SIPCHEM
Petrochemicals – Industrial
SIPCHEM AB: Saudi Arabia
01 August 2021

Al Rajhi Capital

US$6.560bn	90%	US$22.29mn
Market cap	Free float	Avg. daily volume

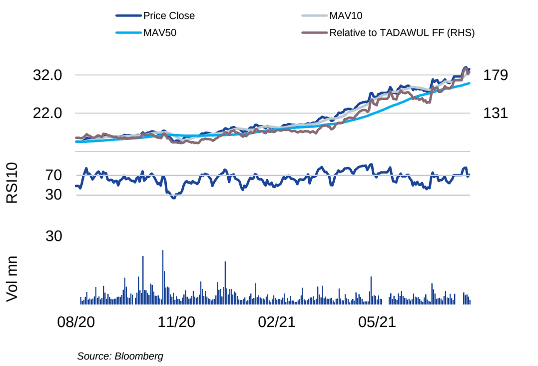
Target price	40.00	+19.2% over current
Current price	33.55	as at 29/7/2021

Research Department
Pritish K. Devassy, CFA
+966 11 836 5464, devassyp@alrajhi-capital.com

Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

(SARmn)	2020	2021e	2022e
Revenue	5,323	8,472	7,854
Y-o-Y	-2.1%	59.2%	-7.3%
Gross profit	1,173	4,677	3,691
Gross margin	22.0%	55.2%	47.0%
EBITDA	1,291	4,401	3,403
EBITDA margin	24.3%	51.9%	43.3%
Net profit	176	2,533	2,003
Net margin	3.3%	29.9%	25.5%
EPS (SAR)	0.24	3.45	2.73
DPS (SAR)	0.50	1.50	2.00
Payout ratio	208.5%	43.4%	73.2%
ROE	0.7%	9.7%	7.4%
EV/EBITDA	23.6x	6.9x	9.0x
P/E	NM	7.8x	9.9x

Source: Company data, Al Rajhi Capital

SIPCHEM

Q2: Earnings beat; TP raised to SAR40/sh.

Sipchem reported an excellent set of Q2 results with top-line and bottom-line coming above our and consensus estimates, likely due to higher-than-expected sales volume amid improving demand, and better cost efficiencies. The company continued to positively surprise us with the sharp improvement in production efficiencies (~18% q-o-q decline production costs despite 16% higher revenues in Q2), with gross and operating margins reaching their highest levels. Going forward, Sipchem is expected to continue benefiting from high operating leverage (key feedstock is methane, which is fixed at $1.25/mmbtu, and hence any improvement in product prices would translate directly into profits). Average Methanol prices continued to rise since Q2 2020 and now stabilized at around $400/t in Q3 (higher than the YTD price of $384/t and our forecast of ~$360/t for 2021), mainly aided by tightens supply-demand balance and rising oil prices. The demand also looks favorable, driven by rebounding industrial and energy consumption post opening up the economies across the globe. Further, the shutdown of loss-making/low–margin plants (PBT and GACI) plants may continue to support the margins. Accordingly, we expect the company to distribute a DPS of SAR1.5 (yield: 4.5%) for 2021 with a possibility of further upside next year if Methanol prices sustain at the current level. Based on our revised estimates and DCF valuation, we raise our TP to SAR40/sh. (SAR35/sh. earlier) and remain Overweight on the stock.

Figure 1 SIPCHEM Q2 2021 results

(SAR mn)	Q2 2021	Q2 2020	Y-o-Y	Q1 2021	Q-o-Q	ARC est	vs ARC
Revenue	**2,363**	**950**	**148.7%**	**2,031**	**16.3%**	**2,228**	**6.0%**
Gross profit	1,478	162	814.4%	956	54.5%	1,052	40.5%
Gross margin	62.5%	17.0%		47.1%		47.2%	
Operating profit	1,140	(23)	NM	733	55.4%	802	42.1%
Operating margin	48.2%	-2.5%		36.1%		36.0%	
Net profit	**830**	**(99)**	NM	**412**	101.7%	**652**	27.2%
Net margin	35.1%	-10.4%		20.3%		29.3%	

Source: Company data, Al Rajhi Capital.

Q2 results: Revenues increased by 16.3% q-o-q to SAR2,363, beating our estimate of SAR2,228mn (consensus: SAR2,294mn), likely due to higher-than-expected sales volume, particularly for intermediate products. Further, better-than-expected improvement in production efficiencies pushed the gross and operating profits above our estimates, offsetting higher-than-expected SG&A costs. Overall, the company reported a net profit of SAR830mn (+101.7% q-o-q), higher than our estimate of SAR652mn (consensus: SAR723mn).

Valuation and Risks: We value Sipchem using DCF (based on FCF, cost of equity 11.3%) at SAR40/sh, implying an Overweight for the stock. We have been conservative with our estimates (assume lower prices in H2 2021 and 2022 compared to H1 2021) and hence there is a margin of safety factored in the valuation. At our TP, the stock trades at ~11.6x on 2021E EPS (~9.9x on 2021E EPS based on the current market price; 18.9x 3Y average fwd P/E), which is appealing in our view. Key upside drivers are better-than-expected prices, announcement of new projects, suspending unprofitable ventures, and above-expected dividends. Major downside risks to earnings 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 oil and Methanol prices.

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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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Contact us

Mazen AlSudairi
Head of Research
Tel : +966 11 836 5468
Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

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