

## Saudi Petrochemical Sector -on the road to recovery ...

January 23, 2022

### Company

### Rating

Advanced  
(APPC)

Hold

Yansab  
(YANSAB)

Hold

Saudi Industrial  
Investment  
Group (SIIG)

Buy

- **Saudi Petrochemicals resilient amid COVID-19 pandemic and rebounded in 2021 as demand revived.**
- **Demand expected to continue from both the East (India, China) and the West (US, EU).**
- **Saudi Petrochemical companies demonstrate strategic advantage as the world's lowest cost producers.**
- **Major product-feedstock spreads to remain steady after suffering from downcycle till 2020.**

We initiate coverage on the Saudi Petrochemicals Sector with three names in focus - Advanced (APPC), Yansab (YANSAB), and Saudi Industrial Investment Group (SIIG). Our valuations are based on a mix of DDM (35% weight), EV/EBITDA (25% weight), P/E (25% weight) and DCF (15% weight). Globally, petrochemicals demand recovered in 2021 as economic activity rebounded from the lows of 2020 and appears to resume the super-cycle seen from 2010-2018. Petrochemical prices rose sharply in 2021 and especially during 2Q21, which we believe will correct from the multi-year highs, but still remain strong enough to maintain margins in spite of feedstock price rise. Capacity surplus overhang, which impacted sector performance in 2019, remains a key concern. We will be expanding our coverage to include more GCC petrochemical companies in due course.

- **Saudi Petrochemicals resilient amid Covid-19 and ride global economic recovery wave in 2021.** The year 2021 witnessed global economic recovery after the lows of 2020 impacted by COVID-19. Along with the rise in crude oil prices (+43% YTD) to average over USD 70 per barrel, petrochemical prices have also risen between 25-35% over 2020. The price rise was driven by a rebound in economic demand as well as global supply chain bottlenecks. Saudi Petrochemicals industry rode this wave of rebound to post strong topline and bottom-line results in 2021 (9M) and looks set to continue the momentum into 2022.
- **Demand expected to continue from both the East (India, China) and the West (US, EU).** The demand is coming from both developing economies like India but also those like US and China who had seen peak growth some time back. While crude as a source of fuel may be impacted by global environmental concerns, the widespread application of petrochemicals across industries – from packaging to construction to transportation – is likely to result in continued demand for the near to medium term at least.
- **Saudi Petrochemical companies demonstrate strategic advantage as the world's lowest-cost producers.** Middle East-based Petrochemical companies and more specifically Saudi petrochemical companies are among the low-cost producers on the cost curve, due to the lowest cost of oil extraction further flowing down the value chain.
- **Major product-feedstock spreads to remain steady after suffering from downcycle till 2020.** Spreads across major pairs such as Polyethylene (PE)-Naphtha, Polypropylene (PP)-Naphtha, and Polypropylene (PP)-Propane have witnessed a rebound in 2021 and are likely to remain steady for the next few years due to continued economic recovery. Consequently, margins and cash flows of Saudi Petrochemical companies are also likely to sustain.

We prefer Petrochemical companies that have significant market share in major petrochemicals product segments like PE and PP, have feedstock allocations from Aramco, and have low leverage (they stand to be insulated from expected rising interest rates). We have assumed demand, prices, and spreads to sustain till 2024. Risks to our valuations arise from renewed economic restrictions to halt the spread of new COVID-19 variants, which could negatively affect oil prices as well as demand from industrial segments like automotive.

Name	Last Px (SAR)	Target Price (SAR)	Upside / (Downside) (%)	Current P/E	P/E'22e, (x)	EV/EBITDA'22e, (x)	ROE'22e, %	Cash Div Yield, %
Advanced	72.3	65.2	-10%	19.2	23.3	17.9	17.6%	3.6%
Yansab	70.0	65.4	-7%	25.7	20.9	11.4	12.8%	4.3%
SIIG	33.9	48.6	43%	12.2	8.4	7.9	9.8%	2.9%
Average				19.0	17.5	12.4	13.4%	3.6%

Source: Reuters, U Capital Research, note: \*actual reported eps used to calculate P/E

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# Saudi Petrochemicals Sector

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## Valuation

We have used a mix of DDM (35% weight), EV/EBITDA (25% weight), P/E (25% weight) and DCF (15% weight) to arrive at our target price for each company. We find present value for each year over the forecast period (2021-2024e). This present value is then added to the present value of terminal year valuation. For terminal value calculation, we use the Weighted Average Cost of Capital (WACC) and terminal growth rate for each entity.

	APPC	YANSAB	SIIG
<b>DDM Methodology (35% weightage)</b>			
Expected Dividend (2022e) - SAR/share	2.7	3.8	1.0
Dividend Yield (historical)	5.0%	5.4%	2.9%
Growth rate	1.0%	1.0%	1.0%
<b>Target Price, SAR</b>	<b>66.9</b>	<b>86.2</b>	<b>51.3</b>
<b>EV/EBITDA Median Multiple (25% weightage)</b>			
EBITDA '22e, SAR mn	905	3,180	2,829
<b>Target Price, SAR</b>	<b>44.7</b>	<b>66.1</b>	<b>53.5</b>
<b>P/E Median Multiple (25% weightage)</b>			
Earnings per share '22e, SAR	3.1	3.3	4.0
<b>Target Price, SAR</b>	<b>49.0</b>	<b>50.9</b>	<b>51.0</b>
<b>DCF Methodology (15% weightage)</b>			
<b>PV of Future Cashflows to the Firm (SAR mn)</b>			
2022e	717	2,139	2,307
2023e	673	2,000	1,921
2024e	588	1,634	1,498
Terminal Value	34,628	13,650	7,704
Total PV of Future Cashflows (Enterprise Value, SAR mn)	36,606	19,423	13,430
<b>Assumptions</b>			
Risk Free Rate, % (Saudi 10Yr Bond Yield)	2.74%	2.74%	2.74%
Risk Premium, % (Equity Risk Premium: Bloomberg)	8.44%	10.81%	15.08%
Beta (2 year weekly), x	0.754	0.967	1.349
Cost of Equity (COE), %	9.1%	13.2%	23.1%
Growth Rate, %	1.0%	1.0%	1.0%
Cost of Debt (COD), %	2.0%	1.7%	2.0%
WACC, %	8.0%	13.1%	20.6%
Debt/Equity Ratio, %	19%	1%	13%
Net Debt, SAR mn	(4,975)	(3,051)	(64)
Fair Value of Equity, SAR mn	26,474	22,474	13,494
Outstanding Shares, mn	216	563	450
<b>Target Price, SAR</b>	<b>122.3</b>	<b>40.0</b>	<b>30.0</b>
<b>Weighted Average Target Price, SAR</b>	<b>65.2</b>	<b>65.4</b>	<b>48.6</b>
Current Market Price, SAR	72.3	70.0	33.9
Upside/(Downside), %	-9.9%	-6.5%	43.3%
<b>Recommendation</b>	<b>Hold</b>	<b>Hold</b>	<b>Buy</b>

Source: Company Financials, Refinitiv, U Capital Research

Note: For APPC, DCF valuation includes future expansion projects' estimates (from 2025 onwards) including debt-driven funding.

For SIIG, we have given a holding company discount of 20% to both the peer PE and EV/EBITDA-based multiples

The EV/EBITDA and P/E median peer multiples are average peer group multiples over the period 2014-2019 as long-term normal years; we have excluded multiples for 2020 and 2021 due to abnormal economic environment due to COVID-19 induced disruptions which also skewed valuations during these years

## Risks to Valuation

Key downside risks to our valuations include

- A slower-than-expected economic growth due to renewed lockdowns triggered by new COVID-19 variants
- New capacity additions that would lead to surplus in key petrochemicals like polypropylene and polyethylene.

Key upside risks to our valuation include

- Any delay in planned capacity additions
- Stronger than expected demand for petrochemicals that will lead to higher-than-expected prices

## Sensitivity Analysis

Our TP for APPC is sensitive to the single product Polypropylene prices (+/- USD 100/t) and input cost of Propane (+/- USD 50/t). Between them, the higher sensitivity is towards Polypropylene prices. Our TP is also sensitive (though relatively lower) to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards the Cost of Equity.

### APPC

		Cost of Equity							PP price (USD/t, 2022e)				
Terminal Growth rate		7%	8%	9%	10%	11%	Propane price (USD/t, 2022e)		1012	1012	1112	1212	1312
	0.50%	62.7	61.6	60.7	60.1	59.5		560	63.6	63.6	70.9	78.1	85.4
	0.75%	65.0	63.8	62.8	62.1	61.5		610	60.7	60.7	68.0	75.3	82.6
	1.00%	67.5	66.2	65.2	64.4	63.8		660	57.9	57.9	65.2	72.5	79.7
	1.25%	70.3	68.9	67.8	67.0	66.3		710	55.0	55.0	62.3	69.6	76.9
	1.50%	73.5	71.9	70.8	69.9	69.2		760	52.2	52.2	59.5	66.8	74.1

Our TP for Yansab is sensitive to the prices of one of its main product Monoethylene Glycol or MEG (+/- USD 100/t) and input cost of Propane (+/- USD 50/t). MEG contributes over 30% of revenues. Between them, the higher sensitivity is towards MEG prices. Our TP is also sensitive (though relatively lower) to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards terminal growth rate.

### YANSAB

		Cost of Equity					MEG price (USD/t, 2022e)						
Terminal Growth rate		11%	12%	13%	14%	15%	Propane price (USD/t, 2022e)		475	575	675	775	875
	0.50%	63.1	62.6	62.2	61.8	61.5		560	63.4	66.4	69.4	72.4	75.4
	0.75%	64.7	64.1	63.7	63.3	63.0		610	61.4	64.4	67.4	70.4	73.4
	1.00%	66.4	65.9	65.4	65.0	64.7		660	59.5	62.4	65.4	68.4	71.4
	1.25%	68.4	67.8	67.4	67.0	66.6		710	57.5	60.5	63.5	66.4	69.4
	1.50%	70.6	70.0	69.5	69.1	68.8		760	55.5	58.5	61.5	64.5	67.4

Our TP for SIIG is sensitive to the prices of its main product High-Density Polyethylene or HDPE (+/- USD 100/t) and the input cost of Aramco Propane (+/- USD 50/t). Polyethylene contributes over 73% of revenues. Between them, the higher sensitivity is towards HDPE prices. Our TP is also sensitive (though relatively lower) to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards the terminal growth rate.

### SIIG

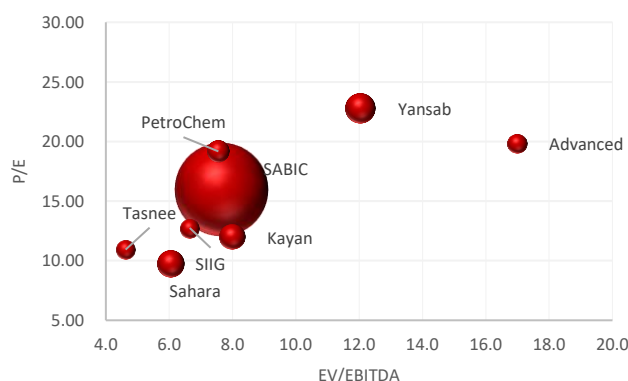
		Cost of Equity					HDPE price (USD/t, 2022e)						
Terminal Growth rate		20%	22%	23%	24%	25%	Aramco Propane price (SAR/t, 2022e)		928	1028	1128	1228	1328
	0.50%	45.2	45.0	44.8	44.6	44.5		443	45.7	49.7	53.7	57.7	61.6
	0.75%	46.9	46.7	46.5	46.3	46.1		493	43.2	47.1	51.1	55.1	59.1
	1.00%	49.0	48.8	48.6	48.4	48.2		543	40.6	44.6	48.6	52.5	56.5
	1.25%	51.7	51.5	51.2	51.1	50.9		593	38.1	42.0	46.0	50.0	54.0
	1.50%	55.3	55.1	54.8	54.6	54.5		643	35.5	39.5	43.4	47.4	51.4

## Peer Group Valuation

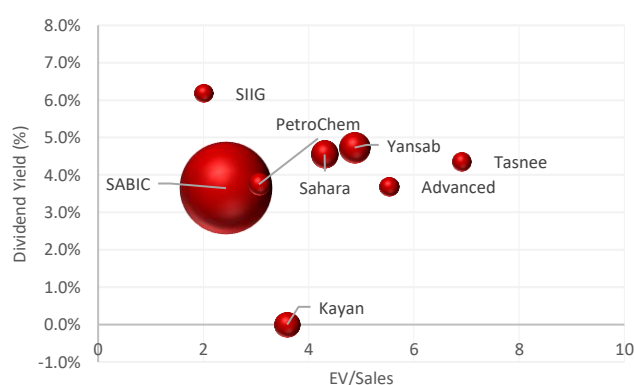
Name	Mkt Cap (SAR bn)	Last Px (SAR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current EV/EBITDA (x)	EV/EBITDA '22e (x)	P/E '22e (x)	EV/Sales '22e (%)	Div Yield '22e (%)
<b>SABIC</b>	379.2	126.4	9.0	(5.8)	8.4	8.92	7.66	15.94	2.43	3.6%
<b>PetroChem</b>	21.1	43.9	5.7	(13.9)	10.4	8.51	7.55	19.17	3.06	3.8%
<b>Kayan</b>	27.9	18.58	6.4	(9.5)	8.7	8.15	7.98	12.00	3.59	0.0%
<b>Tasnee</b>	14.8	22.18	8.6	(11.1)	10.5	9.18	4.62	10.93	6.91	4.4%
<b>Advanced</b>	15.7	72.3	5.7	(2.8)	3.6	15.31	16.98	19.81	5.53	3.7%
<b>Yansab</b>	39.4	70	-	(10.7)	1.3	11.81	12.03	22.80	4.87	4.7%
<b>SIIG</b>	15.3	33.9	5.1	(17.8)	9.0	7.06	6.65	12.74	2.01	6.2%
<b>Sahara</b>	33.0	45.05	3.6	(4.7)	7.6	7.32	6.04	9.77	4.30	4.5%
<b>Average</b>						<b>9.53</b>	<b>8.69</b>	<b>15.40</b>	<b>4.09</b>	<b>3.9%</b>
<b>Median</b>						<b>8.72</b>	<b>7.61</b>	<b>14.34</b>	<b>3.95</b>	<b>4.1%</b>

### Peer Group Valuation (2022E)

#### EV/EBITDA vs P/E



#### EV/Sales vs Dividend Yield (%)



Source: Refinitiv; valuation as of 20 January 2022; Size of the bubble indicates market capitalization

# Local Peer Group Analysis

## Saudi Petrochemical Sector – Listed Companies

In terms of the listed companies, there are eight Petrochemical companies listed on Tadawul, with SABIC being the largest by a wide margin, as can be seen from the table below. SABIC is an industry giant with operations comparable to global peers such as Lyondell, BASF, Chevron, ExxonMobil, and others. Petrochemicals, being a capital-intensive industry, has seen very little change in terms of new entrants. On the other hand, periodical merger activity is witnessed. Recently, Sipchem and Sahara combined to form a merged entity. Among other players, SIIG has announced acquiring the remaining 50% stake in its subsidiary Petrochem, which will make the combined entity among the top producers in the country.

In terms of operations, the companies have their operations based in Saudi Arabia, close to the production of feedstock. The feedstock such as naphtha and natural gas liquids like methane are allocated by the government to various petrochemical companies. As such any expansion plans are contingent on securing incremental allocations. While the pricing for these allocations are not publicly disclosed, the comparison of historical market prices for these inputs and cost trends of petrochemical companies indicate that the prices closely track market price trends.

Saudi Petrochemical companies have their end-consumers across the globe as the country is located strategically mid-way from both sets of major buyers – US, Europe, as well as Asia-Pacific countries. Among western economies, the trend appears to be veering towards closure of older plants in the US and Europe, while replacement capex is not being added quickly enough, thereby creating an opportunity for the Saudi Petrochemical industry to expand market share in these economies.

Among the companies covered in this report, Advanced Petrochemicals is focused on Polypropylene, while Yansab is a diversified player that produces various petrochemical products with a production capacity of over 4mn tpa and comprising of basic chemicals (ethylene, propylene) to intermediate and final chemicals (HDPE, LLDPE, PP, MEG). For SIIG, although it produces several chemicals through its JVs and subsidiaries, the main products are polyethylene and polypropylene.

## Saudi Petrochemical Sector: Revenue, Net Income, Gross Profit and Net Profit Margin Trends

### Revenue

SAR mn	2018	2019	2020	9M21
SABIC	169,128	135,396	116,949	123,648
Kayan	12,263	9,536	8,007	9,091
SIIG	8,930	7,435	5,941	*
Petrochem	8,930	7,435	5,941	*
Sipchem	5,036	5,440	5,323	6,899
Yansab	7,628	6,065	5,035	5,486
SABIC AN	3,860	3,288	3,328	5,552
Tasnee	3,065	3,019	2,272	2,510
Advanced	2,748	2,595	2,231	2,206
<b>Total Sector</b>	<b>221,588</b>	<b>180,209</b>	<b>155,027</b>	<b>155,392</b>

### Net Income

SAR mn	2018	2019	2020	9M21
SABIC AN	1,738	1,474	1,294	2,465
Yansab	2,414	1,090	678	1,196
Advanced	717	759	596	654
Petrochem	1,165	674	230	1,158
Sipchem	920	300	176	2,271
SIIG	865	606	92	1,015
SABIC	21,521	5,198	67	18,100
Tasnee	1,202	-1,580	-447	1,018
Kayan	1,702	-637	-785	1,941
<b>Total Sector</b>	<b>32,244</b>	<b>7,884</b>	<b>1,901</b>	<b>29,818</b>

### Gross Profit Margin

SAR mn	2018	2019	2020	9M21
SABIC AN	55.2%	51.5%	50.0%	59.7%
Advanced	30.1%	34.7%	32.7%	36.6%
Sipchem	32.5%	30.1%	22.0%	55.1%
Yansab	37.6%	24.7%	21.6%	30.0%
SABIC	34.2%	21.7%	19.6%	30.2%
Petrochem	30.1%	25.3%	15.9%	*
SIIG	30.0%	25.3%	15.9%	*
Tasnee	14.0%	13.3%	14.5%	26.1%
Kayan	27.4%	11.2%	5.2%	30.4%
<b>Average</b>	<b>33.6%</b>	<b>22.4%</b>	<b>19.5%</b>	<b>32.4%</b>

### Net Profit Margin

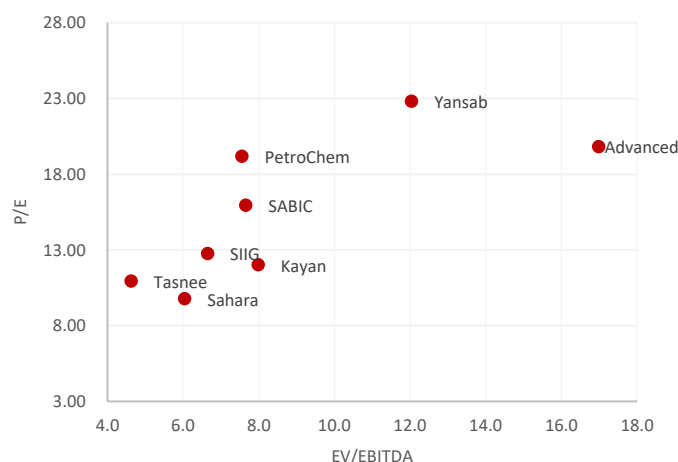
SAR mn	2018	2019	2020	9M21
SABIC AN	45.0%	44.8%	38.9%	44.4%
Advanced	26.1%	29.3%	26.7%	29.6%
Yansab	31.6%	18.0%	13.5%	21.8%
Petrochem	13.1%	9.1%	3.9%	*
Sipchem	11.6%	5.5%	3.3%	32.9%
SIIG	9.7%	8.2%	1.5%	*
SABIC	12.7%	3.8%	0.1%	14.6%
Kayan	13.9%	-6.7%	-9.8%	21.4%
Tasnee	39.2%	-55.5%	-19.7%	40.5%
<b>Average</b>	<b>14.4%</b>	<b>4.3%</b>	<b>1.2%</b>	<b>19.2%</b>

Source: Company filings; Note: SIIG is the holding company with Petrochem being its only subsidiary, SIIG reports the revenue reported by Petrochem and therefore they share similar revenue; Petrochem, following a reassessment in 3Q21, ceased to consolidate its subsidiaries and rather treat them as investments under the equity method following which Petrochem no longer reports revenue rather directly reports the share of results accounted for using the equity method. To account for this change, revenue has not been reported for the SIIG & Petrochem.

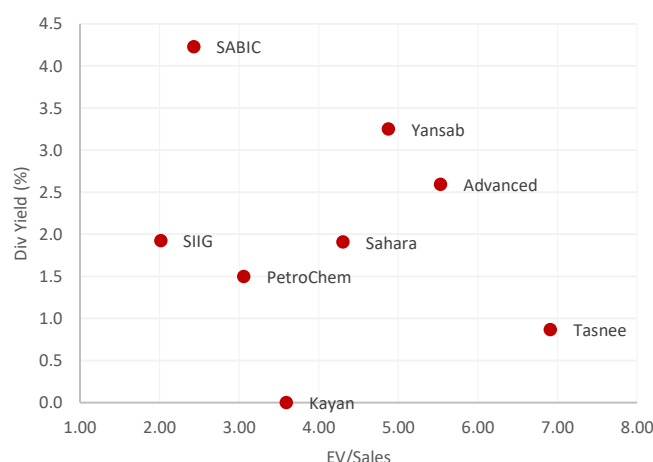
Saudi Petrochemical companies' stock prices and valuations have seen a jump in 2021 driven by product price increases as well as capacity addition announcements along with merger activity. As a result, several companies are trading at relatively fair valuation. Further, the dividend track record also plays an important part of Saudi Petrochemicals companies' relative attractiveness to stocks from other sectors. On an EV/EBITDA and P/E basis, Advanced Petrochemicals is trading at higher levels as compared to other peers due to the announcement of large capacity addition coming up in 2024, as well as a small capacity addition coming online in 2021. On an EV/Sales and Dividend yield basis, Tasnee (Saudi Industrialization) is trading at higher levels to other stocks, while sector leader SABIC is trading at relatively attractive valuation levels.

## Saudi Petrochemicals Valuation (2022E)

### EV/EBITDA vs P/E



### EV/Sales vs Dividend Yield (%)



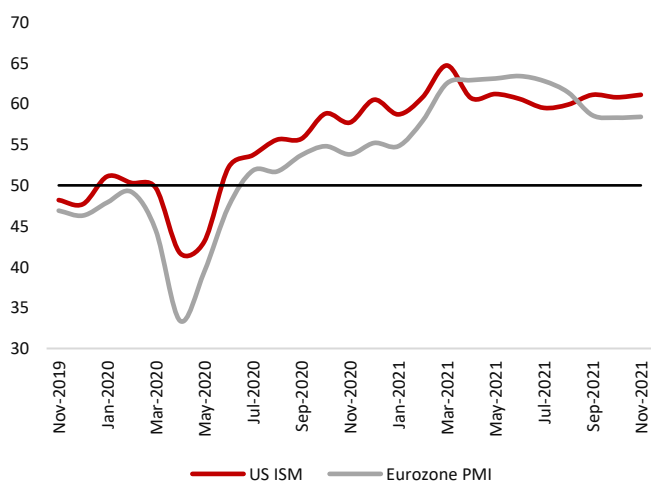
Source: Refinitiv; valuation as of 20 January 2022

# Global and Sector Outlook

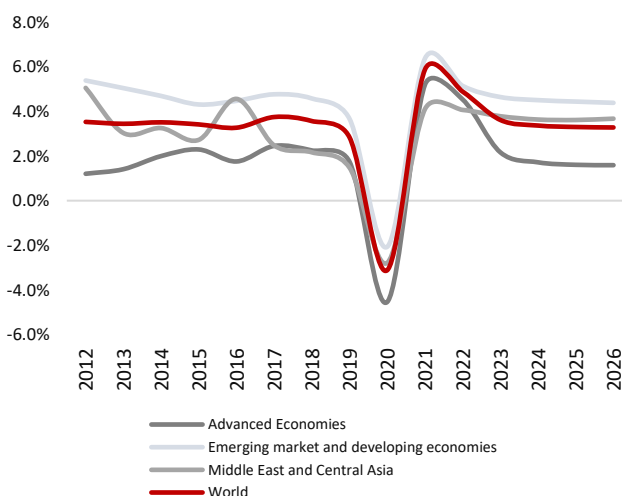
## Global economy recovered in 2021

Led by vaccination and subsiding of Delta wave of COVID-19, global economy recovered in 2021 from the lows of 2020. Economic growth, especially manufacturing bounced back across the globe, as can be seen from the Purchasing Managers Indices (PMIs). Since petrochemicals have wide variety of end-use applications across both industrial and consumer segments, the resumption of manufacturing activity led to revival in petrochemical demand in 2020 and continued in 2021 as well. In terms of future prospects for global growth and consequently demand petrochemicals, growth is expected to moderate from 2021 highs but remain steady for the medium term, thus auguring well for the sector.

### Manufacturing PMIs



### Global GDP – historical and forecasts

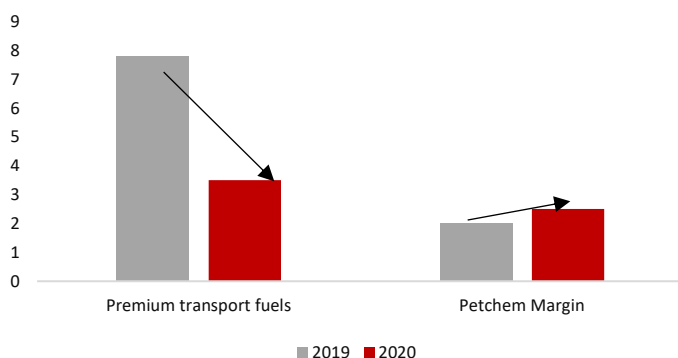


Source: The World Bank, Institute of Supply Management, IHS Markit

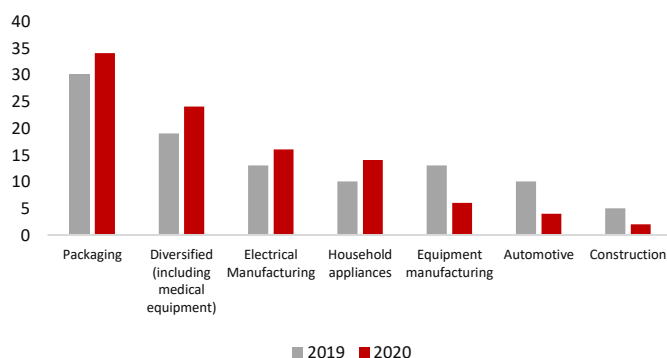
## Petrochemicals industry resilient amid COVID-19 and ride global economic recovery wave in 2021

While COVID-19 impacted the oil market adversely in 2020 (crude oil fell to abnormally low levels in 2Q20), the petrochemicals sector has demonstrated relative resilience during 2020 and has further grown on that foundation in 2021 (first nine months). Demand for petrochemicals from sectors such as healthcare and packaging increased during the pandemic and offset the fall in demand from the automotive sector. In general refining margins for petrochemicals increased in 2020 as compared to 2019, in contrast, to fall in refining margins for transport fuels.

### Indicative margins (USD/bbl)- premium fuels refining vs petrochemicals



### Change in share of demand (%) from key end-use sectors



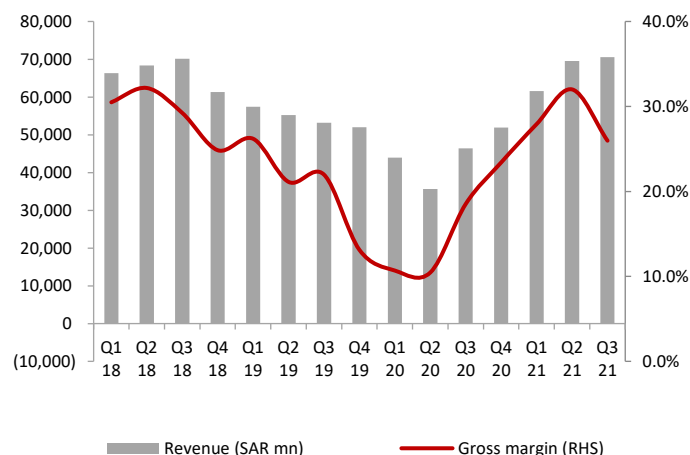
Source: IEA, ICIS



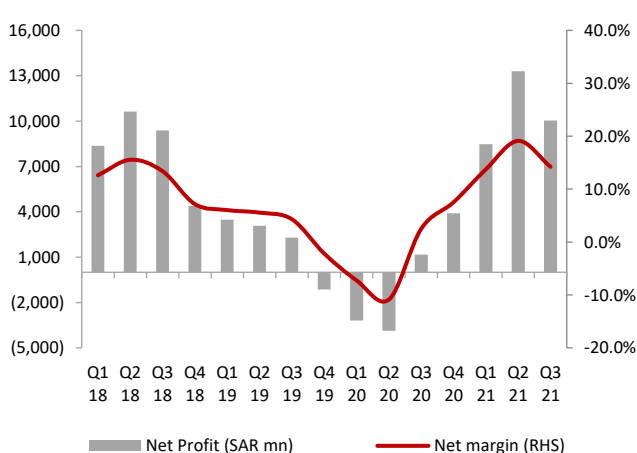
The year 2021 witnessed global economic recovery after the lows of 2020 impacted by COVID-19. Along with rise in crude oil prices (+43% YTD) to average over USD 70 per barrel, petrochemical prices have also risen between 25-35% over 2020. The price rise was driven by a rebound in economic demand as well as global supply chain bottlenecks, and inventory drawdowns amid low CAPEX by oil & gas companies. Saudi Petrochemical industry rode this wave of rebound to post strong topline and bottom-line results in 2021 (9M) and looks set to continue the momentum into 2022.

## Saudi Petrochemical Sector

### Quarterly Revenue and Gross Margins



### Net Profit and Net Margins

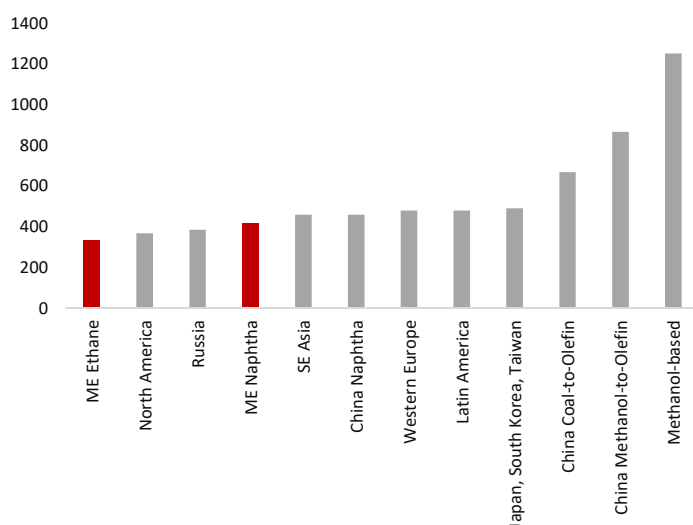


Source: Company filings

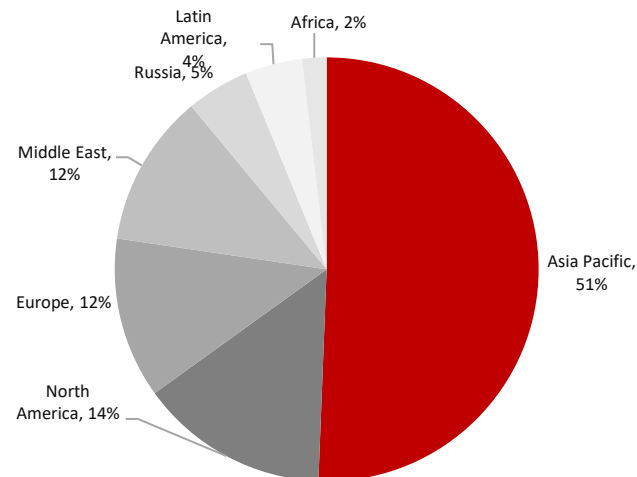
### Impact of COVID-19 on Petrochemicals industry

The impact of the coronavirus on petrochemicals demand was different across value chains, with automotive and construction sectors seeing particularly steep declines in 2020 while packaging demand (especially in food, sanitary products, and medical applications) remained robust and also improved in specific end-products. The versatility of petrochemicals has led to its applications across a wide range of end-use sectors, ranging from packaging, automotive, construction, medical equipment, textiles, electricals and, electronics as well as several other sectors. The well-diversified nature of end-use sectors helped the Petrochemicals industry to limit the impact of COVID-19. Further, Saudi Petrochemicals companies are at the lower end of the global cost curve due to proximity to feedstock (Ethane, Naphtha) which in turn is supported by the lowest cost of extraction for crude oil in Saudi Arabia. As such the cost benefit flows through the value chain and helps Saudi Petrochemicals companies to remain relatively resilient as compared to its global peers.

### Petrochemicals cost curve (USD/mt) as of mid-2020



### Petrochemical production capacity across the globe



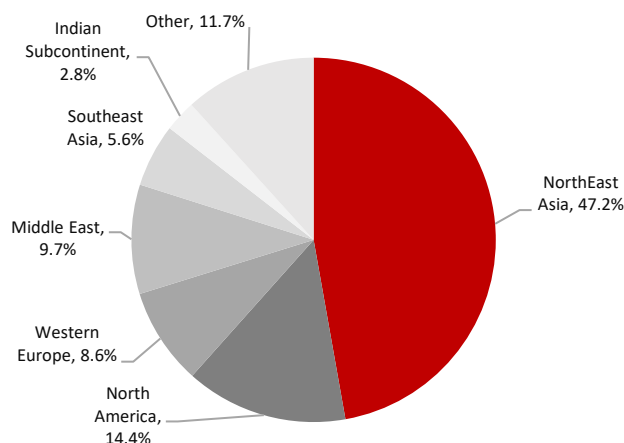
Source: McKinsey Chemicals Insight, ICIS; ME -Middle East

### Demand expected to remain robust from both the East (India, China) and the West (US, EU)

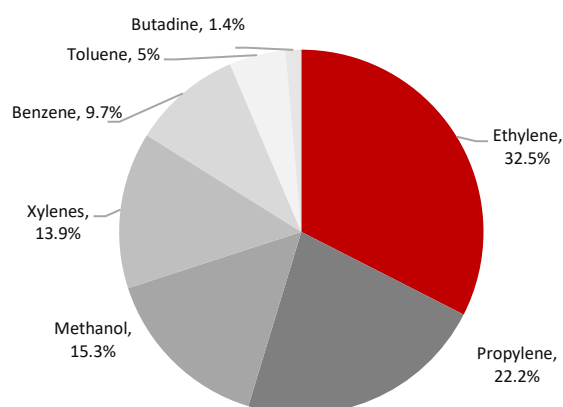
The demand is coming from both developing economies like India but also those like US and China who had seen peak economic growth in the past. While crude as a source of fuel may be impacted by global environmental concerns, the widespread application of petrochemicals across industries – from packaging to construction to transportation – is likely to result in continued demand. As of now, there are no immediate substitutes available for major petrochemicals that could impact demand.

The major demand currently is coming from Asia (China, Japan, India, SEA), while product demand is dominated by Ethylene, Propylene and its variants. From an industry perspective, the packaging industry is a major consumer, both in terms of consumer packaging (such as food and beverage), as well as industrial packaging used for business-to-business transactions. According to Grandview Research, the global petrochemicals market size was estimated at USD536bn in 2020 and is estimated to grow at a CAGR of 6.4% till 2028.

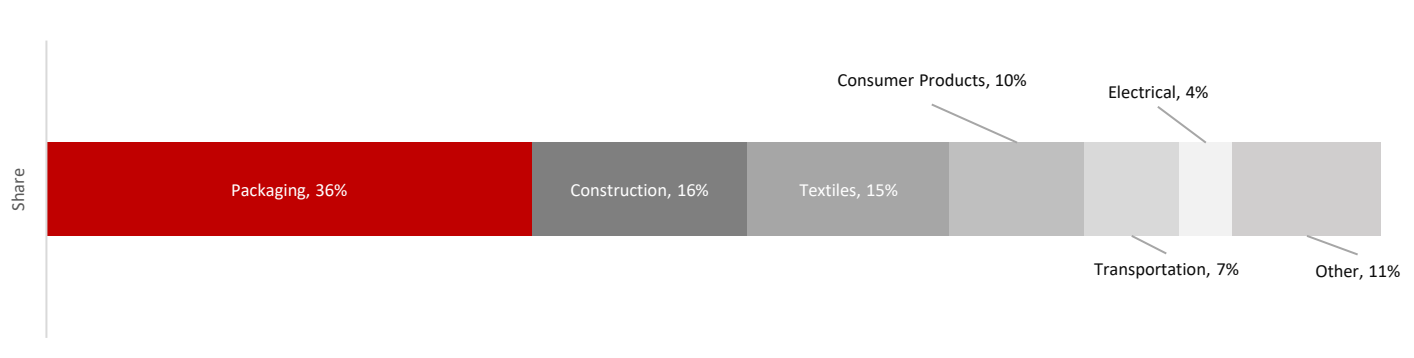
#### World Consumption of Primary Petrochemicals- By Region



#### World Consumption of Primary Petrochemicals by Resin



#### World Consumption of Primary Petrochemicals- By End Use



Source: IHS Markit

### Environment concerns may not materially impact the Petrochemical sector

Globally, with climate change and growing consensus about decarbonization, all industries including petrochemicals are being increasingly scrutinized for environmental impact. The non-biodegradable nature of plastics is a major concern among environmentalists. There is also a growing momentum for ban on single use plastics. Governments are beginning to either limit or tax single use plastics or non-recycled plastic used in packaging. Further, recycling targets and other innovative plastic technologies also aim to limit incremental ubiquitous use of plastics. The International Energy Agency estimates that these initiatives may have only a moderate impact on overall plastics consumption. As of now, there are no immediate alternatives to petrochemicals, unlike fossil fuels which are being replaced by alternative energy sources. The Petrochemicals industry itself is conscious of the broader shift towards greener alternatives and is undertaking research for longer term biodegradable alternatives as well as reducing their own carbon footprint generated through energy intensive production.

## Petrochem companies ESG initiatives

Company	ESG initiatives
Advanced	<p><b>Environment:</b> Compared to the baseline value (2017), Advanced during FY20 was able to reduce GHG intensity by 3.8%, water intensity by 11.9%, energy intensity by 1.3%, material intensity by 22.0%. Compared to FY19 performance, Advanced increased its water recycling intensity by 13.9%.</p> <p><b>Social:</b> Spent SAR 5.7+ million towards CSR activities, provided 100 tablets for needy students in a bid to help them complete their education remotely, provided integrated medical clinic to 34 schools and neighborhood clubs, provided medical insurance for Kanaf Charitable Society beneficiaries for 3 years.</p>
Yanbu	<p><b>Environment:</b> Yansab has successfully continued to achieve the agreed sustainability and energy objectives for FY20 compared to the performance indicators for FY10, as follows: reduced greenhouse gas emissions by 17.17%, lowered energy consumption by 34.04%, reduced the rate of water consumption by 52.54%, reduced the rate of production of environmentally harmful substances and recycled them by 47.69%.</p> <p><b>Social:</b> supplied coronavirus test devices to the competent health authorities in Yanbu city, equipped an integrated building with a capacity of 55 beds to receive cases with all the necessary equipment, supplied medical equipment to competent authorities, contributed to the establishment and operation of the Autism comprehensive center in Madinah for five years starting in 2020.</p>
SIIG	<p><b>Environment:</b> the subsidiary companies remained committed to the principles of sustainability by using materials that are less harmful to the environment.</p> <p><b>Social:</b> during FY20, SIIG supported the Health Endowment Fund by contributing SAR 2 million, contributed SAR 1.5 million towards the interest of the society by getting associated with several support programs,</p>

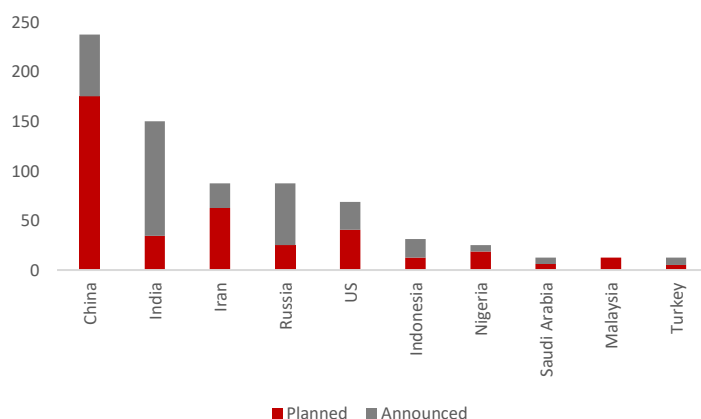
Source: Company filings

## Oversupply concerns from 2024/2025 onwards due to announced capacity expansions in end-consumer countries

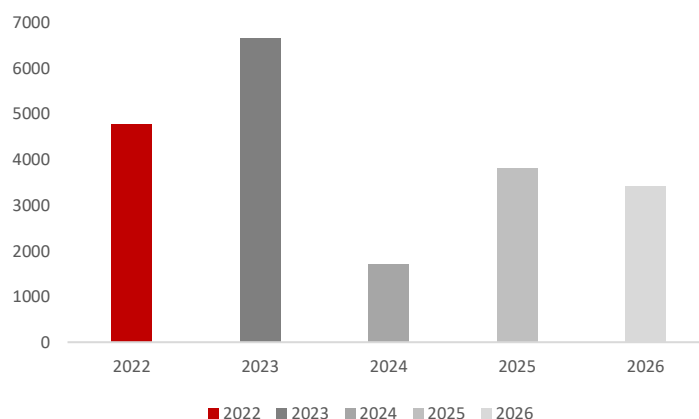
The Asia Pacific region accounts for half of the world's production and China is the largest producer in the region. The major consumers – China, India and US – have seen capacity expansion announcements. Driven mainly by China, global petrochemical capacity is expected to increase from 2.13bn mtpa in 2019 to 3.03bn mtpa in 2030, as per IEA. A production surplus can result in triggering the next downcycle in the Petrochemicals industry earlier than expected. However, Middle East producers are amongst the lowest-cost producers and have a strategic advantage.

According to IEA, petrochemical manufacturers in the US are investing a total of USD200 billion for the construction of new petrochemical facilities, which is around 40% of the current capacity. China's petrochemical producers are expected to launch 2 mb/d of refining capacity between 2019 and 2024, accounting for an estimated 40% of global net capacity additions and 90% of Chinese capacity increases over the same period. Further, among the oil refining companies in China, the tendency is to spend incremental capex on petrochemical-oriented projects, with outputs geared towards producing olefins and aromatics. The objective is to replace feedstock or imports of petrochemical base materials, which is likely to be achieved in the second half of this decade.

### Global Capacity Additions by top countries (mtpa) by 2024



### Year-wise capacity addition ('000 t/y')



Source: Petrochemical analytics, GlobalData Oil and Gas Intelligence Centre, IEA

## Select Petrochemical plant additions underway across the world

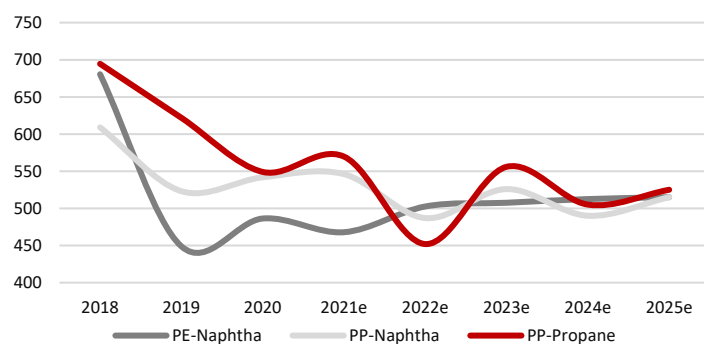
Projects	Country	Capacity ('000 t/y')	Feedstock	Scheduled year
INEOS Cracker, Antwerp	Belgium	1000	Ethane	2023
SINOPEC Gulei JV Cracker, Zhangzhou	China	800	Naphtha	2022
PetroChina Cracker, Korla	China	600	Naphtha	2025
Carbon Holdings Cracker, Ain Sokhna	Egypt	1500	Naphtha	2023
HPCL-Mittal Energy Limited (HMEI) Cracker, Bathinda	India	1200	Naphtha/Kerosene	2022
PT Lotte Chemical Titan Cracker, Merak	Indonesia	1000	Naphtha	2023
Dehloran Sepehr PC Cracker, Dehloran	Iran	500	Ethane	2024
Ganaveh-Dashtestan PC Cracker, Ganaveh	Iran	500	Ethane	2025
Nizhnekamskneftekhim Cracker 2, Nizhnekamsk	Russia	650	Ethane/Naphtha	2023
Sibur-Amur Cracker, Svobodny	Russia	1200	Ethane/Propane	2025
Rosneft-VNHC Cracker, Nakhodka	Russia	1400	Ethane	2026
Aramco-Sabir Cracker, Yanbu	Saudi Arabia	2000	Naphtha	2026
Lotte-Hyundai Cracker, Daesan	South Korea	750	Naphtha/LPG	2022
GS Caltex Cracker, Yeosu	South Korea	700	Naphtha	2023
PTTGC Cracker 5, Map Ta Phut	Thailand	525	Naphtha/LPG	2022
Shell Cracker, Monaca	US	1497	Ethane	2022
Exxon-SABIC Cracker, Corpus Christi	US	1800	Ethane	2023
Formosa Cracker 1, St. James	US	1200	Ethane	2024
Borouge Cracker 4, Ruwais	UAE	1500	Ethane	2025

Source: IEA

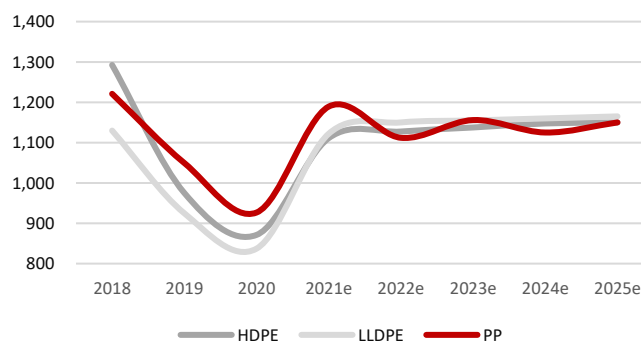
## Major product-feedstock spreads to remain steady after suffering from downcycle till 2020

While petrochemicals have enjoyed a super cycle between 2010 and 2018, the capacity additions during this period caught up with demand, resulting in lowering of spread across major pairs such as Polyethylene-Naphtha, Polypropylene-Naphtha, and Polypropylene-Propane. However, in 2020, led by a collapse in crude prices and consequently lower naphtha prices, the spreads stabilized and even increased in 2021 in the case of specific pair of products and feedstock. Product prices had jumped in 2Q21 but have moderated in 2H21 and are expected to continue correcting into 2022 based on the trend observed in 4Q21. Thereafter, the spreads are expected to remain steady for the next few years due to continued economic recovery. Consequently, margins and cash flows of Saudi Petrochemical companies are also likely to sustain.

### Product Price Spreads (USD/t)



### Product Price Trends (USD/t)



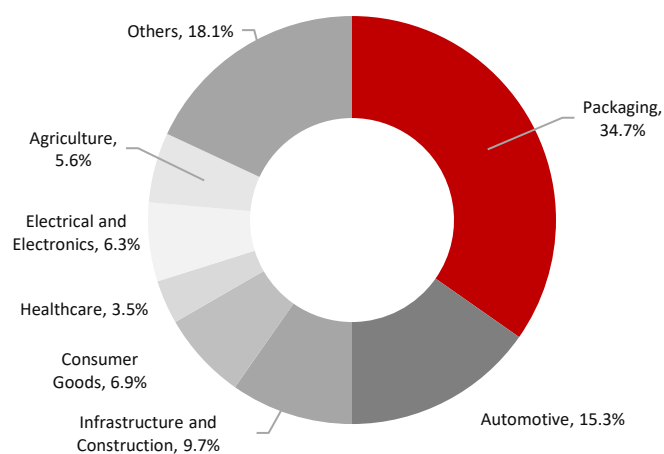
Source: Refinitiv

## Major Petrochemicals Demand Trends

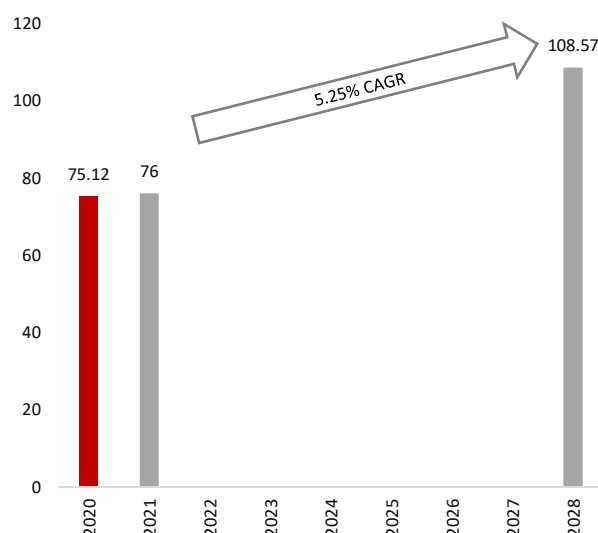
### Polypropylene (PP)

The global polypropylene (PP) market is projected to grow from USD76.00 billion in 2021 to USD108.57 billion in 2028 at a CAGR of 5.2% in forecast period, 2021-2028, as per Fortune Business Insights report. Growing demand for efficient plastic packaging products is the key driver behind global demand for polypropylene. Currently, PP is widely used in injection molding applications due to various characteristics such as tensile strength, high chemical resistance, and low moisture absorption. PP is easily melted and molded into any shape and size without modifying its original quality. It is easy to process, provides effective sealing as well as stiffness, thus making it attractive to use in various end-use products. The main industries that use PP are those with need for lightweight plastics such as automotive, consumer goods and electronics industries. In automotive industry, PP is widely used and is estimated to have accounted for 32% share (in 2020) among all plastics used in automobile industry, as per Plastic Trade Association. Polypropylene demand growth is majorly due to increased use in packaging industry, in turn driven by rise in consumption of packaged food and beverages over the years, and especially since COVID-19 pandemic in 2020.

### Polypropylene demand by end-use sector



### Polypropylene estimated market size (USD) & demand growth



Source: Fortune Business Insights

During 2020, the demand for PP from automotive and building construction sectors declined due to lower end-consumer demand for automobiles as well as halt in non-essential economic activities imposed by governments to curb spread of COVID-19. On the other hand, the demand from healthcare and food packaging industries increased due to increased use of one-time use products in healthcare as well as packaged food and beverages. The demand for PP from healthcare and pharmaceutical industries for surgical equipment has increased during the pandemic.

Global PP capacity is expected to experience CAGR growth of 9.8% over the next five years from 85.57 mtpa in 2020 to 136.79 mtpa in 2025, as per a report by GlobalData. Out of the 146 planned and announced Polypropylene projects expected to be commissioned by 2025, the main ones are predominantly in Asia followed by the Middle East. Among Asian countries, the major consumer China is expected to also lead PP capacity additions by 2025, followed by the India and Iran. Among Indian companies, Reliance Industries Ltd and Indian Oil Corp Ltd, while the Oriental Energy Co. Ltd of China are the top three companies by planned and announced capacity additions over the upcoming years. These capacity additions are expected to come online by 2024-2025 and may start to put pressure on PP prices around that time.

### Polyethylene (PE)

The global polyethylene (PE) market is projected to grow from USD107.4 billion in 2019 to USD130.3 billion in 2027 at a CAGR of 3.4% in forecast period, as per Fortune Business Insights report. Polyethylene is the most widely used polymer in the world with large part

of demand coming from the packaging industry due to its characteristics. PE is a versatile material with properties such as durability, resistance to moisture, high strength to density ratio, resistance to physical stress yet easy customization allowing easy molding into various products.

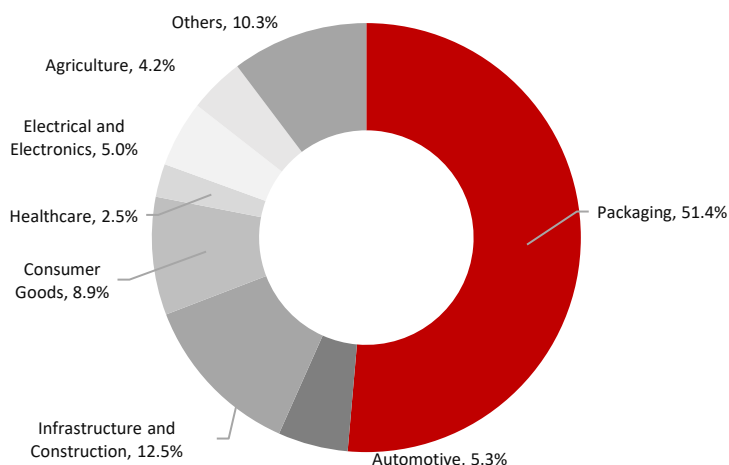
The main industries that use PE are packaging, automotive, electrical and electronics, food and beverage and consumer goods. In automotive industry, PE is used due to its easy processability, sealing and stiff properties in addition to being light weight. In the food and beverage industry, the moisture barrier property of PE leads to its use in packaging solutions. PE is also widely used in consumer goods industry ranging from fashion apparel to sports goods to toys, due to its ability to handle physical stress. In agriculture, its durability and resistance to moisture has led to its use in making of drippers, piping solutions, nozzles and other irrigation related systems.

### Types of PE

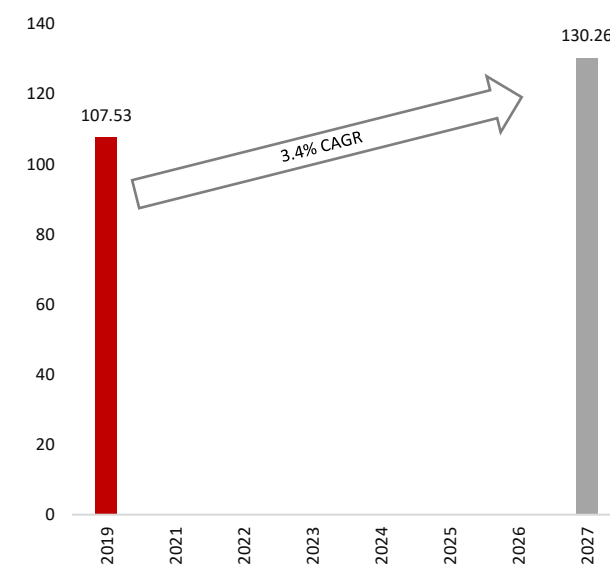
Polyethylene is mainly used in three variants – High Density Polyethylene (HDPE), Low Density Polyethylene (LDPE) and Linear Low-Density Polyethylene (LLDPE). Among these, HDPE has most applications across wide variety of industries and hence has higher share compared to LDPE and LLDPE. Some common daily use products made from HDPE include plates, bottle caps, food storage containers, plastic bottles that hold chemicals such as detergents, liquid soaps etc. LDPE is mainly used in packaging due to its flexibility and softness as well as resistance to chemicals. The industries that mainly use LDPE include food and beverages, healthcare, and electronics. LLDPE has high tensile strength, high impact resistance along with flexibility, which finds applications in industries such as packaging, healthcare, agriculture, and building construction.

During 2020, the demand for PE from automotive, electrical and electronics, and consumer goods sectors declined. However, demand from healthcare and packaging industries increased. Especially in the healthcare segment, demand for single use plastic products, personal protective equipment (PPE), sampling containers, saline bottles, curtains and similar other products has increased and expected to remain elevated in near future until various variants of COVID-19 virus keep evolving leading to high number of infections.

### Polyethylene demand by end-use sector



### Polyethylene estimated market size (USD bn) and demand growth



Source: Fortune Business Insights

# Advanced Petrochemical Company

Target Price: SAR 65.2

Downside: 9.9%

<b>Recommendation</b>	Hold
Bloomberg Ticker	APPC:AB
Current Market Price (SAR)	72.30
52wk High / Low (SAR)	83.0 / 62.3
12m Average Vol. (mn)	0.47
Mkt.Cap. (SAR bn)	15.7
Shares Outstanding (mn)	216
Free Float (%)	94%
3m Avg Daily Turnover (SAR mn)	23.5
6m Average Daily Turnover (SAR mn)	34.0
PE 2022e (x)	23.33x
EV/EBITDA 2022e (x)	17.90x
Dividend Yield '22e (%)	3.7%
<b>Price Performance:</b>	
1 month (%)	5.7%
3 months (%)	-2.8%
12 months (%)	13.0%

Source: Bloomberg, as of 20<sup>th</sup> Jan 2022

Price -Volume Performance



Source: Bloomberg

- One of the largest producers of polypropylene across the MENA region.
- Global presence with 94% of the revenue from overseas sales.
- Major markets are India (24%), Asia and Pacific (23%), Turkey (21%), and China (18%)
- Upcoming polypropylene expansion to increase Advanced's capacity by 151.1% to 1,130K tpa by 2024/2025; We estimate substantial Capex of SAR6.0bn
- Consistently rewards its shareholders through dividends

We initiate coverage on Advanced Petrochemical company with a **Hold** rating and a target price of SAR 65.2 per share, implying a downside of 9.9% to the last closing price (20<sup>th</sup> January 2022). Our target price implies a P/E'22e of 21x. The stock has rallied in the recent past, underpinned by the revival of the overall economy, pent-up demand for petrochemical products, and the company's massive expansion project which will increase its capacity by over 1.5 times by 2024.

## Investment Thesis

**Valuation & Risks:** Our valuation is based on mix of dividend discount model (35% weight), discounted cash flows (15% weight) and multiples approach (25% weight each to both PE & EV/EBITDA based multiples). Key downside risks to our valuation include an increase in the cost of funds and delays in the upcoming expansion project. Key upside risks include on-time commencement of new capacity and reduction in funding cost.

## Focused business model

Advanced remains well-diversified geographically with presence across MENA, Europe, India, Asia and Pacific, Turkey, and China. With its upcoming capacity in KSA, the company plans to not only increase its existing polypropylene capacity but also add Isopropanol to its product offerings.

**Risks:** To fund the company's upcoming plant in KSA, Advanced has resorted to borrowings which will lever its balance sheet. With the increase in borrowings, the company's bottom line is likely to take a hit via an increase in funding cost. Advanced is currently trading at 23 times its FY22 EPS which is 87.0% higher than its historical average 1-year forward of 12.1x. With the downward pressure on earnings via an increase in finance cost, the valuation may look more expensive.

## Key Indicators

Year	FY19	FY20	FY21e	FY22e	FY23e	FY24e
Sales	2,595	2,231	3111*	2,864	2,914	2,861
Gross profit	899	729	1059*	826	921	813
EBITDA	948	809	1,088	905	993	893
Operating profit	732	592	868*	677	760	655
Share of an associate	77	34	57	65	75	86
Net income	759	596	815*	671	765	671
EPS	3.51	2.75	3.76*	3.10	3.53	3.10
P/E	20.61x	26.28x	18.7**	23.33x	20.47x	23.33x
EV/EBITDA	16.10x	18.85x	14.90x	17.90x	16.32x	18.16x
Dividend yield	5.5%	3.9%	3.6%	3.7%	3.7%	3.7%

Note: \*Actual reported numbers, \*\*2021 year-end close price by FY21 actual reported eps



### Upcoming project (APOC) to increase capacity by 1.5x and drive the company's topline

Advanced Global Investment Company (AGIC), a wholly-owned subsidiary of Advanced, and SK Gas Petrochemical Pte. Ltd. (SKGP), a subsidiary of SK Gas Co., Ltd. incorporated Advanced Polyolefins Industry Company (APOC), which is owned 85% by AGIC, to construct and operate a Propane Dehydrogenation (PDH) plant which will process propane and produce propylene with a nameplate capacity of 843,000 tons p.a., a Polypropylene (PP) plant which will process propylene and produce polypropylene with a nameplate capacity of 800,000 tons p.a. and Isopropanol (IPA) plant which will process propylene and produce isopropanol with a nameplate capacity of 70,000 tons p.a. APOC currently is under construction phase and is anticipated to be completed by the end of 2Q24. Saudi Aramco will be supplying the JV with feedstock (propane). The total cost of the project is expected to be USD 1.88 Bn (SAR 7.05 Bn) which will be financed 25% by the shareholders of APOC and the remaining will be financed through borrowings. The addition of this plant will not only increase the company's polypropylene capacity from 450,000 tpa to 1,130,000 tpa (considering Advanced's stake) but also add one more product, Isopropanol in the company's product offerings. This augurs well for the company with regard to product diversification.

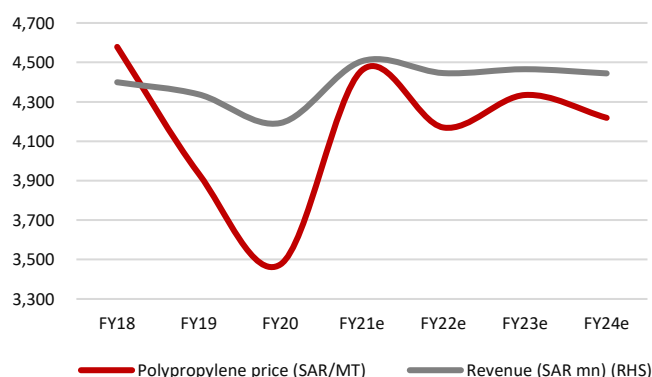
### Commencement of new PP plant to help Advanced increase its income from associates

In 2021, Advanced via its associate, SK Advanced, witnessed the commencement of the commercial operation of its polypropylene plant in South Korea with a design capacity to produce 400,000 metric tons per annum. The project is a joint venture between SK Advanced and PolyMirae Company Ltd with SK Advanced's share in the project at 49.99%. The joint venture will be supplied with its key feedstock, propylene, which is produced by SK Advanced. SK Advanced has been operating a PDH plant that produces propylene in South Korea since 2016 with a design capacity of producing 600,000 metric tons per annum. This expansion will help the company to garner additional revenue and enhance its bottom line.

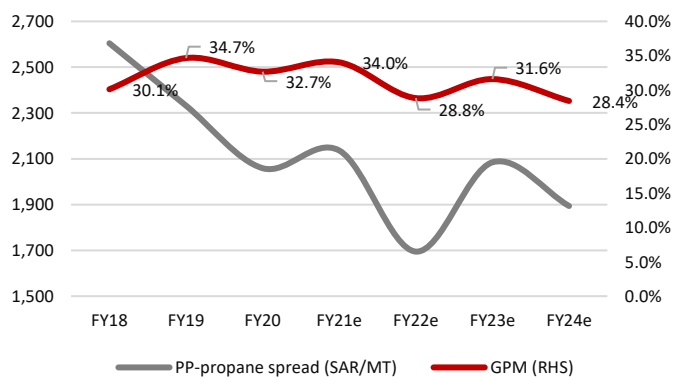
### Topline to remain range-bound

Advanced's revenue had been declining at a CAGR of 9.9% between FY18 to FY20 to reach SAR 2.2 Bn in FY20 owing to the decline in the company's product price (polypropylene) which fell at a CARG of 12.9% during the same period. However, during 9M 21, the company's sales soared by 38.0% YoY led by an improvement in polypropylene price which increased by ~32.4% YoY. We forecast revenue to increase by 35.1% YoY in FY21 marked by an increase in polypropylene price. However, the topline is anticipated to remain range-bound following an increase in FY21 resulting from constrained movement in polypropylene price.

#### Revenue – Polypropylene price trend



#### PP-Propane spread vs gross margin

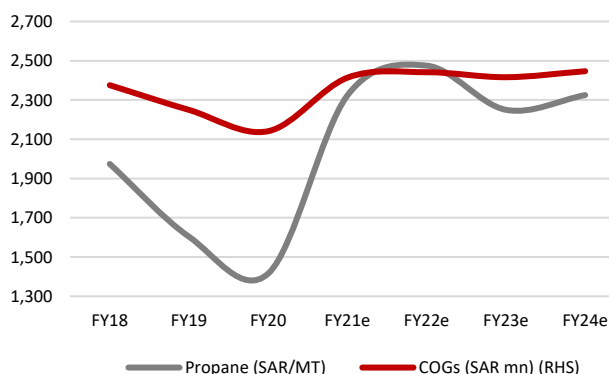




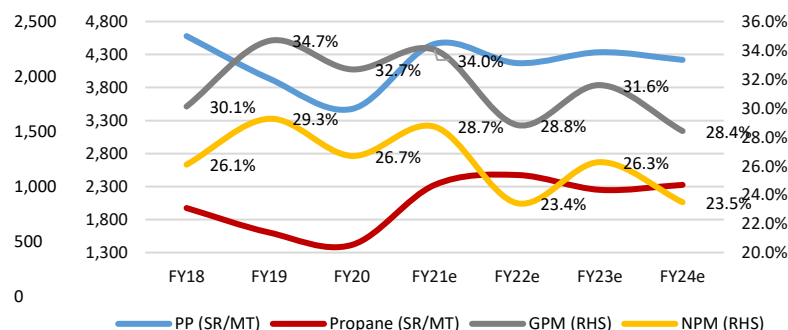
### Margins to trade in a narrow range

Baring FY20, historically, margins had been moving on an upward trajectory buoyed by conducive product price dynamics which were also supported by the spreads between polypropylene and propane prices. We expect margins to remain at a lower end in FY22 and FY23 following an increase in FY21, resulting from a narrow spread between polypropylene and propane prices.

#### Propane vs COGs



#### PP, Propane prices vs margins



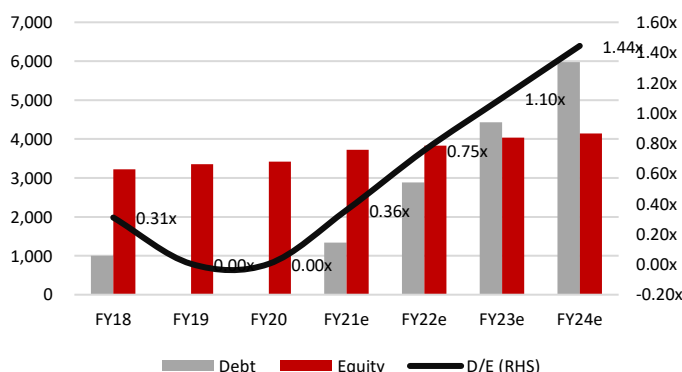
Share of income from associates has been an integral part of the company's bottom line. We estimate income from associates to increase going ahead led by incremental income from the recently commenced joint venture project between SK Advanced and Polymirae in South Korea to manufacture polypropylene. These incremental inflows from the JV project will provide some cushion to the bottom line amidst not-so-favorable movement in product prices.

### Leverage to remain under control despite funding the capex via debt

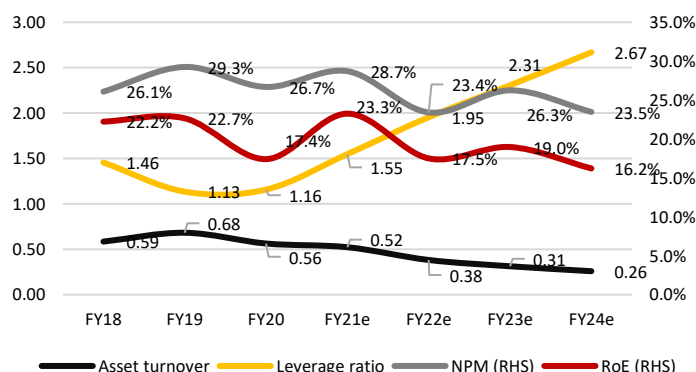
Advanced's debt to equity has remained low until FY20 (Sukuk funding in FY18 got fully redeemed during 4Q19). However, since FY21, the company's D/E has been on the rise to fund the company's expansion project (PDH, PP, and IPA plant) which according to the company is scheduled to commence operations from 2Q24. Overall, D/E for the company is at reasonable levels despite the rise in debt from 0.19x during 9M 2021 to 1.15x in FY 2023.

Breaking the components of return on equity, it's observed that RoE is mainly driven by the movement in net margin however, during FY21 increase in leverage did help RoE to perform better despite a fall in net margin.

#### Leverage trend



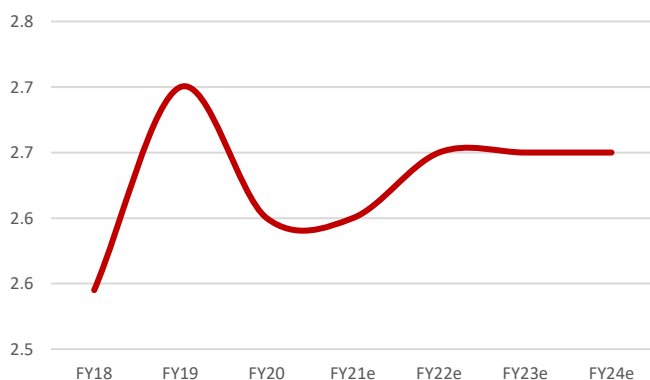
#### Asset Turnover vs Leverage and Margins



### A stable dividend distributor

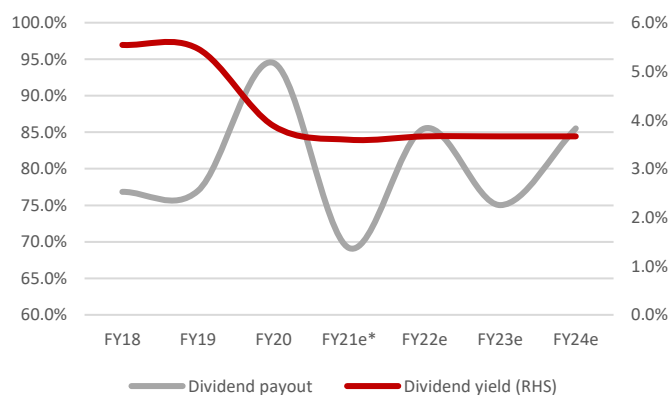
Advanced has been consistently rewarding its shareholders with dividend payments. However, the quantum was reduced marginally in FY20 in the backdrop of global crises induced by the pandemic. We assume that the company will continue paying dividends of SAR 2.65 going ahead as well.

#### Dividend per share (SAR)



Note: \*Actual reported eps used to calculate the dividend payout

#### Dividend payout and dividend yield



## Relative valuation

We have given a weightage of 25% each to the P/E and EV/EBITDA valuation based on multiples - average historical multiple of peers in the period 2014-2019. The peer set includes the companies from the Kingdom of Saudi Arabia. At average median peer P/E multiple of 15.8x and EV/EBITDA multiple of 10.64x, we arrive at target price of SAR 49 and SAR 44.7 per share respectively.

## Dividend Discount Method

We have given a weightage of 35% to DDM method. We arrive at target share price using expected dividend in 2022, expected dividend yield equal to historical dividend yield (2018-2020) and long-term growth rate of 1%. With expected dividend per share of SAR 2.65, target dividend yield 5% and growth rate 1%, we arrive at target price SAR 66.9 per share.

## Discounted Cash Flow

We have valued the company based on two parts, one being its existing capacity and the other being its upcoming capacity using free cash flow to the firm (FCFF). The upcoming capacity is scheduled to commence operations from 2Q24, but considering the likely delays, we have assumed the cash flows flowing from the upcoming capacity from FY25. We have forecasted the cash flows coming from the upcoming capacity in a proportionate manner using existing capacity as the reference. Using respective WACC for the existing and upcoming capacity, we have derived valuation for both and eventually derived the intrinsic value of the stock.

### Cash flows from existing capacity

		FY22e	FY23e	FY24e	Terminal Value
	Pegged on January 20, 2022				
	Time period index	0.95	1.95	2.95	2.95
<b>Free cash flow</b>					
	NOPAT	646	725	625	
	Depreciation	229	233	237	
	Changes in Working Capital	40	(31)	17	
	Less: Capex	(143)	(146)	(143)	
	Free cash flow to the firm (FCFF)	771	781	737	10,691
	Discounted FCFF	717	673	588	8,530

Enterprise Value	10,508
Less: Net debt (Includes lease liabilities), as of Sept 2021	(481)
Equity Value	10,027
Shares O/S	216
Equity Value per share	46.3
Current share price (SR)	72.3
% upside/downside	-35.9%

### Assumptions

WACC	8.0%	5.7%
Tax Rate	4.6%	4.6%
Cost of debt / Lease Liabilities	2.02%	4%
Cost of Equity	9.1%	11.5%
Terminal growth rate	1.0%	1.0%

### Cost of Equity Calculation

Risk-Free Rate	2.74%	4.00%*
Beta	0.754	0.75
Equity Risk Premium	8.44%	9.9%**

**Weights calculated as of Sept 2021**

Debt	15.8%	75.0%
Equity	84.2%	25.0%

### Cash flow from additional capacity

	FY25e	FY26e
	3.95	4.95
		1,236

PV of free cash flows generated by additional capacity in FY25	26,098
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Enterprise Value	20,941
Less: Net debt (Includes lease liabilities)	(4,494)
Equity Value	16,447
Shares O/S	216
Equity Value per share	76.0

**Note:** \*Expected rate hikes by FY25. \*\*equity risk premium to increase by FY25 factoring risk element & expected delays in project

## About Advanced

Established in October 2005, Advanced Petrochemical Company (Advanced), is a Saudi joint-stock company listed on the Saudi Stock Exchange Tadawul since 2007. Advanced is into manufacturing of petrochemicals, which includes manufacturing of propylene and polypropylene. The company uses propylene as an intermediate product in the production of polypropylene. It currently produces 455,000 tons per year of propylene and 450,000 tons per year of polypropylene from its production facility located in Jubail industrial city, KSA. Advanced derives its major chunk of revenues from overseas sales representing ~94% of total revenues. The company not only markets and sells its product in KSA but also outside the KSA through international off-takers like Vinmar International, Mitsubishi Corporation, Tricon Dry Chemicals, and Domo N.V. The company is a known name across the MENA region for delivering superior products which are being produced using state-of-the-art technology.

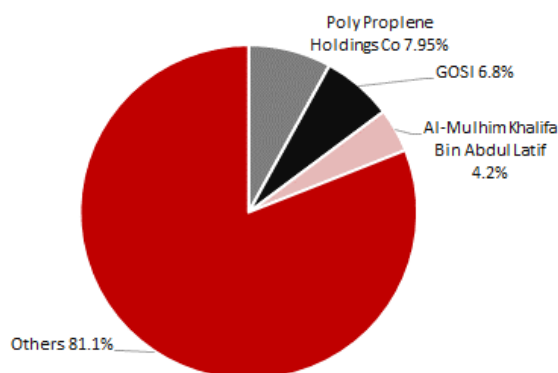
The company owns the following subsidiaries and associate company

Company	Type	Ownership
Advanced Renewable Energy Company	Subsidiary	100%
Advanced Global Investment Company	Subsidiary	100%
Advanced Polyolefins Industry Company	Subsidiary	85%

Product sold	Revenue contribution
Polypropylene	100%

Source: Company filings

## Advanced's shareholding structure



Source: Bloomberg

## Key financials

(SAR mn)	FY19	FY20	FY21e	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Sales	2,595	2,231	3,111*	2,864	2,914	2,861
COGS	(1,695)	(1,502)	(2,052)*	(2,039)	(1,993)	(2,048)
<b>Gross profit</b>	<b>899</b>	<b>729</b>	<b>1,059*</b>	<b>826</b>	<b>921</b>	<b>813</b>
Selling & distribution expenses	(26)	(27)	(27)	(26)	(29)	(29)
G&A expenses	(141)	(110)	(136)	(123)	(131)	(129)
<b>Operating profit</b>	<b>732</b>	<b>592</b>	<b>868*</b>	<b>677</b>	<b>760</b>	<b>655</b>
Finance charges	(40)	(6)	(16)	(44)	(55)	(78)
Other income/expenses	20	3	4	5	21	40
Share in loss of an associate	77	34	57	65	75	86
<b>Income before zakat</b>	<b>789</b>	<b>624</b>	<b>908</b>	<b>703</b>	<b>801</b>	<b>703</b>
Zakat and income tax	(29)	(29)	(42)	(32)	(37)	(32)
<b>Net income</b>	<b>759</b>	<b>596</b>	<b>815*</b>	<b>671</b>	<b>765</b>	<b>671</b>
<b>Balance Sheet</b>						
Bank balances and cash	48	62	74	430	798	1,140
Trade receivables	311	328	445	430	445	444
Inventories	132	175	236	228	234	235
Property, Plant & Equipment	1,779	1,756	3,184	4,510	5,832	7,149
Investment in an associate	637	693	750	815	890	976
<b>Total assets</b>	<b>3,803</b>	<b>3,959</b>	<b>5,764</b>	<b>7,476</b>	<b>9,278</b>	<b>11,021</b>
Accounts payable	88	144	196	204	206	216
Accruals and other current liabilities	208	216	294	304	303	315
End-of-service indemnities	111	129	166	213	273	350
Loan	0	0	1,325	2,875	4,423	5,970
Share capital	2,165	2,165	2,165	2,165	2,165	2,165
Statutory reserve	637	697	697	697	697	697
Other components of equity	84	122	122	122	122	122
Retained earnings	465	435	739	836	1,027	1,124
<b>Total stockholders' equity</b>	<b>3,350</b>	<b>3,419</b>	<b>3,722</b>	<b>3,819</b>	<b>4,010</b>	<b>4,107</b>
<b>Total liabilities &amp; stockholders' equity</b>	<b>3,803</b>	<b>3,959</b>	<b>5,764</b>	<b>7,476</b>	<b>9,278</b>	<b>11,021</b>
<b>Cash Flow Statement</b>						
Cash from operations	845	758	901	935	949	923
Cash from investing activities	564	(179)	(1,651)	(1,554)	(1,554)	(1,554)
Cash from financing	(1554)	(565)	761	975	973	973
Net changes in cash	(145)	14	12	356	368	342
Cash at the end of period	48	62	74	430	798	1,140
<b>Key Ratios</b>						
Current ratio	1.6	1.6	1.6	2.2	2.9	3.4
Inventory turnover ratio	11.9	9.8	9.7	8.8	8.6	8.7
Debtors turnover ratio	8.8	7.0	7.8	6.5	6.7	6.4
Creditors turnover ratio	14.8	12.9	11.7	10.2	9.7	9.7
Gross profit margin	34.66%	32.68%	34.04%	28.83%	31.60%	28.41%
Operating margin	28.22%	26.55%	27.90%	23.63%	26.10%	22.91%
Net profit margin	29.27%	26.69%	26.20%	23.42%	26.24%	23.45%
EBITDA margin	36.52%	36.27%	36.08%	31.61%	34.10%	31.21%
Return on equity	23.10%	17.60%	24.25%	17.79%	19.53%	16.52%
Return on assets	17.87%	15.35%	17.81%	10.13%	9.13%	6.61%
Debt/Equity (x)	0.00x	0.00x	0.36x	0.76x	1.11x	1.46x
Interest coverage ratio (x)	18.39x	106.96x	52.67x	15.52x	13.78x	8.36x
P/E	14.08x	24.35x	18.70x**	23.33x	20.47x	23.33x
P/BV	3.19x	4.24x	4.20x	4.10x	3.90x	3.81x
P/Sales	4.12x	6.50x	5.19x	5.46x	5.37x	5.47x
EV/Sales x	3.88x	6.22x	5.38x	5.66x	5.56x	5.67x
EV/capacity x (USD)	2,673.82x	3,680.92x	4,301.55x	4,301.55x	4,301.55x	4,301.55x
EPS (SR)	3.51	2.75	4.00	3.10	3.53	3.10
BPS (SR)	15.48	15.79	17.19	17.64	18.53	18.97
Cash EPS (SR)	4.50	3.75	5.04	4.16	4.61	4.20
CFO per share	3.90	3.50	4.16	4.32	4.38	4.26
Dividend yield (%)	5.47%	3.88%	3.60%	3.67%	3.67%	3.67%
Net debt (SR 'million)	(34)	(49)	1,264	2,457	3,636	4,841
Net debt/ EBITDA	-0.04	-0.06	1.16	2.71	3.66	5.42

Source: Company Financials, U Capital Research, note: \*actual reported numbers, \*\*calculated based on actual reported eps, market price as on 20 Jan 2022

# Yanbu National Petrochemical Company

Target Price: SAR 65.4

Downside: 6.5%

<b>Recommendation</b>	Hold
Bloomberg Ticker	YANSAB AB
Current Market Price (SAR)	70.00
52wk High / Low (SAR)	84.9 / 62.2
12m Average Vol. (mn)	0.55
Mkt.Cap. (SAR bn)	39.4
Shares Outstanding (mn)	563
Free Float (%)	39%
3m Avg Daily Turnover (SAR mn)	37.7
6m Average Daily Turnover (SAR mn)	48.1
PE 2022e (x)	20.91x
EV/EBITDA 2022e (x)	11.42x
Dividend Yield '22e (%)	5.4%

## Price Performance:

1 month (%)	0.0%
3 months (%)	-10.7%
12 months (%)	6.1%

Source: Bloomberg, as of 20<sup>th</sup> Jan 2022

## Price-Volume Performance



Source: Bloomberg

- Strong parentage of SABIC which is owned 70% by Aramco
- Products sold globally through SABIC. Sales to Asia represents 49%, Europe (12%), Middle East (24%), Africa (12%), and the USA (3%)
- A virtually debt-free company with a dividend yield of 4.4%
- MEG product price rise in 2021 has driven Yanbu valuation to unjustifiable levels

We initiate coverage on Yanbu National Petrochemical Company (Yansab) with a **Hold** rating and a target price of SAR 65.4 per share, implying a downside of 6.5% to the last closing price (20<sup>th</sup> Jan. 2021). Our target price implies a P/E'22e of 19.5x. The stock has rallied ~79% from its low of SAR 39.1 in March 2020. The company's prospects are closely tied with the trends in the petrochemical industry.

## Investment Thesis

**Valuation:** Our valuation is based on mix of dividend discount model (35% weight), discounted cash flows (15% weight) and multiples approach (25% weight each to both PE & EV/EBITDA based multiples). Yansab is currently trading higher at 20.9x FY22 eps as compared to its historical forward PE of 19.5x. Product price recovery and a healthy demand outlook resulting in higher top-line and gross margin expansion are the key upsides to valuation, while lower than expected operational efficiency may be a downside risk to valuation.

## Strong parentage with a well-diversified business model

Along with a well-diversified product offering, Yansab also remains well-diversified geographically with a presence across Asia, the Middle East, Europe, Africa, and the USA. With the help of a strong and established parent company (SABIC) which is owned 70% by Aramco, Yansab benefits from (i) the ability to access key feedstock on a long-term basis at a discounted price (ii) Yansab sells most of its product to Sabic under marketing agreement which due to its widespread presence markets Yansab's products locally, regionally and at the global level.

**Risks:** Key downside risks include (i) an increase in feedstock prices to pressure margins. (ii) Decline in petrochemical product prices and spreads to exert pressure on margins lower. (iii) Any reduction in feedstock discounts to affect the company's margins and profitability. (iv) Increased competitiveness and risk of economic slowdown resulting from ongoing Covid crisis and its variants to pressurize margins further. Key upward risks include improved product prices and an overall uptick in demand.

## Key indicators

Year	FY19	FY20	2021e	2022e	2023e	2024e
Sales	6,065	5,035	7,407.7*	7,799	7,791	7,850
Gross profit	1,498	1,089	2,154.3*	2,396	2,497	2,326
EBITDA	2,336	1,901	2,917	3,180	3,335	3,121
Operating profit	1,096	728	1,651*	1,952	2,076	1,831
Net income	1,090	678	1,531.3*	1,883	2,004	1,795
EPS	1.94	1.20	2.72	3.35	3.56	3.19
P/E	28.85x	53.05x	25.24x**	20.91x	19.64x	21.93x
EV/EBITDA	12.17x	17.39x	12.45x	11.42x	10.89x	11.64x
Dividend yield	6.3%	3.9%	4.3%	5.4%	5.4%	5.4%

Note: \*Actual reported numbers, \*\* 2021 year-end close price by FY21 actual reported eps

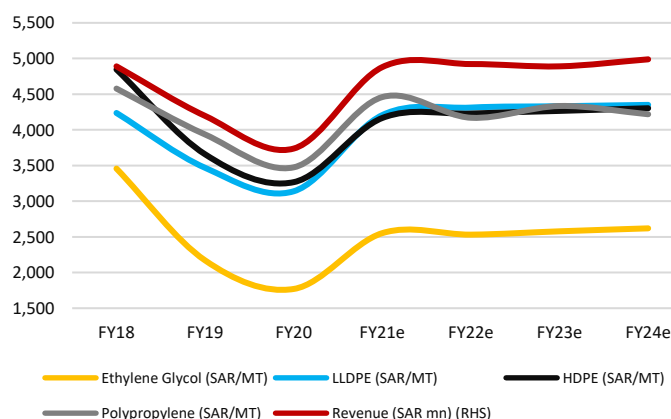
### Due to the cyclical nature of business, net income to stay in sync with the performance of the overall petrochemical industry

In FY20, net income reached SAR678mn (-37.8% YoY) due to lower sales price of all products despite lower production costs. In 9M21, net profit increased to SAR1.2bn (+247% YoY) driven by the higher sales price of all products despite lower production and sales quantity due to planned shutdowns during the period and higher feedstock prices. In FY21e, net income is expected to reach SAR1.6bn compared to SAR678mn in FY20 driven by a recovery in product prices resulting in higher top-line and gross margin expansion. In FY22e, net income is expected to decline to SAR1.5bn (-4.0% YoY) due to marginal revenues increase (+1.3% YoY) and gross margin contraction. Despite the decline in topline in FY23e, net profit is expected to increase by 8.2% YoY led by a decline in feedstock price which is expected to fall by 9.1% YoY.

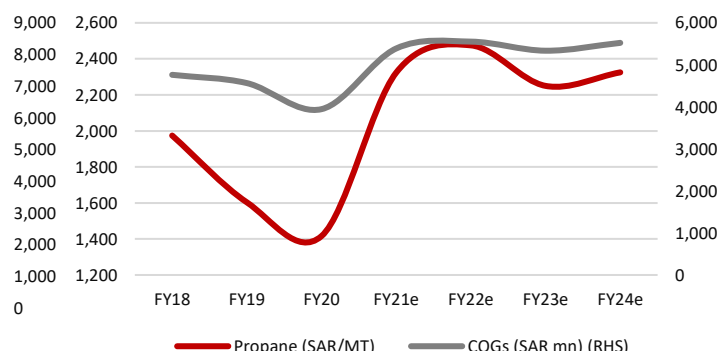
### Revenue and profitability to remain impacted due to pricing dynamics

In FY20, revenues declined 17.0% YoY to SAR5.0bn. Gross margin came in at 21.6% compared to 24.7% in FY19 due to lower revenues and utilization rates. Utilization rates reached 96% in FY20 compared to 103% in FY19. During 9M21, revenues increased to SAR5.5bn (+50.0% YoY). Gross margin reached 30% in 9M21 compared to 16.8% in 9M20 driven by higher revenues. Revenues in FY21e are expected to come in at SAR7.6bn (+51.0% YoY). Gross margin is expected to expand to 29.1% from 21.6% in FY20 driven by the higher sales price of most products despite higher production costs. Utilization rates are expected to average 98% from 96% in FY20. In FY22e, gross margin is expected at 27.9% from 29.1% in FY21. Top-line is expected to marginally increase in FY22e before declining by 1.3% YoY in FY23e led by not-so-favorable product prices.

#### Revenue and end-product price trends



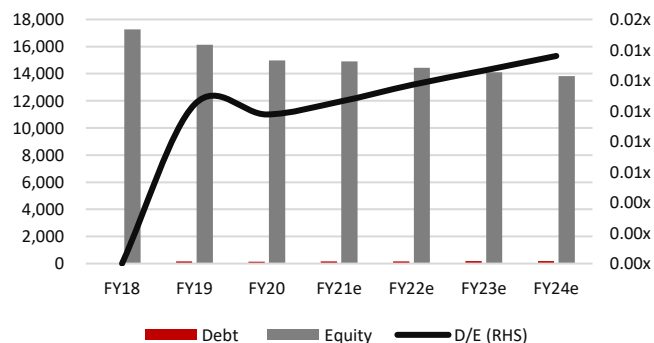
#### Cost of goods sold and feedstock price



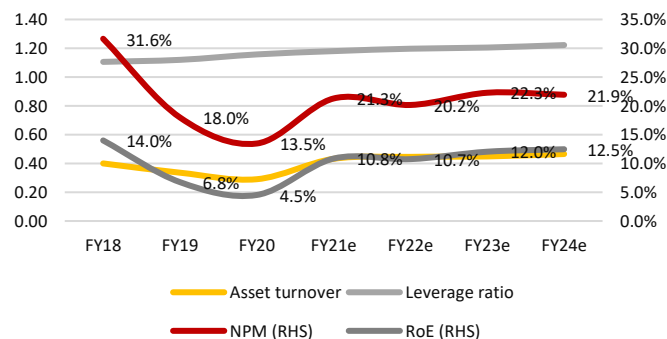
### Stable dividends yield in addition to being a virtually debt-free company

Yansab has a de-levered balance sheet with a net debt/ EBITDA of 0.1x in FY20 and stable cash flows. The stock delivered a sustainable dividend yield averaging 5% over FY18-FY20 due to the strong balance sheet and cashflows over the same period. Over the forecast period (FY21-FY24), the dividend yield is expected to average at 5%.

#### Leverage trend



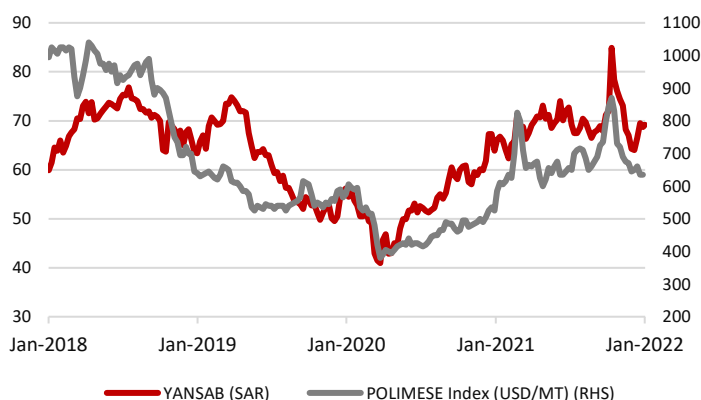
#### Components of RoE



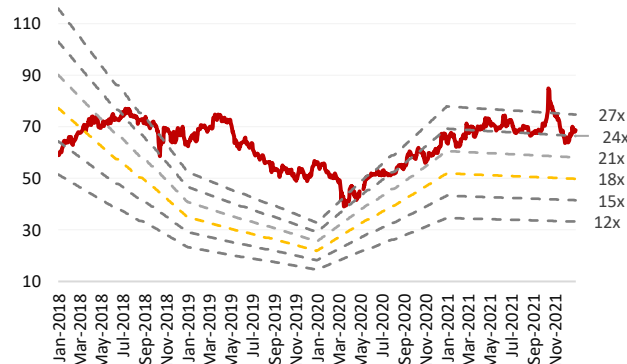
### Run up in valuation due to spike in MEG prices

From the below charts, it is evident that Yansab's stock price continues to be closely driven by the movement in the price of its key product MEG. MEG price has climbed ~73.4% from its average low of USD 414 per mt clocked during the second quarter of FY20. Similarly, Yansab's stock price has moved up ~49.2% from its average price of SAR 47.8 during the same period. Petrochemical prices, in general, have rallied up in FY21 as against FY20 due to an increase in demand and opening of economies. Accordingly, MEG prices have also moved up ~43.8% YoY in FY21. Following the rise in prices, Yansab is currently trading higher than its historical forward PE of 19.5x. Led by MEG prices going up, the market has rerated the stock buoyed by the correlation which MEG and Yansab's stock price share along with the overall positive sentiment in the market. Apart from an increase in MEG prices due to overall economic recovery in FY21, prices increase also due to reduced output from Chinese plants and European anti-dumping duty.

### Yansab stock price vs MEG



### PE band chart



### Reduced run rate of coal-based olefin plants

In a bid to support the country's carbon emission goals, China's top economic planner and energy administrator plan to upgrade coal-fired power plants nationwide. Also, the obsolete and closed coal-fired power plant will continue to exist rather than demolishing it and serve as a standby option during the time of emergency. The coal-olefins power plants have reduced their operations to reduce increased power usage after the suspension of the Yuan's coal-olefins plant in northwest Shaanxi province was suspended for violating energy consumption limits. MEG prices going ahead will likely remain impacted by any further announcement made by the government with regards to the power cut issue.

### European Anti-dumping duty

On June 12, 2021, European Commission imposed a provisional duty on imports of mono ethylene glycol from the United States and Saudi Arabia which contributed to the increase in MEG prices.



## Relative valuation

We have given a weightage of 25% each to the P/E and EV/EBITDA valuation based on multiples - average historical multiple of peers in the period 2014-2019. The peer set includes the companies from the Kingdom of Saudi Arabia. At average median peer P/E multiple of 15.2x and EV/EBITDA multiple of 10.74x, we arrive at target price of SAR 50.9 and SAR 66.1 per share respectively.

## Dividend Discount Method

We have given a weightage of 35% to DDM method. We arrive at target share price using expected dividend in 2022, expected dividend yield equal to historical dividend yield (2018-2020) and long-term growth rate of 1%. With expected dividend per share of SAR 3.8, target dividend yield 5.4% and growth rate 1%, we arrive at target price SAR 86.2 per share.

## Discounted Cash Flow

	FY22e	FY23e	FY24e	Terminal Value
Pegged on	January 20, 2022			
Time period index	0.95	1.95	2.95	2.95
<b>Free cash flow</b>				
NOPAT	1,757	1,869	1,648	
Depreciation	1,228	1,259	1,290	
Changes in Working Capital	7	1	3	
Less: Capex	(588)	(588)	(592)	
<b>Free cash flow to firm (FCFF)</b>	<b>2,403</b>	<b>2,541</b>	<b>2,349</b>	<b>19,617</b>
Discounted FCFF	2,139	2,000	1,634	13,650

Enterprise Value	19,423
Less: Net debt (Includes lease liabilities)	(3,051)
Equity Value	22,474
Shares O/S	563
Equity Value per share	40.0
Current share price (SR)	70.0
% upside/downside	-42.9%

### Assumptions

WACC	13.1%
Cost of debt / Lease Liabilities (A-T)	1.69%
Cost of Equity	13.2%
Terminal growth rate	1.0%

### Cost of equity calculation

Risk-Free Rate	2.74%
Beta	0.967
Equity Risk Premium	10.81%

### Weights

Debt	0.9%
Equity	99.1%

## About Yansab

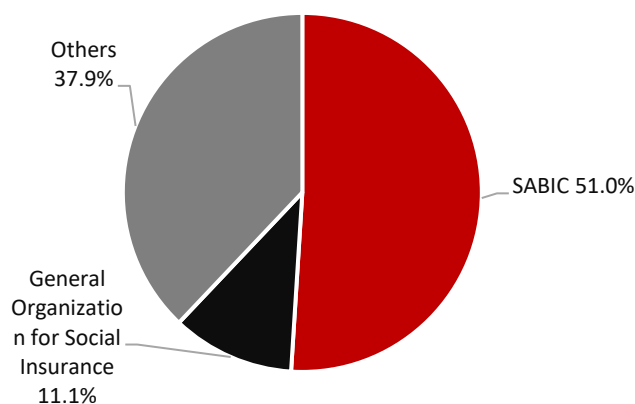
Established in 2006, Yansab is a listed Saudi joint-stock company with a fully paid-up capital of 562.5mn shares of SAR10 per share. Commenced commercial operations in 2010, Yansab is a diversified player that produces various petrochemical products with a production capacity of over 4mn tpa and comprising of basic chemicals (ethylene, propylene) to intermediate and final chemicals (HDPE, LLDPE, PP, MEG).

Products sold	Revenue contribution
Ethylene Glycol	30.1%
LLDPE	19.9%
HDPE	16.1%
Polypropylene	21.3%
Others (benzene)	12.6%

Yansab sells its products globally through SABIC. Geographically, sales to Asia represent 49% of revenues, Europe (12%), Middle East (24%), Africa (12%), and USA (3%).

Yansab has a mixed feedstock structure with propane constituting 40% and ethane (60%) of the feedstock mix. The company enjoys a long-term contract with Saudi Aramco which allowed it to receive ethane at USD0.75/ MMBtu and propane at a 30% discount to Japanese Naphtha prices. However, the feedstock grace period due to which the Saudi petrochemical companies benefitted ended in 2016. Now, Yansab receives ethane at a fixed price of USD1.75/ MMBtu (from USD0.75/ MMBtu earlier) and propane at a 20% discount to market rates (vs 30% discount to Japan naphtha price).

## Yansab's shareholding structure



Source: Bloomberg

## Key financials

(SAR mn)	FY19	FY20	FY21e	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Sales	6,065	5,035	7,408*	7,799	7,791	7,850
COGS	(4,567)	(3,946)	(5,253)*	(5,403)	(5,294)	(5,524)
<b>Gross profit</b>	<b>1,498</b>	<b>1,089</b>	<b>2,154.3*</b>	<b>2,396</b>	<b>2,497</b>	<b>2,326</b>
SG&A expenses	(402)	(361)	(494)	(444)	(421)	(495)
<b>Operating profit</b>	<b>1,096</b>	<b>728</b>	<b>1,651*</b>	<b>1,952</b>	<b>2,076</b>	<b>1,831</b>
Finance income	91	51	21	69	80	95
Other income	64	64	99	101	101	102
Finance charges	(26)	(25)	(29)	(30)	(31)	(33)
<b>Income before zakat</b>	<b>1,225</b>	<b>817</b>	<b>1,812</b>	<b>2,093</b>	<b>2,227</b>	<b>1,995</b>
Zakat	(135)	(140)	(194)	(209)	(223)	(199)
<b>Net income for the period</b>	<b>1,090</b>	<b>678</b>	<b>1,531.3*</b>	<b>1,883</b>	<b>2,004</b>	<b>1,795</b>
<b>Balance Sheet</b>						
Cash & Cash equivalents	136	20	73	224	561	813
Short-term investments	3,051	3,015	2,925	3,276	3,571	3,892
Receivables	1,753	1,793	2,457	2,519	2,517	2,529
Inventories	736	808	1,003	921	910	871
Property, plant and equipment	11,849	11,078	10,481	9,869	9,225	8,556
Intangible assets	27	26	23	20	17	14
Right of use assets	171	147	154	161	167	172
<b>Total assets</b>	<b>18,070</b>	<b>17,340</b>	<b>17,598</b>	<b>17,482</b>	<b>17,459</b>	<b>17,339</b>
Accounts payable	457	590	586	577	557	589
Accruals and other current liabilities	555	594	795	783	755	799
Lease liabilities - current	14	19	21	22	24	25
Lease liabilities	154	127	137	147	156	164
Share capital	5,625	5,625	5,625	5,625	5,625	5,625
Statutory reserve	1,688	1,688	1,688	1,688	1,688	1,688
Actuarial reserve	(8)	(155)	(155)	(155)	(155)	(155)
Retained earnings	8,838	7,828	7,758	7,532	7,426	7,111
<b>Total stockholders' equity</b>	<b>16,143</b>	<b>14,985</b>	<b>14,916</b>	<b>14,689</b>	<b>14,583</b>	<b>14,268</b>
<b>Total liabilities &amp; stockholders' equity</b>	<b>18,070</b>	<b>17,340</b>	<b>17,598</b>	<b>17,482</b>	<b>17,459</b>	<b>17,339</b>
<b>Cash Flow Statement</b>						
Cash from operating activities	2,552	1,875	2,122	3,050	3,169	3,099
Cash from investing activities	(317)	(281)	(393)	(799)	(731)	(747)
Cash from financing activities	(2,125)	(1,711)	(1,676)	(2,099)	(2,100)	(2,101)
Net changes in cash	110	(117)	53	151	338	251
Cash at the end of the period	136	20	73	224	561	813
<b>Key Ratios</b>						
Current ratio	5.1	4.4	4.3	4.6	5.1	5.2
Inventory turnover ratio	6.1	5.9	6.0	5.6	5.8	6.2
Debtors' turnover ratio	3.1	2.8	3.6	3.1	3.1	3.1
Creditors turnover ratio	10.5	7.5	9.2	9.3	9.3	9.6
Gross profit margin	24.70%	21.62%	29.08%	30.72%	32.05%	29.63%
Operating margin	18.07%	14.45%	22.29%	25.04%	26.65%	23.33%
Net profit margin	17.97%	13.46%	20.67%	24.15%	25.73%	22.87%
EBITDA margin	38.51%	37.76%	38.36%	40.77%	42.81%	39.76%
Average return on equity	6.53%	4.35%	10.82%	12.72%	13.70%	12.45%
Average return on assets	5.87%	3.83%	9.26%	10.74%	11.47%	10.32%
Debt/Equity (x)	0.01x	0.01x	0.01x	0.01x	0.01x	0.01x
Interest coverage ratio (x)	42.03x	29.37x	60.25x	64.62x	67.44x	54.90x
P/E	28.85x	53.05x	25.24x**	20.91x	19.64x	21.93x
EV/EBITDA	12.17x	17.39x	12.45x	11.42x	10.89x	11.64x
EV/Sales	4.69x	6.57x	4.90x	4.66x	4.66x	4.63x
EV/capacity x (SR)	6,890.89x	7,616.41x	8,369.52x	8,369.52x	8,369.52x	8,369.52x
EPS (SR)	1.94	1.20	2.72	3.35	3.56	3.19
Dividend payout ratio	180.66%	207.54%	104.32%	112.04%	105.27%	117.53%
Dividend yield (%)	6.26%	3.91%	4.37%	5.36%	5.36%	5.36%
Net debt (SR 'million)	32	127	86	(55)	(382)	(624)
Net debt/ EBITDA	0.01	0.07	0.03	-0.02	-0.11	-0.20
ROCE	6.48%	4.55%	10.73%	12.28%	13.05%	11.65%

Source: Company Financials, U Capital Research, note: \*actual reported numbers, \*\*calculated based on actual reported eps, market price as on 20 Jan 2022

# Saudi Industrial Investment Group

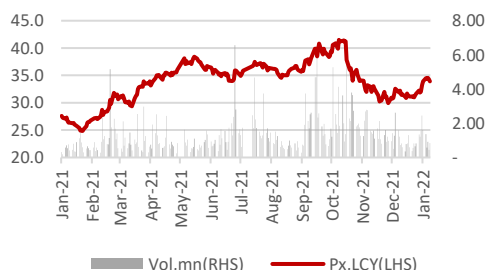
**Target Price: SAR 48.6**

**Upside: 43.3%**

<b>Recommendation</b>	BUY
Bloomberg Ticker	SIIG:AB
Current Market Price (SAR)	33.90
52wk High / Low (SAR)	41.5 / 24.8
12m Average Vol. (mn)	1.36
Mkt.Cap. (SAR bn)	15.3
Shares Outstanding (mn)	450
Free Float (%)	87%
3m Avg Daily Turnover (SAR mn)	50.9
6m Average Daily Turnover (SAR mn)	57.5
PE 2022e (x)	8.41x
EV/EBITDA 2022e (x)	7.94x
Dividend Yield '22e (%)	2.9%
<b>Price Performance:</b>	
1 month (%)	5.1%
3 months (%)	-17.8%
12 months (%)	28.7%

Source: Bloomberg, as of 20<sup>th</sup> Jan 2022

**Price-Volume Performance**



Source: Bloomberg

- **Leading petrochemical company with a well-diversified product portfolio**
- **Products expansion and diversification achieved through investments in JVs**
- **Global exposure with presence in the Middle East, Asia, and Europe/Africa**
- **Increased synergies from the proposed merger between SIIG & Petrochem to create one of the largest petrochemical companies in the Kingdom**

We initiate coverage on Saudi Industrial Investment Group (SIIG) with a **Buy** rating and a target price of SAR 48.6 per share, implying an upside of 43.3% to the last closing price (20<sup>th</sup> Jan. 2022). Our target price implies a P/E'22e of 12.0x. The stock has rallied over ~47% from its low of SAR 23.0 clocked in September 2020 triggered by the proposed merger between SIIG and Petrochem in which it already holds 50%. Despite this rally, we see a further upside led by the synergies from the merger, expanded market share, and greater pricing power by virtue of SIIG becoming one of the top three petrochemical companies in Saudi Arabia.

## Investment Thesis

**Valuation and risk:** Our valuation is based on mix of dividend discount model (35% weight), discounted cash flows (15% weight) and multiples approach (25% weight each to both PE & EV/EBITDA based multiples). SIIG is currently trading 57.4% lower than its historical forward PE of 19.7x, at 8.4x its FY22 eps of SAR 4.03. Strong business fundamentals along with the proposed merger make SIIG an attractive bet as a long-term investment.

## Global footprints; synergies from merger to augur well for the company

Apart from being well-segmented into polymers and aromatics, SIIG has enhanced its global reach. Along with its regional presence in the Middle East (17% of total revenue), it is also present in Asia (51%) and Europe/Africa (32%). SIIG's post-merger synergies include: (i) increased operational synergy in the form of extended product offerings and cost synergies (ii) Post merged entity will be well poised to tab both organic and inorganic expansion. (iii) Financial synergies in the form of expanded capital base (iv) Post merged entity will be better placed to benefit from the Shareek program. (v) The post merged entity will be better to hedge risks from oil price movement and limit its impact on earnings. (vi) Improved investor base coupled with larger market capitalization increases its chances of being included in major indices. Per the announcement made by the company, SIIG post-merger, is expected to incur annual recurring incremental earnings of SAR 13-17 million, mainly due to cost synergies.

**Risks:** Product price recovery and improved demand coupled with post-merger synergies are the key upsides to valuation, while subdued global demand and delays in the merger may be a downside risk to valuation.

### Key Indicators

Year	FY19	FY20	FY21e	FY22e	FY23e	FY24e
Sales	7,656	6,113	9,073	8,909	9,061	9,026
Gross profit	1,883	944	2,759	2,481	2,626	2,419
EBITDA	2,428	1,279	4,013	2,829	2,957	2,761
Operating profit	1,541	402	3,138	1,953	2,078	1,879
Share of an associate	274	(15)	981	252	258	263
Net income	1,284	333	3,031	1,815	1,942	1,766
EPS	1.35	0.20	6.74	4.03	4.32	3.93
P/E	1.35x	0.20x	4.62x	8.41x	7.86x	8.64x
EV/EBITDA	8.32x	16.24x	5.60x	7.94x	7.60x	8.14x
Dividend yield	3.1%	1.8%	2.9%	2.9%	2.9%	2.9%

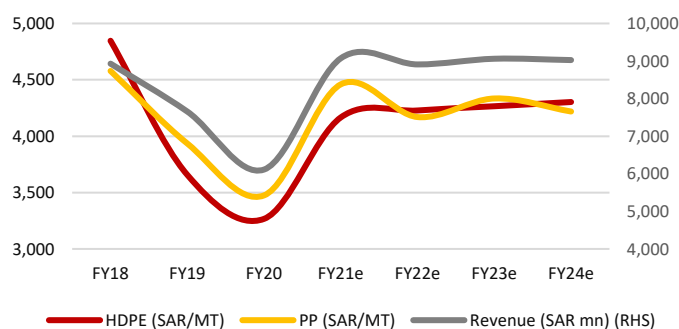
### Following a recovery in prices in 2021, topline to remain in a narrow range

Historically, the topline declined at a CAGR of 17.3% between FY18 and FY20. This was mainly due to a fall in prices of its key products polyethylene and polypropylene which fell at a CAGR of 17.9% and 12.9% respectively during the same period. Product prices in FY19 took a hit mainly due to the oversupply before falling further in FY20 resulting from a curb in demand due to the onset of the Covid crisis. Prices in FY21 recovered underpinned by a resumption in trade activities and an overall increase in demand triggered by positive sentiments in the market buoyed by the declining number of Covid cases. Revenues will continue to remain impacted by the movement in product prices which is why we see a decline in revenue by 1.8% YoY in FY22 following an increase of 48.4% YoY in FY21. We also anticipate a marginal uptick in topline in FY23 led by an improvement in product prices.

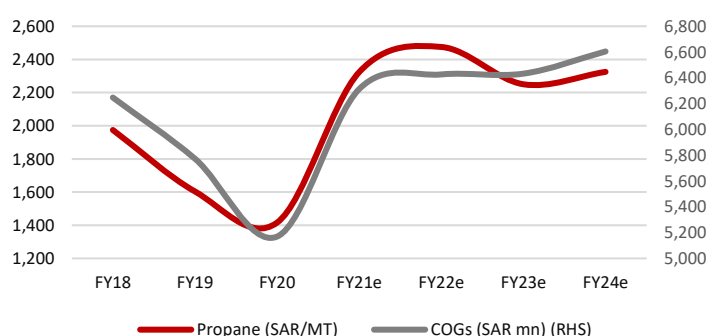
### Gross margin to remain as a function of feedstock and end-product prices

Propane remains the key feedstock for the company apart from Ethane. It accounts for ~89.1% of the total feedstock cost for the company. A closer look at the relationship between COGs and propane cost can be seen in the chart below.

**Revenue & end product prices**



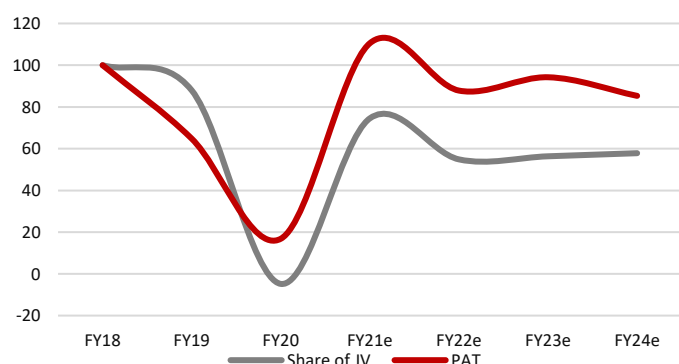
**Cost of goods sold and feedstock price**



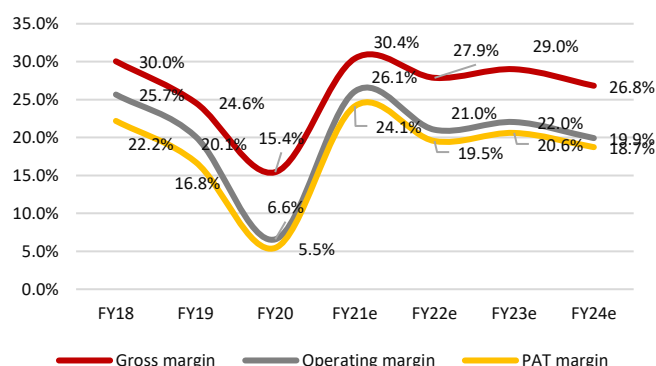
### Share of income from jointly owned projects to stabilize post the rise in FY21

The other most relevant line item driving the company's profitability apart from revenue is the share of earnings of jointly controlled projects. SIIG owns a 50% stake in each Saudi Chevron Phillips Company, Jubail Chevron Phillips Company, and Aromatics Distribution Company. The business of the jointly owned companies also lies in the manufacturing and marketing of petrochemical products which links the performance of the jointly owned projects to the movement in the petrochemical prices.

**Share of joint venture vs net profit**

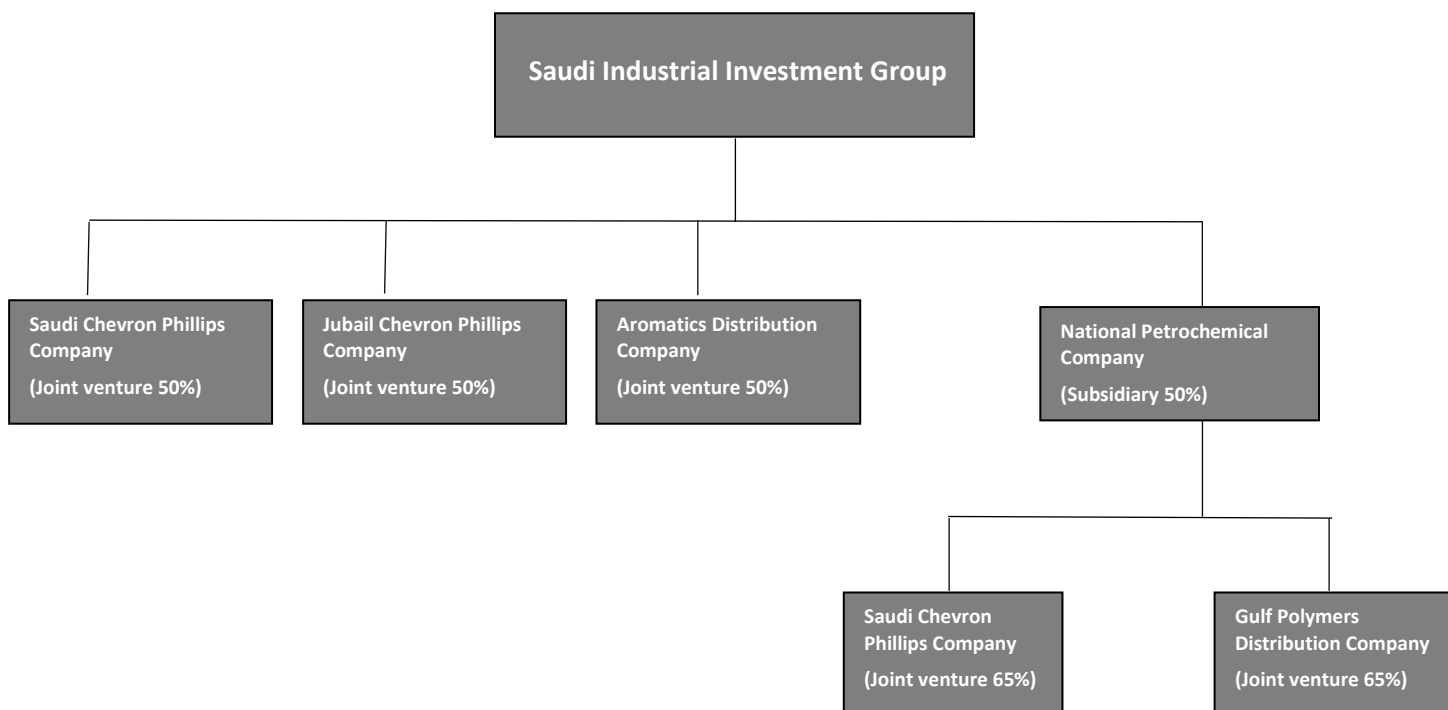


**Profit margins**



### SIIG functions like a holding company structure

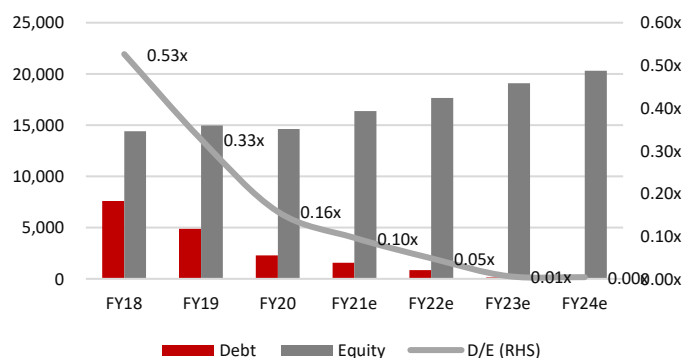
Until 2Q21, Petrochem (subsidiary) consolidated Saudi Chevron Phillips and Gulf Polymers Distribution company. However, in 3Q21, the company concluded that Petrochem exercised joint control according to the requirements of IFRS 10 & 11 and subsequently will account for it using the equity method. Thus SIIG is now effectively acting like a holding company of another holding company.



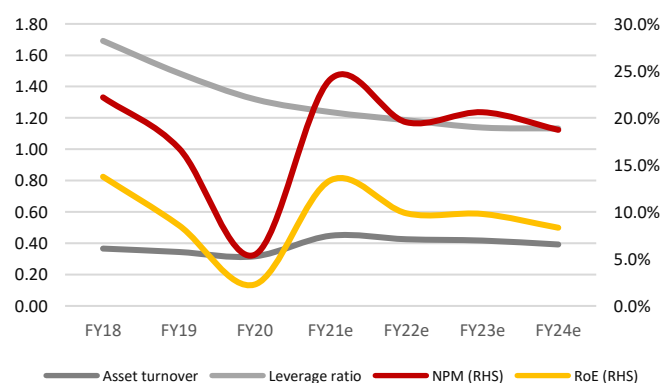
### SIIG is on the path to becoming virtually debt-free; RoE to stabilize post its rise in FY21

In a bid to refinance its existing senior debts, during FY20, SIIG obtained loans to the tune of SAR 3.0 billion, which it had planned to repay over 8 equal semi-annual installments beginning June 2020. By the end of FY23, SIIG plans to repay almost all the outstanding loans and become virtually debt-free assuming no other loans are raised by the company. By analyzing the components of return on equity (RoE), It's been observed that though RoE is marginally buoyed with improving asset turnover, but it remains majorly driven by the movement in net margin.

#### Debt and equity



#### RoE and its components



## Relative valuation

We have given a weightage of 25% each to the P/E and EV/EBITDA valuation based on multiples - average historical multiple of peers in the period 2014-2019. The peer set includes the companies from the Kingdom of Saudi Arabia. We have given a holding company discount of 20% to both the 2022e median price and enterprise-based multiples to account for not only being a holding company but the subsidiary in which it owns a stake is also a holding company. The holding company discount is commonly applied by investors while valuing holding companies. At average median peer P/E multiple of 15.8x and EV/EBITDA multiple of 8.5x, we arrive at target price of SAR 51.0 and SAR 53.5 per share respectively.

## Dividend Discount Method

We have given a weightage of 35% to DDM method. We arrive at target share price using expected dividend in 2022, expected dividend yield equal to historical dividend yield (2018-2020) and long-term growth rate of 1%. With expected dividend per share of SAR 1, target dividend yield 2.9% and growth rate 1%, we arrive at target price SAR 51.3 per share.

## Discounted Cashflow valuation

(SAR mn)	FY22e	FY23e	FY24e	Terminal Value
Pegged on				
January 20, 2022				
Time period index	0.95	1.95	2.95	2.95
<b>Free cash flow</b>				
NOPAT	1,830	1,947	1,761	
Depreciation	876	879	882	
Changes in Working Capital	85	(20)	(1)	
Less: Capex	(37)	(38)	(38)	
Free cash flow to firm (FCFF)	2,754	2,768	2,604	13,394
Discounted FCFF	2,307	1,921	1,498	7,704

Enterprise Value	13,430
Less: Net debt (Includes lease liabilities) as of 30th June 2021	(64)
Equity Value	13,494
Shares O/S	450
Equity Value per share	30.0
Current share price (SR)	33.9
% upside/downside	-11.5%

### Assumptions

WACC	20.6%
Tax Rate	12.3%
Cost of debt / Lease Liabilities (A-T)	1.96%
Cost of Equity	23.08%
Terminal growth rate	1.0%

### Cost of equity calculation

Risk-Free Rate	2.74%
Beta	1.349
Equity Risk Premium	15.08%

### Weights

Debt	11.6%
Equity	88.4%

## About SIIG

Established in 1996 in Riyadh, Kingdom of Saudi Arabia; Saudi Industrial Investment Group (SIIG) is a joint-stock company that engages in industrial investment activities especially in the field of petrochemicals. The company commenced its first project in alliance with Chevron Phillips Petrochemical Co., a partner with experience in the complex field of petrochemicals. The company through its subsidiary and joint ventures is engaged in the production of petrochemicals Benzene, Cyclohexane, Styrene, Propylene, Ethylene, Polyethylene, Polypropylene 1-Hexane along with motor gasoline

The entity was established with an aim to invest in the petrochemical industry to accelerate industrial development in Saudi's economy and give the opportunity to the local private sector to participate in other industries

The company operations through the following subsidiary and joint ventures

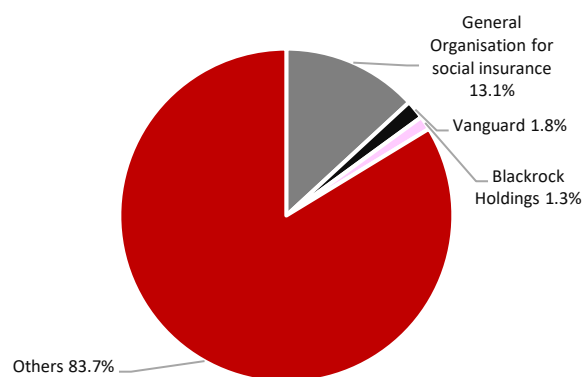
Company	Type	% owned
National Petrochemical Company (Petrochem)	Subsidiary	50%
Saudi Chevron Phillips Company	Joint venture	50%
Jubail Chevron Phillips Company	Joint venture	50%
Aromatics Distribution Company	Joint venture	50%
Saudi Polymers Company	Joint venture	65%
Gulf Polymers Distribution Company	Joint venture	65%

Products sold *	Revenue contribution
Polyethylene	73%
Polypropylene	27%

*Note: For SIIG revenue is coming from revenue reported by Petrochem. Petrochem sold products manufactured by its subsidiaries which are no longer considered as subsidiaries. But our model for SIIG is built on the assumption that Petrochem still owns subsidiaries.*

Geographically, SIIG's sales to Asia represent 51%, Europe/Africa amounts to 32% and domestic (Middle East) sales are 17%.

## SIIG's shareholding structure



Source: Bloomberg



## Key Financials

(SAR mn)	FY19	FY20	FY21e	FY22e	FY23e	FY24e
<b>Income Statement</b>						
Sales	7,656	6,113	9,073	8,909	9,061	9,026
Cost of sales	(5,773)	(5,169)	(6,315)	(6,429)	(6,435)	(6,607)
<b>Gross profit</b>	1,883	944	2,759	2,481	2,626	2,419
Selling and distribution expenses	(422)	(333)	(454)	(499)	(507)	(505)
General and administrative expenses	(194)	(193)	(148)	(282)	(299)	(298)
Share in earnings of jointly controlled projects, net	274	(15)	981	252	258	263
<b>Operating profit</b>	1,541	402	3,138	1,953	2,078	1,879
Finance costs	(225)	(78)	(57)	(44)	(33)	(22)
Finance income	112	32	15	15	15	15
Other income-net	14	24	13	13	13	13
<b>Profit before zakat and income tax</b>	1,442	380	3,109	1,936	2,072	1,885
Zakat expense	(158)	(47)	(78)	(122)	(130)	(119)
<b>Profit for the year</b>	1,284	333	3,031	1,815	1,942	1,766
<b>Balance Sheet</b>						
Property, plant and equipment	14,176	12,951	12,132	11,311	10,489	9,666
Investments in joint ventures accounted for using the equity method	2,011	1,291	2,272	2,525	2,783	3,046
Inventories	915	1,013	1,121	1,141	1,142	1,170
Prepayments and other current assets	94	148	165	162	165	164
Trade receivables	906	785	1,121	1,101	1,120	1,112
Cash and cash equivalents	3,658	2,081	3,113	4,503	5,910	7,829
<b>Total assets</b>	22,235	19,306	20,968	21,791	22,660	24,040
Share capital	4,500	4,500	4,500	4,500	4,500	4,500
Statutory reserve	897	906	906	906	906	906
Retained earnings	1,397	1,005	3,587	4,951	6,443	7,760
Non-controlling interests	8,174	8,222	8,222	8,222	8,222	8,222
<b>Total equity</b>	14,968	14,633	17,214	18,579	20,071	21,388
Long-term borrowings	3,435	1,494	1,014	528	37	3
Lease liabilities	52	42	35	39	44	49
Trade payables	203	301	296	301	301	308
Accrued and other liabilities	364	392	382	459	461	472
Current portion of long-term borrowings	1,210	743	504	263	18	1
Current portion of lease liabilities	13	23	19	21	24	27
<b>Total equity and liabilities</b>	22,235	19,306	20,968	21,791	22,660	24,040
<b>Cash Flow Statement</b>						
Cash from operations	2,662	1,794	2,523	2,631	2,644	2,459
Cash from investing activities	332	(18)	(38)	(37)	(38)	(38)
Cash from financing	(3,443)	(3,353)	(1,453)	(1,204)	(1,200)	(502)
Net changes in cash	(449)	(1,577)	1,032	1,390	1,406	1,919
Cash at the end of period	3,658	2,081	3,113	4,503	5,910	7,829
<b>Key Ratios</b>						
Current ratio	1.9	1.9	3.1	4.0	5.2	6.1
Inventory turnover ratio	8.4	6.0	8.1	7.8	7.9	7.7
Debtors' turnover ratio	8.4	7.8	8.1	8.1	8.1	8.1
Creditors turnover ratio	28.4	17.2	21.4	21.4	21.4	21.4
Gross profit margin	24.59%	15.43%	30.40%	27.85%	28.98%	26.80%
Operating margin	20.12%	6.58%	34.59%	21.92%	22.93%	20.82%
Net profit margin	16.77%	5.45%	33.41%	20.37%	21.43%	19.57%
EBITDA margin	31.71%	20.93%	44.23%	31.75%	32.63%	30.59%
Average return on equity	8.74%	2.3%	19.0%	10.1%	10.0%	8.5%
Average return on assets	5.51%	1.60%	15.05%	8.49%	8.74%	7.56%
Debt/Equity (x)	0.31x	0.16x	0.09x	0.05x	0.01x	0.00x
Debt/Capital (x)	0.24x	0.14x	0.08x	0.04x	0.01x	0.00x
Interest coverage ratio (x)	6.85x	5.14x	54.59x	44.11x	62.55x	84.62x
P/E	17.78x	137.00x	4.62x	8.41x	7.86x	8.64x
EV/EBITDA	8.32x	16.24x	5.60x	7.94x	7.60x	8.14x
EV/Sales	2.64x	3.40x	2.48x	2.52x	2.48x	2.49x
EPS (SR)	1.35	0.20	6.74	4.03	4.32	3.93
ROCE	8.01%	2.39%	16.58%	9.84%	9.95%	8.46%

Source: Company Financials, U Capital Research

## Disclaimer

### Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%



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