



**US\$1.848bn** Market cap    **92.3%** Free float    **US\$3.131mn** Avg. daily volume

Target price **23.30** 23.33% over current  
 Consensus price **24.90** 31.7% over current  
 Current price **18.90** as at 29/7/2012

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**Underweight**    **Neutral**    **Overweight**

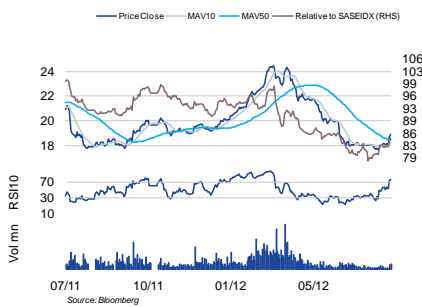
**Key themes**

We expect Saudi petrochemical suppliers to outperform global rivals with margins driven by cheap feedstock costs and strong demand emanating from Asia. Sipchem's production is currently focused on methanol and its derivatives, with a heavy concentration toward Chinese demand.

**Implications**

Sipchem commissioned its Phase 2 expansion program in mid-2010. The Phase 3 facility, which will come online in 2013, is expected to broaden its product portfolio. We remain Overweight on the stock.

**Performance**

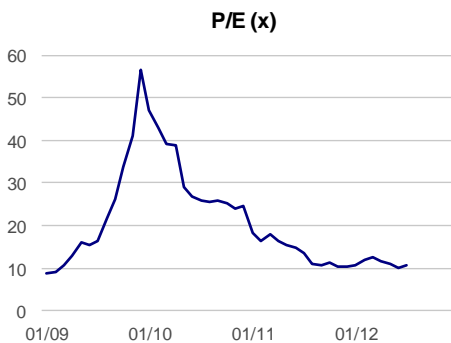


**Earnings**

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	3,324	3,878	3,792	4,406
Revenue Growth	66.8%	16.6%	-2.2%	16.2%
EBITDA (mn)	1,768	1,662	1,615	1,820
EBITDA Growth	65.3%	-6.0%	-2.9%	12.7%
EPS	1.93	1.69	1.58	2.02
EPS Growth	87.0%	-12.5%	-6.1%	27.7%

Source: Company data, Al Rajhi Capital

**Valuation**



Source: Company data, Al Rajhi Capital

# Sipchem Shutdown dented Q2 results

Sipchem reported a net profit of SAR136mn, down 18.2% year-on-year. The reported earnings were significantly below our forecasts of SAR166mn as well as consensus estimate of SAR160mn. The company's Q2 performance was materially affected by an undisclosed but planned maintenance shutdown at its acetic acid and carbon monoxide plants, despite higher methanol prices. Methanol prices remained healthy during Q2 with a 3.1% q-o-q increase, bucking the declining trend in other petrochemical prices. We expect the average prices of methanol to remain largely stable in the near-term as rising demand for blending with traditional fuels will support prices. Sipchem remains one of our preferred stocks in the Saudi petrochemical space, as we believe the company will achieve better operating rates in the coming quarters. We maintain our Overweight rating on the stock with an unchanged target price of SAR23.3 per share.

**Lower production owing to maintenance, hampered Q2:** According to the Q2 earnings release, Sipchem conducted an undisclosed but planned maintenance shutdown at its acetic acid and carbon monoxide plants in Q2. However, there were no reports of similar shutdown at its methanol plant. That said, Sipchem remains one of the most efficiently-run companies with more than 100% utilization rate. We expect the operating rates to recover in Q3 2012, thus marginally improving Sipchem's performance on a q-o-q basis.

**Methanol prices to remain strong:** Methanol prices remained resilient in Q2, improving by 3.1% q-o-q, whereas prices of other petrochemical products declined by more than 8-15%. As methanol is used increasingly for fuel blending, its demand drivers are starkly different from other basic petrochemicals. We believe the recent slowdown in industrial activities in China and possible influx of Iranian methanol supply in the Asian markets can pose near-term headwinds. Hence, we expect methanol prices to remain in the range of USD370-380/tonne for the remainder of 2012.

**SAR1.4bn loan approved for Sipchem's subsidiary – IPC:** International Polymers Company (IPC) – one of the subsidiaries of Sipchem – has signed SAR1.4bn loan and bridge facilities with four major Saudi banks to fund the development of its EVA/LDPE plant. The loan is repayable after 2.5 years in semi-annual instalments. The plant is currently under construction and is expected to commence production in H2 2013, with an annual production capacity of 200,000tpa in Jubail Industrial City.

**H2 2012 performance to remain robust:** Despite weak Q2 results, we estimate that stable methanol prices and higher utilization rates will help the company to deliver a robust H2 performance. We expect Sipchem to report revenue of SAR963mn (up by 11.3% y-o-y) in Q3 2012 with a net profit of SAR163mn.

**Valuation and conclusion:** Despite a weak Q2, we expect Sipchem to continue its strong performance on the back of 1) methanol exposure, 2) strong financials and 3) more than 100% utilization rate. Further, the company can continue to pay healthy dividends and hence, maintain its attractive dividend yield (5.3% annualized for 2012E). We retain our Overweight rating with an unchanged target price of SAR23.3, implying a 23.3% upside from the current levels.



### Corporate summary

Sipchem is something of a rarity in the Saudi petrochemicals sector. While the other big players like SABIC and PetroRabigh are owned directly or indirectly by the government, Sipchem is a company promoted by a private sector enterprise – the Zamil Industrial Group (the government owns only 8% through the Public Investment Fund).

### Share information

Market cap (SAR/US\$) 6.93bn / 1.848bn  
 52-week range 17.65 - 24.45  
 Daily avg volume (US\$) 3.131mn  
 Shares outstanding 366.7mn  
 Free float (est) 92.3%

Performance:

	1M	3M	12M
Absolute	5%	-12.9%	-10.9%
Relative to index	2.2%	-2.5%	-15.9%

Major Shareholder:

Al-Zamil Group Holding Co.	9.6%
National Industries Group Holding.	8.3%

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	3,324	3,878	3,792	4,406
EBITDA (SARmn)	1,768	1,662	1,615	1,820
Net Profit (SARmn)	707	619	581	742
EPS (SAR)	1.93	1.69	1.58	2.02
DPS (SAR)	1.25	1.25	1.45	1.38
EPS Growth	87.0%	-12.5%	-6.1%	27.7%
EV/EBITDA (x)	6.4	7.1	7.8	6.8
P/E (x)	9.8	11.2	11.9	9.3
P/B (x)	1.2	1.2	1.2	1.1
Dividend Yield	6.6%	6.6%	7.7%	7.3%

Source: Company data, Al Rajhi Capital

Weak Q2 results due to maintenance shutdown

## Promising growth ahead

### Below-par Q2 results on lower production volumes

Sipchem posted Q2 revenues of SAR904mn, up 8.8% y-o-y, but below our estimates of SAR1,091mn, primarily due to an undisclosed maintenance shutdown, despite an improvement in methanol prices. The Q2 performance was hit by lower plant utilization as well as an increase in interest expenses due to an issuance of Sukuk. We believe the overall utilization rates were close to 90% in Q2, as the company underwent a shutdown activity at its acetic acid and carbon monoxide plants.

In Q3, we expect the company to improve its utilization rate to around 100% and hence estimate revenues to be around SAR963mn (+6.5% q-o-q) on relatively stable methanol prices. We expect net profit in Q2 to be close to SAR163mn on higher revenue base and lower cost of sales as a percentage of revenue.

Figure 1 Sipchem: summary of Q2 2012 results

(SAR mn)	Q2 2011 actual	Q1 2012 actual	Q2 2012 ARC est	Q2 2012 actual	% chg y-y	Q3 2011 actual	Q3 2012 ARC est	% chg y-y
Revenues	832	1,058	1,091	904	8.8%	865	963	11.3%
Gross profit	316	335	355	314	-0.7%	417	337	-19.2%
Gross margin	38.1%	31.6%	32.6%	34.7%	-331 bps	48.2%	35.0%	-1322 bps
EBITDA	400	416	424	404	0.9%	505	424	-16.1%
EBITDA margin (%)	48.1%	39.3%	38.9%	44.6%	-349 bps	58.4%	44.0%	-1439 bps
Operating Profit	288	304	323	283	-1.6%	393	308	-21.5%
Net profit	166	152	166	136	-18.2%	208	163	-21.8%
Capex	(220)	(251)	(475)	(492)	123.7%	(112)	(450)	300.3%
Capex / Sales	26.5%	23.7%	43.5%	54.5%	n/m	13.0%	45.9%	n/m
Net debt	2,945	2,501	3,126	3,012	2.3%	2,679	3,050	13.9%
Net debt / Annualized EBITDA (x)	1.8	1.5	1.8	1.9	n/m	1.3	1.8	n/m

Source: Company data, Al Rajhi Capital

Interim dividend announcement has been viewed positively by the market

### Interim dividend of SAR0.5 per share

Sipchem announced an interim dividend of SAR0.5 per share for the first half of year 2012 on July 28<sup>th</sup>, which translates to an annualized dividend yield of 5.3%. The Company has said that this interim cash dividend reflects its continuing interest to maximize shareholders returns. It is pertinent to note that Sipchem has not announced interim dividends in the last few years and hence this step has been viewed positively by the market (+4.4% since the dividend announcement).



Phase II expansion program is driving strong revenue growth

We expect EPS to grow at a double digit over 2012-14

Sipchem has one of the lowest cost structures in the world, which supports its margins

Income Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
<b>Revenue</b>	<b>1,993</b>	<b>3,324</b>	<b>3,878</b>	<b>3,792</b>	<b>4,406</b>
Cost of Goods Sold	(1,131)	(1,898)	(2,563)	(2,545)	(2,930)
<b>Gross Profit</b>	<b>861</b>	<b>1,427</b>	<b>1,315</b>	<b>1,248</b>	<b>1,476</b>
Government Charges					
S.G. & A. Costs	(97)	(125)	(119)	(114)	(132)
<b>Operating EBIT</b>	<b>764</b>	<b>1,302</b>	<b>1,196</b>	<b>1,134</b>	<b>1,344</b>
Cash Operating Costs	(923)	(1,556)	(2,216)	(2,177)	(2,586)
EBITDA	1,069	1,768	1,662	1,615	1,820
Depreciation and Amortisation	(305)	(466)	(467)	(481)	(476)
<b>Operating Profit</b>	<b>764</b>	<b>1,302</b>	<b>1,196</b>	<b>1,134</b>	<b>1,344</b>
Net financing income/(costs)	(100)	(169)	(164)	(168)	(138)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	(4)	-	-	-	-
Other Expenses					
<b>Net Profit Before Taxes</b>	<b>660</b>	<b>1,133</b>	<b>1,032</b>	<b>966</b>	<b>1,206</b>
Taxes	(44)	(26)	(45)	(37)	(30)
Minority Interests	(238)	(400)	(369)	(348)	(434)
<b>Net profit available to shareholders</b>	<b>378</b>	<b>707</b>	<b>619</b>	<b>581</b>	<b>742</b>
Dividends	-	(458)	(458)	(532)	(504)
Transfer to Capital Reserve					
	<b>12/10A</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>
Adjusted Shares Out (mn)	366.7	366.7	366.7	366.7	366.7
CFPS (SAR)	2.513	4.289	3.965	3.845	4.506
EPS (SAR)	1.031	1.928	1.687	1.585	2.023
DPS (SAR)	0.000	1.250	1.250	1.450	1.376
	<b>12/10A</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>
<b>Growth</b>					
Revenue Growth	139.9%	66.8%	16.6%	-2.2%	16.2%
Gross Profit Growth	259.7%	65.6%	-7.9%	-5.1%	18.3%
EBITDA Growth	218.6%	65.3%	-6.0%	-2.9%	12.7%
Operating Profit Growth	354.0%	70.4%	-8.2%	-5.2%	18.5%
Net Profit Growth	168.4%	87.0%	-12.5%	-6.1%	27.7%
EPS Growth	168.4%	87.0%	-12.5%	-6.1%	27.7%
	<b>12/10A</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>
<b>Margins</b>					
Gross profit margin	43.2%	42.9%	33.9%	32.9%	33.5%
EBITDA margin	53.7%	53.2%	42.9%	42.6%	41.3%
Operating Margin	38.4%	39.2%	30.8%	29.9%	30.5%
Pretax profit margin	33.1%	34.1%	26.6%	25.5%	27.4%
Net profit margin	19.0%	21.3%	16.0%	15.3%	16.8%
	<b>12/10A</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>
<b>Other Ratios</b>					
ROCE	6.9%	9.8%	8.9%	8.2%	9.8%
ROIC	8.0%	13.6%	11.9%	10.4%	11.6%
ROE	7.7%	13.4%	10.8%	9.9%	12.3%
Effective Tax Rate	6.7%	2.3%	4.3%	3.8%	2.5%
Capex/Sales	18.9%	27.1%	42.4%	32.8%	10.0%
Dividend Payout Ratio	0.0%	64.8%	74.1%	91.5%	68.0%
	<b>12/10A</b>	<b>12/11A</b>	<b>12/12E</b>	<b>12/13E</b>	<b>12/14E</b>
<b>Valuation Measures</b>					
P/E (x)	18.3	9.8	11.2	11.9	9.3
P/CF (x)	7.5	4.4	4.8	4.9	4.2
P/B (x)	1.4	1.2	1.2	1.2	1.1
EV/Sales (x)	5.9	3.4	3.1	3.3	2.8
EV/EBITDA (x)	11.1	6.4	7.1	7.8	6.8
EV/EBIT (x)	15.5	8.6	9.9	11.1	9.2
EV/IC (x)	1.3	1.2	1.1	1.1	1.1
Dividend Yield	0.0%	6.6%	6.6%	7.7%	7.3%

Source: Company data, Al Rajhi Capital



Phase III expansion program is expanding the balance sheet

Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	1,621	3,630	3,103	2,572	2,478
Current Receivables	596	688	686	801	837
Inventories	209	281	305	411	441
Other current assets	-	-	-	-	-
<b>Total Current Assets</b>	<b>2,426</b>	<b>4,599</b>	<b>4,093</b>	<b>3,784</b>	<b>3,755</b>
Fixed Assets	9,568	9,993	11,140	11,902	11,866
Investments	-	-	-	-	-
Goodwill	-	34	34	34	34
Other Intangible Assets	33	39	68	68	68
Total Other Assets	-	-	-	-	-
<b>Total Non-current Assets</b>	<b>9,601</b>	<b>10,066</b>	<b>11,243</b>	<b>12,004</b>	<b>11,969</b>
<b>Total Assets</b>	<b>12,027</b>	<b>14,665</b>	<b>15,336</b>	<b>15,788</b>	<b>15,724</b>
Short Term Debt	410	542	648	648	648
Accounts Payable	447	721	1,143	1,298	1,322
Accrued Expenses	-	-	-	-	-
Zakat Payable	-	54	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
<b>Total Current Liabilities</b>	<b>857</b>	<b>1,317</b>	<b>1,791</b>	<b>1,947</b>	<b>1,970</b>
Long-Term Debt	4,561	5,674	5,633	5,633	5,119
Other LT Payables	543	586	564	564	564
Provisions	53	66	75	75	75
<b>Total Non-current Liabilities</b>	<b>5,156</b>	<b>6,326</b>	<b>6,271</b>	<b>6,271</b>	<b>5,757</b>
Minority interests	1,092	1,391	1,478	1,651	1,868
Paid-up share capital	3,333	3,667	3,667	3,667	3,667
Total Reserves	1,588	1,964	2,129	2,252	2,462
<b>Total Shareholders' Equity</b>	<b>4,921</b>	<b>5,630</b>	<b>5,796</b>	<b>5,918</b>	<b>6,129</b>
<b>Total Equity</b>	<b>6,014</b>	<b>7,022</b>	<b>7,273</b>	<b>7,570</b>	<b>7,997</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>12,027</b>	<b>14,665</b>	<b>15,336</b>	<b>15,788</b>	<b>15,724</b>

High net debt resulting from the Phase III expansion program to come down gradually

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	3,350	2,586	3,178	3,709	3,289
Net Debt/EBITDA (x)	3.13	1.46	1.91	2.30	1.81
Net Debt to Equity	55.7%	36.8%	43.7%	49.0%	41.1%
EBITDA Interest Cover (x)	10.7	10.4	10.2	9.6	13.2
BVPS (SAR)	13.42	15.36	15.81	16.14	16.71

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
<b>Net Income before Tax &amp; Minority Interest</b>	<b>660</b>	<b>1,133</b>	<b>1,032</b>	<b>966</b>	<b>1,206</b>
Depreciation & Amortisation	305	466	467	481	476
Decrease in Working Capital	(535)	184	345	(66)	(43)
Other Operating Cashflow	(55)	(17)	(47)	(37)	(30)
<b>Cashflow from Operations</b>	<b>375</b>	<b>1,765</b>	<b>1,797</b>	<b>1,344</b>	<b>1,610</b>
Capital Expenditure	(376)	(900)	(1,644)	(1,243)	(441)
New Investments	79	(19)	-	-	-
Others	(9)	-	0	-	-
<b>Cashflow from investing activities</b>	<b>(306)</b>	<b>(919)</b>	<b>(1,643)</b>	<b>(1,243)</b>	<b>(441)</b>
<b>Net Operating Cashflow</b>	<b>69</b>	<b>846</b>	<b>154</b>	<b>101</b>	<b>1,169</b>
Dividends paid to ordinary shareholders	(336)	-	(458)	(458)	(532)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(48)	(107)	(288)	(174)	(217)
<b>Cashflow from financing activities</b>	<b>(280)</b>	<b>1,163</b>	<b>(681)</b>	<b>(632)</b>	<b>(1,263)</b>
Total cash generated	(211)	2,009	(527)	(531)	(94)
Cash at beginning of period	1,831	1,621	3,630	3,103	2,572
<b>Implied cash at end of year</b>	<b>1,621</b>	<b>3,630</b>	<b>3,103</b>	<b>2,572</b>	<b>2,478</b>

We expect capex to remain heavy over 2012-2013

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	18.9%	27.1%	42.4%	32.8%	10.0%

Source: Company data, Al Rajhi Capital



## Disclaimer and additional disclosures for Equity Research

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#### 1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"**Overweight**": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"**Neutral**": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

#### 2. Definitions

"**Time horizon**": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"**Fair value**": We estimate fair 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.

"**Target price**": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

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.

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