Sipchem

Petrochemicals – Industrial

SIPCHEM AB: Saudi Arabia

26 October 2017

Al Rajhi Capital

US$1.465bn	90%	US$3.490mn
Market cap	Free float	Avg. daily volume

Target price	16.60	10.6% over current
Current price	15.00	as at 25/10/2017

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Existing rating

Underweight | Neutral | **Overweight**

Performance

Source: Bloomberg

Earnings

(SARmn)	2016	2017e	2018e
Revenue	3,515	4,237	4,429
Y-o-Y	0.0%	20.5%	4.6%
Gross profit	861	1,368	1,601
Gross margin	24.5%	32.3%	36.2%
Net profit	43	340	440
Y-o-Y	-85.1%	NM	29.5%
Net margin	1.2%	8.0%	9.9%
EPS (SAR)	0.12	0.93	1.20
DPS (SAR)	-	0.50	0.65
Payout ratio	0.0%	53.9%	54.2%
P/E (Curr)	NM	16.3x	12.6x
P/E (Target)	NM	17.9x	13.8x

Source: Company data, Al Rajhi Capital

Saudi International Petrochemical Co (SIPCHEM AB)

Healthy Q3; maintain TP at SAR16.6/sh

Sipchem reported net profit of SAR122mn, above our (SAR73mn) and consensus estimates (SAR82mn). Though revenue was slightly lower than our expectation, improvement in operating leverage, lower than expected operating costs and possibly zakat as well were mainly responsible for the earnings beat. The sharp improvement seen in q-o-q and y-o-y was mainly due to shutdowns in the respective past periods. Given the company's improving financial performance, we expect the company to reinstate dividends in 2H17 (last payment was in 1H15) – one of the key triggers for the stock. Other upside triggers are related to news on possible value accretive mergers, and further improvement in operating rates and efficiencies. We expect average 7% y-o-y improvement in Methanol price in 2018 and factor in less than optimum operating rates for the plants (around 90% in 2018) to arrive at EPS of SAR1.2/sh for 2018. Based on this EPS, current P/E stands at 12.6x. We maintain TP at SAR16.6/sh based on equal mix of relative and DCF valuation and rate the company OW (upside: 10.6%).

Figure 1 Q3 2017 Sipchem results

(SARmn)	3Q16	2Q17	3Q17	q-o-q	y-o-y	ARC	Comments
Revenue	681	918	1062	15.7%	55.9%	1118	Operating rates picked up significantly post shutdowns across Acetic Acid and VAM plants.
Gross profit	128	281	367	30.6%	186.3%	347	Helped by operating leverage the gross profit came above estimates
Gross margin	18.8%	30.6%	34.6%			31.0%	
Operating profit	32	176	254	44%	704%	224	
Op margin	4.6%	19.2%	23.9%			20.1%	
Net profit	-49	60	122	104.0%	nm	73	Beat in gross profit and possibly lower zakat, along with lower than expected opex helped in the net profit beat
Net margin	-7.2%	6.5%	11.5%			6.5%	
Approx. benchmark prices (USD/tonne)							
Methanol	239	294	300	2.0%	25.5%		
LDPE	1189	1235	1190	-3.6%	0.1%		
EVA	1270	1576	1630	3.5%	28.3%		

Source: Company data, Al Rajhi Capital, Bloomberg

Valuation: We remain positive on Sipchem, given its continued healthy performance over the past two quarters despite multiple plant shutdowns, and its improving efficiencies and cost saving measures. We use Methanol price estimate of US$318/t for 2017 and US$340/t in 2018 as we believe Methanol demand may pick up at MTO plants. Additionally, we believe that Sipchem could announce SAR0.5/sh DPS by the end of 2017, given its improving free cash flow, declining debt and robust cash balance. The stock is currently trading at a P/E of 12.6x on our 2018E EPS. Our TP remains at SAR16.6/share, implying an upside of ~10.6% from the current level and hence we rate it at OW.

Risks:

Key upside risks include sustained improvement in Methanol price and higher than expected operating efficiencies. 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 shutdown at Methanol plant could lead to steep decline in gross margin. The last shutdown of IMC was in Q4 2015.

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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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