

Target Price: SAR43.0/share
Market price: SAR31.85/share
Upside: +35% (+Div. Yield: 7.8%)
Rating: Overweight

Sahara International Petrochemical - SIPCHEM

Weak 3Q earnings; Remain Overweight with SAR43/sh. TP

- 3Q23 top-line grew by 5.2% q/q on increased sales volume, however earnings (-25.5% q/q) were impacted, due to weaker-than-expected margins, mainly for the polymer and marketing segments.
- Methanol prices are likely to recover, aided by better demand, mainly from Asia, firm oil prices, and slower growth in capacity expansion, supporting product spreads.
- Post weak 3Q23 earnings, we revise our TP to SAR43.0/sh. based on blended valuation (EV/EBITDA and DCF) but remain overweight on the stock.

3Q23 results: Top-line rose 5.2% q/q to SAR1.8bn (largely in line with our estimate), mainly driven by increased sales volume following the shutdowns at the IMC and IDC plants in 2Q, offsetting a decline in prices for some products. However, despite higher top-line growth and lower feedstock costs, gross profits were impacted by 13% q/q, with gross margin narrowing down by 5.4ppts to 25.6% (lower than our estimate of 35.2%) during the quarter.

The gross profit miss was mainly due to higher-than-expected costs associated with the polymer business (-4ppts q/q decline in gross margin) and inter-segment adjustments (mostly marketing volumes), offsetting an improvement in Basic Chemical (+2ppts q/q) and Intermediate (+11ppts) segments gross margins. This further flowed down the operating level as well. In addition, the company witnessed a decline in equity income (-33% q/q), despite lower feedstock prices. Overall, net profit came in at SAR233mn (-25.5% q/q; the lowest level since 4Q20), missing our (SAR375mn) and consensus (SAR404mn) estimates.

Earnings to recover on a likely recovery in Methanol prices: After declining by 17% q/q in 2Q23, mainly due to weak demand and lower coal/gas prices, average Methanol prices recovered by 3% q/q in 3Q23. Going forward, we expect Methanol prices to continue to recover, driven by i) firm oil prices (a recent spike in oil prices may reflect in Methanol prices with a lag), ii) improving demand in China (Figure 5) on higher MTO plants operating rates (Figure 4) and a recovery in Chinese economic activities post-stimulus package announced by the government, iii) a recovery in coal (Figure 3; highly correlated with Methanol price) and gas prices iv) likely restocking activities, mainly in China and v) slower growth in capacity additions (Figure 6).

Figure 1: Key financial metrics

SARmn	2022a	2023e	2024e	2025e
Revenue	10,254	7,554	8,144	8,613
Revenue growth	3%	-26%	8%	6%
Gross Profit	4,839	2,383	2,779	3,154
Gross Profit margin	47%	32%	34%	37%
EBITDA	4,961	2,549	2,917	3,226
Op. income	4,047	1,661	2,030	2,362
Net profit	3,595	1,368	1,697	2,029
Net profit margin	35%	18%	21%	24%
EPS	5.0	1.9	2.3	2.8
P/E	6.4x	16.9x	13.7x	11.4x

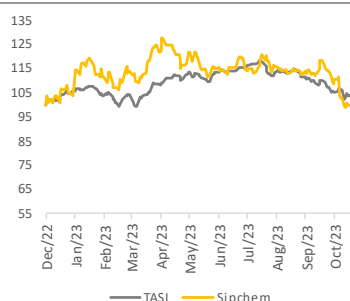
Source: Company data, GIB Capital.

Stock data

TASI ticker	2310
Mcap (SARmn)	23,357
Avg. Trd. Val (SARmn)	59.3
Free Float	89.0%
QFI Holding	14.1%
TASI FF weight	1.23%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

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Further, the long-term outlook for Methanol remains positive due to its low carbon footprint. Methanol is gaining traction in the global shipping market with shipping and trading firms with large fleets either ordering new methanol-run vessels or retrofitting existing fleets. Accordingly, on a conservative basis, we expect Methanol prices to improve by ~6% y/y in 2024e. This, along with likely improvement in average Acetic Acid (+6% q/q so far in 4Q), VAM prices (+9% q/q), and polymer prices (+3-6% q/q) may support product spreads (Figure 2) and thereby drive the near to medium-term earnings.

Upside catalysts: In addition to the likely improvement in earnings next year, we expect the two recent developments may act as an upside catalyst, which may support the share price going forward. These include i) Sipchem, in Sep 2023, has secured the required feedstock volume to develop a blue ammonia plant in Jubail with a capacity of 1.2mtpa and ii) The company plans to expand the capacity of the PP, VAM, and EVA plants by 25-30%. Both these projects would be EPS accretive in our view, however, we have not factored these into our estimates due to limited data availability.

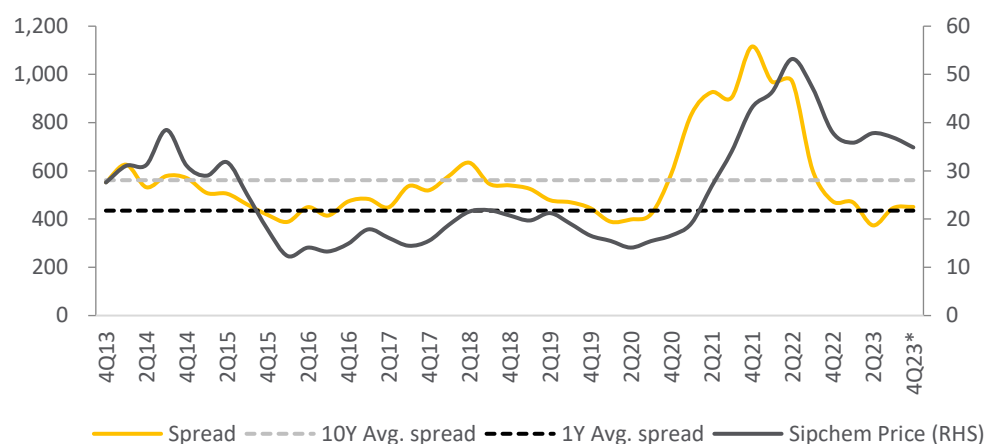
Dividend likely to be maintained in 2H23e/2024e: Despite earnings pressure so far this year, we expect the company to maintain DPS at SAR1.25 for 2H23 and SAR2.5/sh. for 2024e, implying a robust dividend yield of ~8%. We note that the company has strong cash positions (SAR2.2bn including short-term investments) with healthy free cash flow generation abilities (SAR2.0-2.8bn over 2024e-30e). Further, Sipchem's robust leverage position (net debt to EBITDA: 0.2x in 2024e vs 0.8x in 3Q23) should help the company improve its dividends gradually as well as provide sufficient headroom for future growth plans.

Valuation: Post weak 3Q results and updating our latest commodity price deck, we revise our forward-looking estimates, leading to a revision in our TP. We value the company based on an equal blend of EV/EBITDA and DCF valuation. We use an EV/EBITDA of 9x (3-year average EV/EBITDA has been 9x) to arrive at a multiple-based 12-month forward valuation of SAR41/share. For DCF, we use a WACC of 10.5% and cost of equity of 11.3% and arrive at a 12-month forward DCF target of SAR45/share. Given the 35% upside, we maintain our Overweight rating for the stock. Also notably, the company had bought shares from the market (~2mn through two phases), at a total value of ~SAR100mn, an average price of SAR48.8/share in 2022. Further, in May 2023, Sipchem's shareholders approved a repurchasing maximum of 65.12mn shares within 12 months using its internal sources.

Risks to our view:

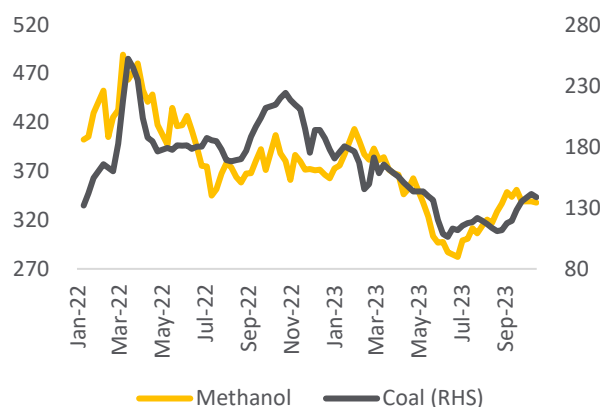
- **Doubled-edged operating leverage:** The high operating leverage acts in both ways and hence further weakness in key product prices may lead to disproportionately weaker profits.
- **Shutdowns:** The waterfall model of production (that is the output of one plant feeds as input into another plant) makes it difficult to forecast earnings with accuracy given the complexity in accounting. Additionally, a shutdown at its first-stage plant may weaken production at all of its other plants. The last time IMC had a shutdown was in 2Q23.
- **Dividend risk:** Given the weak earnings over the past couple of years, there is a possibility for a reduction in dividends. We note that the payout was above 100% in 1H23.

Figure 2: Weighted average Sipchem's spreads (US\$/t) vs. average stock price (SAR)



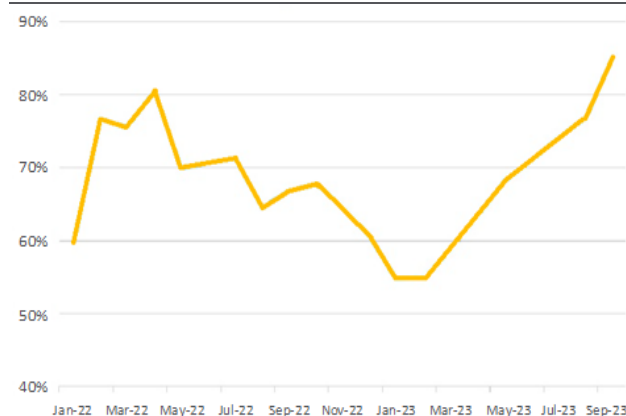
Source: Company data, Bloomberg, GIB Capital. * QTD

Figure 3: Methanol and coal prices trend (US\$/t)



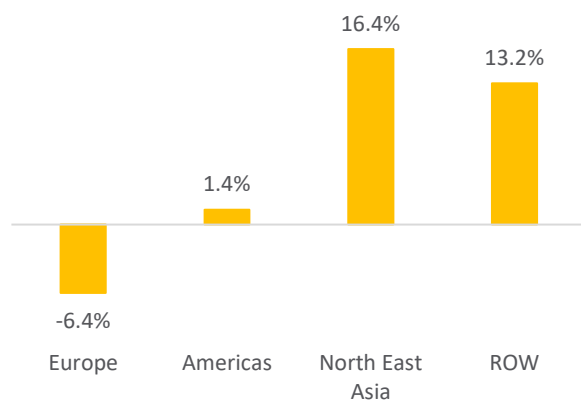
Source: Bloomberg, GIB Capital

Figure 4: China CTO/MTO operating rate (%)



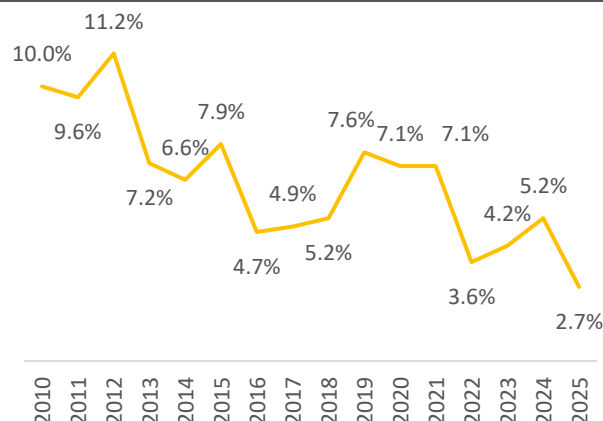
Source: ICIS, GIB Capital

Figure 5: Methanol demand growth, 2019-23e



Source: ICIS, GIB Capital. * ROW – Rest of the world

Figure 6: Methanol capacity growth rate



Source: ICIS, GIB Capital

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