0.8356

Source: aljazira capital, company annuncment

Figure2: price scenarios of proposed merger valuation



Source: aljazira capital, company annuncment

The current MOU would further enhance the potential merger of two mid-cap size petrochemical companies to become a stronger entity with diversified products portfolio and at least SAR 16.0bn in market cap. We believe that the current merger is considered as a "horizontal merger"; as both companies are operating in the similar industry with recognizable differences in the products and feedstock. This merger could open an opportunity to partially create an integration business between International Polymers Company (IPC – 75% ownership by Sipchem) and Saudi Ethylene & Polyethylene Co. (SEPC- 24.4% ownership by SAHARA).

We expect that the successful completion of the proposed merger could effectively lead the new merged entity to further strengthen its operational synergies with best interest of the shareholders of both companies. Based on the operational focus of both companies, we believe the successful merger deal will result in;

i. Diversified downstream product to mitigate the risks associated with current dependence on a single product base.
ii. Diversified feedstock to reduce the risk of subsidy reduction, and minimizing volatility in margins.
iii. The combined entity will be in better position to benefit from the marketing and logistic experience of each counterparty.
iv. Strengthen the financial position, while giving the ability to expand into value-added products and other polyolefin products instead of focusing on single scope product.
v. Proposed merger could result in cost synergy through lowering operational and administrative cost, while improving the status of the balance sheet (figure 3).
vi. The proposed merger will support Sipchem to increase its self-sufficiency in basic chemicals by getting access to ethylene feedstock via Sahara's associate (SEPC).

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SIPCHEM- SAHARA Merger Synergies

ALJAZIRA CAPITAL الجزيرة كابيتال الجزيرة للأسواق المالية

Table1: Sipchem-Sahara Product/Feedstock Portfolios

Company	Sipchem-Sahara Product/Feedstock Portfolios			
	Plant	% Ownership	Feedstock	Products
Saudi International Petrochemical Company (SIPCHEM)	International Methanol Company (IMC)	65.0%	Methane	Methanol
	International Gases Company (IGC)	72.0%	Methane	Carbon Monoxide (CO)
	International Diol Company (IDC)	53.91	Methanol	Butanediol (BDO): (THF),(MAn)
	International Acetyl Company (IAC)	87.0%	Methanol/CO	Acetic Acid
	International Vinyl Acetate Company (IVC)	87.0%	Acetic Acid	Vinyl Acetate Monomer - VAM
	Sipchem Chemicals Company (SCC)	95.0%	Acetic Acid/BDO	Ethyl Acetate & Butyl Acetate, PBT
	International Polymers Company (IPC)	75.0%	Ethelyene/VAM	Ethylene Vinyl Acetate-EVA, LDPE
	The Saudi Specialized Products Company	75.0%	Ethelyene/VAM	Ethylene Vinyl Acetate (EVA)
	Gulf Advanced Cable Insulation (GACI)	50.0%	EVA/LDPE	Cable Insulation Polymers
Sahara Petrochemical Company (SPC)	AL WAHA Petrochemicals	75.00%	Propane	Propylene, Polypropylene
	SAHARA & Ma'aden Petrochemicals (SAMAPCO)	50.00%	Chlor-alkali	EDC, Caustic Soda
	Saudi Ethylene & Polyethylene (SEPC)	24.41%	Propane, Ethane	Ethelyene, HDPE, LDPE
	Saudi Acrylic Acid Company (SAAC)	43.16%	Propylene	Acrylic Acid, SAP, Butyl-A

Source: Company Annual Report, AlJazira Capital, Argaam

Diversified products portfolio: Sipchem is actively operating through 9 plants in basic and intermediary petrochemical and chemical materials with a vast array of products that mostly are based on methanol and its derivatives. While Sahara's production is highly focused on propylene and its derivatives (almost 73% of the total production share) through Al-Waha (75% direct ownership) and Saudi Ethylene & Propylene SEPC (24.41% direct & non-direct ownership). We believe that production concentration on a single product-base could expose producer to higher risk on revenue side and margins compared to having a diversified products portfolio. Methanol downstream products are highly competitive, subject to supply and demand forces and price volatility. In addition, Sahara's earning is significantly affected by the movements of polypropylene prices. Thus, we believe the merger implementation could reduce the risk of performance fluctuations.

Table2: Feedstock types

	Feedstock
SIPCHEM	Methane represents almost 80% of the total feedstock
SAHARA	Propane represents 100% for AlWaha Plant and 65% for TSOC

Source: AlJazira capital, the company report

Diversifying feedstock types: Sipchem's major feedstock is methane (almost 80%), while Propane represents the largest proportion of Sahara's feedstock that could increase the risk associated with subsidy cut, leading to high volatility in gross margins. We expect that the delay in revision of feedstock subsidy after FY19 will give the sector some brething space; however, we believe that the gradual impact of revised subsidy after FY19 may lead in near future to more mergers and acquisitions deals in the Saudi petrochemical sector. We expect that the new subsidy reform would enforce the industry players to concentrate more on overall cost competitiveness, production efficiency and moving into value added manufacturing. Therefore, proposed merger between Sipchem and Sahara would shield against the impacts associated with subsidy reform.

Integration Business and Marketing support: the proposed merger will support Sipchem to increase its self-sufficiency in basic chemicals by getting access to ethylene feedstock via Sahara's associate (SEPC). As International Polymer Company (Sipchem affiliate – represents 21.8% of the total revenue in FY17) is currently getting the main feedstock (Ethylene) from Jubail United Petrochemical Company (Sabic Affiliate). On the other hand, Sahara is expected to benefits from Sipchem logistics and its marketing arms in Europe and Asia; hence, this might lead to opening new markets & streamline supply chain of Sahara products.

SIPCHEM- SAHARA Merger Synergies

Post-merger Balance sheet and ratio: Since the disclosure regarding the real impact on income statements is limited and the deal is still in process, we will translate the impact on our valuation for Sipchem (post-merger) later. Our preliminary analysis indicated that the consolidation will lead to increase Sipchem balance sheet size; while return on assets and equity are expected to improve after merger to 5.8% and 9.9% from the current 4.0% and 8.6% respectively. Capital structure of Sipchem is subject to change with higher weight of equity due to Sahara low leveraged balance sheet compared to Sipchem total debt of SAR 7.3bn. Thus, debt to equity is expected to decline to 59.4% (post-merger) from the current 96.9%; while debt to capital will drop to 37.3% (post-merger) from the current 49.2%.

Figure3: Post-merger balance sheet and ratios

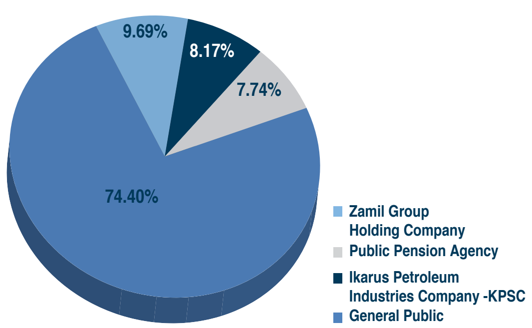
Key financial Information	SIPCHEM	SAHARA	Combined Entity
Stock Price (SAR) - 4th of Oct	22.28	18.12	22.03
Shares Outstanding (mn)	366.7	438.8	733.33
Market capitalization (SARmn)	8,169	7,951	16,120
Cash and cash equivalents (SAR mn)	1,777.8	395.9	2,173.66
Short/Long term borrowings	7,313.7	311	7,624.70
Enterprise Value (EV, mn)	13,705.3	7,866	21,571.43
EV/EBITDA (TTM)	7.1	10.1	7.92
BV (SAR)	20.6	12.04	17.50
PBV (x)	1.08	1.51	1.26
EPS - TTM	1.77	1.42	1.73
PE (x) - TTM	12.59	12.76	12.70
ROA - TTM	4.0%	10.8%	5.8%
ROE - TTM	8.6%	11.8%	9.9%
Debt to Equity ratio	96.9%	5.9%	59.4%
Debt to Capital ratio	49.2%	5.6%	37.3%

Source: Compay report, AlJazira Capital

Shareholding pattern

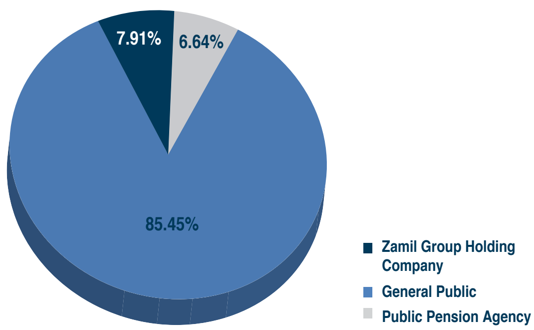
The below chart shows the Sipchem & Sahara current shareholding structure:

Sipchem: Major Shareholders



Source: Tadawul, AlJazira Capital

SAHARA: Major shareholders



Source: Tadawul, AlJazira Capital

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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