Saudi Basic Industries Corp

Petrochemicals – Industrial

SABIC AB: Saudi Arabia

17 May 2022

الراجحي المالية

Al Rajhi Capital

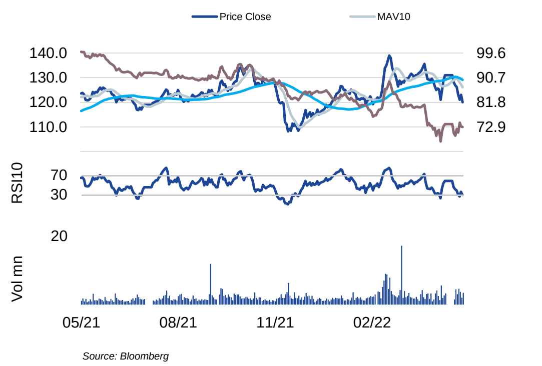
US$96.6bn	21%	US$114.4mn
Market cap	Free float	Avg. daily volume

Target price	135.00	+11.8% over current
Current price	120.80	as at 17/05/2022

Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

(SARbn)	2020	2021	2022e
Revenue	117.0	174.9	218.3
Revenue growth	-13.6%	49.6%	24.8%
Gross profit	22.6	51.6	58.3
Gross margin	19.4%	29.5%	26.7%
EBITDA	20.2	48.3	53.8
EBITDA margin	17.3%	27.6%	24.6%
Net profit	0.1	23.0	25.8
Net margin	0.1%	13.2%	11.8%
EPS	0.0	7.7	8.6
DPS	3.0	4.0	5.0
Payout ratio	NM	52%	58%
EV/EBITDA	17.9x	7.5x	6.7x
P/E	NM	15.7x	14.1x

Source: Company data, Al Rajhi Capital.

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SABIC

Q1: Earnings beat on better margins; TP maintained at SAR135/sh.

SABIC reported a record quarterly revenue of SAR52.6bn (+2.7% q-o-q) in Q1, in line with our estimate of SAR53.0bn (consensus: SAR51.3bn). The sequential growth was primarily aided by a 3% q-o-q rise in average product prices, offsetting a 1% q-o-q decline in sales volume. However, lower-than-expected production costs and operating expenses pushed the gross and operating profits above our estimates with gross and operating margins reaching 27.9% and 27.4%, respectively. During the quarter, the company recorded an impairment and restructuring provisions (non-recurring) worth SAR0.38bn, which was mostly offset by lower financial expenses. Overall, net profit was reported at SAR6.5bn, above our estimate of SAR5.2bn (consensus: SAR5.4bn).

Average polymer prices remain healthy so far in Q2, up by 4-8% q-o-q, driven by healthy demand and tight supply. Further, MTBE prices continue to maintain their upward momentum (+18% q-o-q so far in Q2) this quarter. Methanol and PC prices remain mostly stable, while MEG prices are down by ~8% q-o-q, likely due to weak demand amid higher supply. On the other hand, feedstock prices (Naphtha: +4% q-o-q; Propane: +16%; Butane: +22%) are likely to remain high, on account of increased oil prices. If energy prices remain at the current level, then we may see pressure on the product spreads and margins, considering the current trend of some key products. Nonetheless, the company's ability to control costs, coupled with the anticipated synergies through the Aramco deal, are likely to offset these impacts.

Overall, SABIC is expected to continue reporting robust earnings in 2022 as well, with healthy margins. Higher cash flow generation and controlled capex are also likely to be translated into higher payout (SAR5.0/sh in 2022E vs. SAR4/sh. in 2021) this year. We maintain our TP at SAR135/sh. but revise our rating to Overweight (Neutral earlier) on the stock post ~8% decline in share price this quarter.

Figure 1 Q1 2022 results summary

(SAR mn)	Q1 2022	Q4 2021	Q1 2021	Q1 2020	ARC Est.	Cons Est.	q-o-q	y-o-y	% ch vs 2020	vs ARC	vs Cons
Revenue	**52.6**	**51.2**	**37.5**	**30.2**	**53.0**	**51.3**	***2.7%***	***40.3%***	***74.3%***	***-0.6%***	***2.6%***
Gross Profit	14.7	14.1	11.1	4.7	13.4	NA	*4.6%*	*32.6%*	*212.3%*	*9.8%*	*NM*
G. margin	*27.9%*	*27.4%*	*29.5%*	*15.6%*	*25.3%*	NA					
Op. profit	9.3	8.5	7.0	(0.1)	7.7	NA	*9.6%*	*33.5%*	*NM*	*21.0%*	*NM*
Op. margin	*17.7%*	*16.6%*	*18.6%*	*-0.2%*	*14.5%*	*NA*					
Net profit	**6.5**	**5.0**	**4.9**	**(1.0)**	**5.2**	**5.4**	***30.2%***	***33.1%***	***NM***	***23.7%***	***20.8%***
Net margin	*12.3%*	*9.7%*	*12.9%*	*-3.5%*	*9.9%*	*10.4%*					

Source: Company data, Al Rajhi Capital

Q1 operating performance highlights

- Strong start of the year with adjusted net income reaching $1.8bn in Q1 from $1.5bn in Q4, aided by strong product demand, higher oil prices, and a well-diversified global portfolio.
- Total sales volume declined 1% q-o-q (+10% y-o-y) during Q1 2022, mainly due to lower fertilizers (-23% q-o-q due to in-transit shipments at the end of the month, and lower demand in India and the other markets; +7% y-o-y) and petrochemical (-1% q-o-q; +8% y-o-y) sales volumes. Chemicals accounted for 58% of total petrochemical sales volume, followed by PE (22%), Performance Polymers & Industrial Solutions (19%), and Specialities (1%).

- In the petrochemical and specialties segment, average prices were up (+4% q-o-q and +27% y-o-y), driven by improvement in oil prices, healthy demand, favourable product mix, and higher MTBE prices (+20% q-o-q and +60% y-o-y). However, MEG, Methanol, and PC prices were lower in China and the rest of Asia due to soft demand amid the new year and lockdowns in China. On the other hand, Asian PP and PE prices remained mostly stable in Q1. MEG product spreads were low, due to the new supply and the trend is likely to remain the same over the coming two years.
- Urea prices mostly remained weak in Q1, however prices have started improving due to the Russia-Ukraine conflict. Strong global demand and rising crop prices, coupled with high energy costs are expected to continue to support Urea prices in 2022. Overall, Urea prices increased 2% q-o-q (+113% y-o-y).
- The company mentioned that the overall KSA industry is generally lagging behind 30-60 days in terms of the actual impact of the feedstock prices. On a quarterly basis, feedstock costs increased just 3% q-o-q, on average, in Q1. Going forward, if the energy prices remain at the current level, then we may see pressure on margins, considering the current trend of some key products.
- Q1 EBITDA margin (24% vs. 25% in Q4 2021 vs. 28% in Q1 2021) was impacted by higher feedstock costs. Further, post-merger with Aramco, the sales volume also includes the sales handled by Aramco through its marketing agreement, which has a lower margin as Aramco compensated SABIC with the marketing expenses only. Adjusting these sales, SABIC's EBITDA margin would have been around 25% in Q1, compared to 26% in Q4. Going forward, the company expects a higher impact on its EBITDA margin (1.2-1.3% impact in the near term; 2-3% impact over the time).
    - The company indicated that MTBE and PE products generated higher EBITDA while MEG was under pressure.
- FCF declined 44% q-o-q (+23% y-o-y) to US$1.55bn in Q1 2022.
- The company continued to remain a net cash company with negative net debt to EBITDA ratio of -0.24x in Q1 2022 (vs.0.03x in Q1 2021), demonstrating a strong balance sheet and capital disciplined through the pandemic.

Demand is likely to improve in key business segments. On a yearly basis, the petchem demand for packaging, agriculture, transportation, electrical & electronics, and healthcare sector witnessed an improvement in Q1 2022 compared to Q1 2021. However, the demand from the automotive industry remained weak in Q1 2022. Going forward, SABIC expects an improvement in demand in the packaging, consumer, transportation, industrial, and electrical & electronics, sectors in Q2 2022 while expecting a stable demand across the other industries.

SABIC yields $557mn synergies to date. Post its merger with Aramco, SABIC has yielded synergies worth SAR2.09bn (US$557mn) from June 2020 to Q1 2022. The company has generated a synergy worth US$89mn in Q1 2022.

Gulf Coast Growth Ventures (GCGV) facility update

- The GCGV project (50:50 JV between SABIC and ExxonMobil in the US) successfully started in Jan 2022. This project was completed six months ahead of schedule and within the budget.
- The new facility will manufacture materials that will be used in packaging, construction materials, agricultural film, clothing, and automotive coolants.
- The operations include a 1.8mn mtpa ethane steam cracker, two PE units capable of producing up to 1.3mn mtpa, and a MEG unit with a capacity of 1.1mn mtpa.
- This project will serve the customers in North and South America.
- Financial impact: The company expects the project to contribute US$200-US250mn in 2022 at the EBITDA level (its contribution in Q1 was very limited), which may go up to US$400-500mn over the time.
- The company doesn't expect any significant tax benefits from the US authority.

2022 guidance

- SABIC expects the global economic growth to slow down from an average of 5.8% in 2021 to a range of 3.2-3.6% in 2022, due to economic uncertainty mainly in H2 2022 (such as higher energy prices, Russia-Ukraine conflict, lockdown in China, US inflation rate, a possibility of a higher number of an interest rate rise by the Fed, among others).
- In 2022, SABIC will remain focused on delivering its growth strategy, achieving operational resilience, and meeting our ESG commitments while at all times maintaining a strong balance sheet.
- Sales volume (3-4mn mtpa rise expected; mainly driven by a few projects - 800ktpa GCGV project, around 600ktpa MEG plant, sales and marketing agreement with Aramco, Hadeed and PC project in China) and capex likely to be higher on an annual basis in 2022; while EBITDA is expected to remain flat, as higher sales volume \ offset by the increased feedstock costs.

Valuation. Healthy product prices, higher sales volume post commercialization of new plants, and better efficiencies are likely to push EBITDA to ~SAR54bn in 2022 from ~SAR48bn in 2021. Further, SABIC may even increase its annual dividend payout (SAR5.0 in 2022 vs. SAR4.0 in 2021), aided by higher cash flows and controlled capex. Despite the ability to pay even higher (EPS of SAR8.6/share expected for 2022E), we believe, the company may increase dividends in only a phased manner. Overall, we maintain our TP at SAR135/share based on the DCF valuation model but revise our rating to Overweight (earlier Neutral) on SABIC.

Risks. Supply of new capacity globally, unexpected fall in oil price and petchem product prices, and unplanned plant shutdowns are key downside risks. Key upside risks include higher-than-expected spreads, faster than expected successful commercial launch of its future expansion projects, and recovery in global demand.

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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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