Saudi International Petrochemical Co
Petrochemicals – Industrial
SIPCHEM AB: Saudi Arabia

الراجحي المالية
Al Rajhi Capital

US$3.007bn	72%	US$7.03mn
Market cap	Free float	Avg. daily volume

Target price	31.90	3.9% over current
Consensus price	31.50	2.6% over current
Current price	30.70	as at 15/4/2014

Existing rating

Underweight	Neutral	Overweight

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Sipchem
Unplanned stoppage hits Q1

Sipchem's adjusted net profit (adjusted for a one-time merger study expense of SAR20mn) stood at SAR88.7mn, missing our and consensus estimates by a wide margin. The company had announced a two-week emergency shutdown at its methanol and carbon monoxide (CO) plants and this resulted in a forced stoppage at its acetic acid and butanediol units due to unavailability of feedstock. The overall impact on the bottom-line was much higher than the management guidance of SAR48mn. In addition to the stoppages in Q1, butanediol plant is undergoing a 35-day shutdown right now. Further, methanol prices have been witnessing a sharp decline over the last couple of months due to slowdown in China. These factors together will negatively impact FY2014 earnings and we have revised our estimates downward. Considering the recent run-up in the stock price and limited catalysts in the near term, we downgrade the stock to Neutral and revise our target price to SAR31.9.

Earnings vs. our forecast	Above	In Line	**Below**
Likely impact:			
Earnings estimates	Up	No Change	**Down**
Dividend estimates	Up	**No Change**	Down
Recommendation	Upgrade	No Change	**Downgrade**
Long term view	Stronger	**Confirmed**	Weaker

- **Top-line lower than our expectation:** Revenues stood at SAR916.7mn (+6.9% y-o-y), missing our (SAR1,085mn) and consensus (SAR1,036mn) estimates by a wide margin. We had adjusted the operating rates downward after the guidance in January. However, our calculations indicate that the average utilization rates stood at ~70%, which was well below our estimates.
- **Unplanned stoppage hits operating profit:** Sipchem reported operating profit of SAR167.7mn, which was well below our (SAR267.9mn) and consensus (SAR288.5mn) estimates. However, improved efficiency helped Sipchem's operating profit grow at a faster clip (+12% y-o-y) than its revenue growth. Operating margin improved by 83bps y-o-y to 18.3%.
- **Bottom-line disappoints:** Lower operating profit passed down to the bottom-line. Additionally, a one-time merger study expense of SAR20mn negatively impacted Sipchem's net profit, which came in at SAR68.7mn, missing our and consensus estimates of SAR147.5mn and SAR167.8mn respectively.

Figure 1 Sipchem: Summary of Q1 2014 results

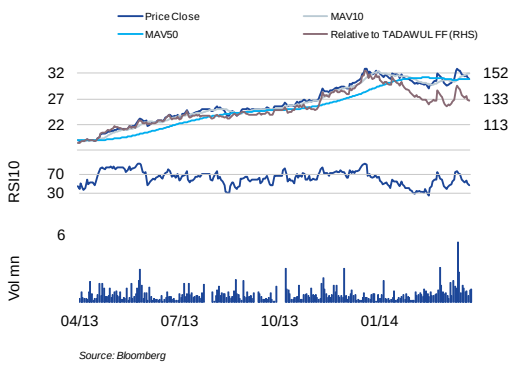
SAR (mn)	Q1 2013	Q4 2013	Q1 2014	% chg y-o-y	% chg q-o-q	ARC est
Revenue	857.4	1,237.0	916.7	6.9%	-25.9%	1,084.6
EBITDA	279.6	517.7	299.3	7.1%	-42.2%	351.0
EBITDA margin	32.6%	41.8%	32.7%	4.1 bps	-919.7 bps	32.4%
Operating profit	149.7	360.7	167.7	12.0%	-53.5%	267.9
Net profit	64.5	196.8	68.7	6.5%	-65.1%	147.5

Source: Bloomberg, Al Rajhi Capital

Flash view

Flash View is an analyst's preliminary interpretation of a results announcement or the impact of a major event. Our investment rating and earnings estimates are not being changed in this report. Any formal changes to our investment rating or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed here.

Performance

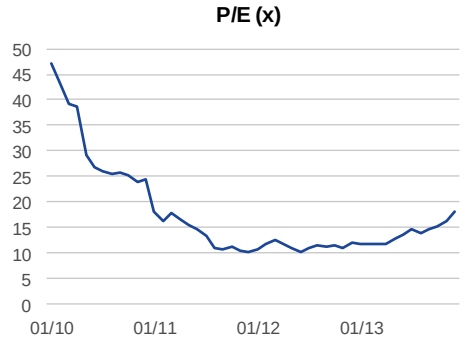


Earnings

Period End (SAR)	12/12A	12/13A	12/14E	12/15E
Revenue (mn)	3,922	4,006	4,201	4,211
Revenue Growth	18.0%	2.1%	4.9%	0.2%
EBITDA (mn)	1,651	1,720	1,586	1,756
EBITDA Growth	-6.6%	4.2%	-7.8%	10.7%
EPS	1.60	1.75	1.69	2.00
EPS Growth	-16.9%	9.4%	-3.7%	18.6%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

- **Conclusion and Valuation:** Considering Sipchem's credible operating history, an unscheduled stoppage at its methanol and CO units came in as a negative surprise for us. The shutdown totaled 30 days, which was almost the same the company had reported in Q1 2013 (33 days). The shutdown led to production outage at its downstream acetic acid and butanediol units. In addition to these shutdowns in Q1, Sipchem has undertaken maintenance and expansion activities at its butanediol plant, which will consume 35 operating days in Q2. Furthermore, methanol prices have nosedived over the last few months due to manufacturing slowdown in China. Overall, the stoppages coupled with declining methanol prices will have a negative impact on the company's FY2014 earnings. As a result, we have revised our earnings estimates downward for the fiscal year.

  Moreover, Sipchem stock rallied by over 50% since the announcement of the merger till its peak price of SAR32.9 on January 2, 2014. Since then, the price movement has been range bound. This indicates the enthusiasm surrounding the Sipchem-SPC merger have been factored in the current stock price.

  In the view of these factors, we revise our target price downward to SAR31.9 a share and downgrade the stock to Neutral.

- **Sipchem-SPC sign a memorandum of understanding (MoU):** According to a filing on Tadawul, both the companies have completed initial studies on the proposed merger and signed an MoU to initiate final due diligence process. After discussions, the companies have agreed that Sipchem will issue 300,574,575 new shares to SPC shareholders in exchange of all the stock issued by SPC, indicating a swap ratio of 0.685. Subsequent to this, Sipchem will have 667,241,241 shares with a capital of SAR6.67bn. At yesterday's close, SPC share price stood at SAR21.2, which is close to SAR 21.03, which should be the swap price considering Sipchem's closing price of SAR30.7.

Major Q1 developments

Sipchem begins maintenance at butanediol plant

Sipchem shut down its butanediol plant for turnaround activities beginning April 1st, 2014. The 35-day shutdown period will also be used for expansion of its existing plant facilities as per the recent details released by Sipchem. The company stated that a financial impact of SAR5mn will be shown in the Q2 2014 results.

Sipchem launches operations at cable insulation polymers plant

In early March, Sipchem announced that it has begun experimental operations at its subsidiary – Gulf Advanced Cables Insulation Company – which is a part of its Phase III projects. Raw material required for the polymer production will come from Sipchem's EVA/LDPE plant, whose trial run is expected to begin in Q2 this year. However, Sipchem did not provide any further details such as a date for launching commercial operations and the financial impact of both of these plants.

Sipchem to begin experimental operations at PBT plant in Q4

Sipchem announced that 77% of construction work at its Polybutylene Terephthalate (PBT) plant has been completed, and added that initial operations are expected to commence in Q4 2014. The PBT plant, which is being constructed at a cost of around SAR600mn, will have a capacity of 63 ktpa. Raw material (butanediol) required for producing PBT will be supplied by Sipchem's affiliate – International Diol Company. PBT is a highly specialized resin used in manufacturing compounds that have applications in automotive, electrical, electronics and IT material industries.

Disclaimer and additional disclosures for Equity Research

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Additional disclosures

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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