SIPCHEM
Petrochemicals – Industrial
SIPCHEM AB: Saudi Arabia
14 February 2019

الراجحي المالية
Al Rajhi Capital

US$1.828bn	90%	US$3.208mn
Market cap	Free float	Avg. daily volume

Target price	24.00	+28.3% over current
Current price	18.70	as at 12/2/2019

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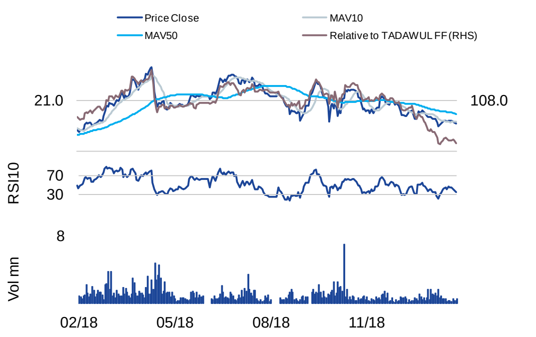
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

(SARmn)	2017	2018e	2019e
Revenue	4,459	5,011	4,965
Y-o-Y	26.9%	12.4%	-0.9%
Gross profit	1,426	1,630	1,757
Gross margin	32.0%	32.5%	35.4%
Net profit	437	581	678
Y-o-Y	NM	32.9%	16.6%
Net margin	9.8%	11.6%	13.6%
EPS (SAR)	1.19	1.59	1.85
DPS (SAR)	0.50	1.15	1.40
Payout ratio	41.9%	72.5%	75.8%
P/E (Curr)	15.7x	11.8x	10.1x
P/E (Target)	20.1x	15.1x	13.0x

Source: Company data, Al Rajhi Capital

SIPCHEM

Q4 earnings miss; Maintain Overweight

Sipchem reported a weaker-than-expected quarter with earnings missing both our and consensus estimates, largely due to higher-than-expected impact of IMC plant shutdown. The shutdown was also longer than announced (at 69 days vs. 35 days announced earlier) resulting in higher than expected costs. Prices of key products are seeing a decline in 2019 YTD, led by Methanol with a ~19% q-o-q YTD decline. On the other hand, the company has increased its Methanol production capacity by ~35%, which, in our view, has not been factored in the stock price. Moreover, despite weak Q3 and Q4 results due to the IMC plant shutdown, the annual payout ratio comes to 72% for 2018. With enhanced capacity offsetting decline in prices we expect potential increase in DPS to SAR1.4 (yield: +7%) from SAR1.15 in 2018. Shutdown of its BDO (41 days) and PBT (21 days) plants already announced will not materially impact earnings in Q1. Post weak Q4 results and revising forecasts for product prices lower, we revise our TP to SAR24/share (earlier SAR26/sh) but remain Overweight on the stock.

Figure 1 SIPCHEM Q4 results

(SAR mn)	Q4 2017	Q3 2018	Q4 2018	Y-o-Y	Q-o-Q	ARC est	Comments
Revenue	**1,279**	**1,338**	**1,053**	**-17.7%**	**-21.3%**	**1,156**	**Missed our estimate of SAR1,156mn (consensus: SAR1,071mn), due to lower-than-expected sales volume on account of IMC shutdown.**
Gross profit	426	470	205	-51.9%	-56.5%	384	Further, higher-than-expected impact on costs from the Methanol plant shutdown led to gross profit miss in Q4.
Gross margin	33.3%	35.2%	19.4%			33.2%	
Operating profit	275	328	74	-73.1%	-77.4%	227	Weaker-than expected operating margin amid the Methanol plant shutdown.
Operating margin	22%	25%	7%			20%	
Net profit	**164**	**180**	**40**	**-75.7%**	**-77.8%**	**110**	**Consequently, missing our estimate of SAR110mn and consensus of SAR86.5mn.**
Net margin	13%	13%	4%			10%	

Source: Company data, Al Rajhi Capital

Methanol plant upgrade to improve earnings in 2019. Following the completion of planned maintenance shutdown (69 days in H2 2018), and efficiency and performance enhancement project (from 970ktpa to 1.3mtpa; fully effective by the beginning of Q2 2019) at IMC, Sipchem's sales volume is likely to improve in the coming quarters. Given that Methanol is the high-margin product and the largest earning contributor, Sipchem's earnings are expected to improve in 2019. However, current weak Methanol prices might limit the improvement in earnings.

Limited impact from shutdowns of BDO and PBT plants in Q1 2019. Sipchem, on Jan 15, 2019, announced a 41 days of shutdown at its BDO plant (IDC; 53.91% affiliate of Sipchem). The management had already indicated about this shutdown in Q3 earnings conference call. Based on our initial calculations, we see just 3.8% impact (-SAR7mn)) on 1Q19E earnings. Shutdown at its PBT plant, effective from Feb 6, 2019 is expected to have an additional just 1.7% impact (-SAR3mn) on its 1Q19E earnings. We believe that the timing of the shutdown is perfect as the company's BDO plant, which supplies ~30% Butandiol to the PBT plant, is also closed for the maintenance. Nevertheless, 2019 will also witness a full year of income from the Polybutylene Terephthalate (PBT) plant (100% owned; 63ktpa capacity; began on July 1, 2018) , ensuring an incremental earnings in 2019.

Half-yearly dividend raised to SAR0.65/sh: For 2H 2018, Sipchem has raised its dividend per share to SAR0.65/share (1H 2018: SAR0.50/share), which is above our estimate. The annual payout ratio comes to 72% for 2018, which implies a further possible increase in dividend in future, given the improvement in earnings post increase in Methanol capacity amid comfortable debt position. At our 2019E DPS of SAR1.40/share, the stock offers an attractive dividend yield of over 7%.

Valuation and Risks: We remain positive on Sipchem, given its strong fundamentals, production & operating efficiencies and cost saving measures along with a strong FCF generation capabilities and comfortable debt position. Post weak Q4 earnings and updating our latest product / feedstock prices, we revise our forward looking estimates downwards. Accordingly, we revise our TP to SAR24/share based on equal mix of relative (SAR27.1/sh. based on 13.0x 12 month forward PE) and DCF valuation (SAR20.9/sh. based on FCF, cost of equity 12.8%). The stock is currently trading at a P/E of 10.1x and 9.2x on our 2019E and 2020E EPS, respectively, below its 3-year historical average of 12.1x. We factor in a higher than historical target multiple to account for the consistent operating performance, healthy long term growth and management quality. We remain Overweight on the stock.

Key drivers for the stock are completion of IMC's Efficiency Enhancement Project (in Q4 2018) , commercialization of the PBT project, proposed merger between SIPCHEM and Sahara Petrochemical and higher dividends in 2019.

Major downside risks involve unexpected disruption at the company's upstream operations, which can further impact its downstream plants as well and persistent weakness in product prices, particularly Methanol prices. Methanol (IMC) is the most profitable segment and we believe any unexpected shutdown at Methanol plant could lead to steep decline in gross margin and may lead to revision in our estimates.

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"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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