



Key themes

Petchem prices to remain weak in near-term before start recovering in 2020

Prefer dividend stocks with healthy operational track records

Sipchem and APCC are our top picks

What do we think?

Stock	Rating	Price Target	Upside
SABIC	Neutral	SAR95.0	+5.4%
YANSAB	OW	SAR55.0	+10.0%
SAFCO	Neutral	SAR75.0	+2.5%
APCC	OW	SAR52.0	+11.9%
Tasnee	UW	SAR10.4	-10.0%
Sipchem	OW	SAR20.0	+29.0%

Saudi Petchem Sector

Weak 4Q expected; No imminent recovery

The Saudi petchem sector has remained under pressure in 2019, primarily due to weak sector fundamentals, owing to a) lower demand in the end-markets on the back of slowdown in global economy amid trade war concerns b) additional capacity coming in the market, and c) decline in oil prices and thereby product prices. We expect spreads for most products to decline sequentially in Q4 2019 amid weaker pricing environment and higher feedstock costs. We do not believe that a recovery for product prices is imminent till at-least H1 2020. Among the names, Sipchem stock is best positioned in our view as we believe Methanol prices could improve. APCC gives the best comfort for dividends and earnings stability and deserves a premium. We believe Yansab may continue with SAR1.75/share DPS in 2H 2019 but may cut in 2020 if prices do not recover.

Petchem prices likely to remain under pressure in the near term on weak demand amid global trade concerns. Weak demand for petchem products amid trade war concerns, along with new capacity additions have impacted demand supply balances in 2019, leading to decline in prices of key petrochemical products during the 9M 2019. In Q4 so far, petchem prices have continued its downward trajectory with Polymer products' prices declining ~15-20% y-o-y and ~3-9% q-o-q and reaching to multi-year low (Figure 3). Similarly, prices of intermediate products are also trading lower, with MEG and VAM prices dropping in the range of 24-30% y-o-y. Earnings performance is likely to remain under pressure in Q4, mainly due to lower product spread amid weak product prices and increased feedstock prices (Propane price: +18.4% q-o-q; Butane: +24.4% q-o-q, Naphtha: +6.6% q-o-q so far in Q4 2019). While petchem prices are mostly around the bottom, we do not expect an immediate recovery in prices in the near-term, given weak momentum in oil prices and the slowdown in end-markets such as automotive production. Nonetheless, we expect prices to start gradually recovering by H2 2020, on likely easing demand concerns due to possible trade agreement and slowdown in capacity additions.

Global commentary mixed: Dow Chemicals believes high-cost producers in many key product chains are at breakeven margin today for MEG. Covestro expects supply could increase more than demand for Polycarbonate. Methanex believes the industry supply-demand dynamics for Methanol is well poised. SABIC believes Polypropylene dynamics remain relatively better than others but the prices have been declining of late. LyondellBasell – industry consultants expect capacity additions, leading to lower operating rates for Polyethylene. Overall tone suggests a longer recovery time for the petchem sector.

Valuations:

Figure 1 Changes in estimates and TP

Companies	Old 2020E earnings (SARmn)	New 2020E earnings (SARmn)	2020E DPS (SAR)	2020E Div. Yield	Old rating	New rating	Old TP (SAR)	New TP (SAR)	CMP*	Upside / (downside)
SABIC	12,965	9,255	4.0	4.4%	Neutral	Neutral	108.0	95.0	90.1	5.4%
Sipchem	1,033	973	1.2	7.7%	UR	OW	UR	20.0	15.5	29.0%
SAFCO	2,020	1,645	3.4	4.6%	Neutral	Neutral	93.0	75.0	73.2	2.5%
Tasnee	69	180	0.0	0.0%	Neutral	UW	14.0	10.4	11.6	-10.0%
Yansab	2,087	1,697	3.0	6.0%	Neutral	OW	61.0	55.0	50.0	10.0%
APCC	761	738	2.6	5.6%	Neutral	OW	53.6	52.0	46.5	11.9%

Source: Company data, Al Rajhi Capital. UR: Under review. OW: Overweight. * As of December 2, 2019



Prices reach multi-year lows

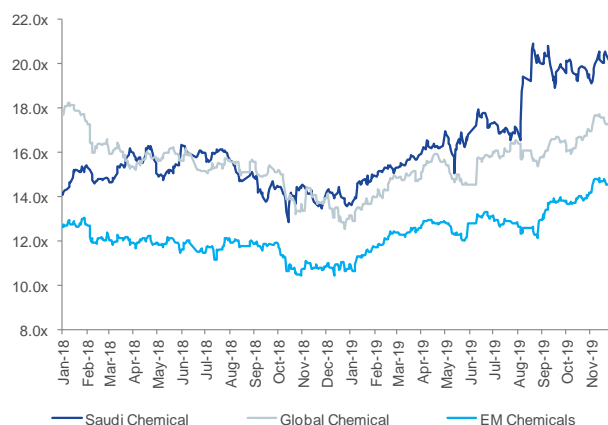
Figure 2 Spot prices declined by double digit % from 2018 level

	2015	2016	2017	2018	2019 YTD	Spot price
Average oil prices						
Brent (US\$/bbl)	54	45	55	72	64	64
WTI (US\$/bbl)	49	43	51	65	57	58
Feedstock prices (US\$/t)						
Naphtha	491	399	496	616	521	562
Propane	415	323	464	539	432	430
Butane	435	355	497	536	439	445
Product prices (US\$/t)						
HDPE	1,238	1,144	1,180	1,302	997	840
LDPE	1,256	1,193	1,255	1,181	1,001	900
PP	1,130	1,003	1,123	1,258	1,088	985
PS	1,219	1,179	1,351	1,466	1,186	1,040
Methanol	295	249	340	409	286	237
Polycarbonates	2,361	2,328	2,736	3,293	2,057	1,900
MEG	938	796	1,028	1,103	742	720
VAM	938	808	967	1,258	948	860
TIO2	2,406	2,158	2,653	3,066	2,763	2,775
Urea	282	206	232	275	261	235

Source: Bloomberg, Al Rajhi Capital

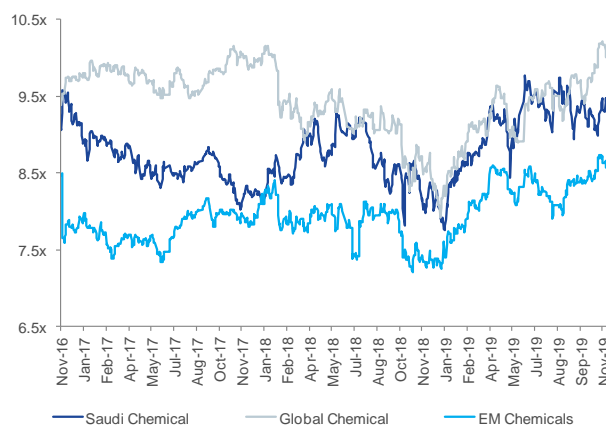
Multiples showing mixed trend

Figure 3 1Y Fwd PE Multiples comparison of EM/DM/Saudi petchem



Source: Bloomberg, Al Rajhi Capital. As of November 27, 2019

Figure 4 1Y Fwd EV/ EBITDA Multiples comparison of EM/DM/Saudi petchem



Source: Bloomberg, Al Rajhi Capital. As of November 27, 2019



Key themes

In Q3 2019, the petchem sector's top-line (based on our petchem coverage) declined 21.9% y-o-y and 5.5% q-o-q, largely in-line with our estimated decline of 22.7% y-o-y and 6.5% q-o-q. The drop was mainly due to lower product prices and weak sales volume amid shortage in feedstock supply for few days following the attack on Aramco's oil fields. Among covered companies, we witnessed a limited impact of reduction in feedstock supply on SABIC, APCC and Tasnee, while Yansab and Sipchem impacted higher than expected. The aggregate petchem sector's earnings (based on our petchem coverage) missed our estimate, primarily due to lower earnings of SABIC (due to SAR1.5bn impairment charged in Clariant) and weak production efficiencies witnessed by Yansab and Sipchem despite lower feedstock prices.

APCC

- Polypropylene seems to be better of the products in terms of price performance, helping Polypropylene producers to outperform the rest. We see that the company's operations have ramped up well after the shutdowns in the early part of the year and the company is now debt free. With FCF per share at SAR3.5 and dividend at SAR2.6/share for 2020, one could expect higher dividends, giving us the most comfort among the names under our coverage. We expect quarterly DPS to be maintained at SAR0.65/share (~5.5% dividend yield) for 4Q 2019, given its healthy cash flow (Q3 EBITDA at ~SAR1.18/sh).
- For Q3, revenue came in above our estimate, as the company was able to maintain its PP production during the Abqaiq incident due to sufficient Propylene inventory and continued supply from SATORP without any interruptions.
- Despite lower top-line growth, both on a yearly and quarterly basis, the company's bottom-line improved by 5.4% y-o-y and 10.8% q-o-q, aided by lower feedstock costs and better efficiencies, reflecting strong operating performance of the company, beating our estimate.
- We observed that during the quarter, the company witnessed an unrealized loss of SAR155.5mn, largely due to its investment in Tasnee (6% stake).
- APCC recently repaid Sukuk (~SAR1bn) on 17 November 2019, resulting into debt-free company. This provides sufficient headroom to fund its future growth capex.

Figure 5 APCC Q3 2019 results

(SAR mn)	Q3 2018	Q2 2019	Q3 2019	Y-o-Y	Q-o-Q	ARC est
Revenue	745	681	647	-13.1%	-5.0%	606
Gross profit	218	246	245	12.5%	-0.5%	216
Gross margin	29.3%	36.2%	37.9%			35.7%
Operating profit	191	207	202	6.0%	-2.6%	177
Operating margin	25.6%	30.4%	31.2%			29.2%
Net profit	202	192	213	5.4%	10.8%	176
Net margin	27.1%	28.2%	32.9%			29.0%

Source: Company data, Al Rajhi Capital

Tasnee Q3

- We still see challenges persisting after the company sold its solid cash generating subsidiary Cristal to Tronox. However better-than-expected performance of its Petrochemical and Downstream & Other segments pushed top-line above our estimate in Q3.
- Gross and operating margins were better-than-expected, mainly due to top-line beat. This flowed down to net profit level as well with earnings coming at SAR41mn vs. our net loss estimate of SAR39mn.
- Despite Q3 earnings beat, we continue to believe that its future performance will depend on its associates mainly polymer based, SEPC and SPC, which are expected to remain under pressure due to challenging market conditions.



Figure 6 Tasnee Q3 2019 results

(SAR mn)	Q3 2018	Q2 2019	Q3 2019	Y-o-Y	Q-o-Q	ARC est
Revenue	849	731	800	-5.8%	9.4%	664
Gross profit	163	88	91	-44.1%	3.5%	55
Gross margin	19.1%	12.0%	11.4%			8.3%
Operating profit	270	6	212	-21.6%	NM	122
Operating margin	31.8%	0.8%	26.5%			18.4%
Net profit	259	297	41	-84.1%	-86.1%	(39)
Net margin	30.6%	40.6%	5.2%			-5.9%

Source: Company data, Al Rajhi Capital

SAFCO

- After a series of shutdowns in H1 2019, we believe there is now stability in operations. We believe there is visibility for higher dividends. Top-line reported broadly in-line with our estimate with our expectation, declining 9.8% y-o-y, mostly due to lower sales volume and Urea prices.
- Equity income from Ibn-AlBaytar (SAR26mn vs. SAR37mn expected) was weaker-than expected, dragging down net profit marginally below our estimate.
- Going forward, operating rates are expected to improve in Q4 2019, due to the completion Ammonia reliability enhancement project in Q2 2019, while lower Urea prices might keep the margins under pressure in near-term.
- While DPS is likely to be maintained at SAR1.5/sh. for H2 2019, we expect it to improve to SAR3.4/sh. (85% payout) for 2020, implying a dividend yield of 4.6%.

Figure 7 SAFCO Q3 2019 results

(SAR mn)	Q3 2018	Q2 2019	Q3 2019	Y-o-Y	Q-o-Q	ARC est
Revenue	1,009	814	910	-9.8%	11.8%	936
Gross profit	585	420	465	-20.4%	10.8%	507
Gross margin	58.0%	51.6%	51.1%			54.2%
Operating profit	481	325	364	-24.4%	NM	404
Operating margin	47.7%	39.9%	40.0%			43.2%
Net profit	522	380	414	-20.7%	8.9%	434
Net margin	51.8%	46.8%	45.5%			46.4%

Source: Company data, Al Rajhi Capital

SABIC

- Slowdown in global economic growth along with weak near-term outlook for petchem product prices are expected to keep SABIC's performance under check. However, strong operating rates, coupled with cost control initiatives might provide support to earnings. In Q3, revenues dropped 22.9% y-o-y and 6.1% q-o-q, largely in-line with our estimate.
- Better-than-expected production and operating efficiencies during the quarter pushed gross and operating profits slightly higher than our estimates.
- However, the company charged SAR1.5bn impairment for its investment in Clariant in Q3, which dragged down net profit to below our estimate. If we were to adjust this, then net income would have been above our expectation.
- Given its healthy balance sheet, we expect SABIC to maintain its DPS for H2 2019, despite lower expected earnings so far in 2019.

Figure 8 SABIC Q3 2019 results

(SAR mn)	Q3 2018	Q2 2019	Q3 2019	Y-o-Y	Q-o-Q	ARC est
Revenue	43,712	35,867	33,690	-22.9%	-6.1%	33,246
Gross profit	15,130	10,030	9,630	-36.4%	-4.0%	9,238
Gross margin	34.6%	28.0%	28.6%			27.8%
Operating profit	9,960	4,830	4,660	-53.2%	NM	4,418
Operating margin	22.8%	13.5%	13.8%			13.3%
Net profit	6,098	2,115	830	-86.4%	-60.8%	2,044
Net margin	14.0%	5.9%	2.5%			6.1%

Source: Company data, Al Rajhi Capital



SIPCHEM

- Post its merger with Sahara Petrochemical, Sipchem has diversified its product portfolio, mainly in the Polymer segment, which reduces the volatility in earnings. The company has also witnessed an improvement in liquidity (cash and cash equivalents: SAR2.6bn as of Q3 2019) and is likely to yield synergies worth SAR175-225mn over the three years' period. In Q3, top-line missed our estimate, largely due to lower-than-expected sales volume on account of feedstock disruption post Aramco incident, and planned shutdown of Acetic Acid, VAM and Carbon Monoxide plants.
- As a result, gross and operating margins narrowed by 8.9pps q-o-q and 10.1pps q-o-q, respectively. Consequently, net profit came in lower than our expectation.
- We remain positive on Sipchem, given its strong operating performance, continued focus on cost efficiencies and the absent of any turnaround activates in near-term. Further, Methanol prices are likely to rise next year, due to improvement in demand in China.
- The company declared SAR0.6 per as a dividend for H1 2019, implying an annual dividend yield of 7.6% based on current share price (as of 1st December 2019).

Figure 9 SIPCHEM Q3 2019 results

(SAR mn)	Q3 2018	Q2 2019	Q3 2019	Y-o-Y	Q-o-Q	ARC est
Revenue	1,338	1,409	1,402	4.8%	-0.5%	1,532
Gross profit	470	489	362	-23.1%	-26.0%	506
Gross margin	35.2%	34.7%	25.8%			33.0%
Operating profit	328	320	177	-46.0%	NM	296
Operating margin	24.5%	22.7%	12.6%			19.3%
Net profit	180	211	111	-38.4%	-47.3%	189
Net margin	13.5%	15.0%	7.9%			12.3%

Source: Company data, Al Rajhi Capital

Yansab

- Yansab has missed our and street estimates for the last two quarters. There were concerns on the higher than expected increase in costs in last two quarters. We expect these costs to remain relatively high in Q4 as well. In Q3, top-line missed our estimate, primarily due to higher-than-expected impact of the Abqaiq incident on operating rates. We expected a 3% impact on operating rate, but it looks like the impact was more around 8%.
- Despite weaker-than-expected Q3 earnings, we do not expect any cut in DPS for H2 2019 unless MEG prices continue to decline. To maintain DPS at SAR1.75/share for H2 2019, dividend as a % of EBITDA is estimated at ~ 100%, which we believe is manageable, given its healthy balance sheet. However it would be up to the board to decide to pay uncovered dividends

Figure 10 Yansab Q3 2019 results

(SAR mn)	Q3 2018	Q2 2019	Q3 2019	Y-o-Y	Q-o-Q	ARC est
Revenue	2,110	1,638	1,423	-32.6%	-13.1%	1,489
Gross profit	839	432	296	-64.7%	-31.4%	391
Gross margin	39.8%	26.3%	20.8%			26.3%
Operating profit	711	330	205	-71.1%	-37.7%	294
Operating margin	33.7%	20.1%	14.4%			19.8%
Net profit	729	316	212	-70.9%	-32.9%	296
Net margin	34.5%	19.3%	14.9%			19.9%

Source: Company data, Al Rajhi Capital



Petchem sector Q3 2019 results snapshot

Figure 11 Q3 2019 earnings summary

	Revenue (SAR mn)						Net profit (SAR mn)					
	Q3 2018	Q2 2019	Q3 2019	Q3 2019E*	Y-o-Y	Q-o-Q	Q3 2018	Q2 2019	Q3 2019	Q3 2019E*	Y-o-Y	Q-o-Q
Covered												
APCC	745	681	647	606	-13.1%	-5.0%	202	192	213	176	5.4%	10.8%
TASNEE	849	731	800	664	-5.8%	9.4%	259	297	41	(39)	-84.1%	-86.1%
SAFCO	1,009	814	910	936	-9.8%	11.8%	522	380	414	434	-20.7%	8.9%
SABIC	43,712	35,867	33,690	33,246	-22.9%	-6.1%	6,098	2,115	830	2,044	-86.4%	-60.8%
Sipchem	1,338	1,409	1,402	1,532	4.8%	-0.5%	180	211	111	189	-38.4%	-47.3%
Yansab	2,110	1,638	1,423	1,489	-32.6%	-13.1%	729	316	212	296	-70.9%	-32.9%
Not-covered												
Chemanol	187	151	113	146	-39.5%	-24.9%	22	(9)	(32)	(9)	NM	NM
Petrochem	2,297	1,651	1,958	1,651	-14.8%	18.6%	307	183	171	NA	-44.4%	-6.8%
Petro Rabigh	12,041	9,032	8,742	NA	-27.4%	-3.2%	243	(308)	394	NA	61.9%	NM
SIIG	2,297	1,651	1,958	1,651	-14.8%	18.6%	319	205	160	NA	-49.7%	-21.9%
Kayan	3,376	2,429	2,303	2,186	-31.8%	-5.2%	472	(273)	1	(330)	-100%	NM

Source: Company data, Bloomberg, Al Rajhi Capital. * ARC estimates for covered companies and consensus estimates for non-covered companies.



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"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"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.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

Contact us

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