VTB Capital

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Initiation of Coverage

MENA Petrochemicals

Best positioned for margin doldrums

With this report, we are initiating coverage of ten petrochemical and fertiliser stocks in the MENA region. We believe the prospects of supercycle margins are marginal even beyond 2014, and the MENA producers, which enjoy both the lowest costs and lower than average financial leverage, offer the most attractive way to gain exposure to the sector. With multiples close to all-time lows (on subdued margin growth expectations of 6% for 2012-13E), as seen with regional bellwether SABIC (Figure 4), we see attractive opportunities in SABIC (+31% expected 12M total return in USD), Yansab (+25%) & NIC (+62%).

No near-term prospects for supercycle margins. Marginal producers' margins are hovering in between the second and third quartile across most categories, but we see little short- to medium-term opportunities of recovery beyond these levels. IP momentum has stalled, and with Asian domestic demand weakening and exports declining sharply, the risk is to the downside.

Asian demand reverts to trend, EU in decline. Asian demand has been the major element of demand growth and surprises over the last three years. With growth returning to trend levels and possibly lower in Asia, we see effective normalised global ethylene operating rates (a key barometer) breaching 75% on downside. Asian capacity growth has to some degree been at the expense of European capacity and with weak European macro and consumer related uncertainty, margin pressures will be more acute than the *prima facie* 18% share of global export imbalance figure might suggest.

Most competitive on cash costs and lowest cyclical leverage. With the cash cost of raws ranging between 20% to 70% of their global peers, Middle Eastern petrochemical producers are comfortably placed at the bottom of the cash cost curve across major commodity petrochemical product chains. Meanwhile, cost competitiveness is essential to ensure high asset operating levels. While investors generally focus on margins, an ability to operate above 70% utilisation is crucial for cash breakeven. In 2H08, Middle Eastern producers were the only ones globally operating at design capacity. With an average 50% margin contribution from advantaged feedstock, their leverage to cyclical chemicals demand supply cycle is also the lowest globally. The remaining leverage is to crude prices.

Strong cash flow, balance sheets and commitment to dividends. Middle Eastern plays have average 2012F free cash flow yields (FCF/Enterprise Value) of 10.1% compared to peers' ranging between 4.5%-7%. Average three-year payout ratios for some companies are as high as 90%. MENA players have average-weighted 2012F Net Debt/EBITDA of 0.7x (with peers at 1.9x) and strong sovereign support (the likes of Saudi Arabia and Qatar).

Valuation. We are establishing Target Prices on the basis of a fair EV/EBITDA multiple set at 8x generically for the sector with company-specific premiums/discounts assigned on the basis of product mix and other factors.

Risks. Risks include but are not limited to geopolitical risks.

Stocks featured: recommendations

	Rec	Last price	Tgt price	Upside CU
Orascom (OCIC EY; EGP)	Hold	292.48	280.00	-4%
SABIC (SABIC AB; SAR)	Buy	90.75	115.00	27%
IQ (IQCD QD; QAR)	Hold	137.50	135.00	-2%
Yansab (YANSAB AB; SAR)	Buy	45.50	53.00	16%
NIC (NIC AB; SAR)	Buy	32.70	52.00	59%
APC (APPC AB; SAR)	Buy	27.40	32.00	17%
Sipchem (SIPCHEM AB; SAR)	Buy	19.70	24.00	22%
SAFCO (SAFCO AB; SAR)	Hold	185.25	175.00	-6%
Kayan (KAYAN AB; SAR)	Sell	14.15	9.10	-36%
Maaden (MAADEN AB; SAR)	Sell	32.70	28.00	-14%

Stocks featured: stock data

	MCAP, USD mn	EV, USD mn	# shares	Freefloat, %
Orascom	10,031	13,911	209	41%
SABIC	72,596	97,637	3,000	25%
IQ	20,768	21,352	550	25%
Yansab	6,825	8,277	563	38%
NIC	5,833	11,021	669	53%
APC	1,198	1,239	164	87%
Sipchem	1,926	2,789	367	65%
SAFCO	12,349	11,298	250	40%
Kayan	5,660	12,882	1,500	35%
Maaden	8,066	14,798	925	33%

Stocks featured: recent performance

	1M	3M	12M	ADTV, 3M, USD mn
Orascom	8.6%	17%	20%	5.1
SABIC	-0.3%	1%	-4%	91.9
IQ	0.7%	4%	12%	3.5
Yansab	-4.8%	3%	-1%	5.9
NIC	-1.8%	1%	3%	4.8
APC	8.3%	17%	8%	3.3
Sipchem	2.3%	9%	8%	2.5
SAFCO	-2.0%	8%	6%	6.0
Kayan	1.4%	-7%	-18%	13.1
Maaden	2.5%	11%	21%	5.5

Source: Bloomberg, company data, VTB Capital Research

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All prices are as of 09.09.12 unless specified otherwise. Important disclosures and equity rating histories regarding the company (companies) that is (are) the subject of this report can be found here.

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Investment Summary

We initiate coverage of ten major companies in the sector offering globally unique investment profiles and rate SABIC, (Buy, TP: SAR 115), Yansab (Buy, TP: SAR 53) and NIC (Buy, TP: SAR 52) as our top three ideas to play the sector.

Why: i) Most competitive cash costs globally; ii) Diversified (upstream leveraged) earnings; iii) Strong cash flows and balance sheets

Our analysis suggests that the cyclical margins for global commodity petrochemicals are likely to revert to levels closer to the third quartile in the short term, but will be constrained from growing higher than the second quartile on a sustainable basis longer term by the new supply (fig 33) and Asian demand growth deceleration (fig 20-21). Furthermore we believe there is a strong possibility of short periods of distressed cyclical margins and demand shocks. We hence prefer Middle Eastern petrochemical plays as the strongest investment candidates in the entire commodity petrochemicals industry for the following reasons:

- **The most competitive companies.** Middle Eastern plays operate at the lowest end of the cash cost curve across their product spectrum (fig 36-37).
- **Leveraging consumer growth, not infrastructure.** We think the key commodities leveraged to Asian consumer demand growth are LLDPE (food packaging, organised retail expansion), MEG (textiles, fibres, energy transfer fluids), PP (most diversified plastic, substitution materials), MTBE (Asian gasoline demand), of which we can get large EBITDA exposure plays in the Middle East.
- **Strong balance sheets and financially robust stakeholders.** Middle Eastern plays have average weighted 2012F Net Debt/EBITDA of 0.7x (peers at 1.9x) and the government has large equity stakes in major firms (fig 49).

Why now: i) Cyclical margins will remain in doldrums; ii) Regional sector trading at historic discount to global peers

- **Strong cash flows and commitment to return cash to shareholders.** Middle Eastern plays have average 2012F free cash flow yields (FCF/Enterprise Value) of 10.1% to peers', ranging between 4.5%-7%

Furthermore, MENA petrochemical companies offer exposure to upstream leverage in the Middle East. Unlike their downstream peers, on average 50% of the cash margins accrued by Middle Eastern producers are a function of the advantaged feedstock (relative to naphtha used by marginal producers), and hence they are not completely exposed to the supply-demand led margin cyclicality. This investment profile coupled with a stable currency, protection for minority interests and strong benevolent government support in one of the most fiscally strong regions of the world is attractive, in our view.

Petrochemicals market outlook

We have assumed naphtha prices to average at USD 880/tonne for 2012F and USD 850/tonne in the medium-to-long term. In our base case scenario, we assumed that LDPE, LLDPE, HDPE, PP and DAP are at the top of the third quartile margins; while product categories that are less exposed to crude prices than petrochemicals, e.g. Methanol, Urea, MTBE and MEG, are assumed to be in the middle of the second quartile margins to conservatively account for cyclical margin volatility.

Our 2013F product price forecasts are in line with our long-term forecasts for ethylene (LDPE, LLDPE and HDPE) and 4% higher on average than actual YTD 2012 prices. On polypropylene and aromatics) our 2013F and long-term price forecast is 5.4% and 4% higher (respectively) than YTD 2012 prices. Our long term (2013F and beyond) forecasts for MTBE (-0.1%) and MEG (0.1%) are largely in line with YTD 2012 prices. We are conservatively factoring in a decline for methanol (-8.5%) and urea (-25%) prices (y-o-y) to account for margin cyclicality reversion and house forecasts.

To compute the commodity prices, we have developed a forecast for each commodity using the following approach for determining the three key elements of prices:

- **Margin derived from the petrochemical cycle.** The margin for a marginal producer (which has no feedstock pricing advantage) would depend on the stage in the petrochemical cycle (extent of demand vs. supply). We have estimated the long-term median margin in four quartiles of the petrochemical cycle (with the first quartile representing the top of the cycle) for each product's marginal producers. For this element of the margins, we have reverted to mid-range second and third quartile margin spectrums across most commodities, depending on leverage to consumer demand in the near term.
- **Feedstock price.** The feedstock prices are dependent on the naphtha prices, which we forecasted based on our house assumptions for crude prices (USD 105/bbl for 2012 and USD 95/bbl for 2013) and our longer-term crude to naphtha correlations.
- **Processing costs:** These are calculated to remain relatively constant and in line with historical levels.

Figure 1: Price forecasts (USD/tonne)

	2012F	2013F	2014F
Naphtha	880	850	850
Methanol	370	330	330
Butanediol	2,600	2,800	2,800
MEG	950	1,000	1,000
Acetic Acid	420	420	420
VAM	1,120	1,180	1,180
LDPE	1,300	1,375	1,375
LLDPE	1,250	1,400	1,400
HDPE	1,340	1,360	1,360
PP	1,375	1,450	1,450
MTBE	1,200	1,180	1,180
PVC	1,020	1,060	1,060
Butene	1,050	1,100	1,100
Benzene	1,220	1,250	1,250
Polystyrene	1,510	1,550	1,550
Polycarbonates	2,700	2,850	2,850
Ammonia	510	525	525
Urea	415	324	324
DAP	550	500	500
Alumina	287	315	315
Aluminium	2,050	2,250	2,250
Ore fines	140	155	155
Steel (Rebar)	685	680	680

Source: VTB Capital Research

Figure 2: VTB Capital estimates vs. consensus (in millions of local currency)

	2012 F EBITDA			2013F EBITDA			2012F Net Income			2013F Net Income		
	VTB	Cons*	Diff (%)	VTB	Cons*	Diff (%)	VTB	Cons*	Diff (%)	VTB	Cons*	Diff (%)
OCI	9,298	9,315	*0%*	10,526	11,173	*-6%*	3,888	5,122	*-24%*	4,267	6,160	*-31%*
Sabic	59,100	57,766	*2%*	61,008	61,490	*-1%*	28,518	27,678	*3%*	31,444	29,385	*7%*
IQ	8,993	9,416	*-4%*	9,410	10,325	*-9%*	8,828	8,406	*5%*	8,963	9,342	*-4%*
Yansab	3,431	4,357	*-21%*	4,070	4,499	*-10%*	2,242	2,941	*-24%*	2,990	3,160	*-5%*
APC	472	523	*-10%*	617	634	*-3%*	244	327	*-25%*	428	414	*3%*
NIC	6,725	6,562	*2%*	7,654	6,911	*11%*	2,361	2,505	*-6%*	2,776	2,708	*3%*
Sipchem	1,593	1,652	*-4%*	1,644	1,718	*-4%*	661	653	*1%*	722	633	*14%*
Kayan	3,304	3,206	*3%*	3,986	5,468	*-27%*	546	504	*8%*	1,323	2,454	*-46%*
Safco	3,832	3,802	*1%*	3,291	3,983	*-17%*	3,779	3,929	*-4%*	3,265	4,060	*-20%*
Maaden	3,122	2,654	*18%*	4,261	3,986	*7%*	1,546	1,066	*45%*	2,116	1,524	*39%*

*Source: VTB Capital Research; *Bloomberg Consensus*

Valuation

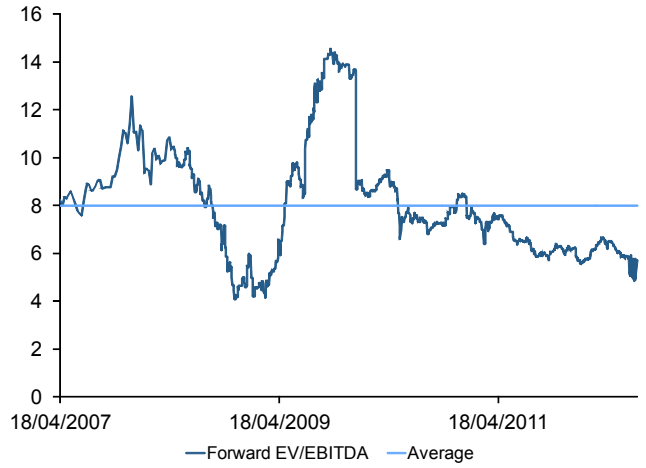
- Our generic sector forward EV/EBITDA multiple for the sector is 8.0x based on a historical trading range average. The multiple is conservative when compared with international peers' mid-cycle EV/EBITDA and adjusted for the Middle Eastern tax regime.
- We assign company-specific fair value premiums/discounts based on product segment exposure (e.g. Maaden) and unique regional dynamics (e.g. Safco). We draw a comparables analysis via a peer set composed of different product segments and compare our forecasted metrics with an EBITDA-weighted sector exposure across different product segments.
- We see material upside in SABIC (+31% expected 12M total return USD), Yansab (+25%), APC (+21%), NIC (+62%) and Sipchem (+22%). We see significant potential for downside in Maaden (-14% expected 12M total return USD) and Kayan (-35%)

Generic 'fair' EV/EBITDA set at 8x

We are adopting a forward EV/EBITDA-based valuation methodology. Our generic sector EV/EBITDA multiple of 8x is close to the average historical forward EV/EBITDA for SABIC (longest trading history). Taxation rates are close to zero in the Middle East and hence elevated EV/EBITDA multiples are justified. On a like-to-like basis, we estimate that an EV/EBITDA of 8x in the Middle East represents a normalised 6.4x multiple outside the Middle East when accounting for a 25% corporate tax rate, all else being equal.

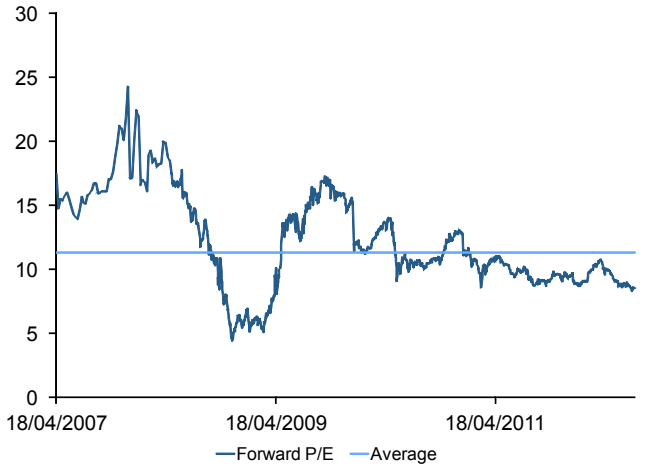
The MENA petrochemical sector trades on a median 2013F P/E of 9.6x against EM peers at 14.4x and developed market peers at 10.8. The consensus earnings growth (2012 -13F) in EM and developed is on average 17.4% and 27%, respectively, against 6% for the Middle East (margin driven component) . With c.50% of cash margins for MENA producers driven by feedstock discounts (directly related to crude prices) and a hazy economic outlook, we believe the earnings growth profile is likely to be more robust and on a risk adjusted basis more attractive than either Asian or North American earnings growth profiles.

Figure 3: SABIC EV/EBITDA (2007 to date)



Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 4: SABIC P/E (2007 to date)



Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Company-specific 'fair' multiples

Of the ten companies in question, we see seven gravitating to the aforementioned generic sector average multiple, while for the rest, we factor in premiums/discounts. The reasons behind these are as follows:

- **OCI.** Due to a combination of Egyptian listing (country risk), the tax regime (not as favourable as Saudi Arabia and Qatar) and the business mix (construction accounts for 30% of EBITDA and a lower multiples business) we assign a fair multiple of 7.4x, a discount of 7% to the generic sector average.
- **Maaden.** The composite fair EV/EBITDA multiple is set at 7.6x as a function of three different business lines viz Gold, Phosphate fertiliser and Aluminium segments. This represents a 5% discount to the generic sector average.
- **Safco.** We deem 10.3x a fair EV/EBITDA multiple, which at a 30% premium to the generic sector might seem excessive, but represents a historical premium that is assigned by the domestic retail investor base, accounting for volumes in excess of 90%. A cash positive balance sheet allows for assignment to locally favoured investment vehicles and lends a premium valuation.

Figure 5: Summary valuation

Ticker	OCI OCIC EY	Sabic SABIC AB	IQ IQCD QD	Yansab YANSAB AB	APC APPC AB	NIC NIC AB	Sipchem SIPCHEM AB	Kayan KAYAN AB	Safco SAFCO AB	Maaden MAADEN AB
Local Currency	EGP	SAR	QAR	SAR	SAR	SAR	SAR	SAR	SAR	SAR
Generic composite sector forward EV/EBITDA	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Benchmark forward EV/EBITDA	7.4	8.0	8.0	8.0	8.0	8.0	8.0	8.0	10.3	7.6
Premium/Discount (%)	-7.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	30.0%	-5.1%
Composite normalized EBITDA (m LC)	10,526	61,008	9,410	4,070	617	7,654	1,644	4,232	3,477	6,313
Other components of EV (m, LC)	415	20,059	2,679	-	-	1,216	-	4,159	1,385	-
EV (m, LC)	78,726	505,686	77,956	32,397	4,915	62,144	13,087	38,011	37,367	47,937
Less: Net Debt (m, LC)	13,205	766	2,047	4,192	(63)	11,491	689	25,524	(4,677)	19,525
Others (m, LC)	-	-	-	-	-	-	-	-	-	-
Less: Minorities (m, LC)	9,828	176,722	4,839	-	-	18,235	4,091	-	-	5,327
Equity Value (m, LC)	55,692	328,198	71,070	28,205	4,978	32,418	8,307	12,487	42,044	23,085
No. of Shares	209	3,000	550	563	164	669	367	1,500	250	925
Equity Value/share (LC)	267	109	129	50	30	48	23	8	168	25
2012F EPS (LC)	18.61	9.51	16.05	3.99	1.49	3.53	1.80	0.36	15.11	1.67
2012F DPS (LC)	13.66	4.04	8.09	1.93	1.13	1.15	0.57	0.09	10.28	-
Target Price (LC)	280.0	115.0	135.0	53.0	32.0	52.0	24.0	9.1	175.0	28.0
Last Price (Sep 9, LC)	292.48	90.75	137.50	44.00	27.40	32.70	19.70	14.15	185.25	32.70
Upside to TP (LC)	-4.3%	26.7%	-1.8%	20.5%	16.8%	59.0%	21.8%	-35.7%	-5.5%	-14.4%
Currency depreciation (to USD)	5.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Dividend yield (2012F)	4.5%	4.2%	5.8%	2.8%	3.0%	3.2%	2.8%	0.0%	2.1%	0.0%
Expected 12M total return (USD)	-4.4%	31.2%	4.1%	24.8%	20.9%	62.5%	24.7%	-35.1%	2.1%	-14.4%
Rating	**Hold**	**Buy**	**Hold**	**Buy**	**Buy**	**Buy**	**Buy**	**Sell**	**Hold**	**Sell**

Source: the BLOOMBERG PROFESSIONAL™ service, Company data, VTB Capital Research

Peer group valuations

The comparables and key variables are detailed in tables below. We have utilized the industry peer groups of petrochemicals, fertilizers, steel and construction segments to create a composite comparable peer with relative weights aligned with the EBITDA breakdown of the our covered companies. For example we have utilized the fertilizer and construction sector peer sets in a 70% and 30% weighed composite contribution to arrive at a comparable peer for OCI. The weights are largely a function of net EBITDA composition.

Figure 6: Composite peer group based relative valuation summary

Company	BBG ticker	MCap USD mn	Net Debt/ Mcap	P/E 12F	P/E 13F	EV/EBITDA 12F	EV/EBITDA 13F	P/CF 12F	Div yield, % 12F	P/BV 11	Net Debt/ EBITDA 12F
OCI	OCIC EY	10,031	24%	15.7	14.3	9.1	7.8	12.0	4.5	2.9	1.6
Composite peer			1%	11.2	10.0	6.7	6.3	8.2	1.9	2.5	-0.05
SABIC	SABIC AB	72,596	0%	9.5	8.7	6.2	5.4	6.6	4.2	2.0	0.4
Composite peer			23%	14.0	11.4	6.8	6.2	7.5	3.2	1.6	1.9
IQ	IQCD QD	20,769	4%	8.6	8.4	8.6	8.3	26.4	5.8	2.9	0.2
Composite peer			18%	11.8	10.4	6.4	6.0	7.1	2.6	1.7	1.2
Yansab	YANSAB AB	6,825	13%	11.4	8.6	9.0	7.2	7.4	2.8	2.5	1.6
Composite peer			26%	14.5	11.7	6.9	6.2	7.5	3.4	1.5	2.0
APC	APPC AB	1,198	10%	18.4	10.5	9.9	7.0	10.0	3.0	2.1	0.3
Composite peer			26%	14.5	11.7	6.9	6.2	7.5	3.4	1.5	2.0
NIC	NIC AB	5,833	0%	9.3	7.9	6.1	5.2	233.8	3.2	2.0	1.9
Composite peer			21%	11.1	9.4	5.8	5.2	7.5	3.0	2.1	1.5
Sipchem	SIPCHEM AB	1,926	16%	10.9	10.0	6.6	5.7	6.4	2.8	1.3	0.9
Composite peer			21%	11.1	9.4	5.8	5.2	7.5	3.0	2.1	1.5
Kayan	KAYAN AB	5,660	13%	38.9	16.0	14.6	11.5	7.5	0.0	1.3	8.2
Composite peer			26%	14.5	11.7	6.9	6.2	7.5	3.4	1.5	2.0
Safco	SAFCO AB	12,349	7%	12.3	14.2	11.1	12.5	13.9	2.1	6.0	-1.0
Composite peer			3%	9.0	9.3	5.8	5.8	7.4	1.7	2.4	0.1
Maaden	MAADEN AB	8,066	-15%	19.6	14.3	17.8	13.6	-6.8	0.0	1.8	6.3
Composite peer			3%	9.0	9.3	5.8	5.8	7.4	1.7	2.4	0.1

Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 7: Petrochemical peer set

Company	BBG ticker	Mcap USD mn	Net Debt/ Mcap	P/E 12F	P/E 13F	EV/EBITDA 12F	EV/EBITDA 13F	P/CF 12F	Div yield, % 12F	P/BV 11F	Net Debt/ EBITDA 12F	Change, % 12M
EM Petrochemicals												
Petronas Chemicals Group BHD	PCHEM MK	16,711	-17%	13.6	12.4	6.9	6.2	11.2	3.8	n/a	(1.4)	(2)
Braskem	BRKM5 BZ	5,124	122%	neg	21.3	6.6	5.4	n/a	1.3	0.8	3.6	(30)
Nan Ya Plastics	1303 TT	14,278	16%	26.7	15.8	20.6	16.2	11.2	3.0	1.5	2.9	(21)
Formosa Petrochemical	6505 TT	26,687	20%	51.9	23.3	21.5	15.0	21.4	1.9	3.4	3.6	(1)
Formosa Plastics	1301 TT	16,798	5%	20.3	14.4	18.3	14.6	11.7	4.0	1.9	0.8	(5)
Honam Petrochemical	011170 KS	7,080	4%	10.4	7.1	5.2	4.3	11.5	0.7	1.4	0.2	(36)
PTT Thailand	PTTGC TB	8,780	31%	9.5	8.4	7.0	5.9	6.4	4.4	1.2	1.7	n/a
Median			**16%**	**16.9**	**14.4**	**7.0**	**6.2**	**11.3**	**3.0**	**1.5**	**1.7**	**(13)**
Developed Market Petrochemicals												
Celanese Corporation	CE US	6,299	33%	10.1	8.4	7.0	5.8	7.4	0.7	3.7	1.7	(3)
BASF	BAS GY	75,095	17%	11.9	10.8	5.7	5.2	7.5	4.0	2.4	0.8	36
DOW	DOW US	36,339	48%	15.5	11.2	7.2	6.2	8.2	3.9	1.5	2.3	18
Lyondell	LYB US	28,437	1%	9.7	8.9	5.3	4.8	7.4	2.9	2.4	0.1	59
Sumitomo Chemical	4005 JT	4,341	248%	327.8	12.1	6.5	6.4	2.8	4.5	0.7	4.6	(35)
Mitsubishi Gas Chemical	4182 JT	2,721	51%	18.2	8.3	7.8	8.3	5.0	2.7	0.8	2.6	(12)
Mitsui Chemicals	4183 JT	2,053	237%	neg	24.2	6.1	7.5	2.6	3.7	0.4	4.3	(39)
Median			**48%**	**13.7**	**10.8**	**6.5**	**6.2**	**7.4**	**3.7**	**1.5**	**2.3**	**(3)**

Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 8: Fertiliser peer set

Company	BBG ticker	Mcap USD mn	Net Debt/ Mcap	P/E 12F	P/E 13F	EV/EBITDA 12F	EV/EBITDA 13F	P/CF 12F	Div yield, % 12F	P/BV 11F	Net Debt/ EBITDA 12F	Change, % 12M
Incitec Pivot	IPL AU	4,825	31%	11.1	9.9	7.8	6.3	8.9	3.7	1.2	1.8	(25)
Yara	YAR NO	14,739	0%	8.2	8.7	5.2	5.3	6.2	2.6	2.0	0.0	(3)
Agrium	AGU US	16,113	8%	9.8	10.1	6.3	6.3	8.0	0.7	2.5	0.5	19
CF Industries	CF US	14,110	4%	8.0	8.8	4.3	4.8	6.7	0.7	3.4	0.2	19
Mosaic	MOS US	25,959	-9%	13.8	12.0	7.6	6.6	11.0	0.4	2.4	(0.8)	(13)
Phosagro	PHOR RX	4,964	3%	8.1	8.6	4.8	4.8	5.3	4.7	n/a	0.1	(0)
Median			**3%**	**9.0**	**9.3**	**5.8**	**5.8**	**7.4**	**1.7**	**2.4**	**0.1**	**(2)**

Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 9: Steel peer set

Company	BBG ticker	Mcap USD mn	Net Debt/ Mcap	P/E 12F	P/E 13F	EV/EBITDA 12F	EV/EBITDA 13F	P/CF 12F	Div yield, % 12F	P/BV 11F	Net Debt/ EBITDA 12F	Change, % 12M
Novolipetsk Steel	NLMK RX	11,446	28%	10.2	8.9	6.3	5.6	6.4	2.8	1.1	1.4	(32)
Posco	005490 KS	28,097	26%	10.4	8.8	7.3	6.5	6.5	2.7	0.8	1.5	(16)
Salzgitter	SZG GR	2,418	-4%	53.8	14.0	4.1	3.4	5.2	1.3	0.4	(0.2)	(24)
Arcelor Mittal	MT NA	24,803	89%	15.9	9.1	5.8	4.8	4.1	4.7	0.4	2.7	(11)
JSW Steel	JSW IB	1,443	119%	20.0	12.8	10.8	6.8	9.9	0.6	1.1	5.9	(31)
SAIL	SAIL IB	5,867	34%	8.1	8.4	6.8	6.7	5.3	3.0	0.7	1.7	(41)
Baoshan	600019 CG	12,422	48%	7.2	9.7	4.7	4.5	3.0	5.5	0.7	1.5	(13)
Median			**34%**	**10.4**	**9.1**	**6.3**	**5.6**	**5.3**	**2.8**	**0.7**	**1.5**	**(24)**

Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 10: Construction peer set

Company	BBG ticker	Mcap USD mn	Net Debt/ Mcap	P/E 12F	P/E 13F	EV/EBITDA 12F	EV/EBITDA 13F	P/CF 12F	Div yield, % 12F	P/BV 11F	Net Debt/ EBITDA 12F	Change, % 12M
Tekfen	TKFEN TI	1,428	-15%	9.4	9.4	5.7	5.2	7.6	2.9	1.4	(1.0)	38
Saipem	SPM IM	21,188	18%	16.1	13.8	8.4	7.2	10.1	2.0	3.4	1.3	19
Abdullah Khodari & sons	ALKHODAR AB	486	55%	9.8	8.6	9.2	8.2	8.0	3.5	2.7	3.3	(34)
Arabtec	ARTC UH	1,180	-6%	17.5	14.5	7.5	6.1	8.1	1.2	1.5	(0.5)	112
Hyundai Engg	000720 KS	6,609	-3%	17.4	11.6	14.2	8.1	10.1	1.0	1.8	(0.5)	5
Sino Thai Construction	STEC TB	702	-8%	20.4	17.9	12.9	11.2	16.0	2.5	4.2	(1.0)	55
Median			**-5%**	**16.1**	**11.6**	**8.8**	**7.7**	**10.1**	**2.5**	**2.7**	**-0.5**	**19**

Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 11: Key figures

	OCI		Sabic		IQ		Yansab		APC		NIC		Sipchem		Kayan		Safco		Maaden	
	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F	2012F	2013F
Income metrics																				
Revenues	33,838	37,861	196,849	199,401	18,180	19,444	9,776	10,328	2,479	2,615	24,148	25,511	3,263	3,353	11,392	12,643	5,312	4,771	4,776	6,506
% growth	3%	12%	4%	1%	10%	7%	1%	6%	-11%	5%	23%	6%	-2%	3%	374%	11%	5%	-10%	215%	36%
EBITDA	9,298	10,526	59,100	61,008	8,993	9,410	3,431	4,070	472	617	6,725	7,654	1,593	1,644	3,304	3,986	3,832	3,291	3,122	4,261
% growth	13%	13%	-3%	3%	7%	5%	-26%	19%	-37%	31%	0%	14%	-10%	3%	735%	21%	-4%	-14%	262%	36%
% margin	27%	28%	30%	31%	49%	48%	35%	39%	19%	24%	28%	30%	49%	49%	29%	32%	72%	69%	65%	65%
Net Income	3,888	4,267	28,518	31,444	8,828	8,963	2,242	2,990	244	428	2,361	2,776	661	722	546	1,323	3,779	3,265	1,546	2,116
% growth	-3%	10%	-2%	10%	11%	2%	-31%	33%	-52%	75%	-3%	18%	-6%	9%	n/a	142%	-8%	-14%	274%	37%
% margin	11%	11%	14%	16%	49%	46%	23%	29%	10%	16%	10%	11%	20%	22%	5%	10%	71%	68%	32%	33%
Cash flow metrics																				
Working capital changes	(192)	(692)	(1,702)	(625)	84	(212)	405	(157)	16	(5)	(1,558)	(472)	(96)	31	(236)	(389)	(288)	111	(1,259)	(1,097)
Operating cash flow	6,040	6,424	54,026	59,645	9,131	93	3,638	3,792	467	614	3,908	5,772	1,369	1,581	2,184	2,725	3,813	3,681	977	1,956
Investing cash flow	(1,836)	(1,172)	(13,779)	(12,961)	(6,936)	(4,725)	(392)	(414)	(38)	(40)	(4,187)	(3,145)	(392)	(350)	(228)	(119)	(213)	(195)	(5,925)	(4,473)
Dividends	(2,722)	(2,987)	(11,539)	(12,722)	(4,414)	(4,481)	(672)	(1,495)	(134)	(235)	(708)	(833)	(198)	(217)	-	(265)	(2,758)	(2,384)	-	-
Change in debt	-	-	-	-	317	41	(2,794)	(1,499)	(335)	(180)	1,213	(2,050)	(2)	(578)	(634)	(629)	-	-	6,117	24
Financing cash flow	(2,722)	(2,987)	(11,539)	(12,722)	(4,059)	(4,400)	(3,466)	(2,994)	(469)	(415)	505	(2,883)	(201)	(794)	(634)	(894)	(2,758)	(2,384)	6,164	74
Net change in cash	1,482	2,266	28,708	33,962	(1,863)	93	(220)	384	(40)	160	226	(255)	776	437	1,322	1,712	841	1,102	1,215	(2,444)
FCF	5,075	6,036	41,100	44,645	2,869	5,237	3,445	3,500	450	573	94	3,022	1,128	1,350	2,840	3,477	3,326	3,215	(4,470)	(1,889)
Interest payments	972	883	2,893	-	246	288	289	254	23	-	761	825	173	164	876	857	-	-	439	586
FCFE	4,424	5,444	38,364	44,645	2,307	4,908	5,950	4,745	763	753	(1,796)	4,338	957	1,763	2,599	3,249	3,326	3,215	(11,025)	(2,499)
Balance sheet																				
Cash & marketable securities	7,881	10,147	79,097	113,059	5,097	5,190	379	763	437	597	4,863	4,607	4,406	4,843	1,791	3,503	4,102	5,205	6,260	3,816
Average assets	60,361	63,295	349,251	383,656	39,586	44,777	22,656	22,379	3,237	3,110,504	42,312	45,660	14,959	15,404	46,720	47,026	9,848	10,786	47,756	53,357
Total working capital	5,817	6,509	48,204	48,829	3,454	3,694	2,933	3,098	74	78	8,364	8,836	290	259	3,645	4,046	1,094	983	721	1,568
Payable receivable deficit	3,501	3,917	15,589	15,791	727	778	978	1,033	(50)	(52)	3,826	4,041	114	81	1,937	2,149	457	410	(1,051)	(846)
Short term debt	6,328	6,328	14,597	14,597	1,367	1,408	1,246	1,122	140	140	5,050	3,000	13	11	477	429	80	80	785	809
Long term debt	16,269	16,269	87,907	87,907	5,812	5,812	3,206	3,206	450	270	12,500	12,500	5,759	5,183	28,399	27,818	80	80	25,000	25,000
Net debt	14,716	12,450	23,408	(10,555)	2,082	2,030	5,447	3,565	153	(187)	12,687	10,893	1,366	351	27,085	24,743	(3,942)	(5,045)	19,525	21,992
Total short term liabilities	19,000	20,400	43,670	43,890	4,736	4,988	3,310	3,274	490	509	8,266	6,287	1,129	1,157	2,474	2,548	544	497	4,032	4,015
Total long term liabilities	20,913	20,913	100,508	100,508	6,620	6,661	6,942	5,568	467	287	15,333	15,333	5,759	5,183	28,519	27,937	595	595	25,999	26,049
Total liabilities	39,913	41,313	144,178	144,398	11,356	11,648	10,253	8,842	957	796	23,599	21,620	6,888	6,340	30,992	30,485	1,139	1,092	30,031	30,064
Shareholder's equity	19,776	21,056	155,002	173,724	30,651	35,132	12,084	13,579	2,138	2,330	12,675	14,619	6,093	6,598	15,758	47,301	9,230	10,112	18,532	20,649
Intangibles	11,398	11,398	20,059	18,381	171	172	234	234	76	76	3,547	3,525	104	148	134	-	85	85	430	413
Leverage																				
Net debt/EBITDA	1.6	1.2	0.4	(0.2)	0.2	0.2	1.6	0.9	0.3	(0.3)	1.9	1.4	0.9	0.2	8.2	6.2	(1.0)	(1.5)	6.3	5.2
Interest/EBITDA	0.1	0.1	0.0	-	0.0	0.0	0.1	0.1	0.0	-	0.1	0.1	0.1	0.1	0.3	0.2	-	-	0.1	0.1
Net debt/Market Cap	24%	20%	9%	-4%	3%	3%	23%	15%	3%	-4%	58%	50%	19%	5%	128%	117%	-9%	-11%	65%	73%
Returns																				
ROE	20%	20%	18%	18%	29%	25%	19%	22%	11%	18%	19%	19%	11%	11%	3%	3%	41%	32%	8%	10%
Valuation																				
P/B	2.8	2.6	1.2	1.1	2.4	2.1	2.1	1.9	2.1	1.9	1.0	0.9	0.9	0.8	1.3	1.3	5.0	4.6	1.4	1.2
P/E	15.7	14.3	9.5	8.7	8.6	8.4	11.4	8.6	18.4	10.5	9.3	7.9	10.9	10.0	38.9	16.0	12.3	14.2	19.6	14.3
EV/EBITDA	9.1	7.8	6.2	5.4	8.6	8.3	9.0	7.2	9.9	7.0	6.1	5.2	6.6	5.7	14.6	11.5	11.1	12.5	17.8	13.6
Dividend Yield	4%	5%	4%	5%	6%	6%	3%	6%	3%	5%	3%	4%	3%	3%	0%	1%	2.1%	2.3%	0%	0%
FCF/EV	6%	7%	11%	13%	4%	7%	12%	13%	10%	13%	0%	8%	11%	14%	6%	8%	8%	8%	-8%	-3%
FCF/Market Cap	8%	10%	15%	16%	4%	7%	14%	15%	10%	13%	0%	14%	16%	19%	13%	16%	7%	7%	-15%	-6%
FCFE/Market Cap	7%	9%	14%	16%	3%	6%	10%	8%	1%	1%	-3%	7%	2%	3%	4%	5%	5%	5%	-18%	-4%

Source: Company data, VTB Capital Research

Key Sector Themes

- Super cycle margins are unlikely until 2014.
- Margins are set to stay in the third quartile on average in 2012-14.
- Chinese demand slowdown impact is marginal and likely to be managed.
- Margins are set to be increasingly volatile with new supply and short-term demand shocks.
- Shale gas is not a near-term threat to industry margins and Middle East export competitiveness.

Margins aren't looking pretty

At the heart of our process of evaluating the profitability cycle in the global petrochemical industry lie two concepts. The first concept is the marginal producers' margin and its location vis-a-vis the historical cyclical distribution of margins. Our framework, which is also widely used in the industry, defines quartiles to draw four easily distinguishable bands. Beyond the framework outline, our proprietary methodology in determining those bands is to calculate a time frame of over five years, with granular resolution of margin data. Thereafter we apply a proprietary filter to remove noise (very short-term volatility) and form-fit a sine wave with cut offs (at 0, 45 and 135 degrees to draw the bands). The second concept involves measuring the incidence (how many times the margin falls in each of the bands identified) of the margins in different bands. The concept of using margin incidence is also a unique approach to studying margin probability dynamics, which gives us a novel insight into margin volatility.

Margins are low except for aromatics, MTBE and HDPE, but we expect them to remain in the doldrums

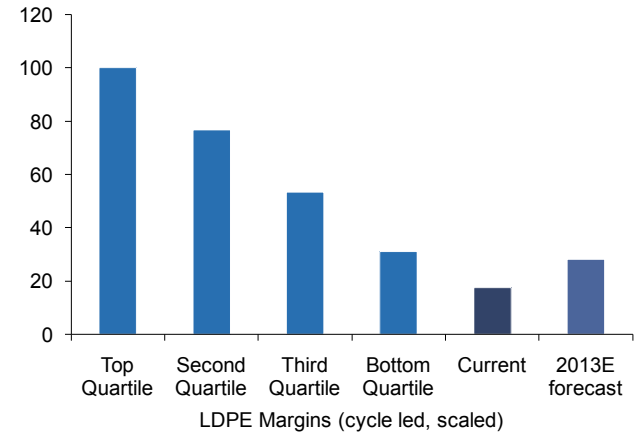
Figure 12 to Figure 17 illustrate the current margins of marginal producers across the key petrochemical product groups produced in the Middle East and accounting for more than 95% of the Middle Eastern petrochemical volumetric throughput. The industry margins are suffering from a weakened demand environment and outside of HDPE (4% above third quartile) and MTBE (at second quartile), margins continue to bounce below third quartile levels for LDPE (-67%), LLDPE (-28%), MEG (-36%) and methanol (-5%). The latter subset accounts for more than 70% of the Middle Eastern petrochemical volumetric throughput.

Polymer Naphtha spreads are above the bottom quartile across several major commodity petrochemical products. Demand has recovered from December 2011 lows, but considering the macro environment, expectations beyond another quartile of upside might be too upbeat in the short to medium term.

The gasoline naphtha spread, while at near term highs, is likely to trend lower post the US summer driving season. The decrease is more likely to be driven by a gasoline decline rather than an increase in naphtha spreads. While much has been said about weak petrochemical demand driving naphtha spreads too low, we believe both the margins and the naphtha spreads are far healthier than the market chatter might suggest.

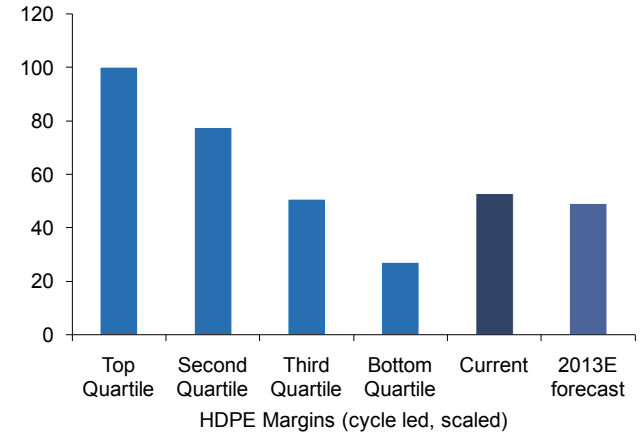
With the decline in naphtha crude spreads and relatively tighter aromatic demand, we expect to see relatively strong margins in the aromatic segment and that these margins will largely outperform the margins in aliphatic polyethylenes. With little aromatic production being exported from the new Middle Eastern capacity, the outlook for future margins is also relatively more robust for aromatics.

Figure 12: Marginal producers' margins - LDPE



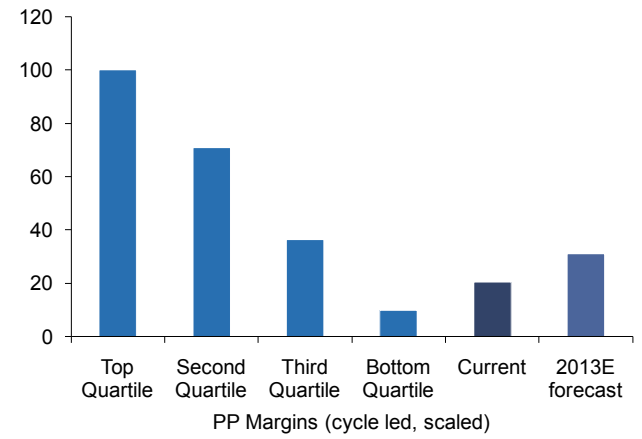
Source: VTB Capital Research

Figure 13: Marginal producers' margins - HDPE



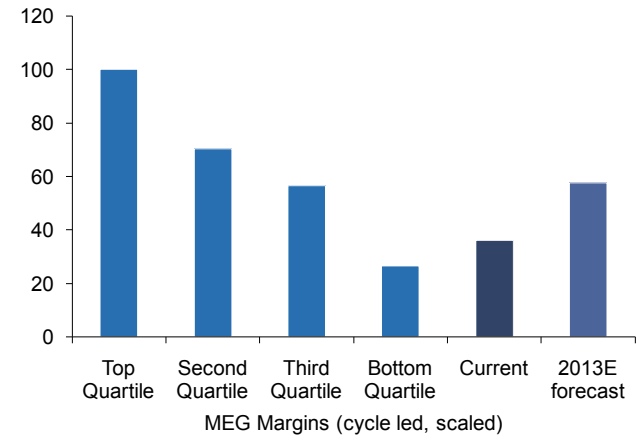
Source: VTB Capital Research

Figure 14: Marginal producers' margins - PP



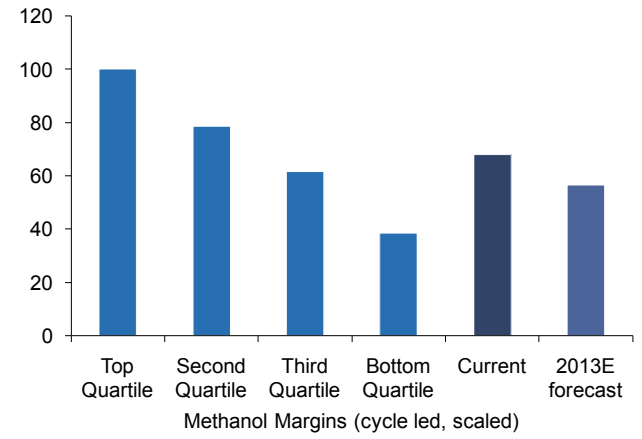
Source: VTB Capital Research

Figure 15: Marginal producers' margins - MEG



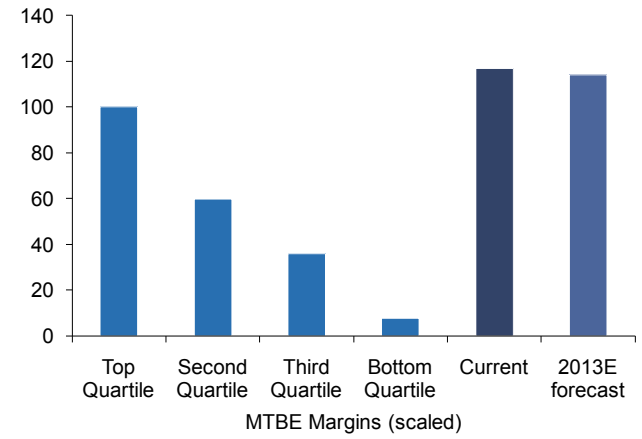
Source: VTB Capital Research

Figure 16: Marginal producers' margins - Methanol



Source: VTB Capital Research

Figure 17: Marginal producers' margins - MTBE



Source: VTB Capital Research

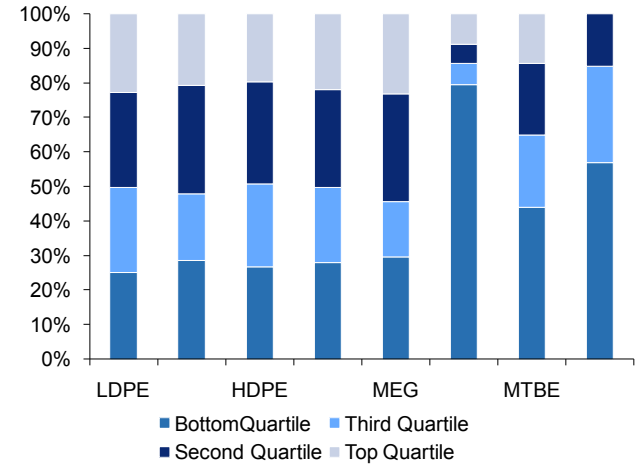
Supercycle margins won't be achievable in short term

But while downside appears limited, supercycle (top quartile) margins will not be achievable in short term

If we consider data dating back to 2005, as depicted in Figure 19, the incidence of bottom quartile margins across major polyolefins has been below 5%. Urea as a nitrogenous fertiliser class, MTBE as regulation affected commodity and methanol as a fuel plus industrial chemical have different pricing dynamics and have hence had a relatively higher concentration of bottom quartile margins in the post 2005 data.

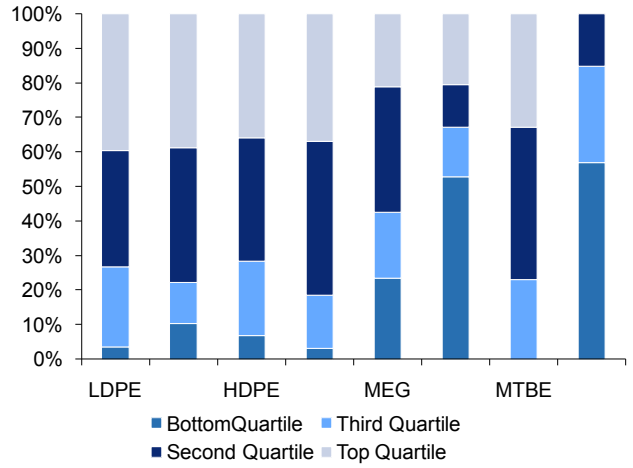
Hence, it would be logical to assume that margins should spring upwards in the short term. However, for a medium term outlook, one must consider the longer time frame data set (1995 onwards) wherein the incidence of bottom quartile margins has been a lot higher in major polyolefins (c.25%). Therefore, while we are likely to see a margin improvement from current levels in the short term, the upside above second quartile margins across polyolefins is far from a given, in our view, due to a weakened demand environment (unless the demand-supply balance changes significantly).

Figure 18: Margin quartile incidence (1995-2011)



Source: VTB Capital Research

Figure 19: Margin quartile incidence (2005-2011)



Source: VTB Capital Research

Chinese demand growth rates moderate

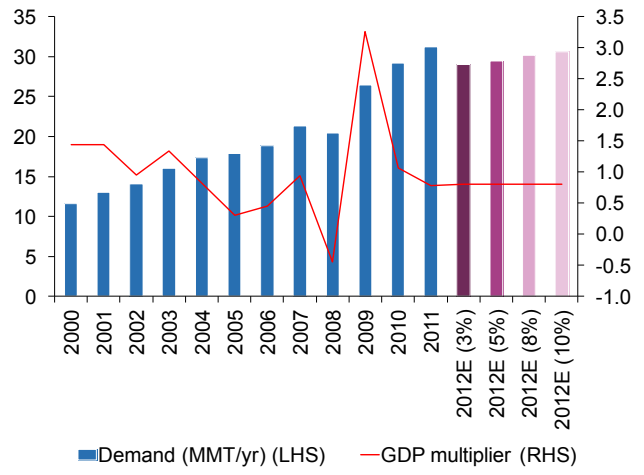
Our forecasts factor in a USD 50-USD 75/t margin improvement across major product categories driven equally by decline in naphtha prices and small improvement in pricing environment in 2013

Chinese demand growth was heavily inflated by domestic stimulus. If we consider ethylene (the single largest product segment by volume) as a gauge, the average GDP multiplier for Chinese ethylene demand for 2000-2008 was 0.8. Demand saw a c.7.84% CAGR during that period, but then we saw a surge in demand for the next three years at a c.15.23% CAGR. This was primarily driven by the investment stimulus and credit expansion in the domestic economy, as export demand in finished products and components remained weak during the period. We see the frontloading as exhausted and reversion to trend growth a base case scenario for 2012 to 2014.

A Chinese slowdown would impact global demand and operating rates in short term (until 2013), but impact would be minimal in medium term

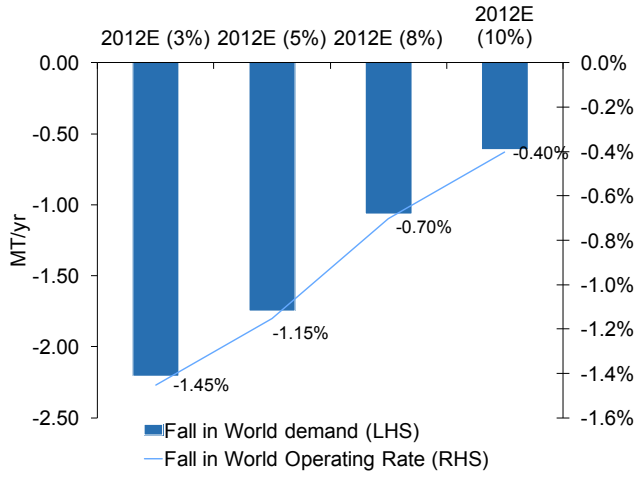
We have looked at four GDP growth scenarios for China in 2012F (GDP growth of 0%, 3%, 6% and 9%) to show the combined potential impact of a Chinese slowdown and demand correction. Fig 20 represents Chinese demand under the different scenarios. In all the scenarios, demand falls below 2011 levels. Fig 21 depicts the incremental impact on global operating rates. The impact of the incremental operating rate could be as much as 1.45% from December 2011 levels of 85.35% (on nameplate capacity utilisation). Except for a demand shock, the impact on global operating rates is not substantial in the medium term in a soft landing scenario.

Figure 20: Chinese demand under different scenarios



Source: VTB Capital Research

Figure 21: Global operating rates: incremental decline under different scenarios of China slowdown



Source: VTB Capital Research

In a downbeat scenario, a managed demand slowdown in China could keep margins below second quartile until 2013

Chinese demand growth accounted for a 71% share of global demand growth over 2008-10. If we include the Middle East and India, their total share of global demand growth was 89%. Hence, any sharp slowdown in Asia would have a highly detrimental impact on the margins and operating rates globally. The relief is that the wave of Middle Eastern supply increases has largely come to an end and if global GDP growth rates of 3% can be sustained, the demand supply balance tilts in favour of the petrochemical producers, in our view.

We take China as an example of supercharged growth and consider the managed slowdown scenarios. The cumulative GDP growth rate over 2006-11 was c.62.92%. Based on the long-term GDP multiplier of 0.8, the Chinese ethylene demand should have grown by only c.50.63%, while the actual cumulative increase was in the order of c.66%. However, in a manufacturing-led economy and infrastructure-led spending, the multiplier could be reasonably assumed at 1.0 (In 2000-04, the multiple average was 1.2). Thus, the adjustment needed on a 2006 base is in the range of 0.58-3.32mmt of ethylene, which in a world of 145mtpa of annual production is hardly excessive. The adjustment accounts for two years of GDP growth of 7.5%, with the supply side managed by the industry's self discipline. Considering that we have a new supply of 5.3mtpa in 2012F, we are unlikely to edge up to even second quartile margins for ethylene until 2013F.

European demand is unlikely to be robust

European and North American demand growth is needed for supercycle margins to be achieved by 2014...unlikely in our view

Europe and to some extent North America are *prima facie* a relatively insignificant driver of demand growth. Between 2000 and 2010, European and North American ethylene demand declined 5.3% and 9.4%, respectively. In the same period, Chinese demand rose 45% on a cumulative basis and Indian demand rose 15%. Middle Eastern demand grew a whopping 94.2% (cumulative basis) from a small base. Thus, from a 50.55% share of global demand, the North American and European share of global demand decreased to a combined 37.1% by 2010. What these figures mask is that the balance of trade has changed, with Europe becoming a net importer of ethylene and the North American export share dwindling, as Middle Eastern and Asian production increasingly grabbed export and Asian market share.

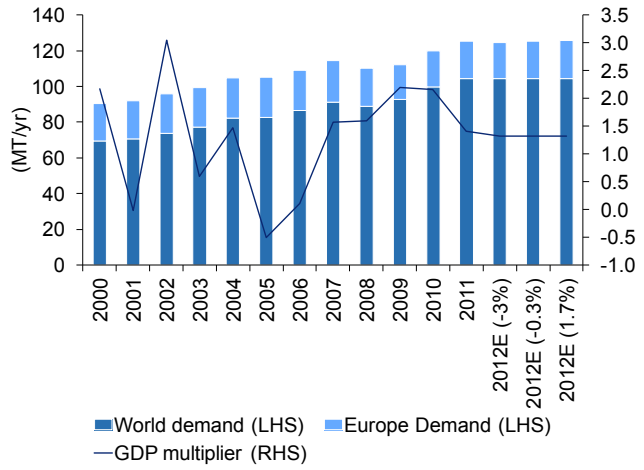
For margins to shift to the supercycle level, we require a net new demand of 10.2mmt of ethylene from 2011 levels (on a constant supply base). We foresee cumulative new ethylene supply in the 2011-2014 period of 12mtpa and an effective supply of 10mtpa. Therefore, the total absolute demand increase by 2014 has to be in the order of 20.2mtpa for a supercycle margin scenario. Asia is likely to deliver 7mtpa of demand growth in a managed decline scenario. The remaining 13.2mtpa have to be delivered by a combination of supply rationalisation and growth in North American and European demand. We believe that this is quite unlikely and hence sustained (> 3 months duration) supercycle margins are unlikely to be achieved in the short to medium term.

European producers are likely to suffer the most...

The worst effects of demand decline are likely to be faced by domestic European manufacturers, which, being marginal producers of commodity chemicals, could suffer from the longer-term operating rate decline of 5.1%, (on nameplate operating capacity). Thus, European demand decline at a sub-system level presents a much higher risk to local producers rather than international exporters to Europe, who are cushioned by other export markets.

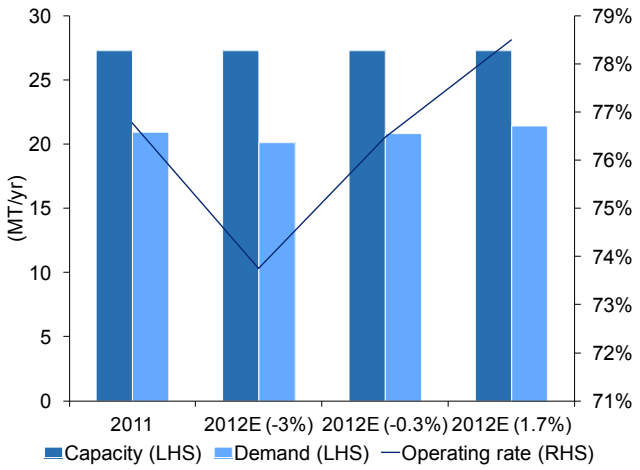
We analyse more extreme scenarios to check for risk tolerance: The European sovereign credit crisis presents a clear risk of impeding demand growth and undermining consumer confidence in 2012. We have analysed three GDP growth scenarios for Europe viz GDP growth of -3%, -0.3% and 1.7%.

Figure 22: Europe and global demand under different scenarios



Source: VTB Capital Research

Figure 23: European local operating rates: Incremental decline under different scenarios

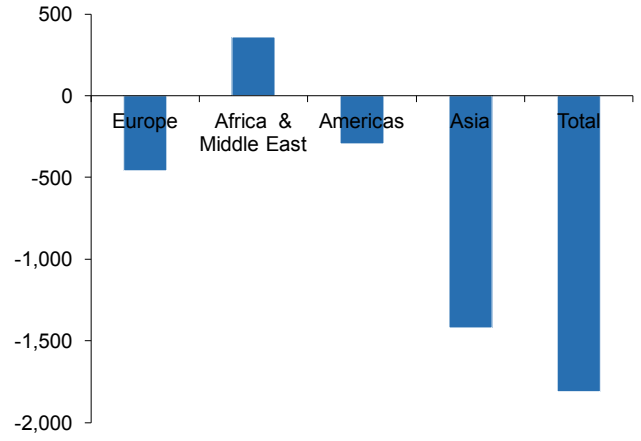


Source: VTB Capital Research

Quick supply response but latent capacity overhang

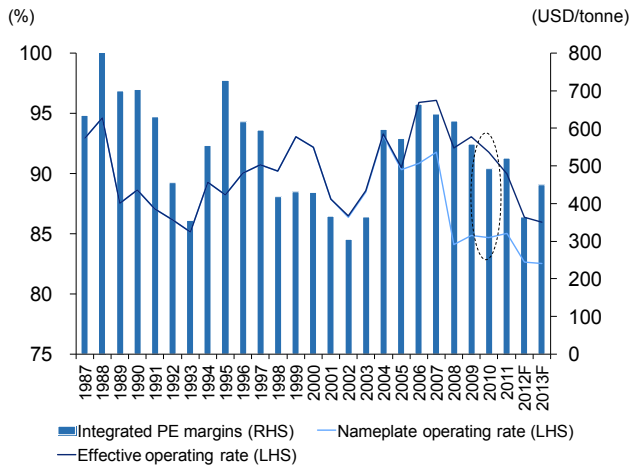
The capacity rationalisation (combination of structural and temporal changes) has reached an annualised rate of 21.6mtpa. While this might appear to be more than sufficient to reach supercycle (considering that even with the stagnant volumetric demand expectation from the rest of the world ex-Asia, we need only to reduce 13.2mtpa of net supply), the current margins and operating rates are driven by destocking and therefore unsustainable. In a normalised scenario, the latent capacity (8mtpa in our view) would prevent sustainable supercycle margins from being attained. Hence margins should rise from current levels, albeit to a small degree, operating rates would go higher and c.76% of the 21.6mtpa supply that we currently see as lost will come back.

Figure 24: Volume decline (June 10 vs. June 12), kt



Source: VTB Capital Research

Figure 25: Optimism shifts to reality

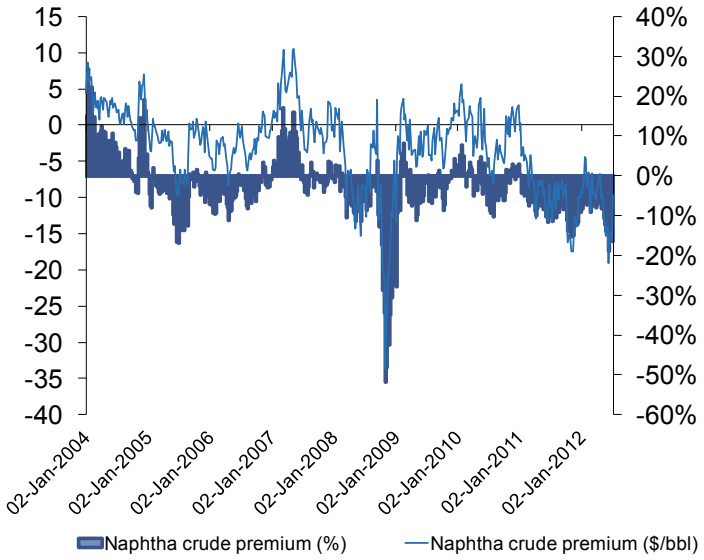


Source: VTB Capital Research

Asian assets: three additional short-term headwinds

- **Naphtha.** We believe the naphtha crude spread (at USD 5/bbl, and a discount of 4.5%) is too unattractive on the refining product slate and we see a mean reversion post reduction in refinery operating rates. With the contraction of the spread, the margins are likely to be under significant duress in the medium term.

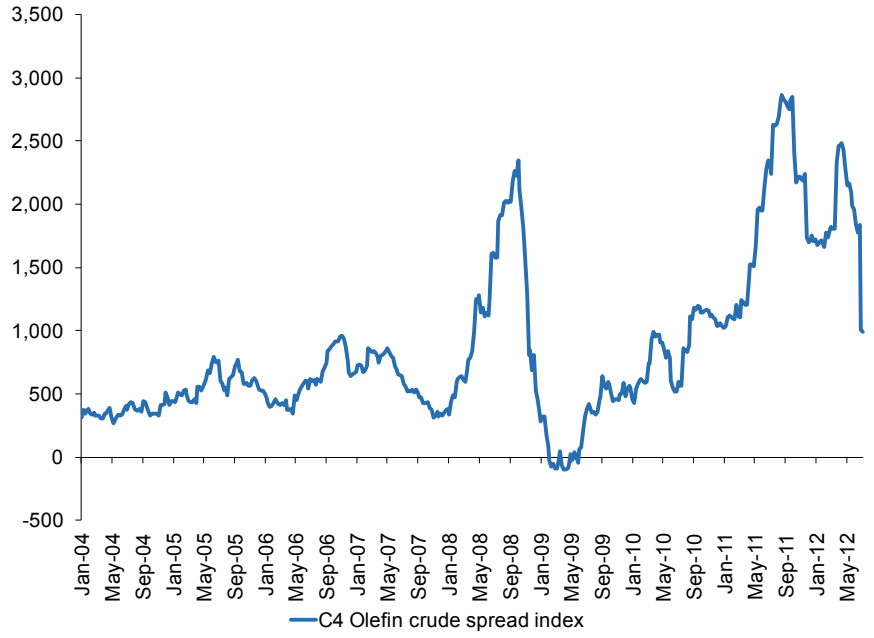
Figure 26: Naphtha crude premium



Source: VTB Capital Research

- **Reduction in by-product prices and margins.** Asian plants at the highest end of the cash cost curve need a minimum of USD100/t of cycle led margin across major polyolefins to break-even. This is excluding support from by-products. By-product credits have underpinned the relatively strong performances from Asian producers, but the cycle has turned from the end of Q1 and will likely impact near-term performance. The increase in margins has not been a function of just naphtha price decline, but also the spreads index against crude prices as Fig 27 depicts.

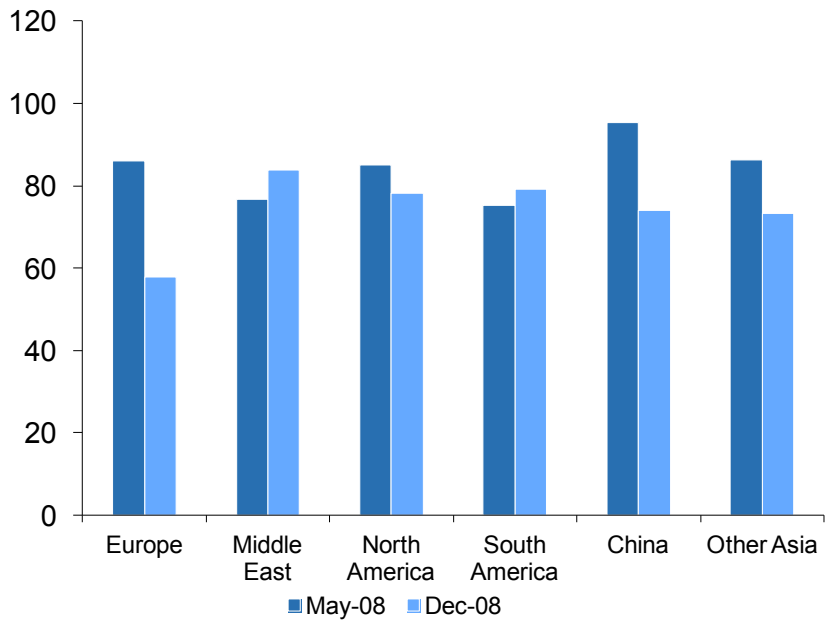
Figure 27: C4 Olefin spreads



Source: VTB Capital Research

- **Operating rates.** As operating rates are at the highest end of the cash cost curve, if there is a significant reduction in demand they will have to head lower. Economic profit is wiped out at an 81% operating rate under the current circumstances. The risk is best illustrated by the aggregate operating rates in the last crisis.

Figure 28: Ethylene cracker operating rates (%)



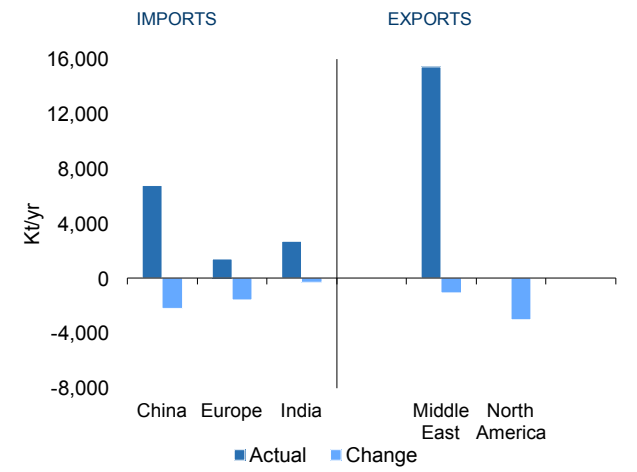
Source: VTB Capital Research

North American assets: tough export competition

…while North American assets will face tough export competition leading to a small output decline in near term

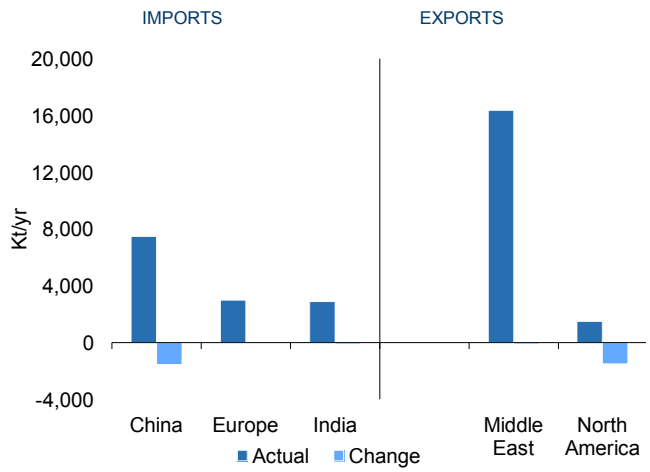
- **Middle Eastern exporters remain more competitive.** For our three scenarios (Pessimistic, Base and Optimistic) we have estimated the Import and Export levels for the above mentioned economies. We expect the Middle Eastern ethylene annual export volume to drop 1.1mmt in the pessimistic scenario and 0.1mmt in the base case. We estimate North American exports falling 3mmt incrementally in 2012 in the pessimistic scenario and 1.5mmt in the base case.
- **But they are also more geared to export decline.** These would represent Middle Eastern operating rates falling incrementally by 3.8% in the pessimistic case and 0.4% in the base case. North American export volumes would be more severely hit due to the cost advantaged position of their Middle Eastern competitors, in our view, but the overall operating rate exposure would be lower due to a reduced export share as a percentage of total production.
- **Even our base case is quite conservative.** These scenarios are quite conservative for exporters because of our expectation of a greater burden of adjustment being placed on them rather than the domestic manufacturers in importing countries in Asia (even while the domestic manufacturers are at a cost disadvantage).

Figure 29: Pessimistic Scenario: trade volume impact



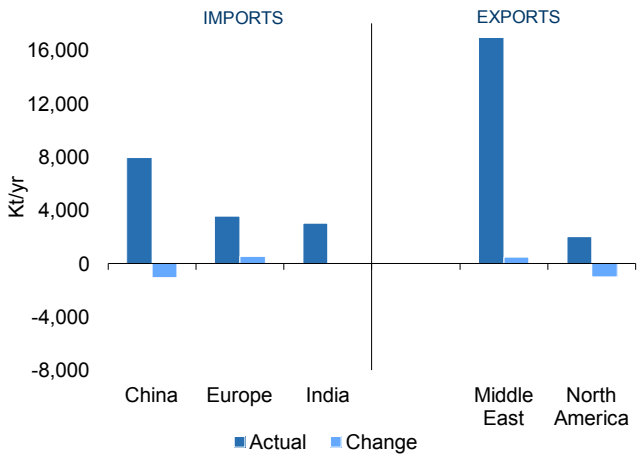
Source: VTB Capital Research

Figure 30: Base Scenario: trade volume impact



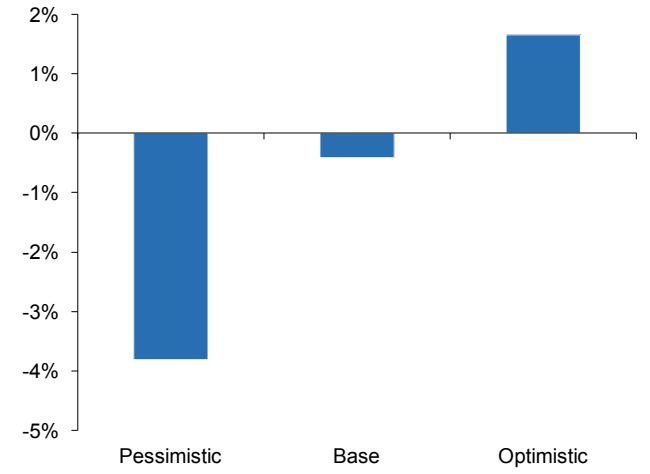
Source: VTB Capital Research

Figure 31: Optimistic Scenario: trade volume impact



Source: VTB Capital Research

Figure 32: Middle East: incremental change to operating rates (nameplate capacity)



Source: VTB Capital Research

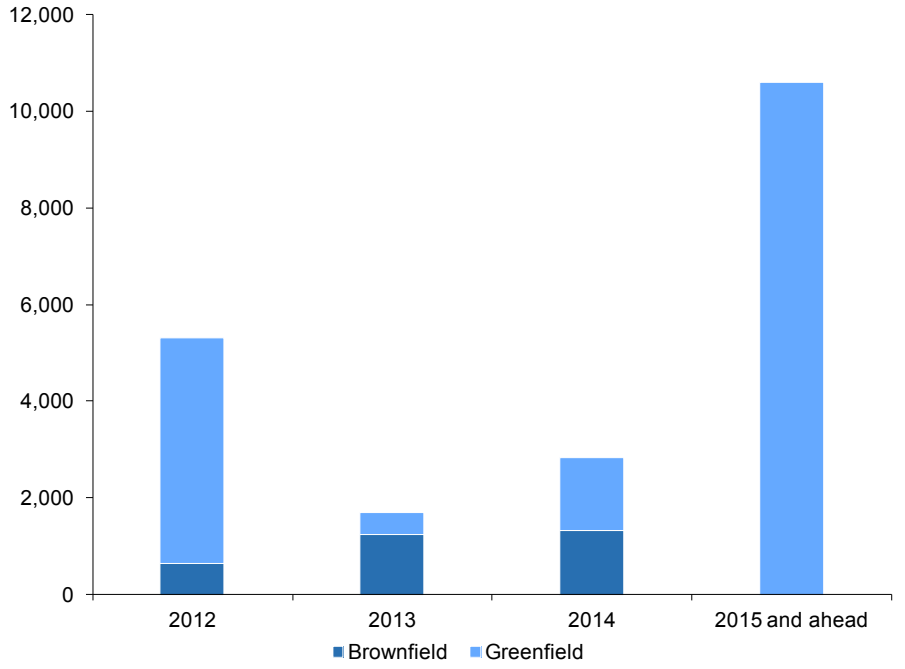
New supply additions are likely to go ahead

New supply additions are likely to go ahead; while relatively balanced, would cap margin upside

We see a limited brownfield capacity addition/restart/debottlenecking, which is likely to add a cumulative 3.2mtpa, or 2.2% to existing nameplate capacity by 2014. These additions are marginal and likely to go ahead. On the greenfield capacity addition, we have a slew of projects adding 6.6mtpa by 2014. Considering that 4.7mtpa of these additions are likely to be staggered over 2012 (and possibly spill over to 2013) most of these additions are likely to come to the market. Furthermore, they largely come below the top 20 percentile of the cash cost curve and are therefore competitive.

A big question mark hangs over a batch of North American and Asian capacities, which could add 10.6mtpa over 2015 and beyond, effecting a 7.3% capacity increase on current ethylene nameplate capacity. Assuming a global GDP growth rate of 3%, we believe the additional capacity will match the organic demand growth. This is discounting the availability of ethane, which many of the North American greenfield operations are predicated upon and whose supply is not yet secured. Nonetheless, the expansion will likely place a cap on any supply deficit and cap margin upside beyond the second quartile across most polyolefins.

Figure 33: Ethylene capacity expansions (ktpa)



Source: VTB Capital Research

Shale gas/liquids: a possible, but yet distant threat

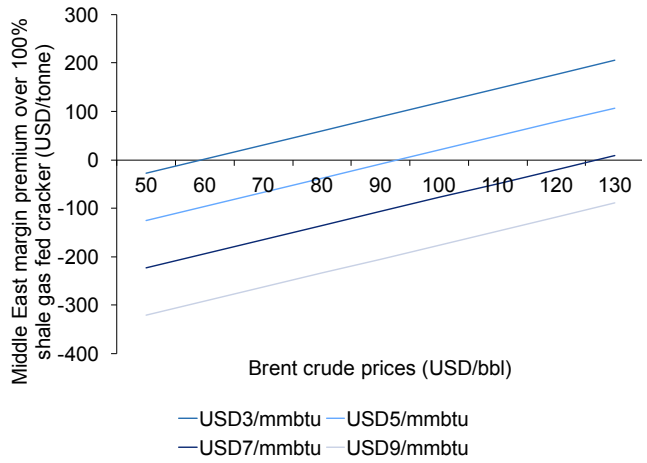
Shale gas/liquids could be a distinct threat over longer term...if prices remain below USD 5/mmbtu

According to BP estimates, total North America gas production grew 3% in 2010 to reach record levels of 826.1bcm, making North America increasingly self reliant. Horizontal drilling technologies have led to shale gas accounting for nearly 23% of US production, up from 4% in 2005.

With gas prices in the US hovering at the USD 3/mmbtu level and the pricing-led energy equivalence of gas to crude at 17% (at a historically low end of the range of 25-65%), we believe that there is an increasing incentive for shale gas to be utilised for conversion to LNG or for petrochemical production, with capex intensity lower for petrochemicals.

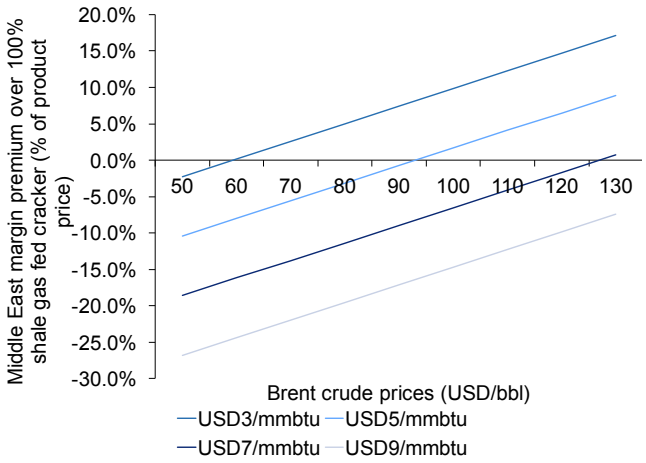
In the short term (up to 2014), we see feedstock availability in ethane (less than 3mtpa) providing some relief to Middle Eastern producers. In the longer run, for shale gas to be a material threat to the export competitiveness of Middle Eastern mixed feed crackers (assuming crude prices stay at or above USD 88/bbl), shale gas based feedstock prices (for C2/C3) will need to be below USD 5/mmbtu. We do not see a distinct threat to Middle Eastern petrochemical exporters' cost economics in the near-to-medium term if the shale supply side does not provide a glut of C2 and C3 feedstock.

Figure 34: Middle Eastern cost premium to shale (USD/tonne)



Source: VTB Capital Research

Figure 35: Middle Eastern cost premium to shale (% of end product price)



Source: VTB Capital Research

Earnings Drivers: Crude and Cyclical Leverage

- Cash margins for MENA producers are a composite function of both commodity cycle driven margins as well as raw material cost advantage driven margins.
- The commodity cycle driven margins are determined by global export vs. import demand and regional demand supply dynamics. The higher the supply deficit, the higher the commodity cycle driven margins.
- Raw material costs range from being fixed (pure ethane and methane) to oil linked (via naphtha linked discounts). The extent of the cost advantage driven margin is a function of conversion ratios (the amount of raw material in mass terms) and the pricing structure of the raw material.

The sector's cash margins are a function of product prices, the state of the commodity cycle and production costs. Unlike marginal producers that accrue only a cycle led margin, Middle Eastern producers accrue both a cycle led margin as well as a raw material price advantage driven margin. Major commodity petrochemical prices are directly a function of marginal producers' cash costs and a cycle driven cash margin. We illustrate the price components with a hypothetical scenario for the two major product groups in the Middle East, accounting for over 70% of volumetric throughput.

Margin determinants: stylised facts

We identify the following factors as the principal determinants of the individual producers' margins:

- **Naphtha – oil link.** The marginal producer of commodity petrochemicals in the polyethylenes operates on naphtha as a feedstock. Naphtha is a light crude fraction and hence highly correlated to crude prices and priced in a narrow -5% to 10% premium to the Brent benchmark. The discount/premium is dependent on the refining and petrochemical demands and refining product slate composition. Naphtha is used as a raw material by marginal producers of polyethylene and polypropylenes (the two products accounting for c.70% of Middle Eastern volumetric production). Hence, the end product prices are directly correlated to naphtha and therefore crude prices.
- **Processing cost.** The processing costs comprise of fixed and variable components of the cost involved in actual production. These range from energy to materials such as catalysts. The processing costs are typically similar across world-scale crackers.
- **Cycle led margin.** The extent of the supply-demand balance dictates the cash margins of the marginal producers and these are referred to as the cycle led margins in fig 36 and fig 37.
- **Tariffs.** Tariff barriers are dependent on geography, origin of product and destination but are a component of final product price.

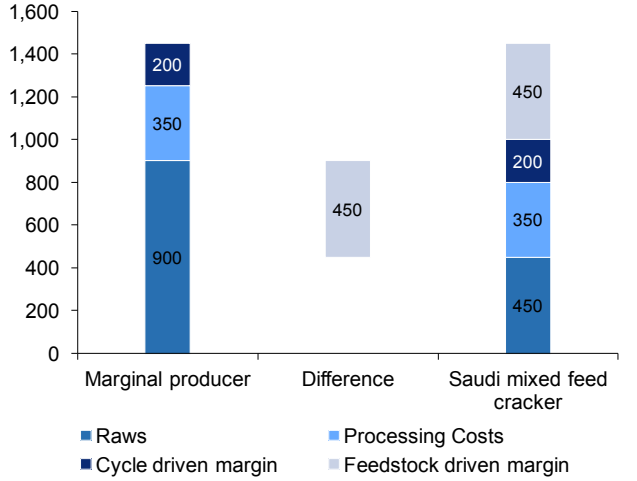
Case studies: polyethylene and propylene

We illustrate the margin structure for the Middle Eastern companies and why their margin structure is different from those of marginal producers on a generic basis. In summary, the two key drivers of margins and earnings for Middle Eastern producers are the crude price driven naphtha prices and the demand vs. supply dynamics.

In the polyethylene margin illustration below, the key difference between a Saudi mixed feed producer and a marginal producer is that while the raws cost is USD 900/tonne for the marginal producer, it is only USD 450/tonne for the Saudi mixed feed producer. Thus, in addition to the USD 200/tonne of cycle driven margin that the marginal producer makes, the Saudi producer makes an additional USD 450/tonne, which is advantaged feedstock driven. No matter how poorly placed the demand supply cycle is, if all else is equal (naphtha prices), the Saudi producer will make the USD 450/tonne even while the cycle driven margin might be zero. In addition, being the lowest cost producer, the Saudi producer will also run at full operational availability, unlike the marginal producer, which might have to pare down production, operating at the highest end of the cash cost curve.

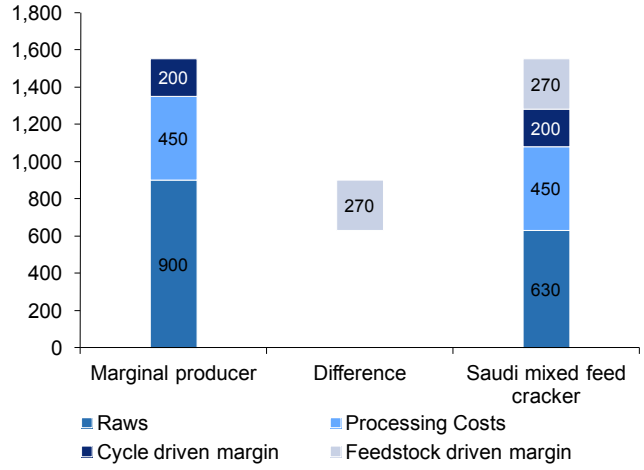
A similar illustration is provided for propylene below wherein the difference in feedstock costs is USD 270/tonne and accounts for the advantaged feedstock driven margin component. The advantaged feedstock driven margin is directly related to naphtha prices and hence the higher the naphtha price, the higher the feedstock driven margin (in absolute terms). We have also illustrated below, in percentile terms, the extent of the raw material cost difference between different operators and cracker types. Our base case assumption is of naphtha prices at USD 850/tonne. The leverage to rising crude prices differs across different product groups and is illustrated in detail for each company under coverage in the latter section.

Figure 36: Polyethylene illustration (USD/tonne)



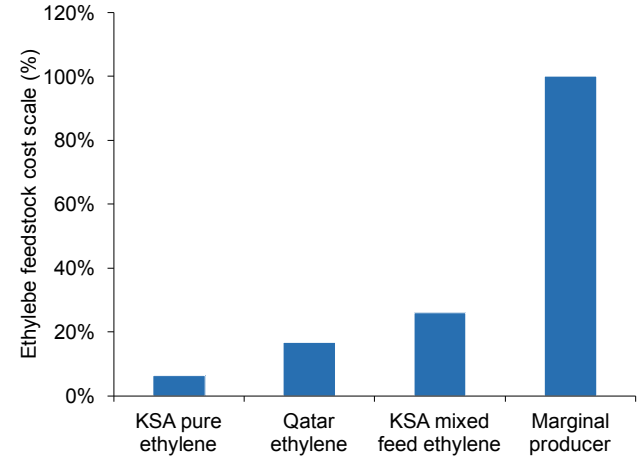
Source: VTB Capital Research

Figure 37: Polypropylene illustration (USD/tonne)



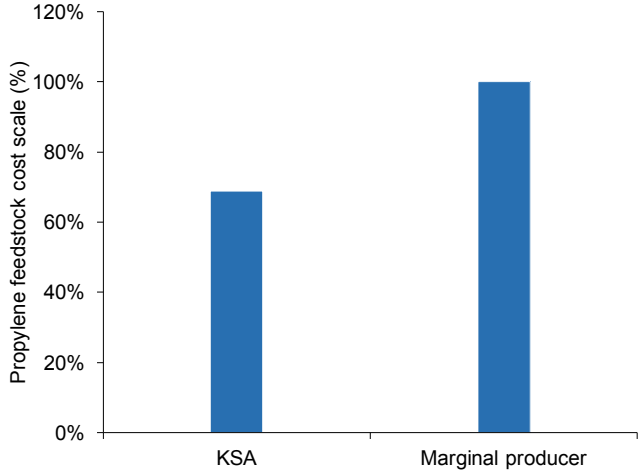
Source: VTB Capital Research

Figure 38: Ethylenes: Raws cost differential



Source: VTB Capital Research

Figure 39: Propylenes: Raws cost differential



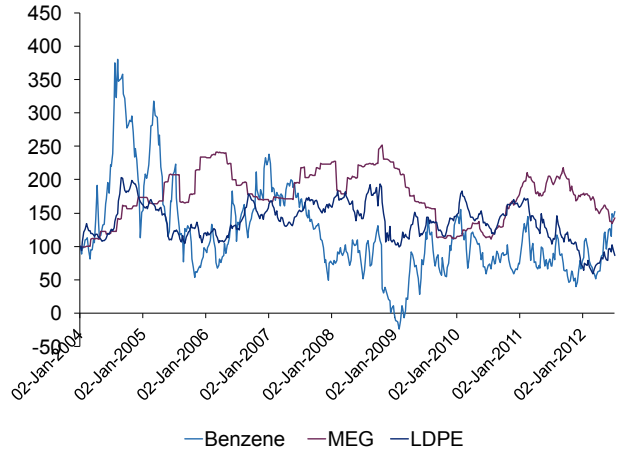
Source: VTB Capital Research

Petrochemicals cycle – misunderstood and overrated

The commodity petrochemicals cycle varies by product and should not be seen as an all-encompassing product cycle. Different subgroups are driven by different dynamics viz consumer demand, automobiles, replacement demand etc. and some product groups' supplies from a cracker stream are inversely related to each other. Thus, while the benzene margin cycle might be peaking, the MEG cycle might be close to a trough and vice versa, as illustrated below. Having an overarching general perspective for margin cycle across all commodity petrochemicals is therefore an aberration.

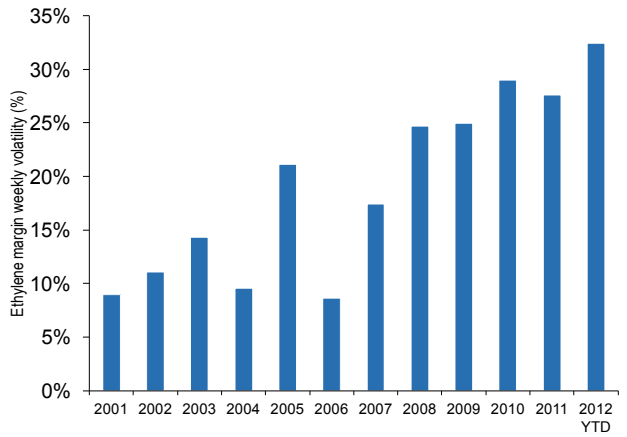
With marginal cash margin volatility at a decade-high level, the cycle periodicity has grown increasingly shorter. This is because the marginal producer enjoys considerable option value in sustaining production at cycle troughs rather than mothballing the plant. Even at the sub product group level, a typical four-to-six-year cycle duration based on the time taken to bring new supply to the market was the norm in 1990s, but the amount of latent capacity in terms of mothballed plants and easy access to credit has reduced that considerably. We illustrate the weekly ethylene margin variance below as an illustrationof the trend.

Figure 40: Marginal producers' margin cycle



Source: VTB Capital Research

Figure 41: Ethylene margins' weekly volatility (%)



Source: VTB Capital Research

MENA Producers: Standing Out From the Pack

- Across the polyolefins, urea, DAP and hydroxyl segments, these producers are the lowest cost producers, globally, with raw material costs ranging from 20% to 70% of those for marginal players.
- While industry margins in Asia and North America are driven in excess of 90% and 83% on average by the commodity cycle, Middle Eastern plays derive a much smaller portion of their margin (on average 45%) from the commodity cycle. The remaining 55% is essentially upstream exposure (directly related to crude price)

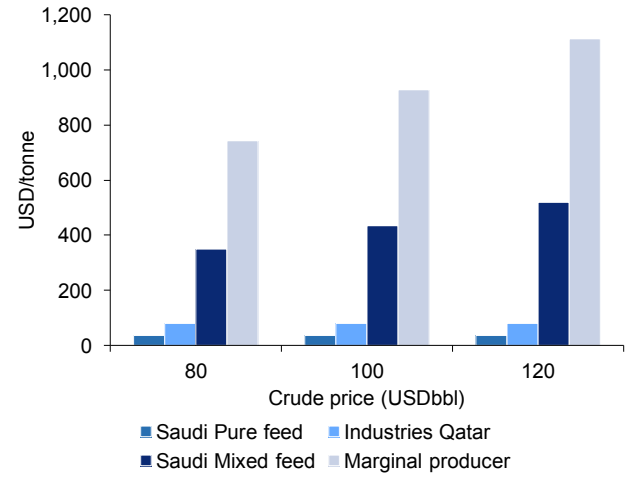
The first impressions of MENA producers, whether related to size, scale, cash returns, volatility, earnings risk profile, minority rights or geopolitical risk, are generally far removed from reality. Whilst technically listed in frontier markets (except OCI which is in the EM market viz Egypt), these assets are best suited for investors seeking stable cash returns and low risk. The most attractive aspect is that in an oil rich region, where there are no listed upstream oil plays (of size), the petrochemical industry's margin structure is geared (to the tune of 55% on average) to upstream dynamics and directly correlated to crude prices. The dichotomy of a simultaneous downstream and an upstream play provides the MENA petrochemical companies with a globally unique investment profile.

World beating competitiveness

Close to the bottom of the cash cost curve

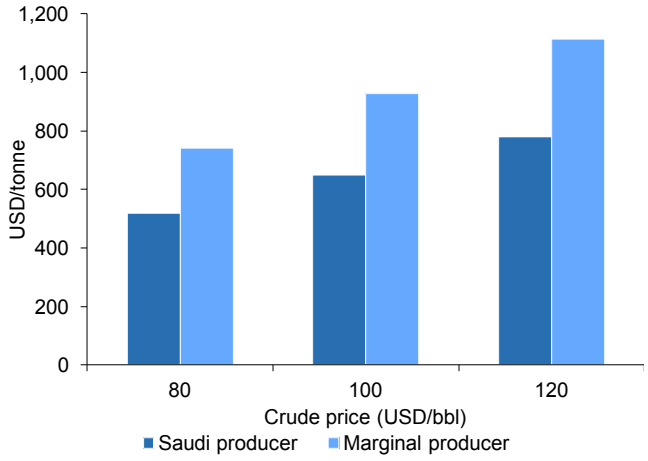
Middle Eastern producers are close to the bottom of the cash cost curve (bottom ten percentile) across most of the major commodity chemical segments they operate in. We illustrate the extent of the advantage by highlighting olefin segments (accounting for c.80%) of Middle Eastern volumetric output where the raw material cost advantage ranges from a minimum of 30% to as high as 80% over the marginal producers' cash cost. Thus, even if global demand fell 50%, Middle Eastern producers could still operate at full utilisation. This risk profile is very attractive across the cycle.

Figure 42: Ethylene segment



Source: VTB Capital Research

Figure 43: Propylene segment

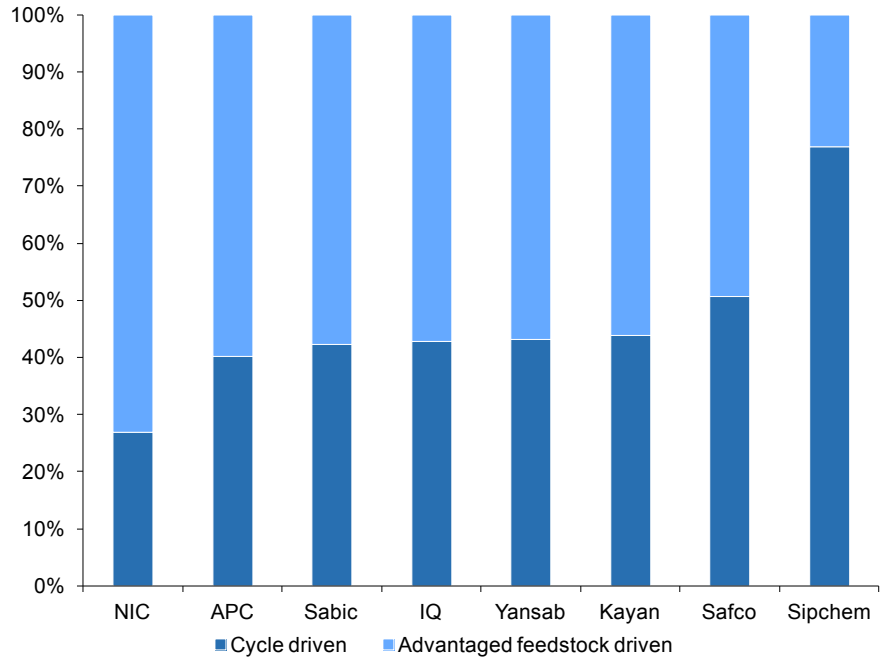


Source: VTB Capital Research

Lower exposure to high beta commodity chemicals cycle

We believe that the upside in cycle driven margins is likely to be limited while the risks induced by the high degree of operating leverage are not desirable in the current macroeconomic uncertainty. Unlike several Asian (Petronas Chemicals and PTT, Thailand, a notable exception) and North American listed petrochemical plays, whose margins are driven in excess of 90% and 83% on average by the commodity cycle, Middle Eastern plays derive a much smaller portion of their margin (on average 45%) from the commodity chemicals cycle and their margins are hence more resilient compared with Asian peers in a high beta industry.

Figure 44: Margin contribution
(Third quartile cyclical margin, USD 100/bbl Brent crude)



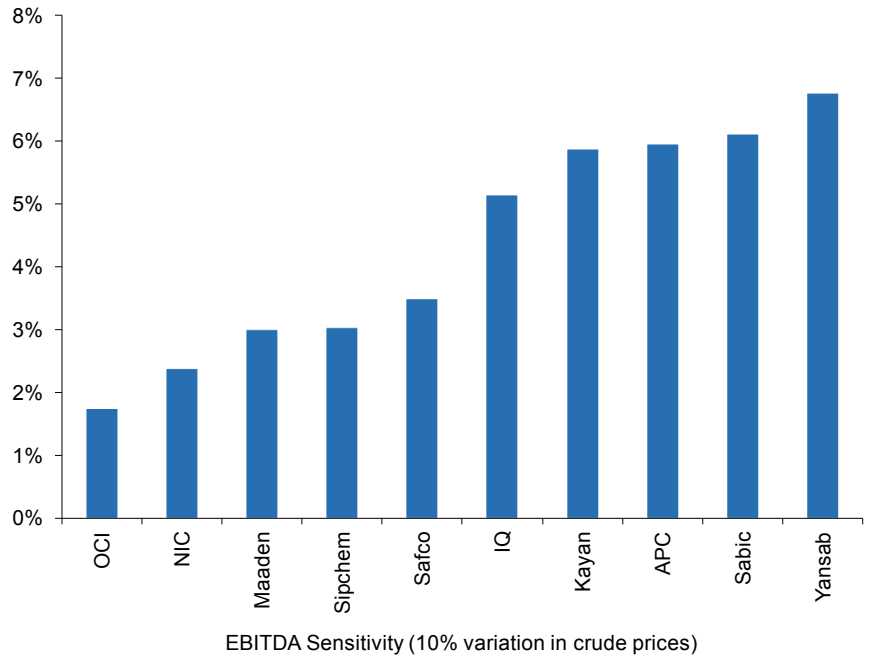
Source: VTB Capital Research

Crude cycle exposure favoured over chemicals cycle

Exposure to crude prices via advantaged feedstock is lower risk at worst, attractive at best

With the medium-term margin environment looking subdued on account of new supply, macroeconomic uncertainty and Asian demand slowdown, we believe crude price exposure risk is relatively more attractive compared with chemical cycle exposure. With the marginal extraction costs heading to USD 80/bbl and Saudi expectations of USD 100/bbl for Brent, we believe crude linked margin exposure has a more robust risk profile.

Figure 45: EBITDA leverage to crude prices

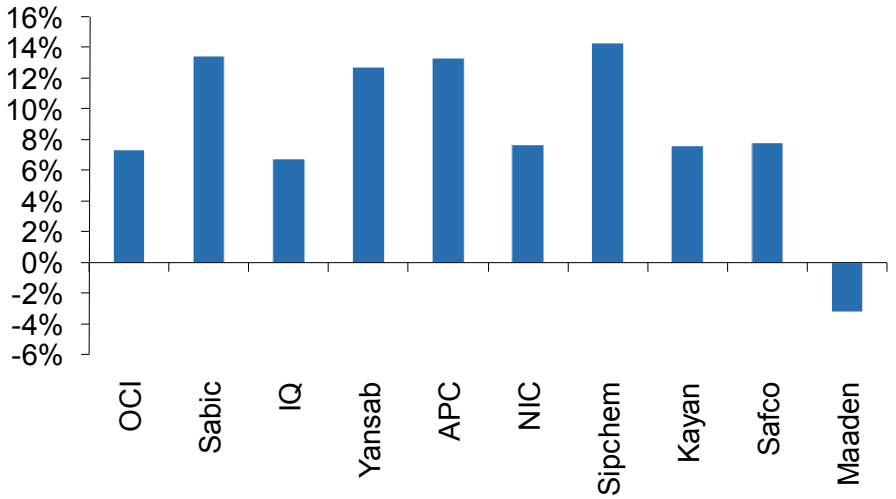


Source: VTB Capital Research

Excellent cash yields and unlevered capital returns

Even while Middle Eastern petrochemical plays have access to abundant and cheap financing, the assets' returns on an unlevered basis are attractive. The older plants such as SAFCO have a return on invested capital (book value) of 78%, while the newer plants, such as Yansab, commissioned in 2010, have returns on invested capital in the order of 12%. On free cash flow yields, the sector as a whole is attractive, with unlevered yields averaging 10.1%.

Figure 46: Unlevered cash returns (2013F)



Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

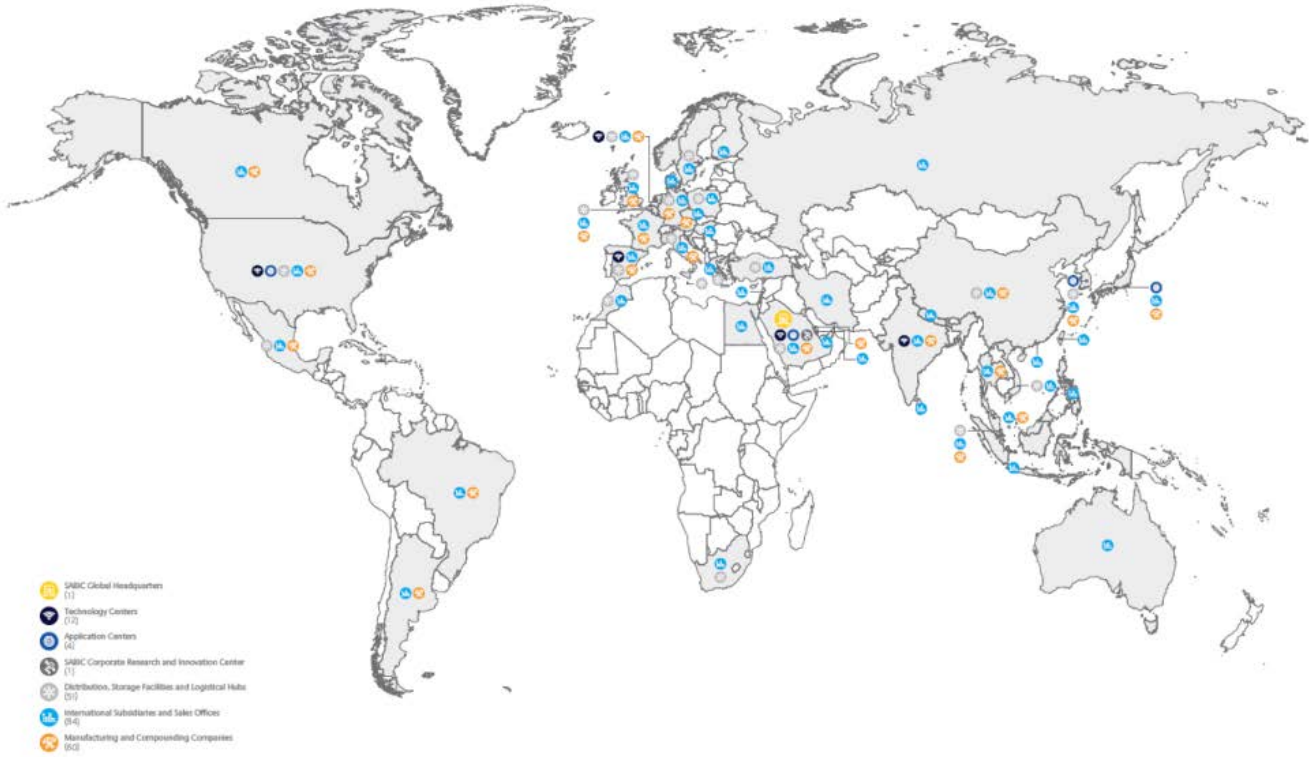
Global multinational plays listed in a frontier market

Saudi Arabia and Qatar, where the large petrochemical plays are listed, have a frontier market classification. The frontier market tag, if anything is slightly misleading. The largest play, SABIC, is a top-ten producer of commodity petrochemicals globally, has a market cap in excess of USD 70bn and trades in excess of USD 50mn daily.

Even a relatively smaller company, Advanced Petrochemicals Company, exports its product across Asia, Europe and Africa. Meanwhile, NIC's subsidiary Cristal Global is a top-five global producer of TiO2 pigment.

The majority of large listed plays are in Saudi Arabia and Qatar, which have fully convertible currencies pegged to USD. The entire value chain is denominated in USD and hence currency risks are minimal.

Figure 47: SABIC: International footprint

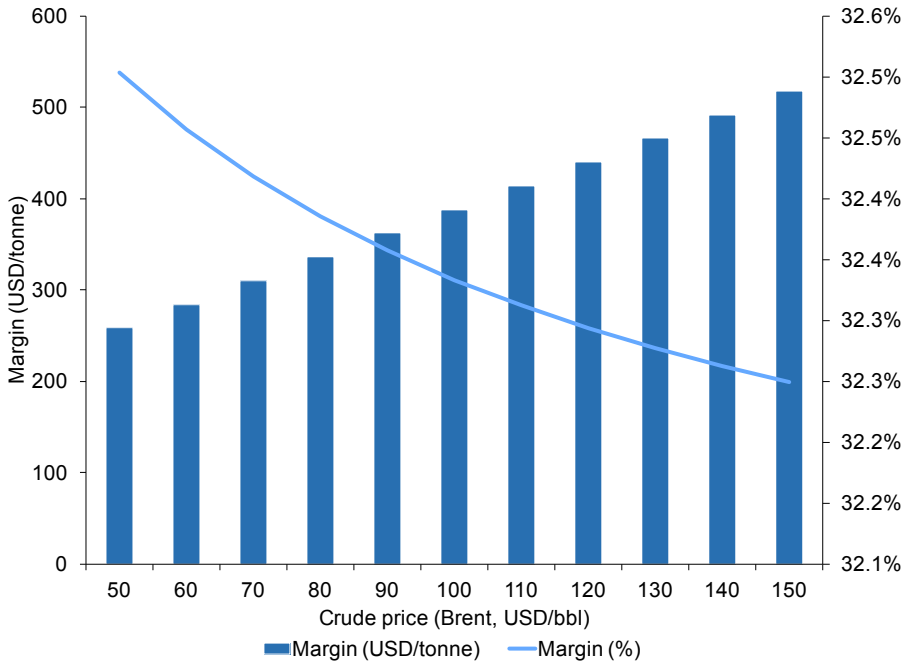


Source: Company data

Geopolitical risks correlated with upside to earnings

The geopolitical risk in the Middle East places crude prices at a premium. Crude prices are highly correlated to naphtha (a raw material for marginal producers of commodity petrochemicals) leading to higher petrochemical product prices. The net effect on Middle Eastern petrochemical producers' earnings is accretive and therefore boosts their earnings. For example, the cost base of Middle Eastern ethylene derivatives is quasi fixed (32% of the cost base is fixed and 68% of the capacity tracks crude prices). An illustration of margin accretion with the full naphtha price increase pass-through assumption is provided in Figure 48. Somewhat similar relationships hold for propylene derivatives.

Figure 48: Ethylene margin – Full naphtha price increase pass-through



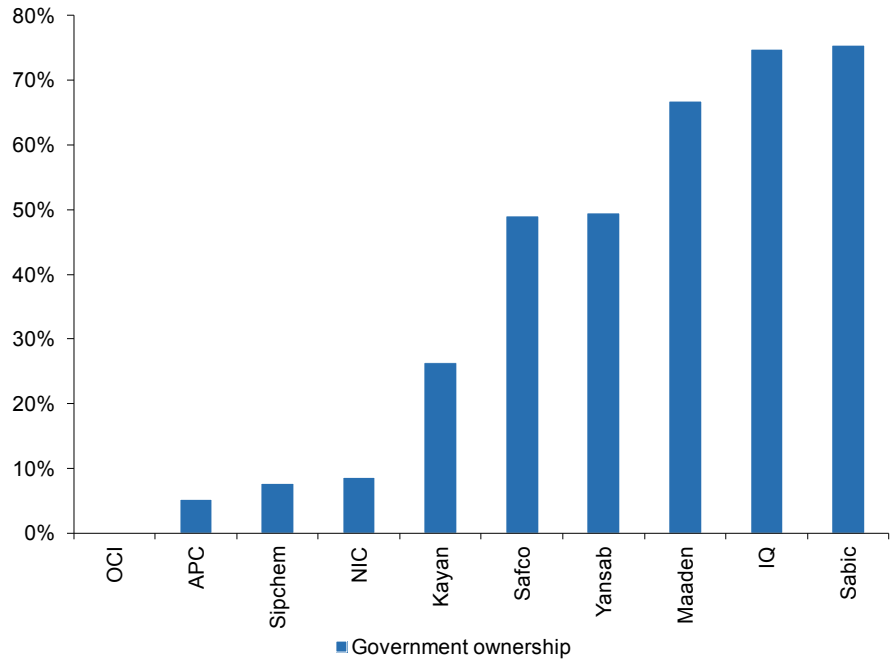
Source: VTB Capital Research

Minority rights and regulation – the right incentives

We believe the treatment of minority interests is very favourable and the typical concerns around resource asset risks in emerging/frontier market economies are invalid.

Government already has majority stakes in all majors and is benevolent. From the country champions of the industry to relatively minor players, the government could potentially choose to exercise an overwhelming degree of control on the companies via feedstock allocation. Furthermore, the government exercises control over major companies, such as SABIC (government ownership of 75%) and Industries Qatar (government ownership of 75%), via direct equity stakeholding. This means easy and attractive financing support is available to large companies. For instance, Yansab's financing in some tranches was as low as 75bp to LIBOR (infrastructure level spreads for a commodity chemicals plant). In many cases, the government provides all the infrastructure and overheads required for new projects. For Maaden, for example, the government set up a 1,200km railway line and a new port with rail freight charges at sub USD10/tonne, among the lowest in the world.

Figure 49: Equity stakeholders



Source: the BLOOMBERG PROFESSIONAL™ service

Earnings of minority interest in play is trivial. That is if it is compared with the earnings of governments' principal resource entities viz Saudi Aramco and Qatar Petroleum. Saudi Aramco and Qatar Petroleum are the principal earnings generators for the governments in Saudi Arabia and Qatar, respectively, and the petrochemical industry on a relative basis is insignificant. To put things in perspective, the net profit of Saudi Aramco is more than 38x of SABIC, of which it controls 70%. The minority interest in play in the biggest listed entity in the region provides less than a 1% of earnings increment to the Saudi government. A USD 2/bbl rise in crude prices does better. Furthermore, this ignores the reserve and asset base of Saudi Aramco completely. A similar argument holds for Qatar, wherein minority stake earnings account for less than 5% of earnings from principal assets.

Saudi, Qatari fiscal positions do not warrant cash squeeze on assets. The Saudi current account is likely to end in excess of 20% of GDP for 2012 and averaged over 18% over 2000-2010. Gross government debt is less than 20% of GDP (December 2011). Qatar has extensively used debt to fund export revenue generating assets, but has a high degree of current account surplus, expected to be in excess of 15% of GDP for 2012, while government gross debt is c.26% of GDP.

Petrochemicals export 93% of output. It does not feed domestic inflation nor does it have a susceptibility to profit margin controls for appeasing domestic constituencies.

Strong capital market regulators with track record of action. Regulators impose injunctions regularly on improper conduct alone. The focus is not on simultaneous disclosure and dissemination alone, but on keeping the exchange as the focal point for the first release of price sensitive information.

Retail local investors account for over 90% of minorities. The government sees IPOs and public markets as avenues for sharing resource wealth. The large state-backed companies do not need to raise capital, but their shares are essentially seen as shared ownership vehicles for citizens. The Saudi Arabian and Qatari equity markets are dominated by retail investors (in excess of 90% of trades) and while the Saudi equity market might trade anywhere between USD 1bn to USD 3bn a month, the volumes are dominated by retail investors. International investors face several restrictions stemming from the availability of the free float, foreign investor stakeholding limits and lack of direct ownership of underlying shares. While the process of increasing foreign institutional participation is likely to be slow, we believe that over time these assets will likely fetch a premium over their international peers.

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Company Profiles

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Initiation of coverage

Orascom Construction Industries

Await the demerger

HOLD

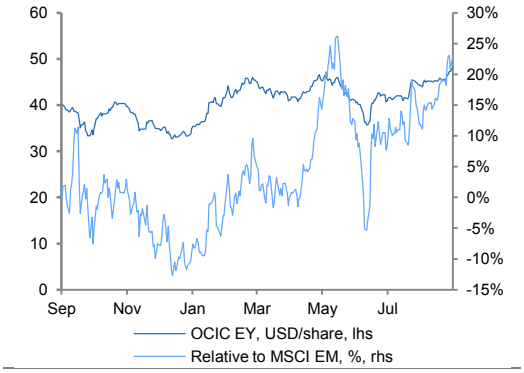
Primary ticker: OCIC EY

Currency: EGP

Stock Data

Last price	292.48
Last price date	09 Sep 2012
Target price	280.00
Target price established	10 Sep 2012
Upside/(downside), %	-4%
52 week price range	196.95 - 292.48
Market cap, USD / EGP mn	10,031 / 61,110
EV, USD / EGP mn	13,911 / 84,742
# shares outstanding, mn	209
Free float	41%
Benchmark Index (MXEF)	950.45

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	8.4%	16%	18%	16%
Price relative	9.6%	10%	23%	5%
ADTV (USD mn)	5.45	5.10	4.16	6.74

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	12.7x	15.7x	14.3x	14.0x
EV/EBITDA, x	9.3x	9.1x	7.8x	7.5x
P/B, x	2.6x	2.8x	2.6x	2.3x
FCF yield, %	-2.0%	8.3%	9.9%	10.9%
DY (ords), %	6.2%	4.5%	4.9%	5.0%
Net sales	32,722	33,838	37,861	37,861
EBITDA	8,223	9,298	10,526	10,534
Net income	4,029	3,888	4,267	4,373
Net sales, chg	19%	3%	12%	-
EBITDA, chg	36%	13%	13%	0%
Net income, chg	20%	-3%	10%	2%
EPS	19.28	18.61	20.42	20.93
DPS (ord.)	15.12	13.03	14.29	14.65
BPS	94.62	102.9	114.2	125.7
EBITDA margin, %	25.1%	27.5%	27.8%	27.8%
ROE, %	22%	20%	20%	20%
Net Debt	16,198	14,716	12,450	9,488
ND/EBITDA, x	2.0x	1.6x	1.2x	0.9x
Net int. cover, x	6.4x	7.7x	9.9x	11.8x

Source: Bloomberg, Company data, VTB Capital Research

Orascom Construction Industries (OCI) is a construction and fertiliser conglomerate with a global footprint and is headquartered in Egypt. OCI has access to fertiliser production assets across US, Algeria, Nigeria, Egypt and the Netherlands. OCI is also the largest listed construction play in the Middle East, executing projects across Europe as well as the Middle East. We are initiating coverage of OCI with a Hold recommendation and TP of EGP 280.

Egypt country and currency risk is limited. With only 20% of 2013F EBITDA exposed to Egyptian assets and projects, the Egyptian asset exposure risk is limited. Furthermore, OCI has been able to grow its Egyptian backlog, highlighting its preferred status. With Egyptian fertiliser production being primarily for export and denominated in USD, the currency risk on the sales side is marginal. Construction businesses are also all denominated in dollars, with completion-based accounting.

Sorfert to power 2011-13E EBITDA CAGR of 13%. We see Sorfert contributing an additional EGP 3.8bn of consolidated EBITDA by 2013F. The EBITDA margins at Sorfert are likely to be at 67.9%. Our forecasts for MENA urea prices (FOB) are at USD 415/tonne for 2012F and USD 350/tonne for 2013F and beyond, presenting an upside risk to estimates, we believe.

Construction backlog healthy and recent wins provide new inroads. The construction backlog is impressive in its variety and exposure to sovereign funded projects across the Middle East and Europe. The largest projects such as Sidra (Qatar), Yas Island mall (Abu Dhabi) are prime examples. In addition, OCI is contracting for the US army, with latest wins outside Egypt in Bahrain. With c.60% of the backlog in the infrastructure sector, the quality of the backlog is strong: we estimate backlog/sales at 2.1 for 2012F.

Demerger and Brazil expansion might provide a further catalyst. OCI intends to split the fertiliser business from the construction business, providing pure plays in both segments with GDRs listed in London. In addition, OCI is exploring a 3mtpa expansion in Brazil.

Valuation. We value OCI via a multiples-based method with a benchmark forward EV/EBITDA of 8.0x. We apply a discount of 7% to arrive at a benchmark 12m forward EV/EBITDA of 7.4x. The multiple is a reflection of the aggregate composite for construction and fertiliser businesses based in relatively higher sovereign risk environments compared with Saudi Arabia and Qatar. Our normalised EBITDA estimate is EGP 10.5bn (at a USD/EGP assumption of 6.4 for 2013F). Using a net debt assumption of EGP 13.2bn and estimating minorities at EGP 9.8bn, we arrive at our 12-mo TP of EGP 280. OCI trades at a 2013F P/E of 14.3x against peers at 10.0x. On 2013 EV/EBITDA, the company trades at 7.8x against peers at 6.3x.

Risks. Input gas price escalation in Algeria or Egypt is a risk to margins.

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VTB Capital Facts & Forecasts

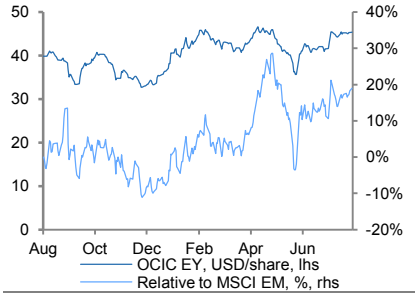
Company country & sectors
Materials / Commodity Chemicals

Orascom Construction Industries

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
OCIC EY	EGP	292.48	280.00	Hold

Share price performance, 12-mo



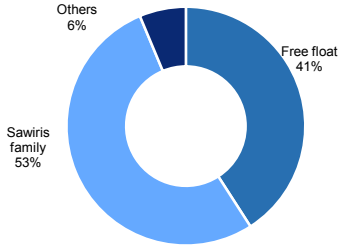
Company description

Orascom Construction Industries (Egypt) – An Egyptian industrial company with both construction and urea segments. The geographical exposure ranges from GCC to North African countries like Algeria.

Company website

http://www.orascomci.com

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 10 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	206.4	209.0	208.9	208.9	208.9	208.9
Avg market cap	52,447	50,984	61,110	61,110	61,110	61,110
EV	73,604	76,097	84,742	82,476	79,514	76,532
Ratios & analysis						
P/E, x	15.7x	12.7x	15.7x	14.3x	14.0x	13.6x
EV/EBITDA, x	12.2x	9.3x	9.1x	7.8x	7.5x	7.3x
P/B, x	2.7x	2.6x	2.8x	2.6x	2.3x	2.1x
Dividend yield (ords), %	4.4%	6.2%	4.5%	4.9%	5.0%	5.2%
EPS	16.20	19.28	18.61	20.42	20.93	21.54
CFPS	11.58	7.74	28.91	30.75	34.43	34.95
Free CFPS	(11.33)	(4.81)	24.29	28.89	31.92	31.59
DPS (ords)	11.22	15.12	13.03	14.29	14.65	15.07
Payout ratio (ords), %	69.3%	78.4%	70.0%	70.0%	70.0%	70.0%
BPS	92.44	94.62	102.9	114.2	125.7	137.5
Revenues growth, %	n/m	19%	3%	12%	-	-
EPS growth, %	n/m	19%	-3%	10%	2%	3%
EBITDA margin, %	22.0%	25.1%	27.5%	27.8%	27.8%	27.8%
Net margin, %	12.1%	12.3%	11.5%	11.3%	11.6%	11.9%
ROE, %	18.5%	21.6%	19.7%	20.3%	19.6%	19.0%
ROIC, %	8.5%	10.2%	10.4%	11.9%	12.3%	12.7%
Capex/Revenues, %	11%	7%	7%	5%	5%	5%
Capex/Depreciation, x	2.3x	1.5x	1.3x	1.0x	1.0x	1.0x
Net debt/Equity, %	64%	82%	68%	52%	36%	23%
Net debt/EBITDA, x	2.0x	2.0x	1.6x	1.2x	0.9x	0.6x
Net interest cover, x	8.2x	6.4x	7.7x	9.9x	11.8x	15.6x
Income statement summary						
Revenues	27,552	32,722	33,838	37,861	37,861	37,861
Cost of sales	(19,863)	(19,737)	(22,674)	(22,498)	(25,293)	(25,285)
SG&A and other opexp.	(1,639)	(1,765)	(1,825)	(2,042)	(2,042)	(2,042)
EBITDA	6,051	8,223	9,298	10,526	10,534	10,543
Depreciation & amortization	(1,385)	(1,488)	(1,777)	(1,782)	(1,728)	(1,679)
Operating profit	4,666	6,734	7,521	8,743	8,806	8,864
Non-operating gains /(exp.)	142	80	100	100	100	100
EBIT	4,666	6,734	7,521	8,743	8,806	8,864
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	4,238	5,767	6,649	7,960	8,159	8,395
Income tax	(840)	(1,556)	(2,194)	(2,627)	(2,692)	(2,770)
Minority interests	305	452	567	1,067	1,093	1,125
VTBC Net income	3,344	4,029	3,888	4,267	4,373	4,499
Cash flow statement summary						
Cash flow from operations	2,391	1,618	6,040	6,424	7,195	7,303
Working capital changes	(3,265)	(4,909)	(192)	(692)	-	-
Capex	(3,146)	(2,223)	(2,369)	(1,704)	(1,704)	(1,704)
Other investing activities	102	81	-	-	-	-
Free cash flow	(2,339)	(1,005)	5,075	6,036	6,670	6,601
Share issue (reacquisition)	-	-	-	-	-	-
Dividends paid	(2,317)	(3,160)	(2,722)	(2,987)	(3,061)	(3,150)
Net change in borrowings	3,808	4,561	-	-	-	-
Other financing cash flow	27	361	-	-	-	-
Movement in cash	(275)	697	1,482	2,266	2,962	2,982
Balance sheet summary						
Cash and equivalents	5,746	6,399	7,881	10,147	13,109	16,091
PP&E	18,606	20,056	20,115	19,504	18,948	18,440
Goodwill	11,062	11,398	11,398	11,398	11,398	11,398
Investments	3,083	829	829	829	829	829
Other assets	16,379	20,619	21,199	23,290	23,290	23,290
Total assets	54,876	59,301	61,422	65,168	67,574	70,048
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	17,805	16,928	17,316	18,716	18,716	18,716
Total liabilities	35,792	39,525	39,913	41,313	41,313	41,313
Total shareholder's equity	18,040	18,610	19,776	21,056	22,368	23,718
Minority interest	1,044	1,166	1,732	2,799	3,892	5,017
Net working capital	2,297	5,625	5,817	6,509	6,509	6,509
Net Debt	12,241	16,198	14,716	12,450	9,488	6,506
Capital	19,304	19,535	20,366	21,466	22,628	23,913

Company Profile

Orascom Construction Industries (OCI) was founded by Eng. Sawiris in 1976 as a general contracting and trading company. OCI embarked on a diverisification into cement, building materials and later fertilisers starting in 1995. OCI has a market capitalisation of USD 9.2bn and is the largest listed play (MCap) in the Egyptian equity market.

Product segments

Construction. The construction segment has been the historical core business of the firm, with the 2012F share of consolidated EBITDA at 26%. Infrastructure forms c.60% of the company's backlog and OCI is also seen as the premier contracting firm for infrastructure projects across the Middle East.

Petrochemicals and Fertilisers. We expect this segment to contribute c.74% of the company's 2012F EBITDA and even more after the Sorfert plant in Algeria is fully commissioned.

Operating assets

Construction. The construction business operates as three distinct business units. Orascom Construction is involved in industrial and infrastructure projects based primarily in North Africa and the Middle East. BESIX Group is a global group (operating since 1909) offering EPC services and operating across 15 countries with strong market outreach in Europe. Contrack (based out of Virginia, USA, and founded in 1985) is also an EPC contractor focussing on projects in the Middle East and Central Asia.

Petrochemicals and Fertilisers. The petrochemicals and fertilisers business has assets in Egypt, Algeria, US, the Netherlands and Nigeria among other minor stakes. The product groups span ammonia, urea, nitrates, methanol and melamine.

Figure 50: Installed Capacity (ktpa)

	2012F	2013F	2014F
Ammonia			
EBIC (Egypt)	700.0	700.0	700.0
EFC (Egypt)	800.0	800.0	800.0
Sorfert (Algeria)	1,600.0	1,600.0	1,600.0
Beaumont (US)	250.0	250.0	250.0
Urea			
EFC (Egypt)	1,550.0	1,550.0	1,550.0
Sorfert (Algeria)	1,200.0		
Ammonium Nitrate (Derivatives)			
EFC (Egypt)	325.0	325.0	325.0
OCI Nitrogen (Netherlands)	1,350.0	1,600.0	1,600.0
Melamine			
OCI Nitrogen (Netherlands)	250.0	250.0	250.0
Methanol			
Beaumont (US)	750.0	750.0	750.0

Source: VTB Capital Research

Figure 51: Production (kpta)

	2012F	2013F	2014F
Ammonia			
EBIC (Egypt)	665.0	665.0	665.0
EFC (Egypt)	1,240.0	1,240.0	1,240.0
Sorfert (Algeria)	272.0	1,360.0	1,440.0
Beaumont (US)	187.5	187.5	225.0
Urea			
EFC (Egypt)	1,353.8	1,353.8	1,353.8
Sorfert (Algeria)	480.0	900.0	1,080.0
Ammonium Nitrate (Derivatives)			
EFC (Egypt)	292.5	292.5	292.5
OCI Nitrogen (Netherlands)	1,215.0	1,440.0	1,440.0
Melamine			
OCI Nitrogen (Netherlands)	162.5	225.0	225.0
Methanol			
Beaumont (US)	0.0	675.0	675.0

Source: VTB Capital Research

Earnings profile highlights

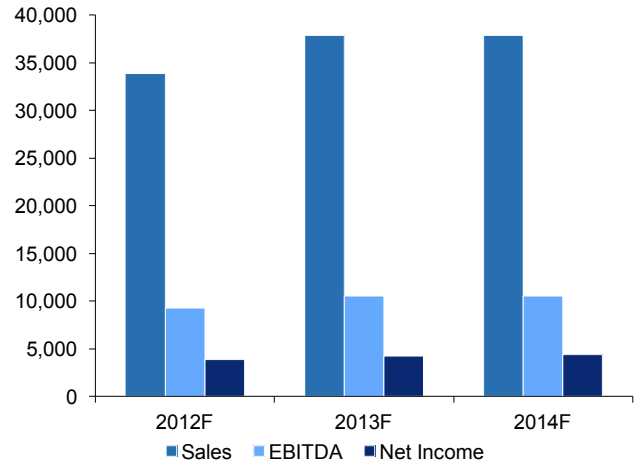
Revenues. According to our forecasts, 2012F revenues are EGP 33.8bn. Long-term revenues are pegged at EGP 37.9bn and we do not factor in any new large-scale volume expansion across any category post 2014F. If future corn prices (currently at USD 8.13bu/acre) remain at currently elevated levels, urea prices are likely to remain strong and our forecasted decline of USD 65/tonne over 2012-2013 is not likely to materialise. Under these circumstances, the fertiliser prices provide an upside risk to the currently forecasted top line and bottom line earnings and valuations. In the construction segment, the backlog has a c.60% exposure to the infrastructure sector and has better receivables and funding visibility due to exposure to the sovereign-backed nature of these projects. Even in other projects, such as Sidra (Qatar), Yas Island mall (Abu Dhabi), Egyptian Grand Museum (Egypt), the backlog is tied to the sovereign's credit risk, which in our view is an attractive profile.

EBITDA. 2012F EBITDA will likely total EGP 9.3bn and normalised EBITDA will likely come in at EGP 10.5bn. We estimate an EBITDA margin of 27.5% for 2012F, rising to 27.8% by 2014F on account of the higher EBITDA contribution from Sorfert's full ramp up. The EBITDA margin for OCI is exposed to fertiliser prices and the higher prices in 2011 on average were primarily responsible for EBITDA margins rising 310bp from 2010-11. We forecast 2012F EBITDA margins of 27.5% with the expected ramp up of Sorfert's urea line. Once fully operational, we see 2013F EBITDA margins at 27.8%, even though our 2013F urea price forecasts (at USD 350/tonne from USD 415/tonne in 2012F) place downward pressure on urea margins. Sorfert's cash costs of urea production are likely to be amongst the lowest globally, with EBITDA margins of 71.3% in 2012F, declining to 67.9% by 2013F on account of lower fertiliser prices.

Debt. Under our calculations, net debt falls from EGP 18.6bn (2011) to EGP 12.4bn by 2013F. Our interest cost assumption is 6% for 2012F. With the current capex cycle coming to an end post Sorfert, we believe there is a strong likelihood of greenfield project announcements over 2013. However, OCI currently has a Net Debt/EBITDA of 2.0 for 1.6x for 2012F, which is quite low and offers low-cost funding optionalities for future capex plans.

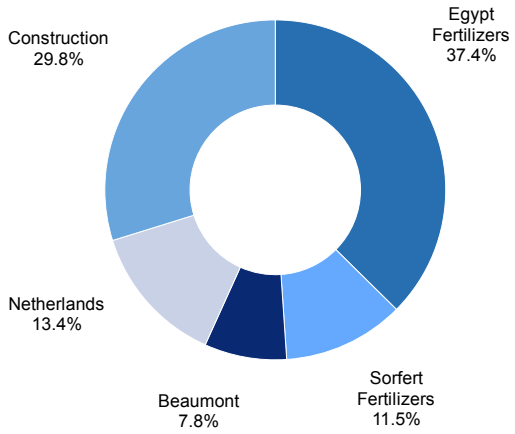
Cash flow. In our view, 2012F cash earnings will come to EGP 6bn, with operating cash flow at EGP 9.2bn. OCI can generate net cash flow of EGP 5.2bn pre dividends with the minorities' stake in the cash flow at c. EGP 1bn. At current prices, the equity free cash flow yield in 2013F is 9% (not discounted). The longer-term (2014F) stable equity free cash flow yields are in the order of 9% (not discounted).

Figure 52: Key Forecasts (in SAR mn)



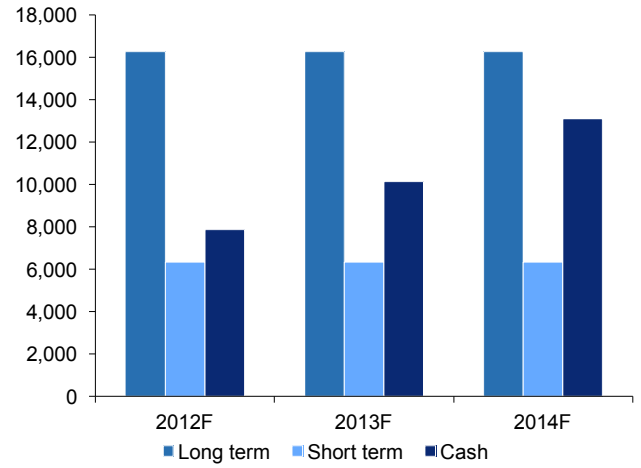
Source: VTB Capital Research

Figure 53: EBITDA Composition (2012F)



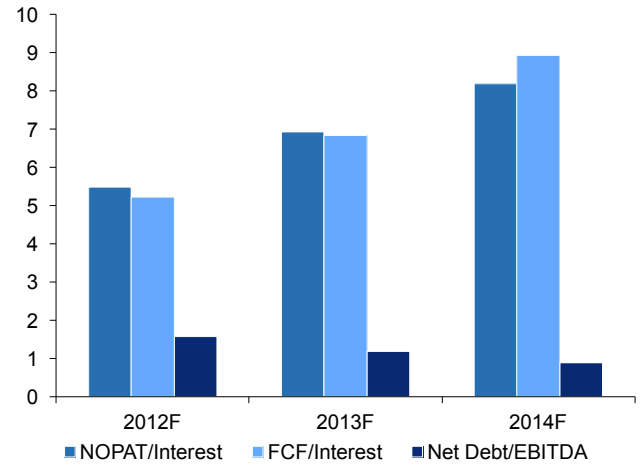
Source: VTB Capital Research

Figure 54: Debt (in SAR mn)



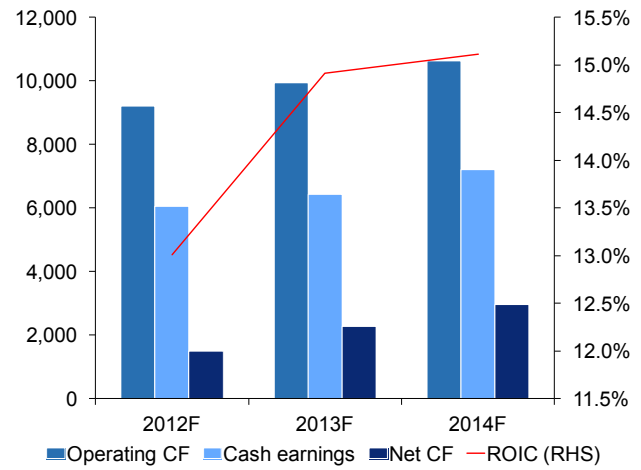
Source: VTB Capital Research

Figure 55: Debt Service Ratios



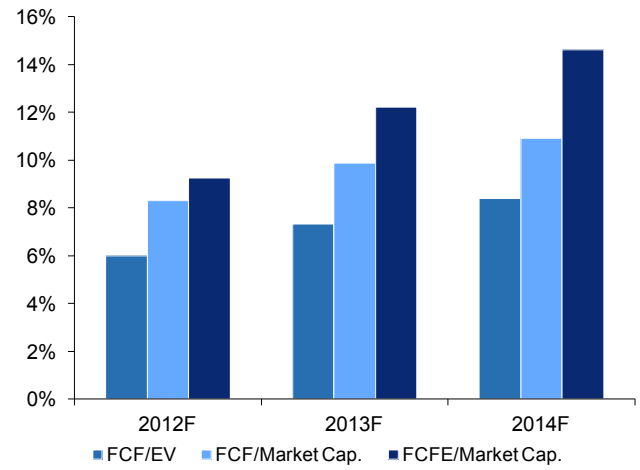
Source: VTB Capital Research

Figure 56: Cash Flows (in SAR mn)



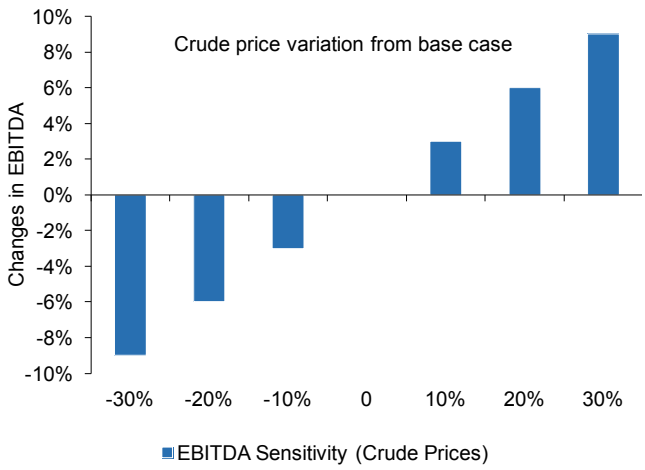
Source: VTB Capital Research

Figure 57: FCF and FCFE Yields



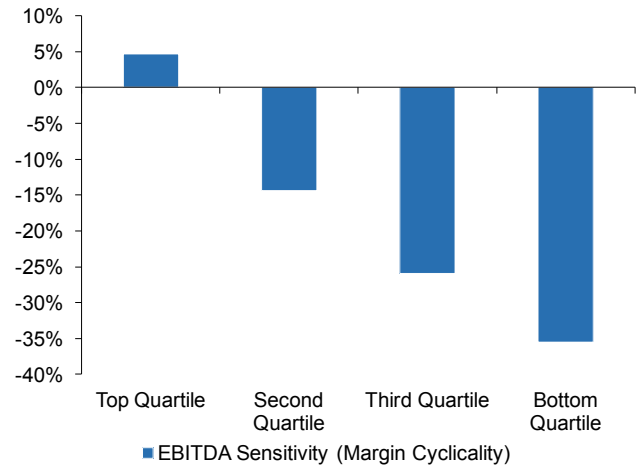
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 58: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 59: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial statements

Figure 60: Income Statement
(Figures in EGP mn, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	32,722	33,838	37,861	37,861	37,861
EBITDA	8,223	9,298	10,526	10,534	10,543
D&A	1,488	1,777	1,782	1,728	1,679
EBIT	6,734.2	7,520.6	8,743.4	8,806.0	8,863.9
Finance Costs	(1,047)	(972)	(883)	(747)	(569)
Other income (expense)	80	100	100	100	100
PBT	5,767	6,649	7,960	8,159	8,395
Taxes	1,556	2,194	2,627	2,692	2,770
Effective tax rate (%)	0	0	0	0	0
Net income before minorities	4,212	4,455	5,333	5,467	5,624
Share of minorities	452	567	1,067	1,093	1,125
Gains/(losses)/(deconsolidation)	269	-	-	-	-
Net income	4,029	3,888	4,267	4,373	4,499
Adjusted net income (pre-exceptionals)	3,760	3,888	4,267	4,373	4,499
Number of shares (mn)	209	209	209	209	209
EPS	19.3	18.6	20.4	20.9	21.5
Adjusted EPS (pre-exceps)	18.0	18.6	20.4	20.9	2
DPS	15.1	13.0	14.3	14.7	15.1
Payout ratio (%)	78%	70%	70%	70%	70%

Source: Company data, VTB Capital Research

Figure 61: Balance Sheet
(Figures in EGPmn, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	20,056	20,115	19,504	18,948	18,440
Intangibles	11,398	11,398	11,398	11,398	11,398
Investments	829	829	829	829	829
Other	568	568	568	568	568
Total non-current assets	32,851	32,910	32,299	31,743	31,235
Cash	6,399	7,881	10,147	13,109	16,091
Accounts receivable	14,772	15,275	17,092	17,092	17,092
Inventories	2,240	2,316	2,591	2,591	2,591
Other	3,039	3,039	3,039	3,039	3,039
Total current assets	26,450	28,512	32,869	35,831	38,813
TOTAL ASSETS	59,301	61,422	65,168	67,574	70,048
Debt	6,328	6,328	6,328	6,328	6,328
Accounts payable	11,386	11,774	13,174	13,174	13,174
Other	898	898	898	898	898
Total current liabilities	18,612	19,000	20,400	20,400	20,400
Debt	16,269	16,269	16,269	16,269	16,269
Other	4,644	4,644	4,644	4,644	4,644
Total non-current liabilities	20,913	20,913	20,913	20,913	20,913
Minorities	1,166	1,732	2,799	3,892	5,017
Shareholders' Equity	18,610	19,776	21,056	22,368	23,718
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**59,301**	**61,422**	**65,168**	**67,574**	**70,048**

Source: Company data, VTB Capital Research

Figure 62: Cash Flow Statement
(Figures in EGPmn, except per share data or if specified otherwise)

	2011	2012F	2013F	2014F	2015F
EBITDA	8,223	9,298	10,526	10,534	10,543
Working capital change	(4,909)	(192)	(692)	-	-
Other	426	100	100	100	100
Cash earnings ex taxes and interest	3,740	9,206	9,934	10,634	10,643
Tax liability	(1,556)	(2,194)	(2,627)	(2,692)	(2,770)
Interest and provisions	(567)	(972)	(883)	(747)	(569)
Operating cash flow	1,618	6,040	6,424	7,195	7,303
CAPEX	(2,223)	(2,369)	(1,704)	(1,704)	(1,704)
Intangibles	(9)	-	-	-	-
Acquisitions (net of disposals)	(532)	532	532	532	532
Other	81	-	-	-	-
Cash flow before financing	(1,065)	4,203	5,253	6,023	6,132
Financing cash flows	1,762	(2,722)	(2,987)	(3,061)	(3,150)
Net borrowing	4,561	-	-	-	-
New equity	-	-	-	-	-
Dividends	(3,160)	(2,722)	(2,987)	(3,061)	(3,150)
Other	361	-	-	-	-
Net Cash Flow	697	1,482	2,266	2,962	2,982

Source: Company data, VTB Capital Research

Initiation of coverage

Saudi Basic Industries

The must-buy stock in its industry

BUY

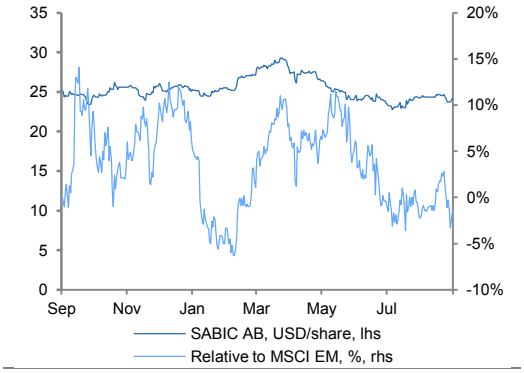
Primary ticker: SABIC AB

Currency: SAR

Stock Data

Last price	90.75
Last price date	09 Sep 2012
Target price	115.00
Target price established	04 Sep 2012
Upside/(downside), %	27%
52 week price range	85.25 - 109.75
Market cap, USD / SAR mn	72,596 / 272,250
EV, USD / SAR mn	97,637 / 366,158
# shares outstanding, mn	3,000
Free float	25%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	-0.3%	1%	-4%	25%
Price relative	-0.1%	-6%	0%	14%
ADTV (USD mn)	80.62	91.86	132.82	143.55

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	10.3x	9.5x	8.7x	8.9x
EV/EBITDA, x	7.0x	6.2x	5.4x	5.0x
P/B, x	1.6x	1.2x	1.1x	0.9x
FCF yield, %	10.4%	15.1%	16.4%	16.7%
DY (ords), %	3.9%	4.2%	4.7%	4.6%
Net sales	189,898	196,849	199,401	195,245
EBITDA	60,654	59,100	61,008	59,743
Net income	29,242	28,518	31,444	30,659
Net sales, chg	25%	4%	1%	-2%
EBITDA, chg	26%	-3%	3%	-2%
Net income, chg	35%	-2%	10%	-2%
EPS	9.75	9.51	10.48	10.22
DPS (ord.)	3.94	3.85	4.24	4.13
BPS	63.07	73.85	85.73	97.32
EBITDA margin, %	31.9%	30.0%	30.6%	30.6%
ROE, %	21%	18%	18%	16%
Net Debt	52,115	23,408	(10,555)	(45,551)
ND/EBITDA, x	0.9x	0.4x	(0.2x)	(0.8x)
Net int. cover, x	16.3x	16.3x	n/a	n/a

Source: Bloomberg, Company data, VTB Capital Research

Saudi Basic Industries Corp (SABIC) is the largest listed company (by MCap) in the Middle East. SABIC operates across various commodity petrochemical segments and also has a metals segment (Steel and Aluminium exposure). SABIC has over 27 subsidiaries and a global footprint with operations in more than 50 countries. We are initiating coverage of SABIC with a Buy recommendation and TP of SAR 115.

Attractive free cash flow yields. SABIC trades at a 2012F price to cash flow of 6.6x against peers at 7.5x and with an attractive balance sheet (net debt turns negative in 2013F).

Largest quasi upstream exposure at the heart of global oil reserves. Oil majors in the Middle East are largely private, state-owned enterprises. With its upstream leverage via advantaged feedstock, SABIC is as close as it gets to an upstream exposure in Saudi Arabia.

EBITDA margins bottomed out in 4Q11 in our view. The structural decline in SABIC's margins as a result of foreign high cash cost capacities has largely bottomed out in our view. With the restart of Geleen facilities in the Netherlands, we believe volumes and EBITDA are likely to edge higher.

M&A could potentially add new product streams. SABIC, as the largest listed company in Saudi Arabia, a large stakeholder at several other domestic firms and owner of most IP licenses for Saudi plants is the key vehicle for seeking M&A opportunities globally. We believe it is quite likely that we will see a potential expansion of product slate into polyurethanes, high temperature coatings and energy storage in the near future. We believe these could be margin accretive for SABIC.

Product slate and diversity is attractive. SABIC has significant exposure to LLDPE, MTBE, MEG, PP and vinyls, which, in our view, have a strong leverage to Asian consumer demand and are attractive growth categories. 48% of SABIC's EBITDA is comprised of an attractive product slate.

Cost management likely to deliver improved margins. SABIC's SG&A expenditure at 6% of sales is likely to trend lower as the footprint expansion slows in light of the establishment of a distribution network for new product streams from Yansab and Kayan. Furthermore, we believe that SABIC's net debt will be negated by 2013F and contribute another 7% to 2012F EPS.

Valuation. We value SABIC via a multiples based method with a generic sector 12m forward EV/EBITDA of 8.0x. Our normalised EBITDA estimate is SAR 61bn. Using a net debt assumption of SAR 0.77bn we arrive at a Target Price of SAR 115. SABIC trades at a 2013F P/E of 8.7x against peers at 11.5x. On 2013 EV/EBITDA, the company trades at 5.4x against peers at 6.2x. Furthermore, with our EPS growth expectations primarily centred on volumes (60%) against peers banking on margin improvement, the risk profile of SABIC's earnings is robust. The strong balance sheet (2012F Net Debt/EBITDA of 0.4x against peers at 1.9x), strong sovereign support and cash generation make it our most compelling investment recommendation on a global basis in its industry.

Risks. A further slump in European demand.

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VTB Capital Facts & Forecasts

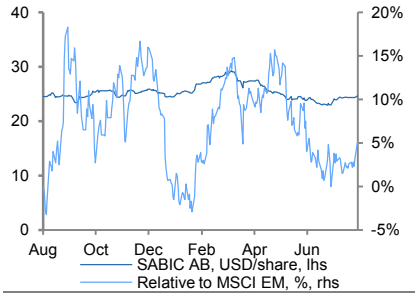
Company country & sectors
Materials / Commodity Chemicals

Saudi Basic Industries

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
SABIC AB	SAR	90.75	115.00	Buy

Share price performance, 12-mo



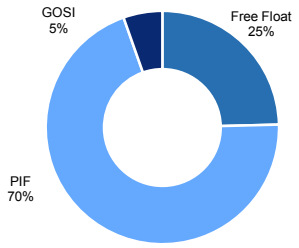
Company description

Saudi Basic Industries (Saudi Arabia) – The largest commodity petrochemical producer in the Middle East with a global operating footprint.

Company website

http://www.sabic.com

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 4 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	3,000	3,000	3,000	3,000	3,000	3,000
Avg market cap	278,821	301,545	272,250	272,250	272,250	272,250
EV	409,329	424,160	366,158	332,195	297,199	263,231
Ratios & analysis						
P/E, x	12.9x	10.3x	9.5x	8.7x	8.9x	8.9x
EV/EBITDA, x	8.5x	7.0x	6.2x	5.4x	5.0x	4.4x
P/B, x	1.7x	1.6x	1.2x	1.1x	0.9x	0.8x
Dividend yield (ords), %	3.2%	3.9%	4.2%	4.7%	4.6%	4.6%
EPS	7.20	9.75	9.51	10.48	10.22	10.22
CFPS	10.16	14.05	18.01	19.88	20.03	19.69
Free CFPS	4.50	10.45	13.70	14.88	15.12	14.78
DPS (ords)	2.99	3.94	3.85	4.24	4.13	4.14
Payout ratio (ords), %	41.5%	40.5%	40.5%	40.5%	40.5%	40.5%
BPS	55.39	63.07	73.85	85.73	97.32	108.9
Revenues growth, %	47%	25%	4%	1%	-2%	0%
EPS growth, %	138%	35%	-2%	10%	-2%	0%
EBITDA margin, %	31.8%	31.9%	30.0%	30.6%	30.6%	30.6%
Net margin, %	14.2%	15.4%	14.5%	15.8%	15.7%	15.7%
ROE, %	17.9%	21.2%	18.4%	18.1%	16.0%	14.6%
ROIC, %	16.6%	20.9%	21.3%	23.7%	25.3%	27.8%
Capex/Revenues, %	11%	6%	7%	7%	7%	7%
Capex/Depreciation, x	1.5x	0.9x	1.2x	1.1x	1.1x	1.1x
Net debt/Equity, %	36%	28%	11%	-4%	-16%	-24%
Net debt/EBITDA, x	1.2x	0.9x	0.4x	(0.2x)	(0.8x)	(1.3x)
Net interest cover, x	11.2x	16.3x	16.3x	n/a	n/a	n/a
Income statement summary						
Revenues	151,711	189,898	196,849	199,401	195,245	195,326
Cost of sales	(62,774)	(90,193)	(115,466)	(123,792)	(124,727)	(121,831)
SG&A and other opexp.	(10,710)	(13,292)	(13,779)	(13,957)	(13,666)	(13,672)
EBITDA	48,226	60,654	59,100	61,008	59,743	59,762
Depreciation & amortization	(10,394)	(11,815)	(11,854)	(11,895)	(11,906)	(11,912)
Operating profit	37,832	48,838	47,246	49,113	47,837	47,850
Non-operating gains /(exp.)	1,360	2,039	2,039	2,039	2,039	2,039
EBIT	37,832	48,838	47,246	49,113	47,837	47,850
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	35,810	47,885	46,393	51,153	49,876	49,889
Income tax	(2,500)	(2,600)	(2,519)	(2,777)	(2,708)	(2,709)
Minority interests	(11,725)	(16,043)	(15,356)	(16,931)	(16,509)	(16,513)
VTBC Net income	21,585	29,242	28,518	31,444	30,659	30,667
Cash flow statement summary						
Cash flow from operations	30,489	42,143	54,026	59,645	60,092	59,073
Working capital changes	(14,597)	(15,612)	(1,702)	(625)	1,018	(20)
Capex	(16,027)	(10,642)	(13,779)	(12,961)	(12,691)	(12,696)
Other investing activities	(2,509)	(1,163)	-	-	-	-
Free cash flow	13,498	31,355	41,100	44,645	45,361	44,337
Share issue (reacquisition)	-	1	-	-	-	-
Dividends paid	(8,962)	(11,831)	(11,539)	(12,722)	(12,405)	(12,408)
Net change in borrowings	3,637	(8,097)	-	-	-	-
Other financing cash flow	(10,758)	(10,225)	-	-	-	-
Movement in cash	(5,732)	(259)	28,708	33,962	34,996	33,969
Balance sheet summary						
Cash and equivalents	50,645	50,389	79,097	113,059	148,055	182,024
PP&E	165,050	165,805	169,562	172,306	174,629	176,822
Goodwill	22,263	21,891	20,059	18,381	16,843	15,434
Investments	8,829	9,701	9,701	9,701	9,701	9,701
Other assets	70,427	84,998	87,300	88,145	86,769	86,796
Total assets	317,214	332,784	365,719	401,592	435,997	470,776
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	40,381	41,073	41,673	41,893	41,535	41,542
Total liabilities	151,033	143,578	144,178	144,398	144,039	144,046
Total shareholder's equity	120,839	138,022	155,002	173,724	191,978	210,237
Minority interest	45,342	51,183	66,539	83,471	99,979	116,493
Net working capital	40,109	46,502	48,204	48,829	47,812	47,831
Net Debt	60,007	52,115	23,408	(10,555)	(45,551)	(79,519)
Capital	122,103	138,947	155,592	174,134	192,238	210,433

Company Profile

Saudi Basic Industries Corporation (SABIC) was formed in 1976 through a royal decree to utilise the country's abundant petroleum and natural gas supplies. The Saudi government owns a 70% stake in SABIC, 5.2% is owned by General Organisation of Social Insurance (GOSI), while the remainder is held by private investors in Saudi Arabia and GCC. SABIC has a market capitalisation of SAR 261bn (USD 70.8bn) and ranks among the top ten petrochemicals companies in the world (by production volume).

Product segments

Petrochemicals. The largest segment of SABIC, is involved in the production and marketing of Basic Chemicals, Performance Chemicals, Innovative Plastics, Polymers and Fertilisers. The segment accounted for c.83% of SABIC's revenues in 2010.

Metals. This segment comprises primarily of the Steel manufacturing subsidiary, Hadeed, which produces long and flat steel. The other products in the Metals segment are Aluminium products.

Business Units

Basic Chemicals is the company's largest SBU with 53% of total petrochemical production volume (ex fertilisers). Produced from hydrocarbon feedstock such as methane, ethane and propane, the output from this SBU is utilised for secondary processing at the Intermediates and Polymers' business units.

Intermediates are produced from basic chemicals to act as feedstocks for downstream products. This business represents c.26% of the company's total petrochemical production. The four main product lines are fibre intermediates, industrial gases, chemical intermediates and linear alpha olefins (LAO). SABIC's intermediates are used as feedstock for the company's affiliates and any surplus production is exported.

Polymers SBU produces petrochemical derivatives such as polyethylene and polypropylene. SABIC is the world's third-largest producer of polyethylene and is the fourth-largest in polypropylene. We estimate it currently accounts for a 17.7% share of the company's total petrochemical production.

Fertiliser SBU produces urea, ammonia and phosphates through three affiliates: Saudi Arabian Fertiliser Company (SAFCO), Al-Bayroni (Al Jubail Fertiliser Company) and Ibn Al-Baytar (National Chemical Fertiliser Company).

Metal SBU is primarily composed of the Saudi Iron and Steel Company (HADEED). Aluminium Bahrain (based in Bahrain) and Gulf Aluminium Rolling Mill Company (Bahrain) are affiliates of SABIC and are managed by the business unit. SABIC's stake in SABAYEK Ferroalloy Smelter (Al Jubail), which is involved in the manufacture of silicon manganese for the steel and foundry industries and silicon metal for the chemical and aluminium industries, is also managed by the metals business unit.

Specialty Products SBU is intended to spearhead the move up the value chain and enter into development, production and marketing of high-value special derivatives. The derivatives are used in automotive applications, oil field chemicals, rubber chemicals, construction materials, specialty polymers, adhesives, sealants, catalysts and other polymer additives.

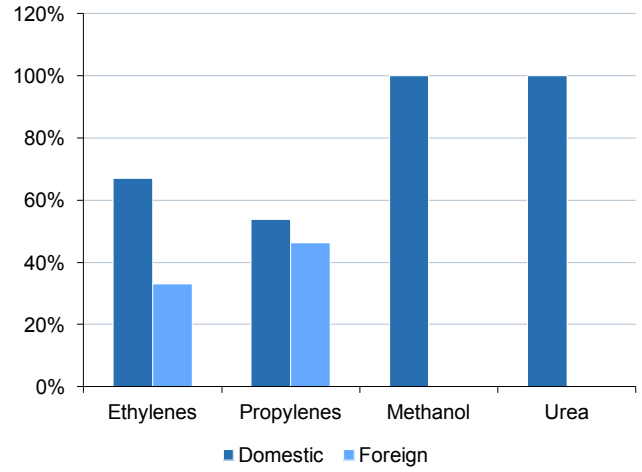
Production assets

The headline products for SABIC in the petrochemicals segment are Polyethylenes, Polypropylenes, Methanol and Urea. SABIC has a total Polyethylene capacity of 9.1mtpa, of which, c.75.4% is installed in Saudi Arabia, while the remainder is installed in the Netherlands, UK and Germany. Of the total Polypropylene capacity of 3.8mtpa, c.64% is in Saudi Arabia, with the rest in the Netherlands, UK, Germany and the US. All of SABIC's Methanol and Urea capacities are installed within Saudi Arabia. SABIC has an installed capacity of 6,425ktpa of Methanol (and 3,130ktpa of MTBE) and 4,276ktpa of Urea.

While the Polyethylene capacities installed in Europe use Naphtha feedstock, c.81% of domestic capacities are produced through mixed feedstock, and c.19% through pure ethane feedstock.

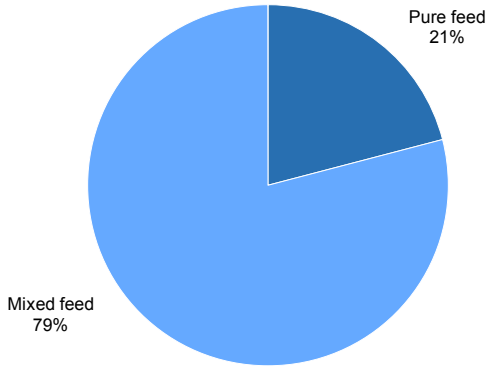
In the metals segment, SABIC has exposure to non-vertically integrated steel effective production capacity of 6.8mtpa. The plant, Hadeed, is based alongside the petrochemical assets in Jubail, Saudi Arabia. Besides marginal exposure in other metals in Saudi Arabian assets, SABIC has exposure to aluminium via ALBA, Bahrain.

Figure 63: Geographical capacity breakdown



Source: VTB Capital Research

Figure 64: Domestic ethylene feedstock breakdown



Source: VTB Capital Research

Figure 65: Capacity and production forecasts

	Installed Capacity (ktpa)			Production (ktpa)		
	2012F	2013F	2014F	2012F	2013F	2014F
Polyethylenes	9,150	9,450	9,450	8,563	8,783.5	8,783.5
Polypropylene	4,030	4,030	4,030	3,748.5	3,627	3,627
PVC	1,041.7	1,041.7	1,041.7	975	937.5	937.5
Polystyrene	1,247	1,247	1,247	1,177.9	1,122.3	1,122.3
Methanol	6,425	6,425	6,425	6,103.8	5,782.5	5,782.5
MTBE	3,130	3,130	3,130	2,966.5	2,817	2,817
Glycols	7,300	8,035	7,035	6,932	7,544	6,594
Resins	1,450	1,450	1,450	1,345	1,305	1,305
Ammonia	560	560	560	532	504	504
Urea	4,276	4,276	4,276	4,062.2	3,848.4	3,848.4
Metals	6,800	7,050	7,050			
Aromatics/Aliphatics/Others	1,717	1,717	1,717	1,555.6	1,545.3	1,545.3
Polycarbonates	260	260	260	234	234	234

Source: VTB Capital Research

M&A options

Coatings. Coatings are thin films applied to the surface of various objects ranging from buildings, metals, plastics and paper. Coatings might be used for protective or decorative purposes, and is a well established industry with large players such as Akzo Nobel, PPG and Sherwin Williams. SABIC might look into the acquisition or addition of coatings manufacturing capabilities to its portfolio. SABIC currently does not have any capacity for production of coatings, while its competitors such as BASF are largely established in the segment. The coatings products such as acrylates and resins are natural fits in SABIC's current petrochemical portfolio, and we feel this product segment might be added to SABIC's portfolio in the future.

Polyurethanes. Polyurethanes are polymer plastics, which are used as insulating materials in many cooling systems. Polyurethanes are used in most refrigerators and freezers manufactured across the world. They are also used in hot water tanks and heating pipelines. We find a lack of polyurethane manufacturing capacities across the Middle East, while most international competitors are large manufacturers of polyurethanes. We feel this is another product that finds a natural fit with SABIC's plastics portfolio, and could be relatively easily added to the portfolio.

Inorganics. Inorganics are non-carbon based compounds, which have a variety of uses depending on the product. Currently, SABIC has no capacity in the inorganic space, and acquisitions could be made in this space to diversify the portfolio.

Earnings profile highlights

Revenues. According to our forecasts, revenues are SAR 196.8bn in 2012F. Long-term revenues are pegged at SAR 195.3bn and we are not factoring in any new large-scale volume expansion across any category post 2014F. The slight decline in petrochemical revenues (-2.1%) in 2014F in spite of the commissioning of Kayan is primarily due to a 26% drop in urea revenues (2012F-14E), in our view. SABIC has the largest number of commodity (all of the polyolefins, methanol and nitrogenous derivative segments) and quasi specialty chemicals (vinyl segment) in its product slate, which are produced from a wide variety of locations (and hence it is not a single plant risk).

EBITDA. We expect 2012F EBITDA to come in at SAR 59.1bn and normalised EBITDA at SAR 61bn. We estimate an EBITDA margin of 30% for 2012F, rising to 30.6% by 2014F on account of the higher EBITDA contribution from foreign capacities benefiting from slightly higher cycle driven margins. SABIC's subsidiaries have so far benefitted from intellectual property sharing and SABIC's marketing and distribution network. The company's SG&A was 7% vs. 2.1% for Yansab in 2010. We believe that with the initial thrust of geographical expansion over, we are likely to see a rationalisation of SG&A in the 50-75bp range and improved EBITDA margins. The upside is not in our estimates. The EBITDA margin declined from 45.6% in 2005 to 28.7% in 2009. This steep decline in the EBITDA margin evolution can be largely explained by the capacity additions and acquisitions along with rising naphtha costs, lower cyclical margins and changed structural margins, burdened by the previously acquired DSM business (2002), Huntsman's UK/European business (2006) and GE Plastics (2007). However that cycle has run its course and we believe the EBITDA margins are likely to reach stability by 2013F.

Debt. In our estimates, net debt will fall from SAR 23.4bn (2011) to SAR -8.6bn by 2013F. Our interest cost assumption is 6% for 2012F. With a cash positive balance sheet, we believe SABIC is highly likely to go for inorganic growth options. SABIC has ramped up its capacity significantly, with self-owned capacity expanding over 6.9mtpa. Beyond Saudi Kayan, we expect to see smaller and strategic capacity expansions, both via organic and inorganic options. The company has also entered into a JV with Japanese Asahi Kasei Chemicals and Mitsubishi Corp. To produce Acrylonitrile and Sodium Cyanide. The new company, Saudi Japanese Acrylonitrile Co. (Shrouq), is set to produce 200ktpa of Acrylonitrile and 40ktpa of Sodium Cyanide. While SABIC still has a healthy 2012F Net Debt/EBITDA position (0.4x) compared with Yansab (1.6x), the interest cost for SABIC is higher than Yansab. We believe that the refinancing options (that SABIC is actively seeking) are likely to lower the company's financing cost burden (though small) in the near term.

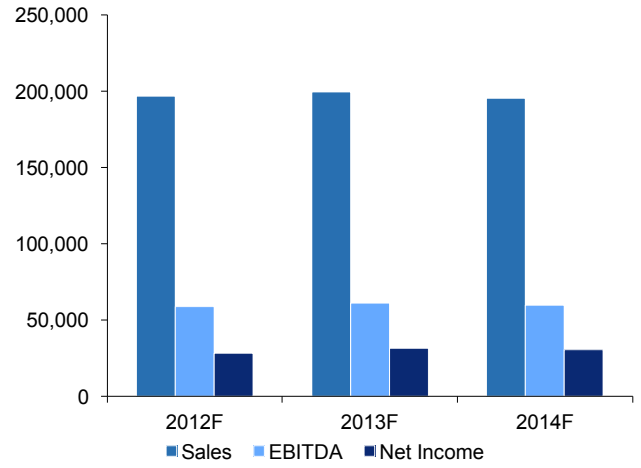
Figure 66: Recent capacity additions

Plant	Location	SABIC's stake	Total capacity (ktpa)	Start-up
YANSAB	Yanbu	56%	4,035	2010
SHARQ	Jubail	50%	3,000	2010
Kayan	Jubail	35%	4,652	2012
Sinopec JV	Tianjin	50%	3,200	2011
Total			**14,887**	

Source: Company data

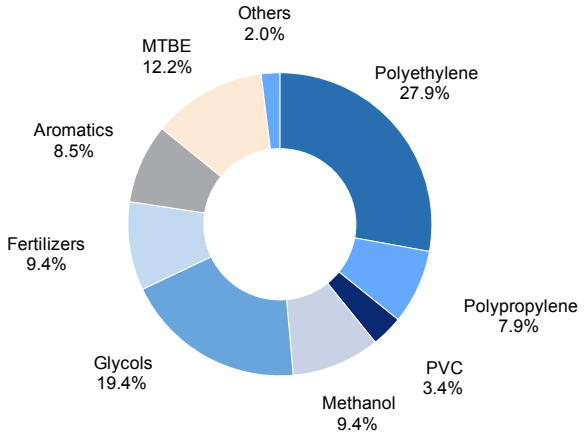
Cash flow. We forecast 2012F cash earnings of SAR 54bn, with operating cash flow at SAR 59.4bn. SABIC is able to generate net cash flow of SAR 46.6bn pre dividends, but we need to take into account the large size of the minority stake (40%). At current prices, the equity free cash flow yield in 2013F is 16% (not discounted). The longer-term (2014F) stable equity free cash flow yields are in the order of 17% (not discounted). The ROIC of the assets in our longer term (2015F) stable cash flow scenario is at 17%.

Figure 67: Key Forecasts (in SAR mn)



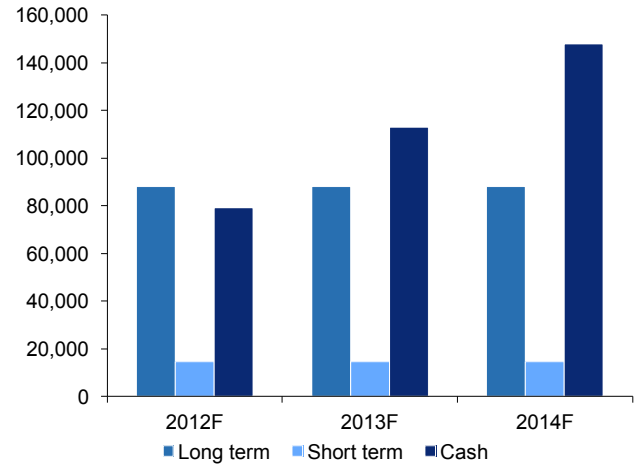
Source: VTB Capital Research

Figure 68: EBITDA Composition (2012F)



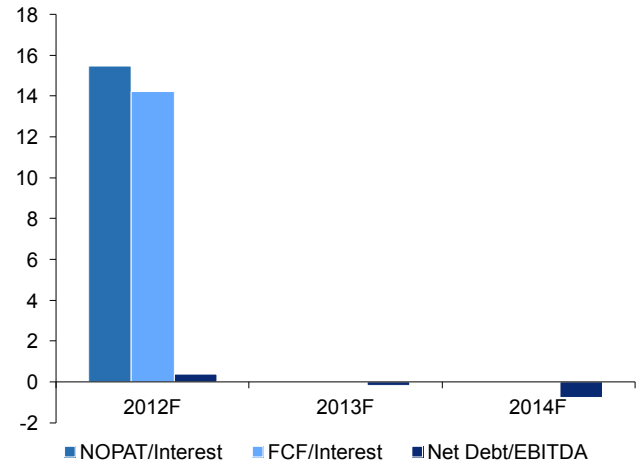
Source: VTB Capital Research

Figure 69: Debt (in SAR mn)



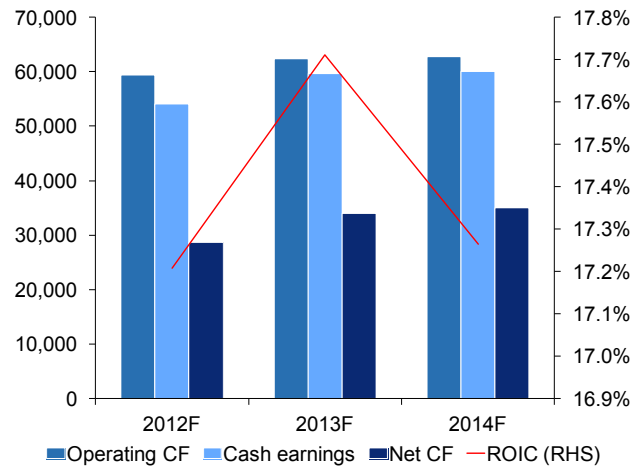
Source: VTB Capital Research

Figure 70: Debt Service Ratios



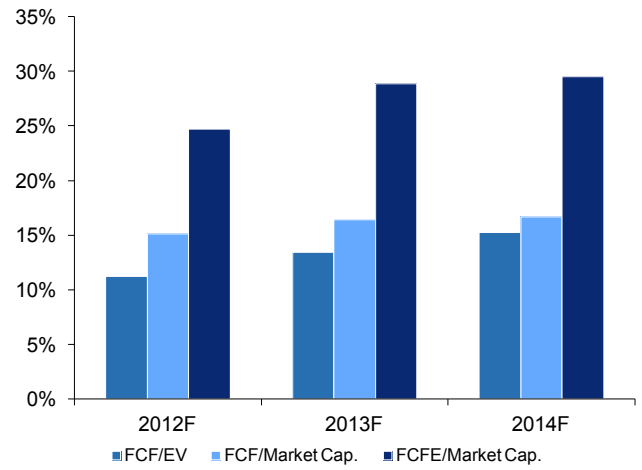
Source: VTB Capital Research

Figure 71: Cash Flows (in SAR mn)



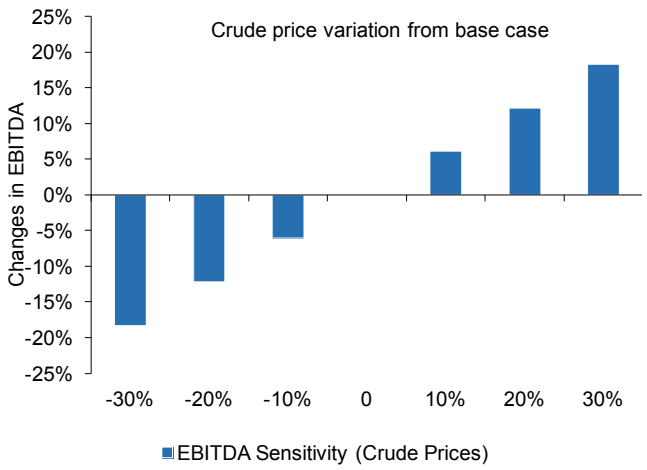
Source: VTB Capital Research

Figure 72: FCF and FCFE Yields



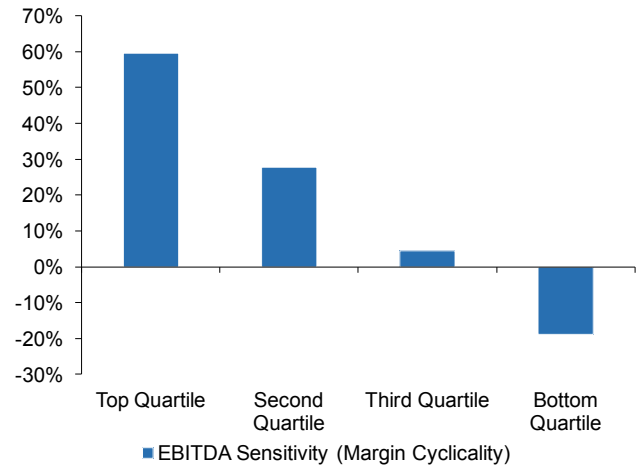
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 73: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 74: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 75: Income Statement
(Figures in SAR mn, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	189,898	196,849	199,401	195,245	195,326
EBITDA	60,654	59,100	61,008	59,743	59,762
D&A	11,815	11,854	11,895	11,906	11,912
EBIT	48,838	47,246	49,113	47,837	47,850
Finance Costs	2,993	2,893	-	-	-
Other income (expense)	2,039	2,039	2,039	2,039	2,039
PBT	47,885	46,393	51,153	49,876	49,889
Taxes	2,600	2,519	2,777	2,708	2,709
Net income before minorities	45,285	43,874	48,375	47,168	47,180
Share of minorities	16,043	15,356	16,931	16,509	16,513
Net income	29,242	28,518	31,444	30,659	30,667
Adjusted net income (pre-exceptionals)	29,242	28,518	31,444	30,659	30,667
Number of shares (mn)	3,000	3,000	3,000	3,000	3,000
EPS	9.7	9.5	10.5	10.2	10.2
Adjusted EPS (pre-exceps)	9.7	9.5	10.5	10.2	10.2
DPS	3.9	3.8	4.2	4.1	4.1
Payout ratio (%)	40%	40%	40%	40%	40%

Source: Company data, VTB Capital Research

Figure 76: Balance Sheet
(Figures in SAR mn, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	165,805	169,562	172,306	174,629	176,822
Intangibles	21,891	20,059	18,381	16,843	15,434
Investments	9,701	9,701	9,701	9,701	9,701
Other	2,986	2,986	2,986	2,986	2,986
Total non-current assets	200,382	202,308	203,374	204,159	204,943
Cash	50,389	79,097	113,059	148,055	182,024
Accounts receivable	31,426	32,577	32,999	32,311	32,325
Inventories	31,464	32,616	33,038	32,350	32,363
Other	19,122	19,122	19,122	19,122	19,122
Total current assets	132,401	163,411	198,219	231,838	265,834
TOTAL ASSETS	332,784	365,719	401,592	435,997	470,776
Debt	14,597	14,597	14,597	14,597	14,597
Accounts payable	16,388	16,988	17,208	16,850	16,856
Other	12,084	12,084	12,084	12,084	12,084
Total current liabilities	43,070	43,670	43,890	43,531	43,538
Debt	87,907	87,907	87,907	87,907	87,907
Other	12,601	12,601	12,601	12,601	12,601
Total non-current liabilities	100,508	100,508	100,508	100,508	100,508
Minorities	51,183	66,539	83,471	99,979	116,493
Shareholders' Equity	138,022	155,002	173,724	191,978	210,237
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**332,784**	**365,719**	**401,592**	**435,997**	**470,776**

Source: Company data, VTB Capital Research

Figure 77: Cash Flow Statement
(Figures in SAR mn, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	60,654	59,100	61,008	59,743	59,762
Working capital change	(15,612)	(1,702)	(625)	1,018	(20)
Other	2,694	2,039	2,039	2,039	2,039
Cash earnings ex zakat and interest	47,736	59,438	62,423	62,800	61,782
Tax paid	(2,600)	(2,519)	(2,777)	(2,708)	(2,709)
Net interest paid	(2,993)	(2,893)	-	-	-
Operating cash flow	42,143	54,026	59,645	60,092	59,073
CAPEX	(10,642)	(13,779)	(12,961)	(12,691)	(12,696)
Intangibles	(445)	-	-	-	-
Other	(1,163)	-	-	-	-
Cash flow before financing	29,893	40,246	46,684	47,401	46,377
Financing cash flows	(30,152)	(11,539)	(12,722)	(12,405)	(12,408)
Net borrowing	(8,097)	-	-	-	-
New equity	1	-	-	-	-
Dividends	(11,831)	(11,539)	(12,722)	(12,405)	(12,408)
Other	(10,225)	-	-	-	-
Net Cash Flow	(259)	28,708	33,962	34,996	33,969

Source: Company data, VTB Capital Research

Initiation of coverage

Industries Qatar

Steel expansion is a distraction

HOLD

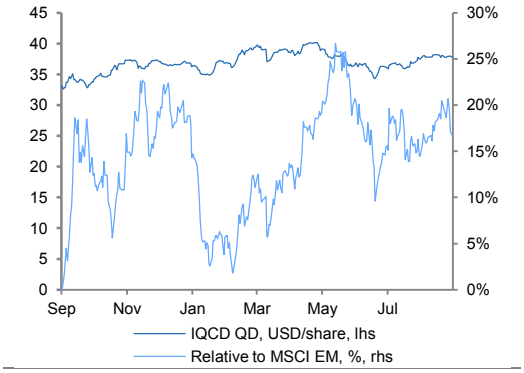
Primary ticker: IQCD QD

Currency: QAR

Stock Data

Last price	137.50
Last price date	09 Sep 2012
Target price	135.00
Target price established	11 Sep 2012
Upside/(downside), %	-2%
52 week price range	118.80 - 146.20
Market cap, USD / QAR mn	20,768 / 75,625
EV, USD / QAR mn	21,352 / 77,752
# shares outstanding, mn	550
Free float	25%
Benchmark Index (MXEF)	950.45

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	0.7%	4%	12%	31%
Price relative	1.8%	-2%	17%	19%
ADTV (USD mn)	2.33	3.51	7.08	8.88

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	9.4x	8.6x	8.4x	8.7x
EV/EBITDA, x	8.9x	8.6x	8.3x	8.2x
P/B, x	2.8x	2.4x	2.1x	1.9x
FCF yield, %	8.7%	3.8%	6.9%	7.9%
DY (ords), %	4.0%	5.8%	5.9%	5.8%
Net sales	16,549	18,180	19,444	19,422
EBITDA	8,428	8,993	9,410	9,386
Net income	7,924	8,820	8,955	8,726
Net sales, chg	34%	10%	7%	0%
EBITDA, chg	45%	7%	5%	0%
Net income, chg	42%	11%	2%	-3%
EPS	14.41	16.04	16.28	15.87
DPS (ord.)	5.50	8.03	8.15	7.94
BPS	48.42	56.43	64.57	72.49
EBITDA margin, %	50.9%	49.5%	48.4%	48.3%
ROE, %	30%	29%	25%	22%
Net Debt	(98)	2,082	2,030	1,112
ND/EBITDA, x	0.0x	0.2x	0.2x	0.1x
Net int. cover, x	49.6x	35.7x	31.0x	30.6x

Source: Bloomberg, Company data, VTB Capital Research

Industries Qatar (IQ) is the largest listed Qatari company (by MCap) and is second only to SABIC in terms of regional volume output. IQ is a conglomerate with presence spanning across petrochemicals, fertilisers, fuel additives and steel segments. The company is coming off a three-year expansion plan, which has seen a volume increase of 75% across petrochemicals and fertilisers and intends to supplement volumes in the steel segment by 2016.

Initiating coverage with a Hold recommendation and TP of QAR 135. We like the cash returns, but the risk profile is relatively unattractive (to MENA peers such as SABIC) on account of strategic negatives such as competition from Qatar petroleum, steel expansion and low foreign ownership limits.

Increased gas production from North Pars unlikely near term. Even with the lifting of the moratorium on North Pars exploration (and future exploitation) we believe that geopolitics would require Qatar to keep any expansion of the gas field it shares with Iran on hold. If there was additional gas production, petrochemical expansion would be the most attractive investment option, in our view (unlevered ROIC of 12% vs. 6% for LNG).

QP's foray into petrochemicals a clear negative for IQ. Qatar petroleum (QP) is IQ's parent company and allocates raw material quotas for it. With QP launching its own JVs for new petrochemical facilities with IQ as a minor partner, the case for strong future optionality for a petrochemical volumetric increase in Qatar appears to be less convincing.

Steel segment expansion outside Qatar negative for ROIC. While Qatar Steel's existing facility is a top-quartile steel asset on margin extraction (fig 86), a similar environment (domestic monopoly, premium pricing, ex GCC import tariffs, no taxes) is unlikely to be replicated in foreign assets. Furthermore, the gas price differential between Algeria and Qatar is marginal at best and the rationale for Algerian expansion is not attractive, in our view.

Leverage to urea margins, currently in top quartile, medium-term risk. With the urea and methanol margin cycle at close to peak levels, we believe medium-term earnings bear a risk in spite of higher volumes. The concentrated EBITDA exposure to urea and ammonia (39% of 2012F EBITDA) is undesirable in the medium term.

Foreign ownership limit lowers liquidity, likely to trade at discount. With foreign ownership limits set effectively at 12.25%, the outstanding liquidity for foreigners is less than 4% of the market cap. Thus, we see strong grounds for IQ to trade at a discount to regional peers.

Valuation. We value IQ via a multiples based method with a generic sector 12m forward EV/EBITDA of 8.0x. Our normalised EBITDA estimate is QAR 9.4bn. Using a net debt assumption of QAR 2.0bn, we arrive at a Target Price of QAR 135. IQ trades at a 2013F P/E of 8.4x against peers at 10.4x. On 2013 EV/EBITDA, the company trades at 8.3x against peers at 6.0x. We believe current growth plans in the steel segment have the potential to lower the company's strong ROIC (27% for 2012F).

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VTB Capital Facts & Forecasts

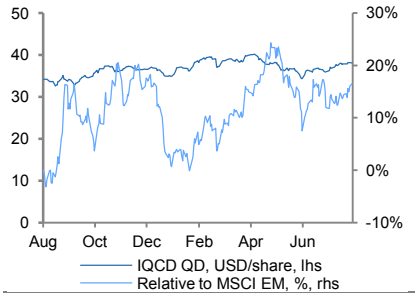
Company country & sectors
Materials / Commodity Chemicals

Industries Qatar

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
IQCD QD	QAR	137.50	135.00	Hold

Share price performance, 12-mo



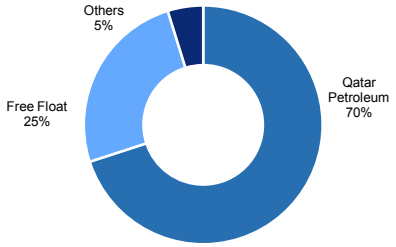
Company description

Industries Qatar (Qatar) – The largest industrial conglomerate in Qatar producing petrochemicals, steel and fertilizers

Company website

http://www.industriesqatar.com.qa

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 11 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	550.0	550.0	550.0	550.0	550.0	550.0
Avg market cap	60,641	74,758	75,625	75,625	75,625	75,625
EV	62,938	74,706	77,752	77,700	76,782	73,751
Ratios & analysis						
P/E, x	10.9x	9.4x	8.6x	8.4x	8.7x	8.9x
EV/EBITDA, x	10.8x	8.9x	8.6x	8.3x	8.2x	7.9x
P/B, x	2.8x	2.8x	2.4x	2.1x	1.9x	1.7x
Dividend yield (ords), %	4.5%	4.0%	5.8%	5.9%	5.8%	5.6%
EPS	10.13	14.41	16.04	16.28	15.87	15.44
CFPS	9.07	14.62	16.60	16.76	17.19	17.22
Free CFPS	6.91	11.76	5.22	9.52	10.93	14.59
DPS (ords)	5.00	5.50	8.03	8.15	7.94	7.73
Payout ratio (ords), %	49.4%	38.2%	50.0%	50.0%	50.0%	50.0%
BPS	39.57	48.42	56.43	64.57	72.49	80.21
Revenues growth, %	25%	34%	10%	7%	0%	-
EPS growth, %	12%	42%	11%	2%	-3%	-3%
EBITDA margin, %	47.1%	50.9%	49.5%	48.4%	48.3%	48.3%
Net margin, %	45.2%	47.9%	48.5%	46.1%	44.9%	43.7%
ROE, %	25.6%	30.2%	28.8%	25.5%	22.1%	19.4%
ROIC, %	21.0%	28.8%	25.6%	23.0%	20.6%	19.5%
Capex/Revenues, %	10%	9%	34%	20%	18%	7%
Capex/Depreciation, x	1.8x	2.2x	27.3x	8.3x	4.9x	1.5x
Net debt/Equity, %	10%	0%	7%	6%	3%	-4%
Net debt/EBITDA, x	0.4x	0.0x	0.2x	0.2x	0.1x	(0.2x)
Net interest cover, x	35.2x	49.6x	35.7x	31.0x	30.6x	30.8x
Income statement summary						
Revenues	12,331	16,549	18,180	19,444	19,422	19,422
Cost of sales	(6,401)	(7,654)	(7,932)	(8,692)	(8,695)	(8,695)
SG&A and other opexp.	(773)	(1,143)	(1,255)	(1,342)	(1,341)	(1,341)
EBITDA	5,807	8,428	8,993	9,410	9,386	9,386
Depreciation & amortization	(650)	(675)	(227)	(476)	(694)	(948)
Operating profit	5,157	7,753	8,766	8,934	8,692	8,438
Non-operating gains /(exp.)	-	-	-	-	-	-
EBIT	5,157	7,753	8,766	8,934	8,692	8,438
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	5,578	7,924	8,820	8,955	8,726	8,491
Income tax	-	-	-	-	-	-
Minority interests	(2)	(7)	(8)	(8)	(7)	(7)
VTBC Net income	5,573	7,924	8,820	8,955	8,726	8,491
Cash flow statement summary						
Cash flow from operations	4,990	8,041	9,131	9,219	9,454	9,470
Working capital changes	(819)	(489)	84	(212)	34	31
Capex	(1,189)	(1,470)	(6,206)	(3,959)	(3,407)	(1,390)
Other investing activities	(2,082)	(1,788)	(728)	(765)	(803)	(843)
Free cash flow	3,799	6,469	2,869	5,237	6,011	8,025
Share issue (reacquisition)	0	-	-	-	-	-
Dividends paid	(2,752)	(3,027)	(4,414)	(4,481)	(4,367)	(4,249)
Net change in borrowings	1,326	(680)	317	41	(248)	(233)
Other financing cash flow	-	390	38	40	42	45
Movement in cash	294	1,466	(1,863)	93	670	2,798
Balance sheet summary						
Cash and equivalents	5,290	6,960	5,097	5,190	5,860	8,658
PP&E	8,874	9,589	15,568	19,052	21,765	22,207
Goodwill	128	169	171	172	174	175
Investments	2,068	2,551	2,679	2,812	2,953	3,101
Other assets	15,547	17,509	18,879	19,934	20,622	21,352
Total assets	31,908	36,778	42,394	47,160	51,373	55,493
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	2,604	3,285	4,177	4,428	4,530	4,640
Total liabilities	10,146	10,147	11,356	11,648	11,502	11,380
Total shareholder's equity	21,748	26,237	30,651	35,132	39,499	43,748
Minority interest	14	395	387	379	372	365
Net working capital	2,627	3,512	3,454	3,694	3,690	3,690
Net Debt	2,252	(98)	2,082	2,030	1,112	(1,919)
Capital	23,012	27,162	31,241	35,542	39,759	43,943

Company Profile

Industries Qatar (IQ) is a high-quality asset among MENA petrochemicals and is primarily a holding company incorporated in Qatar. The business' ownership confers it a presence in Steel, Petrochemicals, Fertilisers and Fuel additives' lines of business via its subsidiaries and joint ventures in Qatar Steel Company Q.S.C (Qatar Steel), Qatar Petrochemical Company Limited Q.S.C. (QAPCO), Qatofin Company Limited Q.S.C (Qatofin), Qatar Fertiliser Company (SAQ) (QAFCO) and Qatar Fuel Additives Company Limited Q.S.C (QAFAC). The FOL (foreign ownership limit) in the stock is 7.5%.

Product segments

Petrochemicals. The products consist primarily of LDPE (Low density polyethylene) and Ethylene of which a significant portion (c.67% in 2008E) of the ethylene production is utilised for the production of LDPE and the rest is supplied to Qatar Vinyl Company. Besides the two main products there are also by-products of Sulphur, LPG and Py-gas whose contribution to revenues is fairly insignificant (viz 0.47% for Sulphur, 0.08% for LPG and 0.21% for Py-gas).

The products are sold in 75 countries, but the main markets are the Middle East, Far East, Africa and the Indian subcontinent. The company has a 70% off-take agreement with Total.

Fuel Additives. The fuel additives comprise of two key products viz Methanol and MTBE manufactured by QAFAC.

Methanol is sold in the Far East, India and to the Gulf Formaldehyde Company, while MTBE's main markets are the GCC, Far East and Europe. QAFCO, which is 75%-owned by Industries Qatar, holds a 70% stake in Gulf Formaldehyde. QAFAC has a 50% off-take agreement for methanol with Qatar Petroleum (QP) and 50% with other partners.

Fertilisers. The fertilisers segment comprises of ammonia and urea. While ammonia is sold to India, Jordan and the USA, the markets for urea are geographically dispersed between the US, Australia, India, Thailand, the Philippines and South Africa. QAFCO has a 70% off-take agreement with Yara for its products.

Steel. Qatar Steel is responsible for the production of Billets, Bars, Sponge Iron, HBI and Wire Rod Coils. A majority of the steel stock is sold locally and the remainder is exported to the UAE, Saudi Arabia and the rest of the GCC.

There are no pre-agreed off-take arrangements and steel is sold primarily via direct marketing. Qatar Steel has a number of investment stakes in various steel companies.

Figure 78: Capacity and production forecasts

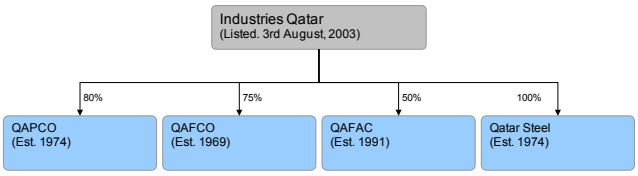
	2012F	2013F	2014F
Installed capacity (ktpa)			
LDPE	655	655	655
LLDPE	450	450	450
Methanol	1,047	1,047	1,047
MTBE	750	750	750
Urea	4,152	5,500	5,500
Ammonia	2,850	3,250	3,250
Rebar steel	2,939	2,939	2,939
Production (ktpa)			
LDPE	655	655	655
LLDPE	405	405	405
Methanol	791	791	791
MTBE	675	675	675
Urea	4,567	6,050	6,050
Ammonia	3,035	3,738	3,738
Rebar steel	2,544	2,672	2,672

Source: VTB Capital Research

Business units

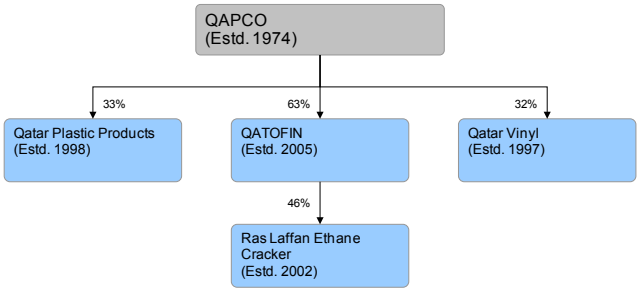
The petrochemicals are produced by QAPCO, in which Industries Qatar has an 80% stake. In QAFAC, IQ has a 50% stake and the investment is accounted for under the equity method. IQ has a 75% stake in QAFCO and is the 100%-owner of Qatar Steel.

Figure 79: Industries Qatar



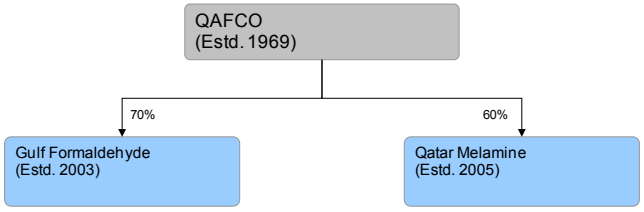
Source: Company data

Figure 80: QAPCO



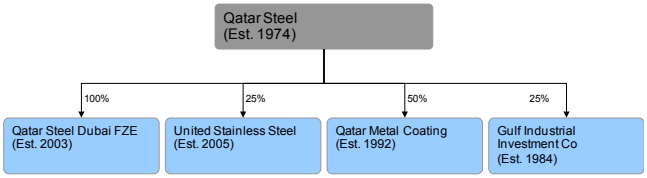
Source: Company data

Figure 81: QAFCO



Source: Company data

Figure 82: Qatar Steel

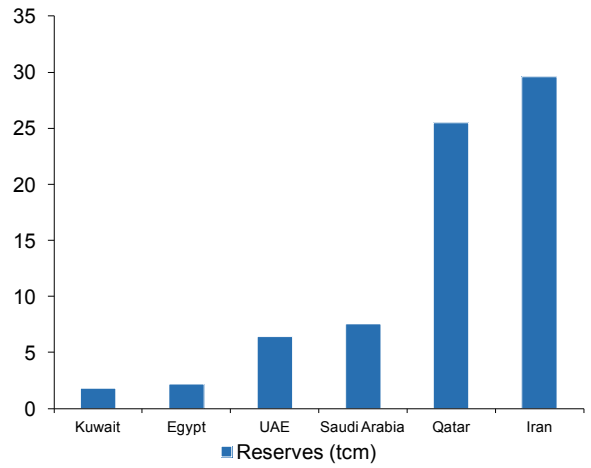


Source: Company data

A play on Qatar's gas reserves

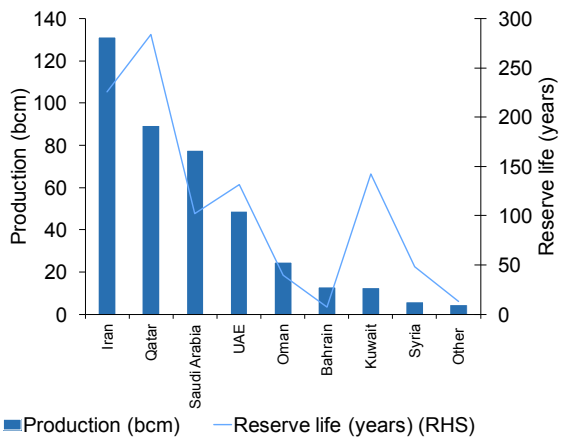
i) IQ's volumetric growth optionality is the highest among all MENA petrochemical plays: Qatar's gas reserves are largely non-associated and hence not dependent on crude production volume, whereas c.60% of Saudi gas production is associated gas (by-product of crude production) and therefore dependent on crude throughput, which is constrained on account of OPEC quotas. Furthermore, the size of the reserves and the current production volume in Qatar offers a reserve life 2.8x that of Saudi Arabia.

Figure 83: Gas Reserves (tcm)



Source: BP

Figure 84: Gas production & reserve life



Source: BP, VTB Capital Research

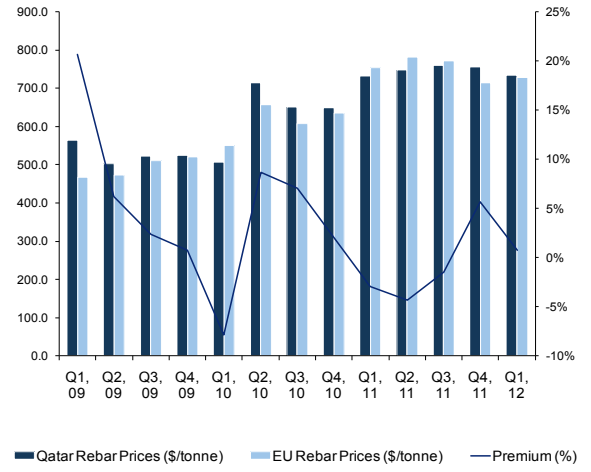
ii) Domestic consumption and growth as a share of production volumes is far smaller a constraint in Qatar than in Saudi Arabia: Qatar's consumption of gas production at 24% is the lowest across the key GCC states. Furthermore, consumption's historic ten-year CAGR of 4.2% contrasts to the higher 5.3% in Saudi Arabia.

Domestic steel segment is an asset, but what about overseas expansion?

IQ's steel segment benefits in theory from an advantageous and monopolistic domestic pricing position (imports ex GCC fetch a 15% tariff and IQ supplies in excess of 95% of domestic volumes in rebars), but a look at Fig 85 illustrates that the average pricing premium in Qatar is on average 3%. The high EBITDA margins, as illustrated in Fig 86, are largely a function of premium pricing in export markets within GCC, which absorb in excess of 40% of Qatari production and low-cost production via EAFs and low gas prices. Hence, the steel capacity within Qatar is an attractive asset.

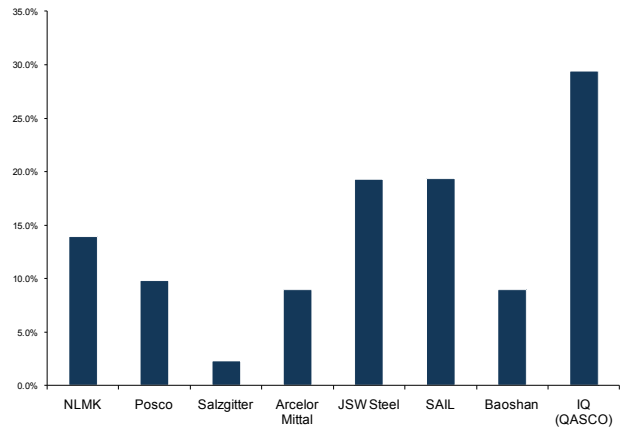
However, the planned forays into Algerian production are unnecessary, in our view, because i) Qatar has enough local gas resources available for the project; ii) there are other regions of the world with a better demand growth profile than Algeria and; iii) the Algerian country risk is not favourable, we believe, when placed in the context of the current Qatari asset base. We view the steel segment expansion in Algeria as marginally positive at best.

Figure 85: Steel price premium



Source: Company data

Figure 86: EBITDA Margins (%, Q1, 2012)



Source: the BLOOMBERG PROFESSIONAL™ service , Company data, VTB Capital Research

Earnings profile highlights

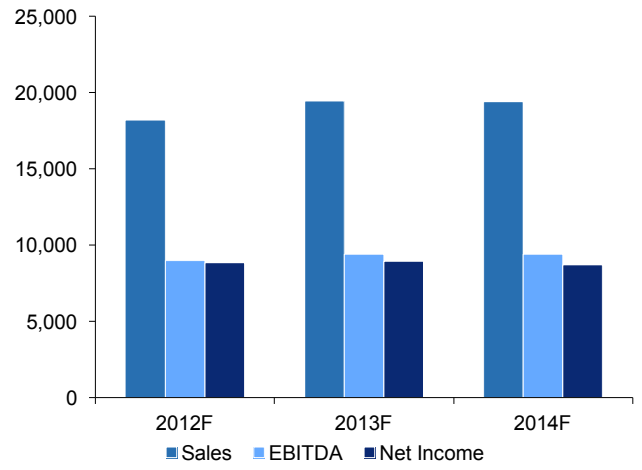
Revenues. We forecast revenues of QAR 18.2bn in 2012F. Long-term revenues are pegged at QAR 19.35bn and we are not factoring in any new large-scale volume expansion across any category post 2014F. The 7% increase in revenues from 2012-13E is driven by steel and the fertilisers segment via increases in volume, in our view.

EBITDA. We expect 2012F EBITDA of QAR 8.99bn and normalised EBITDA at SAR 9.4bn. In our estimates, the EBITDA margin will total 49.5% in 2012F and long-term margins are set to reach 48.3% by 2014F in spite of the improvement in olefin margins on account of a 730bp decline in fertiliser margins.

Debt. According to our calculations, net debt will increase from QAR -97.6mn (2011) to QAR 2.1bn by 2013F. Our interest cost assumption is 3.5% for 2012F. The unusually large capex in 2012F of QAR 6.2bn is a primarily conservative estimation for any post-commissioning related payments for QAFCO 5 and QAFCO 6 as well as start-up related contingencies for QAFCO 6.

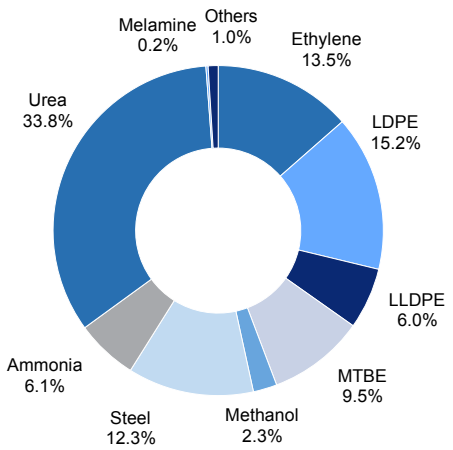
Cash flow. We believe 2012F cash earnings will come in at QAR 9.1bn, with operating cash flow at QAR 9.4bn. IQ can potentially deliver a normalised net cash flow of QAR 5bn pre dividends. Unlike SABIC, the minorities' interest is only c.9%. At current prices, the equity free cash flow yield in 2013F is 6% (not discounted). The longer-term (2015F) stable equity free cash flow yields are in the order of 14% (not discounted). The ROIC of the assets in our longer-term (2015F) stable cash flow scenario is at 20%.

Figure 87: Key Forecasts (in m QAR)



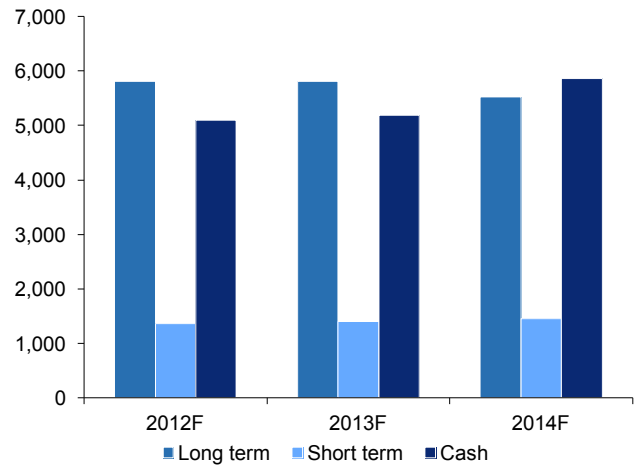
Source: VTB Capital Research

Figure 88: EBITDA Composition (2012F)



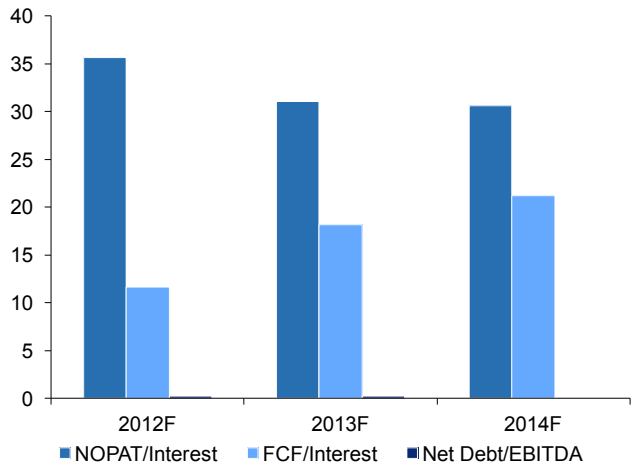
Source: VTB Capital Research

Figure 89: Debt (in QAR mn)



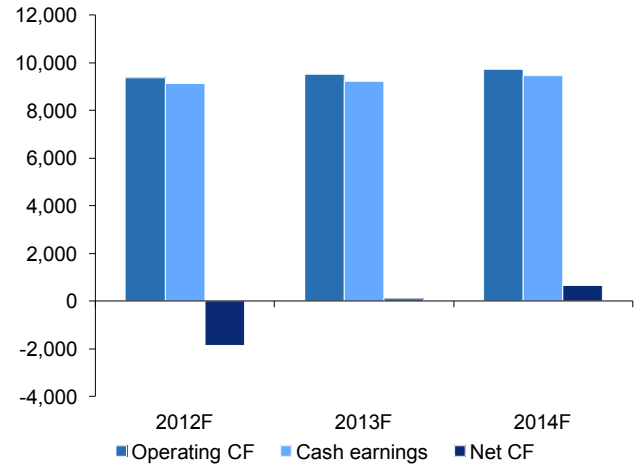
Source: VTB Capital Research

Figure 90: Debt Service Ratios



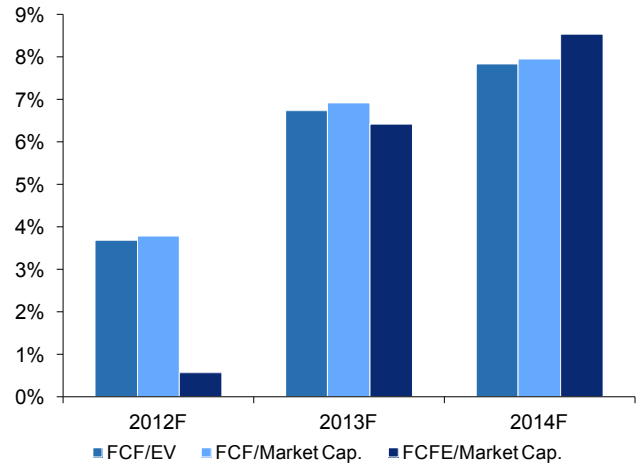
Source: VTB Capital Research

Figure 91: Cash Flows (in QAR mn)



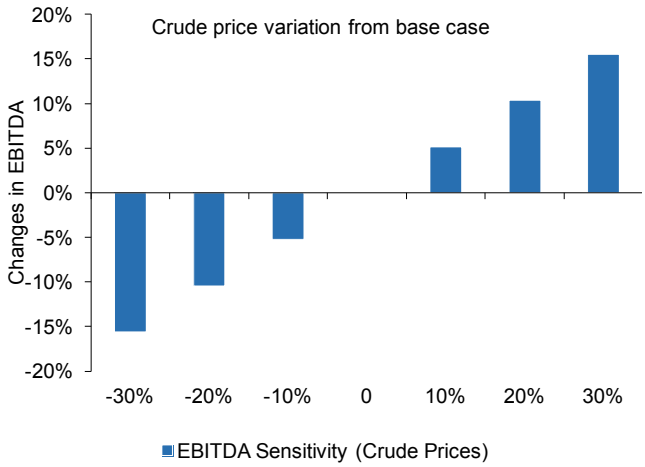
Source: VTB Capital Research

Figure 92: FCF and FCFE Yields



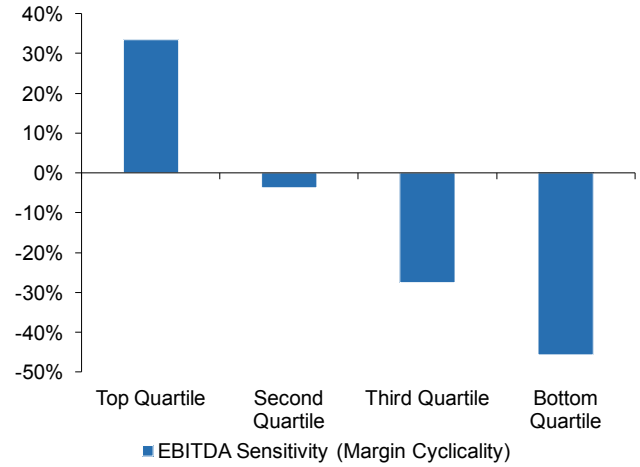
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 93: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 94: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 95: Income Statement
(Figures in '000 QAR, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	16,549,447	18,179,978	19,444,139	19,421,900	19,421,900
EBITDA	8,427,789	8,993,078	9,409,721	9,385,894	9,385,894
D&A	675,096	227,015	475,610	693,940	948,122
EBIT	7,752,693	8,766,063	8,934,111	8,691,954	8,437,771
Finance Costs	(156,428)	(245,727)	(287,982)	(283,835)	(274,217)
Other income (expense)	327,805	300,000	309,000	318,270	327,818
PBT	7,924,070	8,820,336	8,955,129	8,726,388	8,491,372
Net income before minorities	7,924,070	8,820,336	8,955,129	8,726,388	8,491,372
Share of minorities	(6,761)	(7,526)	(7,641)	(7,446)	(7,245)
Net income	7,930,831	8,827,862	8,962,769	8,733,834	8,498,617
Adjusted net income (pre-exceptionals)	7,930,831	8,827,862	8,962,769	8,733,834	8,498,617
Number of shares ('000)	550,000	550,000	550,000	550,000	550,000
EPS	14.4	16.1	16.3	15.9	15.5
Adjusted EPS (pre-exceps)	14.4	16.1	16.3	15.9	15.5
DPS	5.5	8.0	8.1	7.9	7.7
Payout ratio (%)	38%	50%	50%	50%	50%

Source: Company data, VTB Capital Research

Figure 96: Balance Sheet
(Figures in '000 QAR, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	9,589,230	15,568,383	19,051,817	21,764,500	22,206,608
Intangibles	169,250	170,680	172,122	173,577	175,044
Investments	2,550,974	2,678,523	2,812,449	2,953,071	3,100,725
Other	12,015,111	12,615,867	13,246,660	13,908,993	14,604,443
Total non-current assets	24,324,565	31,033,453	35,283,048	38,800,141	40,086,819
Cash	6,960,094	5,096,668	5,190,018	5,860,066	8,658,284
Accounts receivable	2,665,175	2,908,797	3,111,062	3,107,504	3,107,504
Inventories	2,230,641	2,726,997	2,916,621	2,913,285	2,913,285
Other	597,875	627,769	659,157	692,115	726,721
Total current assets	12,453,785	11,360,230	11,876,858	12,572,970	15,405,794
TOTAL ASSETS	36,778,350	42,393,683	47,159,906	51,373,111	55,492,613
Debt	1,327,330	1,367,150	1,408,164	1,450,409	1,493,922
Accounts payable	1,384,261	2,181,597	2,333,297	2,330,628	2,330,628
Other	1,130,460	1,186,983	1,246,332	1,308,649	1,374,081
Total current liabilities	3,842,051	4,735,730	4,987,793	5,089,686	5,198,631
Debt	5,535,140	5,811,897	5,811,897	5,521,302	5,245,237
Other	769,826	808,317	848,733	891,170	935,728
Total non-current liabilities	6,304,966	6,620,214	6,660,630	6,412,472	6,180,965
Minorities	394,610	387,084	379,444	371,998	364,753
Shareholders' Equity	26,236,723	30,650,654	35,132,039	39,498,955	43,748,264
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**36,778,350**	**42,393,683**	**47,159,906**	**51,373,111**	**55,492,613**

Source: Company data, VTB Capital Research

Figure 97: Cash Flow Statement
(Figures in '000 QAR, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	8,427,789	8,993,078	9,409,721	9,385,894	9,385,894
Working capital change	(488,522)	83,988	(212,230)	33,584	30,827
Other	177,442	300,000	309,000	318,270	327,818
Cash earnings ex zakat and interest	8,116,709	9,377,066	9,506,491	9,737,748	9,744,539
Net interest paid	(75,579)	(245,727)	(287,982)	(283,835)	(274,217)
Operating cash flow	8,041,130	9,131,340	9,218,509	9,453,912	9,470,321
CAPEX	(1,470,474)	(6,206,169)	(3,959,043)	(3,406,624)	(1,390,230)
Intangibles	-	(1,430)	(1,442)	(1,454)	(1,467)
Other	(1,788,103)	(728,304)	(764,719)	(802,955)	(843,103)
Cash flow before financing	4,782,553	2,195,437	4,493,304	5,242,878	7,235,521
Financing cash flows	(3,316,873)	(4,058,863)	(4,399,954)	(4,572,830)	(4,437,303)
Net borrowing	(679,623)	316,577	41,014	(248,350)	(232,553)
Dividends	(3,027,250)	(4,413,931)	(4,481,385)	(4,366,917)	(4,249,309)
Other	390,000	38,491	40,416	42,437	44,558
Net Cash Flow	1,465,680	(1,863,426)	93,350	670,048	2,798,218

Source: Company data, VTB Capital Research

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Initiation of coverage

Yanbu National Petrochemical Company

Dividends are due

BUY

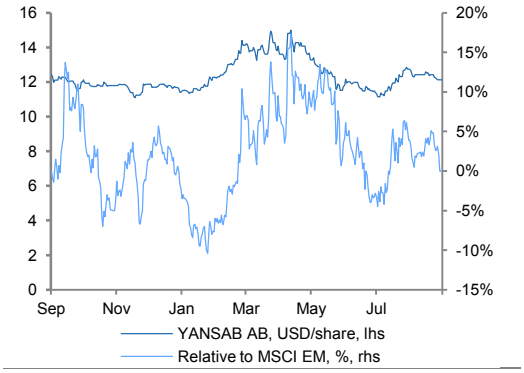
Primary ticker: YANSAB AB

Currency: SAR

Stock Data

Last price	45.50
Last price date	09 Sep 2012
Target price	53.00
Target price established	10 Sep 2012
Upside/(downside), %	16%
52 week price range	41.60 - 56.25
Market cap, USD / SAR mn	6,825 / 25,594
EV, USD / SAR mn	8,277 / 31,041
# shares outstanding, mn	563
Free float	38%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	-4.8%	3%	-1%	63%
Price relative	-4.6%	-3%	3%	48%
ADTV (USD mn)	5.00	5.88	12.31	25.16

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	8.0x	11.4x	8.6x	8.2x
EV/EBITDA, x	7.4x	9.0x	7.2x	6.8x
P/B, x	2.5x	2.1x	1.9x	1.7x
FCF yield, %	15.2%	13.5%	13.7%	14.2%
DY (ords), %	-	2.6%	5.8%	7.3%
Net sales	9,659	9,776	10,328	10,328
EBITDA	4,635	3,431	4,070	4,047
Net income	3,267	2,242	2,990	3,122
Net sales, chg	66%	1%	6%	-
EBITDA, chg	61%	-26%	19%	-1%
Net income, chg	91%	-31%	33%	4%
EPS	5.81	3.99	5.32	5.55
DPS (ord.)	-	1.20	2.66	3.33
BPS	18.69	21.48	24.14	26.36
EBITDA margin, %	48.0%	35.1%	39.4%	39.2%
ROE, %	31%	19%	22%	21%
Net Debt	8,020	5,447	3,565	1,793
ND/EBITDA, x	1.7x	1.6x	0.9x	0.4x
Net int. cover, x	8.8x	8.4x	12.3x	16.5x

Source: Bloomberg, Company data, VTB Capital Research

Yansab, an affiliate of SABIC, is one of the newly commissioned petrochemical plants in Saudi Arabia. The plant has followed through with a flawless commissioning and is a successful project on both operational excellence and cash returns. We are initiating coverage on Yanbu National Petrochemical Company (Yansab) with a Buy recommendation and a TP of SAR 53.

We see near-term upside in ethylene margins. According to our estimates, polyethylenes will contribute 48% of Yansab's 2012F EBITDA. With the average margins in the fourth quartile for major polyethylene products, we view the near-term margin upside as positive.

Exposure to preferred products – Aromatics, LLDPE, PP and MEG. We estimate that our favoured products will contribute in excess of 73% of Yansab's 2012F EBITDA and view this exposure to products underpinning Asian consumer demand growth as a positive.

Dividend initiation could potentially lead to multiples rerating. According to our forecasts, Yansab is set to generate 2012F free cash flow of SAR 3.4bn (SAR6/share) and pre financing cash flow of SAR 3.2bn (SAR 5.7/share). With 2011 net debt at SAR 8bn (1.7x 2011 EBITDA), we believe the balance sheet can support the initiation of dividends. The initial covenants on the debt are at the minimum debt service coverage ratio of 1.5x and dividends are blocked at a 1.3x debt service coverage ratio. Cash earnings (pre interest) are at SAR 3.6bn and financing costs are at SAR 290mn, in our estimates. Outside the working capital facility, the loans have a repayment period ranging between 12-13 years. The repayment requirement is likely to be a maximum of SAR 1.5bn and thus debt service requirements are set to be less than SAR 1.79bn. With dividends of SAR 672.5mn, the coverage ratio is at 1.6x in the most conservative mandated repayment scenario. A faster than necessary repayment of attractively priced debt (spreads as low as 75bp to LIBOR in some tranches) would impede shareholder returns.

What could the payout ratios look like? We believe that initial dividends will be closer to SAR 1.6 per share, rising to SAR 4.9 in the long run.

Valuation. We value Yansab via a multiples-based method with a generic sector 12m forward EV/EBITDA of 8.0x. Our normalised EBITDA estimate is SAR 4.1bn. Using a net debt assumption of SAR 4.19bn we arrive at a Target Price of SAR 53. Yansab trades at a 2013F P/E of 8.6x against peers at 11.7x. On 2013F EV/EBITDA, the company trades at 7.2x against peers at 6.2x. We believe that the end of the capex cycle, an initiation of dividends coupled with strong cash flow generation and under-valuation makes it a compelling exposure in the MENA petrochemical universe.

Risks. A slump in Asian MEG demand presents a major risk.

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VTB Capital Facts & Forecasts

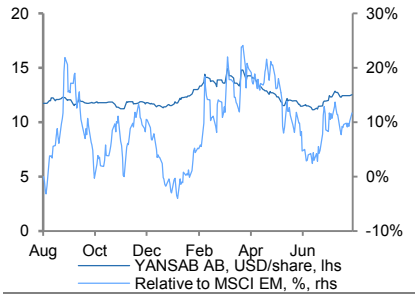
Company country & sectors
Materials / Commodity Chemicals

Yanbu National Petrochemical Company

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
YANSAB AB	SAR	45.50	53.00	Buy

Share price performance, 12-mo

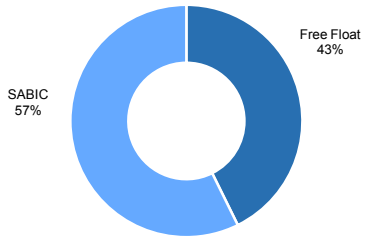


Company description

Yanbu National Petrochemical Company (Saudi Arabia) – A commodity petrochemical producer based in Saudi Arabia with a product slate consisting of polyethylene, polypropylene and MEG

Company website

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 10 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	562.5	562.5	562.5	562.5	562.5	562.5
Avg market cap	22,611	26,129	25,594	25,594	25,594	25,594
EV	33,679	34,150	31,041	29,158	27,387	25,897
Ratios & analysis						
P/E, x	13.2x	8.0x	11.4x	8.6x	8.2x	7.7x
EV/EBITDA, x	11.7x	7.4x	9.0x	7.2x	6.8x	6.4x
P/B, x	3.1x	2.5x	2.1x	1.9x	1.7x	1.6x
Dividend yield (ords), %	-	-	2.6%	5.8%	7.3%	9.1%
EPS	3.05	5.81	3.99	5.32	5.55	5.90
CFPS	0.43	4.84	6.47	6.74	7.22	7.51
Free CFPS	3.85	7.08	6.12	6.22	6.48	6.43
DPS (ords)	-	-	1.20	2.66	3.33	4.13
Payout ratio (ords), %	-	-	30.0%	50.0%	60.0%	70.0%
BPS	13.05	18.69	21.48	24.14	26.36	28.13
Revenues growth, %	n/m	66%	1%	6%	-	-
EPS growth, %	-6,220%	91%	-31%	33%	4%	6%
EBITDA margin, %	49.5%	48.0%	35.1%	39.4%	39.2%	39.0%
Net margin, %	29.4%	33.8%	22.9%	29.0%	30.2%	32.1%
ROE, %	23.3%	31.1%	18.6%	22.0%	21.1%	21.0%
ROIC, %	9.1%	16.2%	11.1%	14.4%	14.7%	15.1%
Capex/Revenues, %	-3%	-3%	4%	4%	4%	4%
Capex/Depreciation, x	(0.2x)	(0.3x)	0.4x	0.4x	0.4x	0.5x
Net debt/Equity, %	151%	76%	45%	26%	12%	2%
Net debt/EBITDA, x	3.8x	1.7x	1.6x	0.9x	0.4x	0.1x
Net interest cover, x	5.4x	8.8x	8.4x	12.3x	16.5x	n/a
Income statement summary						
Revenues	5,822	9,659	9,776	10,328	10,328	10,328
Cost of sales	(2,817)	(4,848)	(6,167)	(6,070)	(6,093)	(6,117)
SG&A and other opexp.	(123)	(175)	(178)	(188)	(188)	(188)
EBITDA	2,881	4,635	3,431	4,070	4,047	4,023
Depreciation & amortization	(835)	(1,018)	(991)	(958)	(928)	(899)
Operating profit	2,047	3,618	2,440	3,112	3,119	3,123
Non-operating gains /(exp.)	43	62	91	132	193	193
EBIT	2,047	3,618	2,440	3,112	3,119	3,123
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	1,713	3,267	2,242	2,990	3,122	3,317
Income tax	-	-	-	-	-	-
Minority interests	-	-	-	-	-	-
VTBC Net income	1,713	3,267	2,242	2,990	3,122	3,317
Cash flow statement summary						
Cash flow from operations	241	2,720	3,638	3,792	4,059	4,225
Working capital changes	(868)	(976)	405	(157)	9	9
Capex	150	323	(391)	(413)	(413)	(413)
Other investing activities	(7)	4	(1)	(1)	(1)	(1)
Free cash flow	2,164	3,983	3,445	3,500	3,643	3,619
Share issue (reacquisition)	-	-	-	-	-	-
Dividends paid	-	-	(672)	(1,495)	(1,873)	(2,322)
Net change in borrowings	(916)	(3,016)	(2,794)	(1,499)	(1,074)	(774)
Other financing cash flow	715	(222)	-	-	-	-
Movement in cash	184	(191)	(220)	384	698	715
Balance sheet summary						
Cash and equivalents	790	599	379	763	1,461	2,176
PP&E	18,426	17,588	16,988	16,443	15,928	15,442
Goodwill	274	234	234	234	234	234
Investments	-	-	-	-	-	-
Other assets	3,674	4,554	4,735	4,981	5,006	5,033
Total assets	23,163	22,975	22,337	22,421	22,629	22,885
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	3,965	3,841	4,427	4,514	4,548	4,582
Total liabilities	15,823	12,460	10,253	8,842	7,801	7,062
Total shareholder's equity	7,340	10,515	12,084	13,579	14,828	15,823
Minority interest	-	-	-	-	-	-
Net working capital	645	3,329	2,933	3,098	3,098	3,098
Net Debt	11,068	8,020	5,447	3,565	1,793	303
Capital	8,604	11,440	12,674	13,989	15,088	16,018

Company profile

Yanbu National Petrochemical Company (Yansab) is a joint stock company that was established on 13 February 2006. The company's plant is located at Yanbu city in Saudi Arabia and has an installed capacity of 770ktpa of glycols, 400ktpa of HDPE, 500ktpa of LLDPE, 400ktpa of polypropylene, 20ktpa of MTBE, 80ktpa of Butene-1/2 (intermediate, internal usage) and 138ktpa of aromatics (benzene derivative). Yansab started production in 2009, but 2009 production volumes predominantly reflected testing, rather than full-scale commercial production.

IPO

Yansab's shares were distributed to the subscribers of the IPO in January 2006. Under the aegis of the IPO, 39.375mn shares were offered at an issue price of SAR 50 per share. Thus, the implied equity value of Yansab at listing was SAR 5.625bn.

Project description

The project has two important units: olefins and aromatics. The olefins unit has an ethylene cracking capacity of 1.3mtpa and a propane cracking capacity of 400ktpa. The aromatics unit has an installed nameplate capacity of 100ktpa of benzene and 38ktpa of toluene and xylene (in aggregate).

The feedstock is composed of 80MMscfd of ethane, 45kb/d of propane and 120,000tpa of gasoline. The project is also set to receive an allocation for utilities and auxiliaries.

Ethane deficient. The key aspect of the feedstock mix is that the ethylene derivatives are not manufactured entirely from ethylene feedstock. The ethylene derivative end product capacity is 900ktpa of primary derivatives (400ktpa of HDPE and 500ktpa of LLDPE). Additionally, there is 700ktpa of nameplate ethylene glycol capacity. If these products were to have an ethylene derivative alone, the feedstock requirement would be around 1.45ktpa of ethane, on our estimates. For the primary derivatives alone, the feedstock requirement for pure ethane derivative is 1,050ktpa. Available feedstock of ethylene, however, is only 590ktpa, creating a 460ktpa primary derivative feedstock shortfall and a 860ktpa overall feedstock shortfall (in ethane-equivalent yield terms).

Propane surplus. The polypropylene capacity of 400ktpa would require a feedstock allocation of propane of 470ktpa. However, the available feedstock stream of 1.5ktpa of propane implies a surplus allocation, which is utilised for ethane cracking.

Exchange: There is also an agreement to exchange 40ktpa of butene 1 and 10ktpa of MTBE for 50 ktpa of propane feedstock.

Figure 98: Capacity and production forecasts

	Installed Capacities (ktpa)			Production volume (ktpa)		
	2012F	2013F	2014F	2012F	2013F	2014F
Polypropylene	400	400	400	372	372	372
LLDPE	500	500	500	465	465	465
HDPE	400	400	400	372	372	372
MEG	700	700	700	651	651	651
Benzene	93	93	93	100	100	100

Source: VTB Capital Research

Technology

Figure 99: Technology licence providers

	Technology licence
Ethylene Glycol	Scientific Design (a JV between SABIC and Sud Chemie)
LDPE	SABIC
HDPE	Basell
Polypropylene	Dow
Benzene	GTC
Butene 1/2	Huls

Source: Company data

Project financing (original)

Yansab's originally estimated project cost was SAR 18.75bn, to be funded with a 30% equity/70% debt mix. With SABIC as a founding partner, the financing for the project was secured on attractive terms in 2006, with loans priced on narrow spreads to LIBOR. Yansab was SABIC's first truly project-financed petrochemical venture.

Figure 100: Project costs (original estimates)

	Cost (SARm)
EPC	12,866
Development costs	1,373
Pre operating expenses	1,211
Spares and catalysts	218
Miscellaneous expenses	911
Financing costs	1,339
Primary working capital	833
Total	18,751

Source: Company data

Figure 101: Source of funds (original estimates)

	Source of funds (SARm)
Company's capital	5,625
Loans	12,293
Primary working capital	833
Total	18,751

Source: Company data

SABIC raised USD 3.5bn (SAR 13.125bn) in debt via six loan tranches. The commercial, Islamic and working capital facilities were priced at a spread of 45/65bp pa (pre/post completion), the EGCD facility was priced at a 10bp pa spread, the SACE at 12.5bp pa and PIF at 50bp pa. The covenant levels include a debt service coverage ratio minimum of 1.5x. Distributions to the sponsors are blocked at a 1.3x debt service coverage ratio, while default is triggered by a debt service coverage ratio of 1.1x or lower (Source: PFI).

Figure 102: Debt tranches (first fund raising)

	Debt tranches (SARm)
Commercial term facility	2,010
ECGD facility	563
SACE facility	2,063
Islamic facility	3,176
Commercial working capital facility	1,313
PIF	4,001
Total	13,125

Source: Company data

Earnings profile highlights

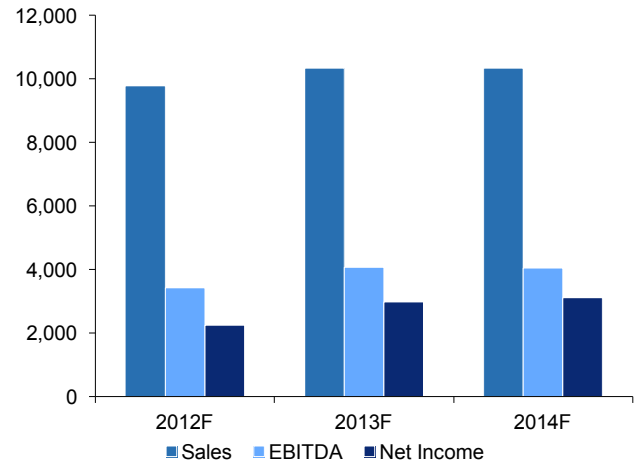
Revenues. We are forecasting revenues of SAR 9.77bn in 2012F with revenues peaking at SAR 10.3bn in 2013F. The 5.6% increase in 2013F revenues is due to an expectation of (cycle driven) margin expansions driving price increases.

EBITDA. According to our estimates, 2012F EBITDA will come in at SAR 3.4bn and long-term normalised EBITDA at SAR 4bn. We estimate an EBITDA margin of 35.1% for 2012F rising to 39.4% by 2014F on account of margin expansions.

Debt. Under our calculations, net debt falls from SAR 8bn (2011) to SAR 3.56bn by end-2013F. We foresee financing charges at SAR 290mn for 2012 and our interest rate assumption is 4%.

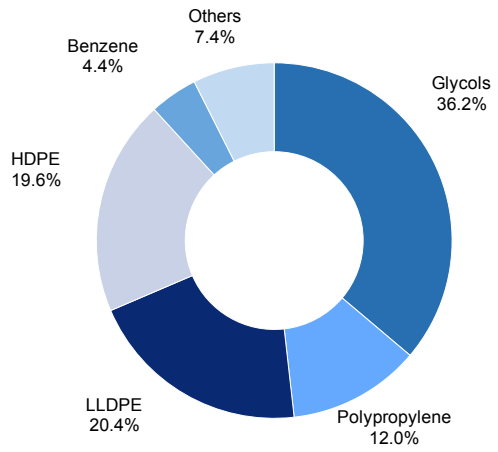
Cash flow. We expect cash earnings to come to SAR 3.6bn by 2012F. We forecast lower working capital requirements for 2012 with better cash cycle management, though inventory requirements are likely to edge up with prevailing volatility in prices. At current prices, the equity free cash flow yield in 2013F is 17% (not discounted). The longer-term (2015F) stable equity free cash flow yields are in the order of 19% (not discounted). The ROIC of the assets in our longer term (2015F) stable cash flow scenario is at 16%, rising from 2012F levels of 12% driven by higher margins from 2012F levels.

Figure 103: Key Forecasts (in SAR mn)



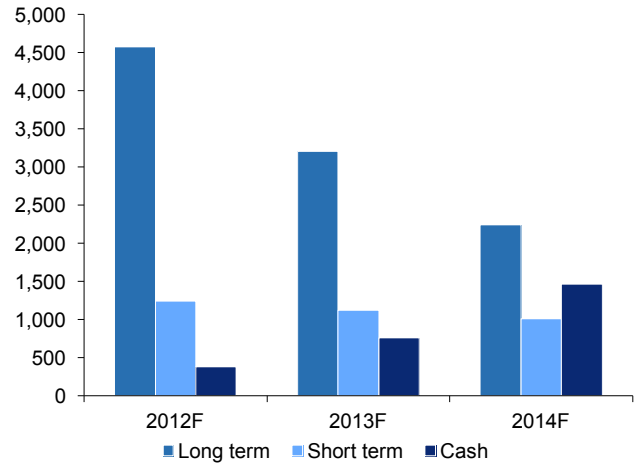
Source: VTB Capital Research

Figure 104: EBITDA Composition (2012F)



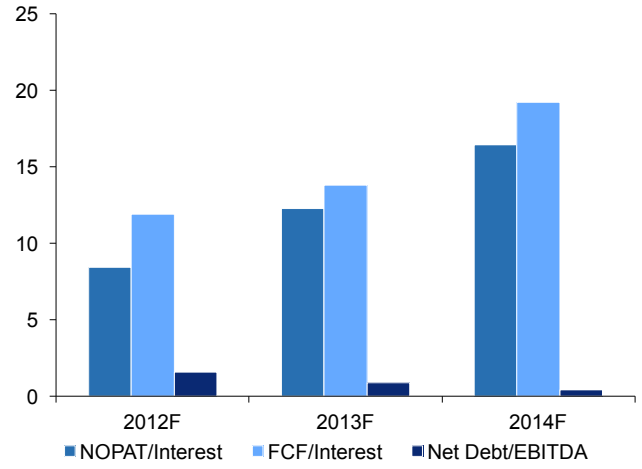
Source: VTB Capital Research

Figure 105: Debt (in SAR mn)



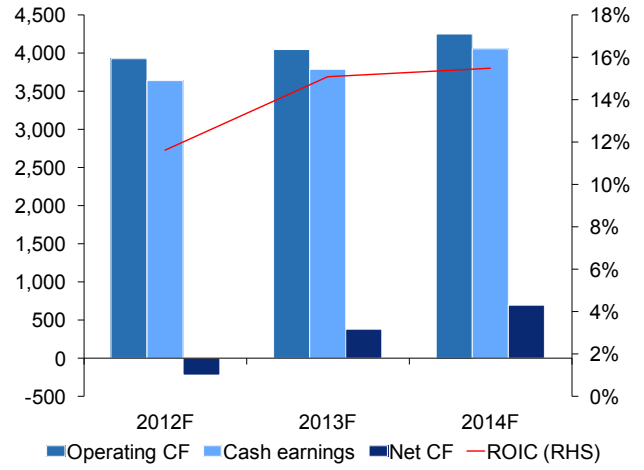
Source: VTB Capital Research

Figure 106: Debt Service Ratios



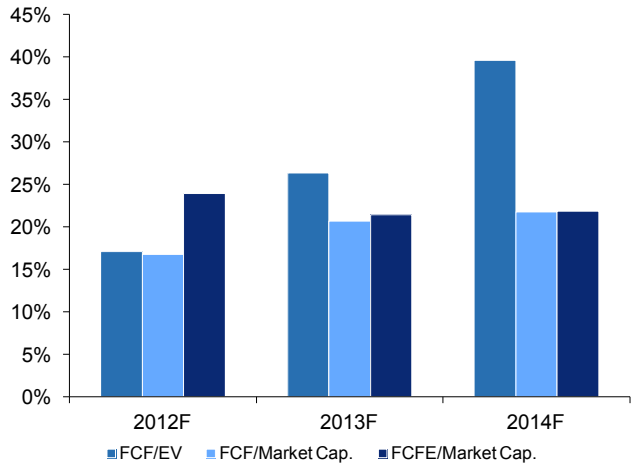
Source: VTB Capital Research

Figure 107: Cash Flows (in SAR mn)



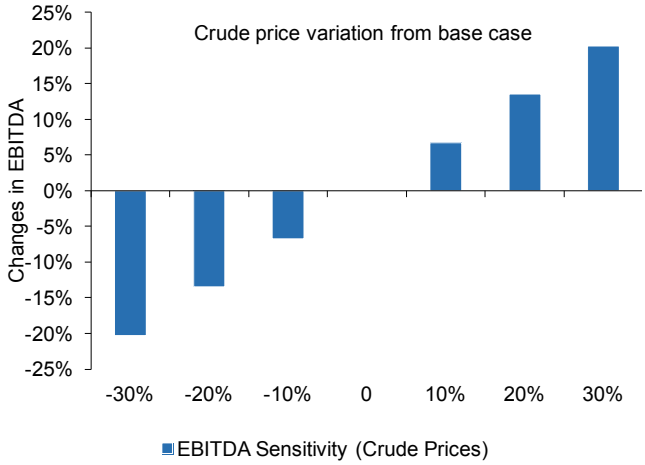
Source: VTB Capital Research

Figure 108: FCF and FCFE Yields



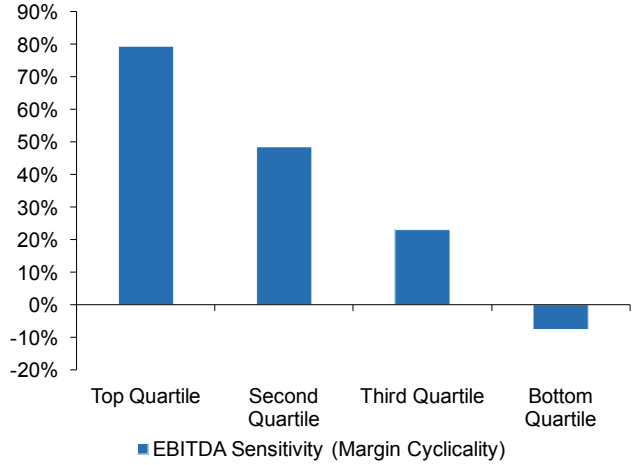
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 109: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 110: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 111: Income Statement
(Figures in SAR mn, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	9,659	9,776	10,328	10,328	10,328
EBITDA	4,635	3,431	4,070	4,047	4,023
D&A	1,018	991	958	928	899
EBIT	3,618	2,440	3,112	3,119	3,123
Finance Income (Expense)	(413)	(289)	(254)	(190)	-
Other income (expense)	62	91	132	193	193
PBT	3,267	2,242	2,990	3,122	3,317
Net income	3,267	2,242	2,990	3,122	3,317
Adjusted net income (pre-exceptionals)	3,267	2,242	2,990	3,122	3,317
Number of shares ('000)	562,500	562,500	562,500	562,500	562,500
EPS	5.8	4.0	5.3	5.6	5.9
Adjusted EPS (pre-exceps)	5.8	4.0	5.3	5.6	5.9
DPS	-	1.2	2.7	3.3	4.1
Payout ratio (%)	0%	30%	50%	60%	70%

Source: Company data, VTB Capital Research

Figure 112: Balance Sheet
(Figures in SAR mn, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	17,588	16,988	16,443	15,928	15,442
Intangibles	234	234	234	234	234
Other	32	33	34	35	36
Total non-current assets	17,855	17,256	16,711	16,198	15,713
Cash	599	379	763	1,461	2,176
Accounts receivable	2,583	1,955	2,066	2,066	2,066
Inventories	1,170	1,955	2,066	2,066	2,066
Other	769	792	816	840	865
Total current assets	5,121	5,081	5,709	6,432	7,172
TOTAL ASSETS	22,975	22,337	22,421	22,629	22,885
Debt	2,077	1,246	1,122	1,009	909
Accounts payable	423	978	1,033	1,033	1,033
Other	1,055	1,087	1,119	1,153	1,187
Total current liabilities	3,555	3,310	3,274	3,195	3,129
Debt	6,542	4,580	3,206	2,244	1,571
Other	2,362	2,362	2,362	2,362	2,362
Total non-current liabilities	8,905	6,942	5,568	4,606	3,933
Shareholders' Equity	10,515	12,084	13,579	14,828	15,823
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**22,975**	**22,337**	**22,421**	**22,629**	**22,885**

Source: Company data, VTB Capital Research

Figure 113: Cash Flow Statement
(Figures in SAR mn, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	4,635	3,431	4,070	4,047	4,023
Working capital change	(976)	405	(157)	9	9
Other	(485)	91	132	193	193
Cash earnings ex zakat and interest	3,175	3,927	4,046	4,249	4,225
Zakat	(42)	-	-	-	-
Net interest paid	(413)	(289)	(254)	(190)	-
Operating cash flow	2,720	3,638	3,792	4,059	4,225
CAPEX	323	(391)	(413)	(413)	(413)
Other	4	(1)	(1)	(1)	(1)
Cash flow before financing	3,047	3,246	3,378	3,645	3,811
Financing cash flows	(3,238)	(3,466)	(2,994)	(2,947)	(3,096)
Net borrowing	(3,016)	(2,794)	(1,499)	(1,074)	(774)
Dividends	-	(672)	(1,495)	(1,873)	(2,322)
Other	(222)	-	-	-	-
Net Cash Flow	(191)	(220)	384	698	715

Source: Company data, VTB Capital Research

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Initiation of coverage

National Industrialization Company

TiO2 margin recovery could surprise

BUY

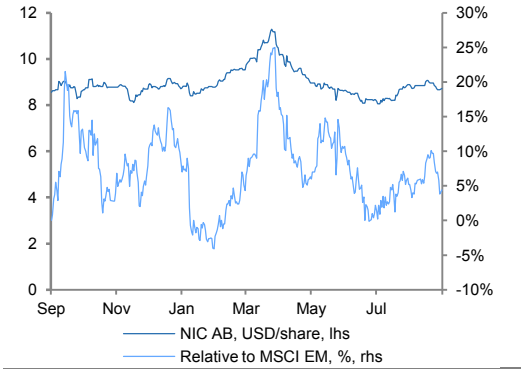
Primary ticker: NIC AB

Currency: SAR

Stock Data

Last price	32.70
Last price date	09 Sep 2012
Target price	52.00
Target price established	12 Sep 2012
Upside/(downside), %	59%
52 week price range	30.20 - 42.29
Market cap, USD / SAR mn	5,833 / 21,874
EV, USD / SAR mn	11,021 / 41,331
# shares outstanding, mn	669
Free float	53%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	-1.8%	1%	3%	128%
Price relative	-1.6%	-5%	8%	107%
ADTV (USD mn)	3.39	4.80	10.60	14.97

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	8.5x	9.3x	7.9x	6.7x
EV/EBITDA, x	5.9x	6.1x	5.2x	4.4x
P/B, x	1.2x	1.0x	0.9x	0.7x
FCF yield, %	2.7%	0.4%	13.8%	23.5%
DY (ords), %	2.4%	3.2%	3.8%	5.9%
Net sales	19,649	24,148	25,511	27,043
EBITDA	6,703	6,725	7,654	8,224
Net income	2,441	2,361	2,776	3,242
Net sales, chg	23%	23%	6%	6%
EBITDA, chg	54%	0%	14%	7%
Net income, chg	66%	-3%	18%	17%
EPS	3.65	3.53	4.15	4.85
DPS (ord.)	0.75	1.06	1.25	1.94
BPS	26.58	31.54	37.38	43.61
EBITDA margin, %	34.1%	27.8%	30.0%	30.4%
ROE, %	22%	19%	19%	20%
Net Debt	11,701	12,687	10,893	7,205
ND/EBITDA, x	1.7x	1.9x	1.4x	0.9x
Net int. cover, x	7.8x	7.0x	7.5x	9.5x

Source: Bloomberg, Company data, VTB Capital Research

National Industrialization Company (NIC/Tasnee) is a commodity petrochemical and Titanium dioxide pigment producer operating in the US, UK, Germany, France, Australia and Saudi Arabia. We are initiating coverage with a Buy recommendation and TP of SAR 52.

Offers unique exposure to mid- and upstream of TiO2 value chain. NIC's subsidiary, Cristal Global, offers exposure to both TiO2 pigment manufacturers via TiO2 manufacturing plants and Cristal's subsidiary Bemax, an industrial sands miner. The TiO2 segment accounts for 59.1% of NIC's consolidated 2012F EBITDA.

Midstream TiO2 value chain margins likely to expand. While pigment prices and ore prices have both risen in the mineral sand supercycle, the margins for TiO2 midstream have been in compression since 2Q11. Pigment manufacturers have not been able to pass through the latest bout of ore costs, leading to price increases and we believe that in spite of the reduction in ore production, pigment margins are likely to expand from here.

Petrochemical margin increase in 2013 to provide fill-up to margins. The petrochemicals segment, which accounts for 34.5% of NIC's consolidated 2012F EBITDA is expected to enjoy a margin uplift alongside the rest of the sector, but the substantial improvement in our forecast 2013F polypropylene margins will provide 34.8% of 2012F-13E petrochemicals EBITDA growth.

Smelter project could be an industry trendsetter. The high-grade ore (rutile, with a high degree of concentration) trades at a 6-8x higher price than the lower-grade ilmenite ore, which has half the level of concentration of TiO2 compared with rutile ore. Due to the relatively better availability of ilmenite, there is thus a potential arbitrage opportunity in ilmenite conversion to synthetic rutile, which can then be utilised to produce high-grade TiO2 pigment, as it is an acceptable input to the chloride process (which cannot take ilmenite as input). Cristal (NIC subsidiary) intends to exploit this arbitrage via the construction of a new smelter. We have not incorporated the potential upside from the smelter in our numbers, but believe it could potentially offer a minimum EPS upside of SAR 0.72.

Attractive upcoming petrochemicals' product slate. The Acrylic Acid (AA) project gives Tasnee exposure to Acrylates, n-Butanol and Superabsorbent polymers (SAPs), which are relatively new to Saudi producers.

Valuation. We value NIC via a multiples-based method with a generic sector 12m forward EV/EBITDA of 8.0x. Our normalised EBITDA estimate is SAR 7.65bn. Using a net debt assumption of SAR 11.49bn we arrive at a Target Price of SAR 52. We value Bemax at SAR 1.2bn. NIC trades at a 2013F P/E of 7.9x against peers at 9.5x. On 2013F EV/EBITDA, the company trades at 5.2x against peers at 5.2x. Our investment horizon for NIC is longer compared to other stocks in our universe and predicated on a margin recovery for TiO2 processors and AA plant operationalization.

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VTB Capital Facts & Forecasts

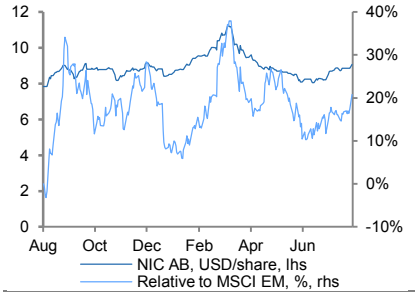
Company country & sectors
Materials / Commodity Chemicals

National Industrialization Company

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
NIC AB	SAR	32.70	52.00	Buy

Share price performance, 12-mo



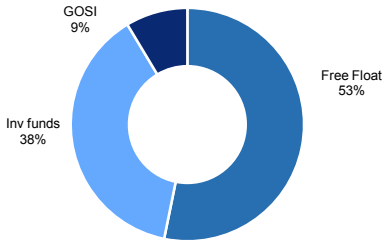
Company description

National Industrialization Company (Saudi Arabia) – A Saudi industrial company operating in both petrochemicals and TiO2 value chain with a global TiO2 operating footprint.

Company website

http://www.tasnee.com

Shareholder structure



Source: Company data, VTB Capital Research

Research team

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Last model update on: 10 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	668.9	668.9	668.9	668.9	668.9	668.9
Avg market cap	14,349	20,796	21,873	21,873	21,873	21,873
EV	32,002	39,267	41,331	39,536	35,848	32,870
Ratios & analysis						
P/E, x	9.7x	8.5x	9.3x	7.9x	6.7x	5.8x
EV/EBITDA, x	7.4x	5.9x	6.1x	5.2x	4.4x	3.7x
P/B, x	1.0x	1.2x	1.0x	0.9x	0.7x	0.7x
Dividend yield (ords), %	3.2%	2.4%	3.2%	3.8%	5.9%	12.1%
EPS	2.20	3.65	3.53	4.15	4.85	5.67
CFPS	3.40	5.03	5.84	8.63	9.60	10.72
Free CFPS	2.63	0.84	0.14	4.52	7.69	8.11
DPS (ords)	0.68	0.75	1.06	1.25	1.94	3.97
Payout ratio (ords), %	31.0%	20.4%	30.0%	30.0%	40.0%	70.0%
BPS	21.52	26.58	31.54	37.38	43.61	49.11
Revenues growth, %	47%	23%	23%	6%	6%	7%
EPS growth, %	183%	66%	-3%	18%	17%	17%
EBITDA margin, %	27.1%	34.1%	27.8%	30.0%	30.4%	30.6%
Net margin, %	9.2%	12.4%	9.8%	10.9%	12.0%	13.1%
ROE, %	15.9%	22.1%	18.6%	19.0%	19.6%	21.4%
ROIC, %	11.9%	17.5%	15.7%	18.1%	20.9%	24.2%
Capex/Revenues, %	13%	21%	17%	12%	5%	5%
Capex/Depreciation, x	1.6x	3.2x	2.9x	2.1x	1.0x	1.0x
Net debt/Equity, %	76%	66%	60%	44%	25%	13%
Net debt/EBITDA, x	2.5x	1.7x	1.9x	1.4x	0.9x	0.5x
Net interest cover, x	4.6x	7.8x	7.0x	7.5x	9.5x	15.7x
Income statement summary						
Revenues	15,989	19,649	24,148	25,511	27,043	28,935
Cost of sales	(11,449)	(12,657)	(15,460)	(15,783)	(16,620)	(17,733)
SG&A and other opexp.	(1,494)	(1,597)	(1,963)	(2,074)	(2,198)	(2,352)
EBITDA	4,340	6,703	6,725	7,654	8,224	8,850
Depreciation & amortization	(1,275)	(1,296)	(1,437)	(1,505)	(1,491)	(1,489)
Operating profit	3,065	5,407	5,288	6,149	6,733	7,361
Non-operating gains /(exp.)	241	(1)	-	-	-	-
EBIT	3,065	5,407	5,288	6,149	6,733	7,361
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	2,636	4,714	4,528	5,324	6,025	6,893
Income tax	(82)	(546)	(498)	(586)	(663)	(758)
Minority interests	(1,081)	(1,726)	(1,669)	(1,962)	(2,221)	(2,541)
VTBC Net income	1,473	2,441	2,361	2,776	3,242	3,794
Cash flow statement summary						
Cash flow from operations	2,274	3,368	3,908	5,772	6,423	7,168
Working capital changes	(421)	(1,205)	(1,558)	(472)	(531)	(655)
Capex	(2,041)	(4,200)	(4,200)	(3,156)	(1,447)	(1,542)
Other investing activities	15	(364)	(40)	(42)	(45)	(47)
Free cash flow	1,759	565	94	3,022	5,141	5,428
Share issue (reacquisition)	-	-	-	-	-	-
Dividends paid	(346)	(499)	(708)	(833)	(1,297)	(2,656)
Net change in borrowings	(373)	1,268	1,213	(2,050)	(2,000)	-
Other financing cash flow	694	(167)	-	-	-	-
Movement in cash	301	(515)	226	(255)	1,688	2,978
Balance sheet summary						
Cash and equivalents	3,886	4,637	4,863	4,607	6,295	9,273
PP&E	19,185	21,936	24,667	26,286	26,209	26,228
Goodwill	3,592	3,569	3,547	3,525	3,504	3,484
Investments	582	809	850	892	937	983
Other assets	7,500	8,977	10,771	11,314	11,925	12,679
Total assets	34,746	39,928	44,697	46,624	48,870	52,647
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	5,580	5,814	6,049	6,120	6,201	6,300
Total liabilities	20,349	22,151	23,599	21,620	19,701	19,800
Total shareholder's equity	9,262	11,023	12,675	14,619	16,564	17,702
Minority interest	5,135	6,754	8,422	10,385	12,605	15,146
Net working capital	5,327	6,805	8,364	8,836	9,366	10,022
Net Debt	10,883	11,701	12,687	10,893	7,205	4,227
Capital	10,525	11,948	13,265	15,029	16,824	17,897

Company profile

Tasnee was established in 1985 as the first joint stock fully held by the private sector. Since then, Tasnee has grown both organically and inorganically and currently has 16 subsidiaries and affiliates with interests in Petrochemicals, Titanium dioxide and other industry segments. Tasnee is a major producer of polyethylene and polypropylene in Saudi Arabia, and the second largest producer of Titanium Dioxide pigments in the world.

Subsidiaries

Cristal Global. Cristal Global (National Titanium Dioxide Company) produces Titanium dioxide pigments. Tasnee holds a 66% stake in Cristal Global, (GIC holds another 33%). Cristal is the second largest producer of TiO2 pigments in the world.

Saudi Polyolefins Company (SPC). SPC is involved in the production of propylene (455ktpa) and polypropylene (720ktpa). NIC holds a 75% stake in the company. The remaining 25% stake is held by Basell Moyen Orient Investissements.

Tasnee & Sahara Olefins Company (TSOC). TSOC is a holding company operating in the petrochemicals domain. TSOC is owned by Tasnee (60.45%), Sahara Petrochemicals (32.55%) and GOSI (7%). TSOC holds a stake in SEPC and SAAC.

Saudi Ethylene & Polyethylene Company (SEPC). SEPC has a production plant for ethylene (1,000ktpa), propylene (285ktpa), HDPE (400ktpa) and LDPE (400ktpa). It is a JV between TSOC (75%) and Basell ME Holding Co. (25%).

Saudi Acrylic Acid Company (SAAC). SAAC is involved in the establishment and operations of Acrylic Acid and derivatives project. SAAC will have two subsidiaries in the form of Saudi Acrylic Monomers Company and the Super Absorbent Polymers project. SAAC is owned by TSOC (65%), Tasnee (20%) and Sahara (15%).

National Industrialisation Petrochemical Marketing Company (NIPMC). NIPMC markets polyethylene and polypropylene in MENA, Pakistan and India. It is fully owned by Tasnee.

Rowad National Plastic Company (Rowad). Rowad is a fully owned subsidiary of Tasnee involved in the manufacturing of plastic sheets and injection products and the recycling of PP automotive batteries. Rowad has two subsidiaries, Rowad Geo and Rowad BOPP Films.

Rowad International Company for Artificial Membrane (Rowad Geo). Rowad Geo produces Polyethylene Geo-membrane liners used in a variety of construction applications. Rowad Geo is held by Rowad (70%) and specialised foreign companies (30%).

Rowad Global Packaging Company Ltd. (Rowad BOPP films). Rowad BOPP films manufactures Bi-axially Oriented Polypropylene (BOPP) films, which are used for printing, packaging and lamination. It is held by Rowad (50%), NIPMC (37.5%) and DMT Technology Inc., Austria (12.5%).

National Batteries Company (Battariat). Battariat is involved in the production of automotive and industrial batteries. Tasnee has an 80% stake in Battariat, while local partners make up another 20%.

National Lead Smelting Company (Rasass). Rasass produces Lead, Polypropylene and Sodium Sulphate by recycling used car batteries. Tasnee holds a 74.9% stake in Rasass with local partners owing the rest.

National Operations and Industrial Services Company (Khadamat). Khadamat is involved in the sales & distribution of industrial products including car batteries and plastic sheets, providing environment preservation services, quality services and technical testing, among others. Khadamat is held by Tasnee (85%) and other local partners (15%).

National Technical Inspection and Testing Ltd. Company (Fahss). Fahss provides industrial services such as testing, inspection & training in Saudi Arabia. Fahss is owned by Tasnee & Khadamat (74.89%) and TUV Nord International German Company (25.11%).

TUV Middle East (TUV-ME). TUV-ME provides industrial services such as testing, inspection & training in Bahrain. TUV-ME is owned by Tasnee and Khadamat (74.89%) and TUV Nord International German Company (25.11%).

Affiliates

National Metal Manufacturing and Casting Company (Maadaniah). Maadaniah is involved in the manufacturing of wires & metal products such as high & low carbonated galvanised wires, iron frames, screws, truck axles etc. Tasnee holds a 35.46% stake in Maadaniah.

National Packing Products Company Ltd. (Watan Pac). Watan Pac produces and markets corrugated cartons. It is held by Asir Company (50.4%), Tasnee (42.6%) and other domestic partners (7%).

Key subsidiaries

Saudi Polyolefins Company (SPC). SPC is a JV between Tasnee and Basell, with Tasnee holding a 75% stake and Basell holding the remaining 25%. The JV was incorporated in 2001 with operations commencing in 2004 with an initial capacity of 450ktpa of propylene and polypropylene (PP). The plant was expanded in May 2009 to increase its PP capacity to 720ktpa. The propylene produced by SPC's propane dehydrogenation (PDH) plant is used as feedstock for the production of polypropylene at the PP plant, and the excess is supplied to SABIC for domestic and international sales. PP is jointly marketed by Basell and Tasnee in international and Gulf markets, respectively.

Saudi Ethylene and Polyethylene Company (SEPC). SEPC is a JV between Tasnee Sahara Olefins Company or TSOC (75%) and LyondellBasell (25%). As mentioned earlier, TSOC is jointly held by Tasnee (60.45%), Sahara Petrochemicals Company (32.55%) and GOSI (7%). SEPC started commercial operations in 1Q09 with an installed capacity of 1,000ktpa of ethylene, 400ktpa of High Density Polyethylene (HDPE), 400ktpa of Low Density Polyethylene (LDPE) and 285ktpa of Propylene.

The ethylene cracker is based on a licence from Linde and has 1mtpa capacity. About 80% of the ethylene produced by the cracker is used internally as a raw material for the production of HDPE & LDPE at the polyethylene plant, while the remaining 200ktpa of ethylene is sold to external parties. The ethylene cracker also produces 285kpta of propylene, of which 100ktpa will be supplied to Tasnee's Acrylic Acid project and 185ktpa will be supplied to SPC.

Saudi Acrylic Acid Company (SAAC). SAAC involves a consortium consisting of Tasnee, Sahara, GOSI, Dow Chemicals, Evonik, Saudi Aramco and Saudi Kayan. The project is expected to be operational by 2Q13 and is located in Saudi Arabia's Jubail Petrochemicals complex. SAAC is owned by TSOC (65%), Sahara (22%) and Tasnee (13%). SAAC has investments in three subsidiary companies, SAMCO, SAPCO and Butanol JV Company. Saudi Acrylic Monomers Company (SAMCO) is owned by SAAC (75%) and Dow Chemicals (25%), and will be the operator for the Acrylic Acid Plant. Super Absorbent Polymers Company (SAPCO) is owned by SAAC (75%) and Evonik (25%), and will be the operator for the superabsorbent polymers plant. Butanol JV is owned equally between SAAC (33.33%), Saudi Kayan (33.33%) and Saudi Aramco/Dow Chemicals JV (33.33%). SAAC will be the operator of the Butanol Plant. SAMCO is expected to produce 145ktpa of crude acrylic acid and 70ktpa of glacial Acrylic Acid. The raw material, propylene (100ktpa), is supplied by SEPC under a long-term agreement. The crude acrylic acid along with Butanol (110ktpa), procured from the Butanol project, will be used to produce Butyl Acrylate (145ktpa). The glacial Acrylic Acid produced by SAMCO will be supplied to SAPCO.

SAPCO plans to use the SAMCO supplied glacial Acrylic Acid to produce 70 ktpa of superabsorbent polymers (SAP).

The Butanol project is set to use propylene, syngas and hydrogen to produce 365ktpa of butylaldehydes. The butylaldehydes will then be processed into n-Butanol (330ktpa) using the Davy/Dow technology. The n-Butanol produced by the Butanol project will be supplied to Saudi Aramco/Dow JV (110ktpa), Saudi Kayan (110ktpa) and SAMCO (110ktpa).

Cristal – Uniquely backward-integrated TiO2 play

Cristal Global (National Titanium Dioxide Company) is the largest subsidiary of Tasnee (by EBITDA contribution) ex the petrochemical segment. Cristal Global is now the second-largest producer of Titanium dioxide pigments in the world post the spate of acquisitions viz Millennium Inorganic in 2007 and Bemax Resources along with International Titanium Powders (ITP) in 2008.

The company's modest roots were in a 50ktpa production capacity of TiO2 at its Yanbu plant and this has now been transformed into a global footprint with the acquisition of Millennium Inorganic (USD 1.2bn). Cristal Global has eight TiO2 manufacturing plants in six countries on five continents. Bemax is a producer of mineral sands and owns two large tracts in Western Australia mining rutile and ilmenite ores. ITP is a producer of Titanium powder, which is used in the manufacture of Titanium metal and Titanium/Vanadium alloy. The product slate of Cristal Global consists of:

TiO2. TiO2 pigments are used in the paints and coatings, plastics and paper industries. In 2011F, Cristal supplied nearly 12% of global demand for TiO2, second only to DuPont (20% global market share), in our estimates.

Titanium Chemicals. Cristal Globalis is also one of the world's largest suppliers of derivatives of Titanium tetrachloride (TiCl4). These find use as catalysts for polymerisation, pharmaceuticals and chemical synthesis, electronic chemicals, pearlescent pigments, Titanium metals and powders, metal and glass surface treatment and TiO2 seeds.

Ultrafine and speciality TiO2. Cristal Global is also a major producer of ultrafine TiO2 through its plant in Thann, France. Ultrafine and speciality TiO2 are used in deNOx, photocatalysis, electronics, refining catalysis, ceramics, glass and various other applications.

Chlor-alkali products. Cristal Global is involved in the production of chlor-alkali products such as caustic soda, caustic flakes, hydrochloric acid and sodium hypochlorite produced by a wholly owned subsidiary of Cristal viz Arabian Chemical Centre. While caustic soda and hydrochloric acid are the basic industrial-grade and widely used chemicals, sodium hypochlorite finds specific use as a bleaching agent in the pulp and paper industry and for water treatment.

Other products. The by-products of the TiO2 synthesis such as gypsum, hydrochloric acid, iron chlorosulfate, molten sulphur and sulphuric acid are sold externally. These products are used in applications such as chromate reduction in cement, feedstock for the production of plasterboards and pigment production, metal treatment, waste and drinking water treatment, and animal feed.

Figure 114: Capacity and production forecasts

	Capacity (ktpa)			Production (ktpa)		
	2012F	2013F	2014F	2012F	2013F	2014F
HDPE	400	400	400	360	360	360
LDPE	400	400	400	360	360	360
Polypropylene	720	720	720	648	648	648
Acrylic Acid	0	0	250	0	0	75
Butyl Acrylate	0	0	160	0	0	48
Sodium Polyacrylate	0	0	80	0	0	0
Titanium Dioxide Pigments	830	830	830	772	772	772

Source: VTB Capital Research

Bemax – Upstream TiO2 exposure

Bemax, a miner of various titanium minerals and zircon was acquired by Cristal in 2008. Bemax's operations are located in the Murray Basin and Western Australia. The Murray Basin, covering over 300,000 sq km across New South Wales, Victoria and South Australia consists of operations at Gingko and a newly commissioned Snapper mine. Murray Basin mines are concentrated in the northern part and have significant reserves of Rutile, the higher-grade TiO2 feedstock used in the chloride process. The basin produces Rutile, Ilmenite, Leucoxene and Zircon. Wet dredging technique is utilised for the extraction of minerals at Murray Basin. The mineral separation facilities are located at Broken Hill. Bemax exploration activities are mainly focused in the Murray Basin area, since the Western Australia region is relatively mature in terms of exploration potential. The proven reserves at Snapper alone stand at 5,850kt of heavy minerals as of 2008. The reserves at Snapper have been identified as being at almost twice the grade compared to the Gingko deposits. The Snapper reserve is located close (10kms) to the Gingko Mine and hence shares infrastructure (roads, power) assets with Gingko.

Bemax carries out its exploration activities in Western Australia through its wholly owned subsidiary, Cable Sands. The two prospective regions are Swan Coastal Plain and the Scott Coastal Plain. The Western Australia operations consist of a mine at Gwindinup and a mineral separation plant at Bunbury. Further exploration is under way at Gwindinup and Happy Valley for the mining of titanium minerals. Dry mining technique is utilised for the production of Ilmenite, Leucoxene and Zircon. The company finalised an acquisition of a number of heavy mineral mining tenements in Western Australia's south west from Sinfo Resources Limited for AUD 25mn . The tenements are located in proximity to Cable Sand's existing operations and to Burnbury mineral separation plant. Of the acquisition amount, AUD 10mn is in royalties and the remaining in upfront cash.

Bemax mined 14.8mmt of ore in 2011, up 96% on 2010 due to the Snapper commissioning. Rutile volumes jumped 31% to reach 0.11mmt, while ilmenites and other titanium mineral volumes were relatively stagnant. Net profit in 2011 was AUD 68.5mn, up from AUD 7.6mn in 2010.

Earnings profile highlights

Revenues. We are forecasting revenues of SAR 24.1bn in 2012F. We expect revenues to increase c.6.6% in 2013F. The 2013F increase is broad-based, driven by pricing improvements in both the TiO2 and the petrochemicals part of the business. We expect that commissioning of the Acrylic Acid Project will lift revenues to SAR 27bn by 2017F (all else being equal).

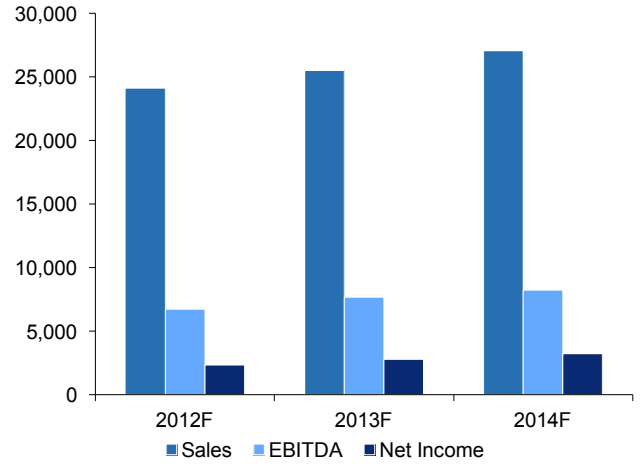
EBITDA. According to our estimates, EBITDA will total SAR 6.7bn in 2012F and rise to SAR 7.9bn by 2013F, driven by a 200bp improvement in margins. Cristal's share of consolidate EBITDA is expected to decline from 65.7% to 61.7%, as petrochemical margin expansion is likely to outperform TiO2 segment expansion. However, we see a distinct possibility that the TiO2 pigment and rutile differential, which has considerably reduced with ore price inflation, will edge higher and provide a large margin surprise.

Debt. NIC's net debt stood at SAR 11.7bn in 2011 and is forecasted to rise to SAR 12.7bn by 2012F. With Acrylic Acid plant led capex demands, we believe the debt load is likely to remain relatively stable until 2013F.

NIC has a direct and indirect (via Tasnee Sahara Olefins Company) stake in Saudi Acrylic Acid Company (SAAC) and NIC's effective contribution to capex is likely to be of the order of SAR 1bn due to cost overruns. Safco is a cash positive company and finished 2011 with a cash positive position of SAR 3.1bn. SAFCO has a highly robust balance sheet position; we expect 2012F cash of SAR 4.1bn against a total debt of SAR 160mn for 2012F. We see limited capex requirements outside of SAAC until 2015F.

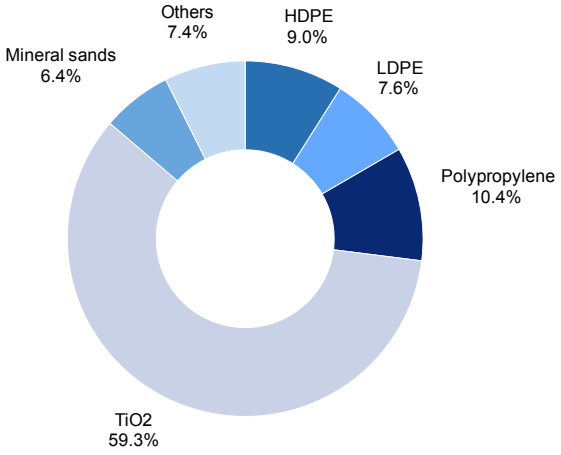
Cash flow. We believe 2012F cash earnings to come at SAR 3.9bn with operating cash flow for 2012F estimated at SAR 5.2bn. At current prices, the free cash flow yield (enterprise) for 2012F is estimated at 11%. This stabilises at 18% in 2014F and rises to 20% longer term post SAAC commissioning (2016F).

Figure 115: Key Forecasts (in SAR mn)



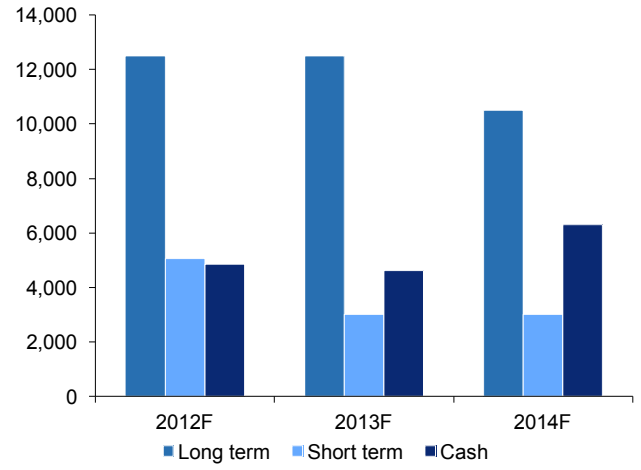
Source: VTB Capital Research

Figure 116: EBITDA Composition (2012F)



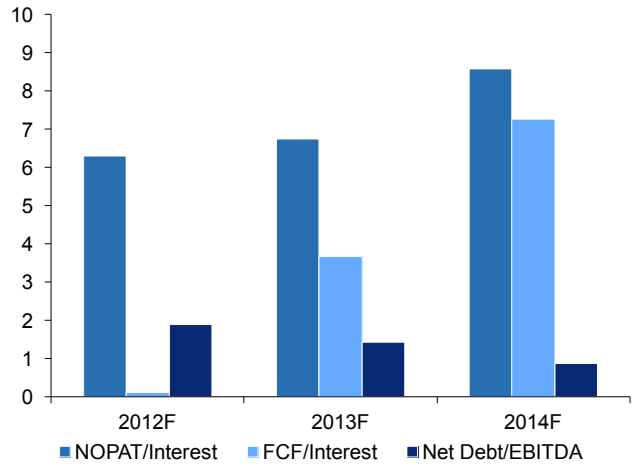
Source: VTB Capital Research

Figure 117: Debt (in SAR mn)



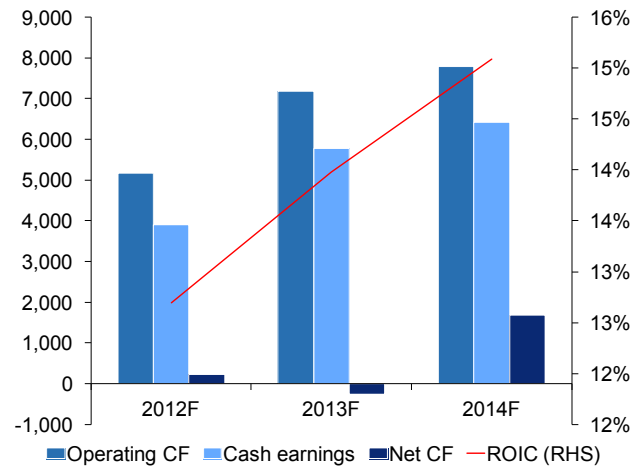
Source: VTB Capital Research

Figure 118: Debt Service Ratios



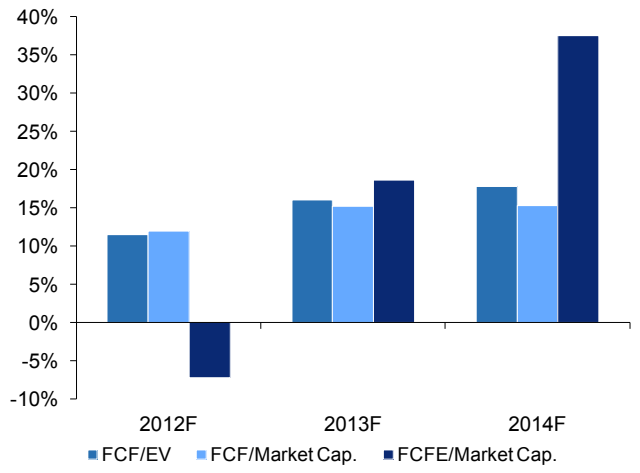
Source: VTB Capital Research

Figure 119: Cash Flows (in SAR mn)



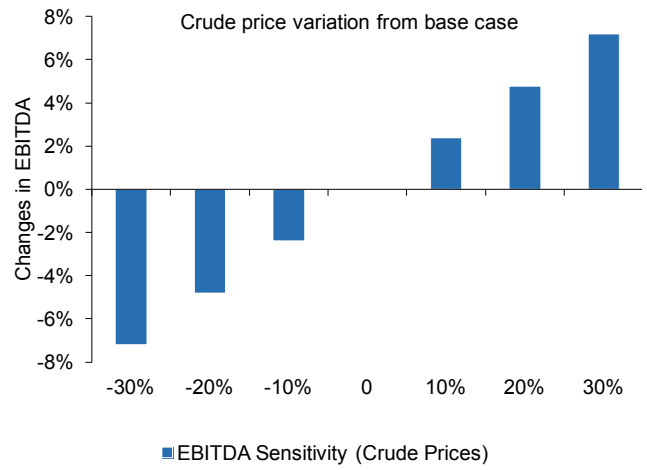
Source: VTB Capital Research

Figure 120: FCF and FCFE Yields



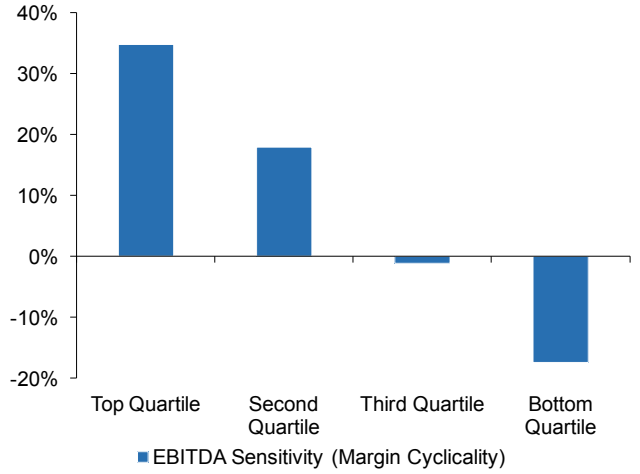
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 121: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 122: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 123: Income Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	19,649	24,148	25,511	27,043	28,935
EBITDA	6,703	6,725	7,654	8,224	8,850
D&A	1,296	1,437	1,505	1,491	1,489
EBIT	5,407	5,288	6,149	6,733	7,361
Finance cost	693	761	825	708	468
Other income (expense)	(1)	-	-	-	-
PBT	4,714	4,528	5,324	6,025	6,893
Taxes	546	498	586	663	758
Net income before minorities	4,167	4,030	4,739	5,362	6,135
Share of minorities	1,726	1,669	1,962	2,221	2,541
Net income	2,441	2,361	2,776	3,242	3,794
Adjusted net income (pre-exceptionals)	2,441	2,361	2,776	3,142	3,594
Number of shares (mn)	669	669	669	669	669
EPS	3.6	3.5	4.2	4.8	5.7
Adjusted EPS (pre-exceps)	3.6	3.5	4.2	4.7	5.4
DPS	0.7	1.1	1.2	1.9	4.0
Payout ratio (%)	20%	30%	30%	40%	70%

Source: Company data, VTB Capital Research

Figure 124: Balance Sheet
(Figures in '000 SAR, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	21,936	24,667	26,286	26,209	26,228
Intangibles	3,569	3,547	3,525	3,504	3,484
Investments	809	850	892	937	983
Other	753	753	753	753	753
Total non-current assets	27,067	29,817	31,456	31,403	31,448
Cash	4,637	4,863	4,607	6,295	9,273
Accounts receivable	4,140	5,089	5,376	5,698	6,097
Inventories	3,693	4,538	4,794	5,082	5,438
Other	391	391	391	391	391
Total current assets	12,861	14,880	15,168	17,467	21,199
TOTAL ASSETS	39,928	44,697	46,624	48,870	52,647
Debt	4,974	5,050	3,000	3,000	3,000
Accounts payable	1,028	1,263	1,334	1,414	1,513
Other	1,953	1,953	1,953	1,953	1,953
Total current liabilities	7,955	8,266	6,287	6,367	6,466
Debt	11,363	12,500	12,500	10,500	10,500
Other	2,833	2,833	2,833	2,833	2,833
Total non-current liabilities	14,197	15,333	15,333	13,333	13,333
Minorities	6,754	8,422	10,385	12,605	15,146
Shareholders' Equity	11,023	12,675	14,619	16,564	17,702
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**39,928**	**44,697**	**46,624**	**48,870**	**52,647**

Source: Company data, VTB Capital Research

Figure 125: Cash Flow Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	6,703	6,725	7,654	8,224	8,850
Working capital change	(1,205)	(1,558)	(472)	(531)	(655)
Other	(892)	-	-	100	200
Cash earnings ex zakat and interest	4,607	5,166	7,182	7,793	8,395
Tax paid	(546)	(498)	(586)	(663)	(758)
Net interest paid	(693)	(761)	(825)	(708)	(468)
Operating cash flow	3,368	3,908	5,772	6,423	7,168
CAPEX	(4,101)	(4,105)	(3,061)	(1,352)	(1,447)
Intangibles	(100)	(95)	(95)	(95)	(95)
Acquisitions (net of disposals)	79	54	54	54	54
Other	(364)	(40)	(42)	(45)	(47)
Cash flow before financing	(1,117)	(279)	2,627	4,985	5,634
Financing cash flows	602	505	(2,883)	(3,297)	(2,656)
Net borrowing	1,268	1,213	(2,050)	(2,000)	-
Dividends	(499)	(708)	(833)	(1,297)	(2,656)
Other	(167)	-	-	-	-
Net Cash Flow	(515)	226	(255)	1,688	2,978

Source: Company data, VTB Capital Research

Initiation of coverage

Advanced Petrochemical Company

Globally unique pure play on PP

BUY

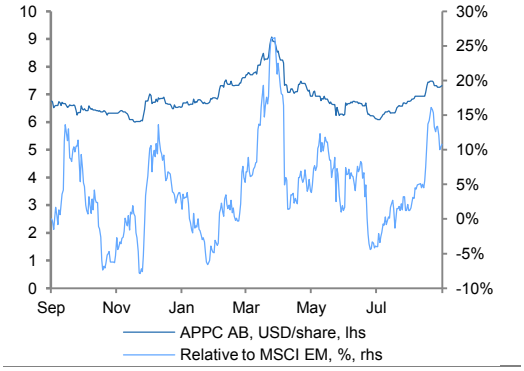
Primary ticker: APPC AB

Currency: SAR

Stock Data

Last price	27.40
Last price date	09 Sep 2012
Target price	32.00
Target price established	11 Sep 2012
Upside/(downside), %	17%
52 week price range	22.50 - 34.00
Market cap, USD / SAR mn	1,198 / 4,494
EV, USD / SAR mn	1,239 / 4,647
# shares outstanding, mn	164
Free float	87%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	8.3%	17%	8%	33%
Price relative	8.5%	9%	12%	21%
ADTV (USD mn)	1.81	3.35	8.48	10.34

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	8.2x	18.4x	10.5x	10.2x
EV/EBITDA, x	6.2x	9.9x	7.0x	6.4x
P/B, x	2.1x	2.1x	1.9x	1.8x
FCF yield, %	15.9%	10.0%	12.8%	12.8%
DY (ords), %	6.7%	3.0%	5.2%	5.4%
Net sales	2,791	2,479	2,615	2,615
EBITDA	751	472	617	617
Net income	513	244	428	441
Net sales, chg	37%	-11%	5%	-
EBITDA, chg	32%	-37%	31%	-
Net income, chg	56%	-52%	75%	3%
EPS	3.13	1.49	2.61	2.69
DPS (ord.)	1.72	0.82	1.43	1.48
BPS	12.37	13.04	14.21	15.42
EBITDA margin, %	26.9%	19.0%	23.6%	23.6%
ROE, %	25%	11%	18%	17%
Net Debt	449	153	(187)	(523)
ND/EBITDA, x	0.6x	0.3x	(0.3x)	(0.8x)
Net int. cover, x	23.6x	11.6x	n/a	n/a

Source: Bloomberg, Company data, VTB Capital Research

Advanced Petrochemicals Company (APC/APPC) is a globally unique pure play polypropylene (PP) producer based out of Jubail, Saudi Arabia. APC has an installed capacity of 450ktpa of polypropylene, which has been debottlenecked to achieve an effective capacity of 500ktpa. We are initiating coverage of APC with a Buy recommendation and TP of SAR 32. The key elements of our investment case are:

Pure play PP exposure. Polypropylene is one the most versatile and consumer demand led commodity plastic with a secular category growth underpinned by cheaper substitution of traditional materials. APC is a globally rare pure play exposure to polypropylene.

Market is missing capacity expansion. APC secured another 50ktpa of propylene supply from SATORP on a three-year agreement with a subsequent one-year automatic renewal. We believe the agreement could lift 2014F EPS 5%, which is not included in our estimates.

Receives feedstock at c.30% discount to spot naphtha price in Japan. This places APC at the lowest end of the cash cost curve for on purpose polypropylene facilities.

State of the art technology. APC uses the CATOFIN PDH technology for the production of propylene from propane. This technology has an on-stream efficiency of more than 98%. The technology has lower investment and operating costs owing to a high per pass conversion rate (48–53%) and high catalyst selectivity. Moreover, it does not require hydrogen recirculation or a dilution stream, which further reduces operating costs. APC uses the NTH-licensed NOVOLEN technology for the production of polypropylene. The technology allows a full range of homopolymers, and random and impact copolymers in only two reactors with catalysts, which allow it to cover a broad range of products. It is a simple, gas-phase, solvent-free process, which requires low operating and maintenance costs. A small reactor volume also helps to minimise reactor residence time.

Valuation. We value APC via a multiples-based method with a generic sector 12m forward EV/EBITDA of APC at 8x. We have put APC multiples in line with the sector, though the pure play exposure should likely fetch a premium. Our normalised EBITDA estimate is SAR 0.62bn. Using a net debt assumption of SAR -63.3mn, we arrive at a Target Price of SAR 32. APC trades at a 2013F P/E of 10.5x against peers at 11.7x. On 2013F EV/EBITDA, the company trades at 7.0x against peers at 6.2x. The EV/EBITDA multiples mask the tax advantages for APC's plant in Saudi Arabia. We believe that the attractive pure play PP exposure (the most versatile commodity plastic) at the trough of the margin cycle is very attractive.

Risks. Changes in commodity prices and tax regimes present a margin volatility risk.

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VTB Capital Facts & Forecasts

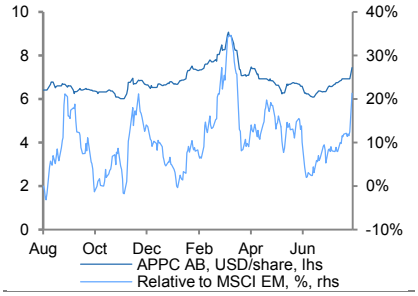
Company country & sectors
Materials / Commodity Chemicals

Advanced Petrochemical Company

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
APPC AB	SAR	27.40	32.00	Buy

Share price performance, 12-mo



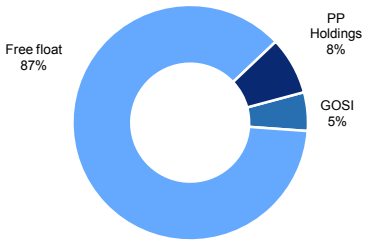
Company description

Advanced Petrochemical Company (Saudi Arabia) – One of very rare pure play polypropylene producers globally operating out of Saudi Arabia.

Company website

http://www.advancedpetrochem.com

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 11 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	164.0	164.0	164.0	164.0	164.0	164.0
Avg market cap	3,195	4,203	4,493	4,493	4,493	4,493
EV	4,002	4,652	4,647	4,307	3,971	3,688
Ratios & analysis						
P/E, x	9.7x	8.2x	18.4x	10.5x	10.2x	9.5x
EV/EBITDA, x	7.0x	6.2x	9.9x	7.0x	6.4x	6.3x
P/B, x	1.8x	2.1x	2.1x	1.9x	1.8x	1.6x
Dividend yield (ords), %	5.5%	6.7%	3.0%	5.2%	5.4%	5.8%
EPS	2.00	3.13	1.49	2.61	2.69	2.88
CFPS	3.79	4.17	2.84	3.75	3.77	3.55
Free CFPS	3.76	4.06	2.75	3.50	3.52	3.30
DPS (ords)	1.07	1.72	0.82	1.43	1.48	1.58
Payout ratio (ords), %	53.6%	55.0%	55.0%	55.0%	55.0%	55.0%
BPS	11.04	12.37	13.04	14.21	15.42	16.72
Revenues growth, %	38%	37%	-11%	5%	-	-
EPS growth, %	158%	56%	-52%	75%	3%	7%
EBITDA margin, %	28.0%	26.9%	19.0%	23.6%	23.6%	22.2%
Net margin, %	16.2%	18.4%	9.8%	16.4%	16.9%	18.1%
ROE, %	18.1%	25.3%	11.4%	18.3%	17.5%	17.2%
ROIC, %	12.3%	18.4%	10.0%	16.8%	18.4%	20.3%
Capex/Revenues, %	0%	1%	2%	2%	2%	2%
Capex/Depreciation, x	0.0x	0.1x	0.2x	0.2x	0.2x	0.4x
Net debt/Equity, %	45%	22%	7%	-8%	-21%	-29%
Net debt/EBITDA, x	1.4x	0.6x	0.3x	(0.3x)	(0.8x)	(1.4x)
Net interest cover, x	11.1x	23.6x	11.6x	n/a	n/a	n/a
Income statement summary						
Revenues	2,031	2,791	2,479	2,615	2,615	2,615
Cost of sales	(1,635)	(2,215)	(1,971)	(1,958)	(1,958)	(1,994)
SG&A and other opexp.	(37)	(42)	(37)	(39)	(39)	(39)
EBITDA	570	751	472	617	617	581
Depreciation & amortization	(211)	(218)	(207)	(192)	(178)	(110)
Operating profit	358	534	265	426	440	471
Non-operating gains /(exp.)	2	2	2	2	2	2
EBIT	358	534	265	426	440	471
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	328	513	244	428	441	472
Income tax	-	-	-	-	-	-
Minority interests	-	-	-	-	-	-
VTBC Net income	328	513	244	428	441	472
Cash flow statement summary						
Cash flow from operations	621	684	467	614	618	582
Working capital changes	122	(42)	16	(5)	(1)	(1)
Capex	4	(24)	(37)	(39)	(39)	(39)
Other investing activities	-	-	(1)	(1)	(1)	(1)
Free cash flow	617	666	450	573	577	541
Share issue (reacquisition)	-	-	-	-	-	-
Dividends paid	(176)	(282)	(134)	(235)	(243)	(260)
Net change in borrowings	(210)	(339)	(335)	(180)	(150)	(65)
Other financing cash flow	-	-	0	1	1	1
Movement in cash	160	20	(40)	160	186	218
Balance sheet summary						
Cash and equivalents	457	476	437	597	783	1,001
PP&E	2,419	2,280	2,110	1,958	1,819	1,748
Goodwill	111	76	76	76	76	76
Investments	-	-	-	-	-	-
Other assets	378	548	472	497	498	500
Total assets	3,365	3,380	3,095	3,126	3,176	3,324
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	289	427	367	386	387	387
Total liabilities	1,553	1,352	957	796	647	582
Total shareholder's equity	1,811	2,028	2,138	2,330	2,529	2,742
Minority interest	-	-	-	-	-	-
Net working capital	63	91	74	78	78	78
Net Debt	807	449	153	(187)	(523)	(806)
Capital	3,075	2,953	2,728	2,740	2,789	2,937

Company profile

APC is a joint stock company, established on 1 October 2005 in Saudi Arabia. APC's 650,000 sq m plant is located in Jubail Industrial City. The company is involved in propane reduction and polypropylene production.

APC has an installed propylene production capacity of 455ktpa and polypropylene capacity of 450tpa. APC uses the CATOFIN technology to convert propane into propylene and uses the NOVOLEN technology to convert propylene into polypropylene. The company's propylene production is fully integrated into downstream polypropylene production.

APC started production in the first quarter of 2008, ahead of schedule, and delivered its first shipment on 31 March 2008. The EPC contractor was Samsung Engineering Company Limited (SECL) and its affiliate, Samsung Saudi Arabia Limited (SSAL).

Figure 126: Capacity and production forecasts

	Installed capacities (ktpa)			Production volume (million tonnes)		
	2012F	2013F	2014F	2012F	2013F	2014F
Propylene	455	455	455	486.9	486.9	486.9
Polypropylene	450	450	450	481.5	481.5	481.5

Source: VTB Capital Research

No large government stakeholding

APC started with an initial paid-up share capital of SAR 750mn. It consisted of 75mn shares at SAR 10 each. APC went public in 2006 through an IPO of 66.375mn shares valued at SAR 10 each. This brought the total number of shares to 141.375mn and paid-up capital to SAR 1.414bn.

Dar chemicals is APC's largest shareholder with a 15.92% stake. Other major Shareholders are IDB Infrastructure Fund of Bahrain with a 9.02% stake and National Polypropylene Company with 7.96%.

Independent company – no technology risks

APC uses the CATOFIN PDH technology, sub-licensed from SABIC, which in turn licenses it from ABB Lummus Global Inc.

The CATOFIN PDH process uses a fixed-bed chrome-alumina catalyst to convert propane into propylene. The process uses fixed-bed reactors and operates on a cyclical basis, which allows for an uninterrupted flow of major process streams. A complete cycle consists of dehydrogenation of propane, purging of steam, air blowing to reheat the catalyst and burning off the small amount of coke that is deposited during the reaction cycle. This is followed by evacuation and reduction before another cycle starts.

The reactor's output is sent for purification in order to obtain high-purity propylene of 99.5%. The propylene in liquid form is then polymerised to polypropylene.

Figure 127: Process features and benefits

Process features	Process benefits
High per pass conversion (48-53%) and high catalyst selectivity	Lower investment and operating costs
Single train capability up to 650,000TPA of propylene (455,000TPA for APC)	Economy of scale
No hydrogen recirculation or dilution steam	Lower investment and operating costs
Fixed-bed reactors	Reliable and robust operation with high on-stream factor.
No catalyst losses	Environmentally sound design

Source: VTB Capital Research

APC utilises the NOVOLEN process to produce polypropylene, which is widely used in polypropylene production design. The NOVOLEN technology has been licensed by Novolen Technology Holdings C.V. ("NTH"), a subsidiary of ABB Lummus Global Inc. ("ABB Lummus").

Polypropylene is produced in two production lines. The first line with a capacity of 180ktpa produces both the homopolymer and random copolymer grades. The second line with a capacity of 270ktpa produces only homopolymer-grade polypropylene.

Figure 128: Process features and benefits

Process features	Process benefits
Produces full range of homopolymers, random and impact copolymers in only two reactors with a selection of catalysts, including metallocene	Covers broad range of products for all markets/applications, including ultra-high (up to 50%) rubber-content impact copolymers and terpolymers
High specification lot-to-lot and within-lot uniformity	Necessary for film and fibre applications, which need consistent and tight specifications
Exclusive pellet degassing	Products with the lowest volatile content in the
	Marketplace. Also very low taste and odour level for highly demanding applications (e.g. food packaging)
Simple, gas-phase, solvent-free process	Among the lowest operating and maintenance
	costs in the industry
Small reactor volume minimises reactor residence time	Rapid grade changes generate minimal "off-specification product specification". Also, reduced inventory results in inherently safer process. It also minimises capital investment.

Source: VTB Capital Research

Independent Company – No marketing risks

APC has off-take agreements with three companies — Vinmar International, Mitsubishi Corporation and Domo N.V. — for the sale of 100% of APC's nameplate polypropylene capacity. The off-take agreement is long term (eight years) and might be extended to 12 years by APC. The target markets for the company's products will be Europe, South East Asia, in particular China, and the Middle East.

The price paid for polypropylene is a netback price calculated as the price realised by the off-taker in sales to its customers minus costs incurred in receiving and transporting the product and a marketing fee paid to the off-taker. The details of the off-takers are as follows:

Domo N.V. Domo N.V. is primarily a manufacturer of chemicals and polymers. It has its own polypropylene plant in the Netherlands with a capacity of 180ktpa. It is also a manufacturer of high-quality carpet yarns, staple fibres and technical textiles.

Vinmar International. Vinmar International is a subsidiary of Vinmar Group, which specialises in trading chemicals, plastics and raw materials. It helps the producers with logistics, sales and credit management activities and also assists them in procuring their raw materials at competitive prices.

Mitsubishi Corporation. Mitsubishi Corporation is one of Japan's largest general trading companies with its foothold spanning over 80 countries worldwide. It is also the owner and operator of a number of polypropylene and polyethylene plants globally.

Earnings profile highlights

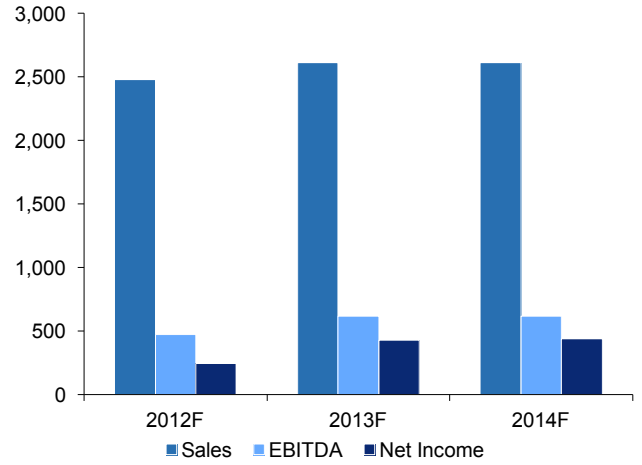
Revenues. We are forecasting revenues of SAR 2.48bn in 2012F, with revenues stabilising at SAR 2.6bn in 2013F. The 5.5% increase in 2013F revenues is primarily on account of polypropylene pricing.

EBITDA. Under our estimates, 2012F EBITDA is SAR 0.47bn and long-term normalised EBITDA totals SAR 0.6bn. Our margin estimates are conservative. We forecast an EBITDA margin of 19% for 2012F rising to 23.6% by 2014F on account of higher polypropylene margins.

Debt. We calculate net debt falling from SAR 0.45bn (2011) to SAR 0.15bn by end 2013. We believe that the company is likely to pursue both organic and inorganic growth opportunities and capex estimates are likely to edge higher. We have not included the recent announcements of a polypropylene plant in Turkey into our estimates, as we await further clarity. Our interest cost assumption is 3% for 2012F, which is slightly conservative (2011 financing rate was 2.1%).

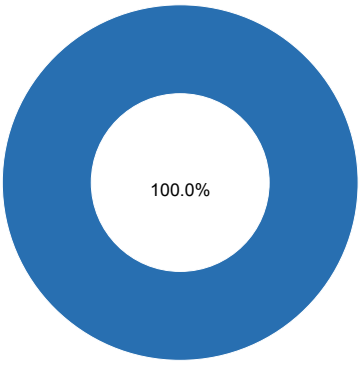
Cash flow. We believe 2012F cash earnings will come at SAR 0.47bn with stable earnings at SAR 0.6bn. At current prices, the equity free cash flow yield in 2013F is 13% (not discounted). The enterprise free cash flow yields are also at 13% due to the low levels of debt. The ROIC of the assets in our longer term (2015F) stable cash flow scenario is at 24%.

Figure 129: Key Forecasts (in SAR mn)



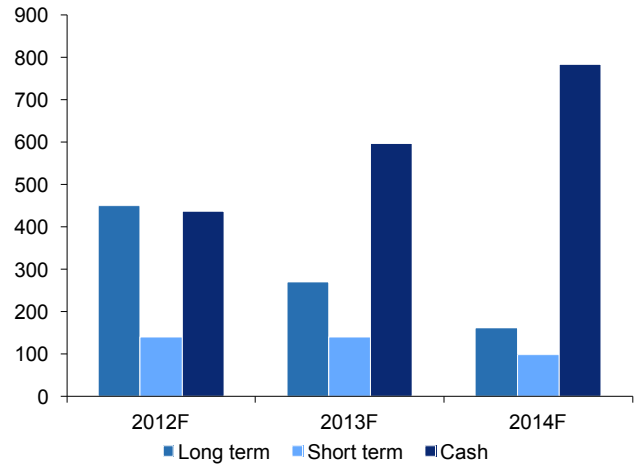
Source: VTB Capital Research

Figure 130: EBITDA Composition (2012F)



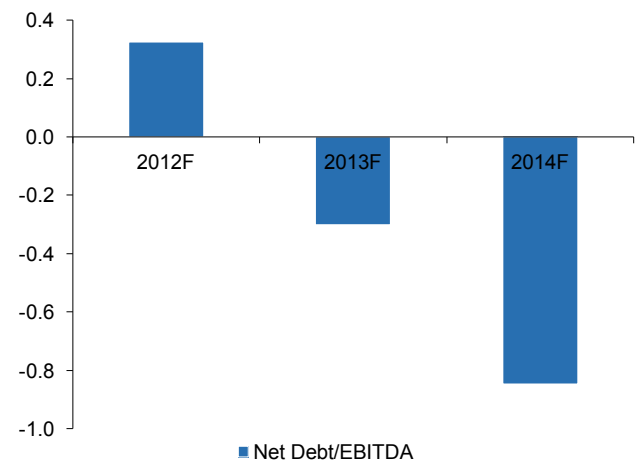
Source: VTB Capital Research

Figure 131: Debt (in SAR mn)



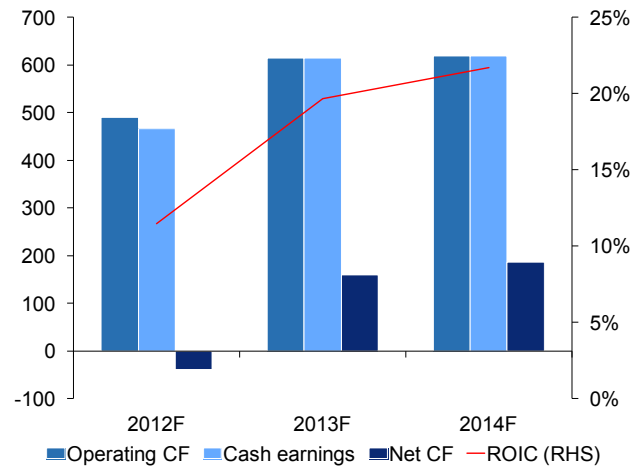
Source: VTB Capital Research

Figure 132: Debt Service Ratios



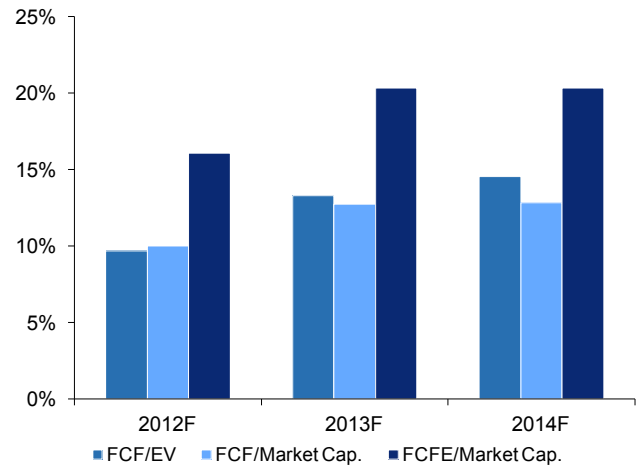
Source: VTB Capital Research

Figure 133: Cash Flows (in SAR mn)



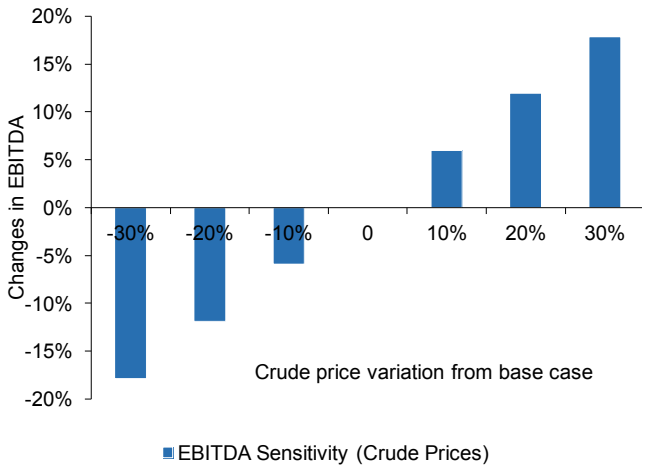
Source: VTB Capital Research

Figure 134: FCF and FCFE Yields



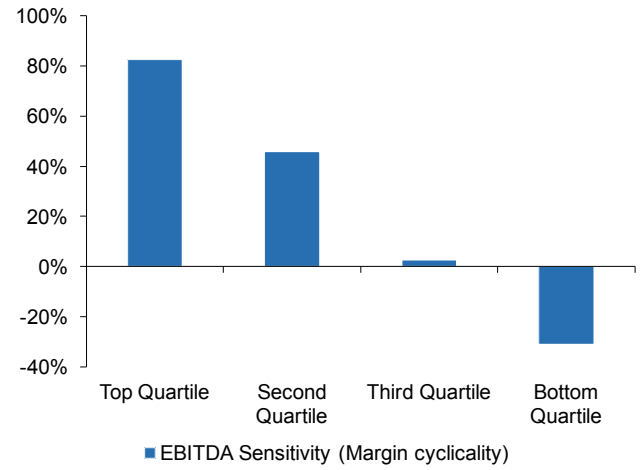
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 135: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 136: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 137: Income Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	2,790,923	2,479,424	2,614,665	2,614,665	2,614,665
EBITDA	751,324	471,513	617,495	617,495	580,890
D&A	217,596	206,845	191,668	177,947	110,308
EBIT	533,728	264,668	425,828	439,548	470,582
Finance Income (Expense)	(22,594)	(22,725)	-	-	-
Other income (expense)	1,670	1,720	1,771	1,824	1,879
PBT	512,804	243,662	427,599	441,372	472,461
Net income before minorities	512,804	243,662	427,599	441,372	472,461
Income before Zakat	512,804	243,662	427,599	441,372	472,461
Net income	512,804	243,662	427,599	441,372	472,461
Adjusted net income (pre-exceptionals)	512,804	243,662	427,599	441,372	472,461
Number of shares ('000)	163,995	163,995	163,995	163,995	163,995
EPS	3.1	1.5	2.6	2.7	2.9
Adjusted EPS (pre-exceps)	3.1	1.5	2.6	2.7	2.9
DPS	1.7	0.8	1.4	1.5	1.6
Payout ratio (%)	55%	55%	55%	55%	55%

Source: Company data, VTB Capital Research

Figure 138: Balance Sheet
(Figures in '000 SAR, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	2,279,686	2,110,032	1,957,584	1,818,857	1,747,769
Intangibles	75,539	75,539	75,539	75,539	75,539
Other	18,292	18,840	19,406	19,988	20,587
Total non-current assets	2,373,517	2,204,412	2,052,529	1,914,384	1,843,895
Cash	476,475	436,747	596,569	782,896	1,000,742
Accounts receivable	343,283	297,531	313,760	313,760	313,760
Inventories	155,837	123,971	130,733	130,733	130,733
Other	30,970	31,899	32,856	33,842	34,857
Total current assets	1,006,564	890,148	1,073,918	1,261,231	1,480,092
TOTAL ASSETS	3,380,081	3,094,560	3,126,447	3,175,614	3,323,987
Debt	175,000	140,000	140,000	98,000	98,000
Accounts payable	407,807	347,119	366,053	366,053	366,053
Other	2,482	2,507	2,532	2,557	2,583
Total current liabilities	585,290	489,626	508,585	466,611	466,636
Debt	750,000	450,000	270,000	162,000	97,200
Other	16,469	16,963	17,472	17,996	18,536
Total non-current liabilities	766,469	466,963	287,472	179,996	115,736
Shareholders' Equity	2,028,323	2,137,971	2,330,390	2,529,008	2,741,615
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**3,380,081**	**3,094,560**	**3,126,447**	**3,175,614**	**3,323,987**

Source: Company data, VTB Capital Research

Figure 139: Cash Flow Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	751,324	471,513	617,495	617,495	580,890
Working capital change	(41,727)	16,025	(4,989)	(960)	(990)
Other	(15,637)	1,720	1,771	1,824	1,879
Cash earnings ex zakat & Interest	693,960	489,258	614,278	618,359	581,780
Zakat	(10,169)	-	-	-	-
Net interest paid	(234)	(22,725)	-	-	-
Operating cash flow	683,557	466,533	614,278	618,359	581,780
CAPEX	(23,624)	(37,191)	(39,220)	(39,220)	(39,220)
Intangibles	(19,483)	-	-	-	-
Cash flow before financing	640,450	428,793	574,492	578,557	541,960
Financing cash flows	(620,589)	(468,520)	(414,671)	(392,231)	(324,114)
Net borrowing	(338,750)	(335,000)	(180,000)	(150,000)	(64,800)
Dividends	(281,839)	(134,014)	(235,179)	(242,755)	(259,854)
Other		494	509	524	540
Net Cash Flow	19,861	(39,728)	159,822	186,327	217,846

Source: Company data, VTB Capital Research

BUY

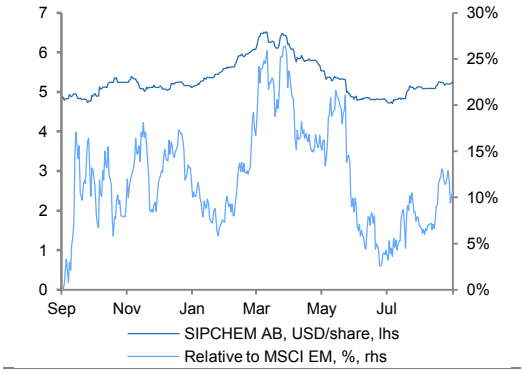
Primary ticker: SIPCHEM AB

Currency: SAR

Stock Data

Last price	19.70
Last price date	09 Sep 2012
Target price	24.00
Target price established	04 Sep 2012
Upside/(downside), %	22%
52 week price range	17.65 - 24.45
Market cap, USD / SAR mn	1,926 / 7,223
EV, USD / SAR mn	2,790 / 10,461
# shares outstanding, mn	367
Free float	65%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	2.3%	9%	8%	5%
Price relative	2.5%	2%	12%	-5%
ADTV (USD mn)	1.69	2.47	7.07	9.97

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	10.7x	10.9x	10.0x	9.4x
EV/EBITDA, x	6.5x	6.6x	5.7x	5.1x
P/B, x	1.1x	0.9x	0.8x	0.8x
FCF yield, %	13.6%	15.6%	18.7%	18.8%
DY (ords), %	-	2.7%	3.0%	3.2%
Net sales	3,324	3,263	3,353	3,359
EBITDA	1,768	1,593	1,644	1,634
Net income	706	661	722	765
Net sales, chg	67%	-2%	3%	0%
EBITDA, chg	65%	-10%	3%	-1%
Net income, chg	87%	-6%	9%	6%
EPS	1.93	1.80	1.97	2.09
DPS (ord.)	-	0.54	0.59	0.63
BPS	19.15	21.27	23.58	26.04
EBITDA margin, %	53.2%	48.8%	49.0%	48.6%
ROE, %	13%	11%	11%	11%
Net Debt	2,144	1,366	351	(723)
ND/EBITDA, x	1.2x	0.9x	0.2x	(0.4x)
Net int. cover, x	7.2x	6.4x	7.0x	7.8x

Source: Bloomberg, Company data, VTB Capital Research

Initiation of coverage

Saudi International Petrochemical Company

Volatile production but attractive products

Saudi International Petrochemical Company (Sipchem) is a Jubail, Saudi Arabia based company producing methanol, butanediol, acetic acid and VAM. The company is working on a new project to add EVA to its product slate. We are initiating coverage on Sipchem with a Buy recommendation and TP of SAR 24. Sipchem's product slate is unique, devoid of any olefins and we believe the company is an important constituent of any petrochemical portfolio. Like other Saudi producers, Sipchem is located at the lowest end of the global cash cost curve across all of its products.

Sipchem is among the lowest cash cost producers. While more than 50% of installed global methanol capacity has access to cheap feedstock, Sipchem is among the lowest cash cost producers. EBITDA margins in the methanol segment are north of 65%.

Pricing floor from energy content. With Brent crude at USD 114.5/bbl, the methanol costs can vary between USD 350/tonne and USD 710/tonne on an energy parity basis. Methanol has an energy content value and because it can be easily transported, it has a floor determined by the energy content — within a volatile 100–200% energy equivalence band. With a current price of USD 360/tonne (cfr, Asia) the commodity is at the bottom of its trading range.

Acetyl complex contribution presents an upside risk. The acetyl complex contributes 38% of Sipchem's 2012F EBITDA (assuming at cost methanol transfer pricing). With both acetic acid and VAM margins close to the bottom quartile, we see a distinct upside risk to current margins and our conservative estimates. VAM is strongly leveraged to US housing demand and we believe the cycle might be about to enter an inflection point with the recent positive news on housing starts in the US.

EVA project offers further upside. Sipchem is commissioning an EVA project with reported ROIC in excess of 13%. We have excluded both the capital expenditure and the earnings uplift from 2014F in our estimates. However, we believe the project is likely to be earnings accretive and enhance returns.

Valuation. We value Sipchem via a multiples-based method with a generic sector 12m forward EV/EBITDA of Sipchem at 9.2x. Our normalised EBITDA estimate is SAR 1.64bn. Using a net debt assumption of SAR 0.69bn, and estimating minorities at SAR 4.09bn we arrive at a Target Price of SAR 24. Sipchem trades at a 2013F P/E of 10.0x against peers at 9.5x. On 2013F EV/EBITDA, the company trades at 5.7x against peers at 5.2x. While Sipchem's valuation is attractive, the historical volatility in operating rates and active provisioning in accounts lends a relatively riskier investment profile to Sipchem compared to other recommended stocks in the report.

Risks. Plant's operational track record elevates operating risk profile.

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VTB Capital Facts & Forecasts

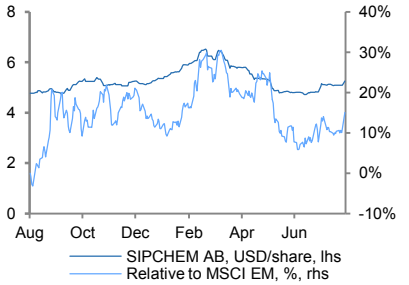
Company country & sectors
Materials / Commodity Chemicals

Saudi International Petrochemical Company

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
SIPCHEM AB	SAR	19.70	24.00	Buy

Share price performance, 12-mo



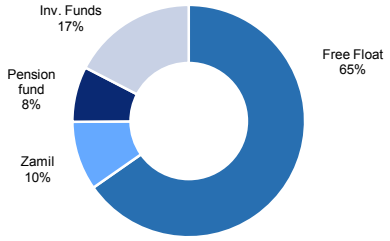
Company description

Saudi International Petrochemical Company (Saudi Arabia) – A Saudi commodity petrochemical manufacturer with main products consisting of methanol and acetyl groups

Company website

http://www.sipchem.com

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 4 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	333.3	366.7	366.7	366.7	366.7	366.7
Avg market cap	7,199	7,535	7,223	7,223	7,223	7,223
EV	12,007	11,551	10,461	9,446	8,372	7,185
Ratios & analysis						
P/E, x	19.0x	10.7x	10.9x	10.0x	9.4x	8.6x
EV/EBITDA, x	11.2x	6.5x	6.6x	5.7x	5.1x	4.5x
P/B, x	1.2x	1.1x	0.9x	0.8x	0.8x	0.7x
Dividend yield (ords), %	4.7%	-	2.7%	3.0%	3.2%	3.5%
EPS	1.13	1.93	1.80	1.97	2.09	2.28
CFPS	1.12	4.81	3.73	4.31	4.38	4.63
Free CFPS	0.34	2.80	3.08	3.68	3.70	3.76
DPS (ords)	1.01	-	0.54	0.59	0.63	0.68
Payout ratio (ords), %	88.7%	-	30.0%	30.0%	30.0%	30.0%
BPS	18.04	19.15	21.27	23.58	26.04	28.72
Revenues growth, %	140%	67%	-2%	3%	0%	0%
EPS growth, %	168%	70%	-6%	9%	6%	9%
EBITDA margin, %	53.7%	53.2%	48.8%	49.0%	48.6%	48.0%
Net margin, %	19.0%	21.2%	20.2%	21.5%	22.8%	24.9%
ROE, %	7.7%	12.5%	10.8%	10.9%	10.7%	10.8%
ROIC, %	8.3%	13.8%	12.3%	13.7%	14.6%	15.6%
Capex/Revenues, %	18%	21%	11%	9%	7%	5%
Capex/Depreciation, x	1.2x	1.5x	0.7x	0.6x	0.5x	0.4x
Net debt/Equity, %	49%	31%	18%	4%	-8%	-18%
Net debt/EBITDA, x	2.7x	1.2x	0.9x	0.2x	(0.4x)	(1.2x)
Net interest cover, x	7.1x	7.2x	6.4x	7.0x	7.8x	8.6x
Income statement summary						
Revenues	1,993	3,324	3,263	3,353	3,359	3,354
Cost of sales	(826)	(1,432)	(1,547)	(1,583)	(1,599)	(1,617)
SG&A and other opexp.	(97)	(125)	(122)	(126)	(126)	(126)
EBITDA	1,069	1,768	1,593	1,644	1,634	1,611
Depreciation & amortization	(305)	(466)	(490)	(485)	(477)	(467)
Operating profit	764	1,302	1,103	1,159	1,156	1,144
Non-operating gains /(exp.)	3	11	22	46	94	194
EBIT	764	1,302	1,103	1,159	1,156	1,144
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	660	1,131	952	1,041	1,103	1,205
Income tax	-	-	-	-	-	-
Minority interests	(238)	(400)	(314)	(343)	(364)	(398)
VTBC Net income	378	706	661	722	765	836
Cash flow statement summary						
Cash flow from operations	375	1,765	1,369	1,581	1,606	1,699
Working capital changes	(535)	184	(96)	31	0	(1)
Capex	(360)	(703)	(361)	(306)	(240)	(172)
Other investing activities	70	(95)	-	-	-	-
Free cash flow	115	1,026	1,128	1,350	1,358	1,377
Share issue (reacquisition)	82	91	-	-	-	-
Dividends paid	(336)	-	(198)	(217)	(229)	(251)
Net change in borrowings	104	1,297	(2)	(578)	(520)	(468)
Other financing cash flow	(131)	(149)	-	-	-	-
Movement in cash	(211)	2,009	776	437	555	719
Balance sheet summary						
Cash and equivalents	1,621	3,630	4,406	4,843	5,398	6,116
PP&E	9,506	9,808	9,679	9,500	9,262	8,967
Goodwill	33	73	104	148	211	301
Investments	63	185	185	185	185	185
Other assets	805	969	879	878	879	879
Total assets	12,027	14,665	15,253	15,554	15,935	16,448
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	1,455	1,869	1,683	1,713	1,715	1,713
Total liabilities	6,013	7,643	7,455	6,907	6,389	5,919
Total shareholder's equity	4,921	5,630	6,093	6,598	7,133	7,718
Minority interest	1,092	1,391	1,706	2,049	2,413	2,811
Net working capital	358	194	290	259	259	260
Net Debt	2,937	2,144	1,366	351	(723)	(1,910)
Capital	6,185	6,555	6,683	7,008	7,393	7,914

Company profile

Saudi International Petrochemical Company (Sipchem) is a petrochemical company established in 1999 with an initial paid-in capital of SAR 650mn. Sipchem's plants are located in the Jubail Industrial City, on the eastern coast of Saudi Arabia.

Sipchem is involved in establishing, operating and managing projects in basic and intermediate petrochemicals.

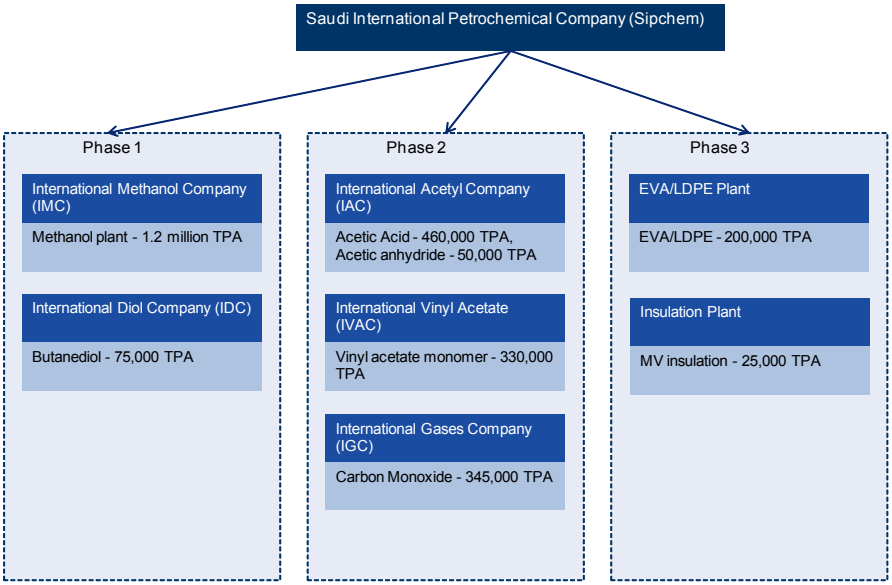
The capacity expansion might be divided into three distinct phases.

Phase 1: It included two companies/units commencing operations: International Methanol Company (IMC) producing methanol and International Diol Company (IDC) producing butanediol. These two companies together produced 1.16mnt of chemicals in 2007.

Phase 2: Sipchem's phase 2 consisted of three projects — International Acetyl Company (IAC), International Vinyl Acetate Company (IVAC) and International Gases Company (IGC) starting production by 4Q09.

Phase 3: This project is under construction and expected to be commissioned by 2014F. It is not factored into our valuation as yet. In this phase, Sipchem was planning to utilise third party sources C2 and C3 alongside its internal VAM to produce EVA with the flexibility to produce LDPE. A subset of LDPE and EVA produced (25ktpa) is expected to be utilised for medium voltage (MV) cable insulation production.

Figure 140: Sipchem: Development phases



Source: Company data

Products and Business segments

Sipchem currently operates through five subsidiaries, all of which are based in Saudi Arabia. Sipchem's subsidiaries are as follows:

Figure 141: Sipchem's subsidiaries

Subsidiary	Stake
International Acetyls Company (IAC)	76.0%
International Viny Acetate Company (IVAC)	76.0%
International Gases Company (IGC)	72.0%
International Methanol Company (IMC)	65.0%
International Diol Company (IDC)	53.9%
Sipchem Marketing Services Company	9.0%
International Polymers Company	75.0%
Gulf Advanced Cable Insulation Company	50.0%
Sipchem Chemical Company	100.0%

Source: Company data

Figure 142: Capacity and production assumptions

Assumptions	Installed capacities (ktpa)			Production(ktpa)		
	2012F	2013F	2014F	2012F	2013F	2014F
Methanol	970	970	970	922	922	922
Butanediol	75	75	75	68	68	68
Acetic Acid	340	340	340	414	414	414
Acetic Anhydride	50	50	50	45	45	45
VAM	300	300	300	270	270	270

Source: VTB Capital Research

International methanol company (IMC)

IMC is a limited liability company established in 2003 in the Jubail Industrial City of Saudi Arabia. It owns and operates a methanol plant with production capacity of c.1MTPA. The plant commenced production in December 2004. The company has a paid-in capital of SAR 361mn.

IMC is 65% owned by Sipchem and 35% by Japan Saudi Arabia Methanol Company (JAMC). JAMC is a consortium of four Japanese companies.

The IMC plant uses natural gas as feedstock for the production of methanol. Methanol is used for the production of a wide variety of other chemical products such as acetic acid and formaldehyde. It is also used as an alternative fuel and even has fuel cell applications.

IMC uses a steam methane reforming and methanol synthesis technology licensed by Jacob Engineering UK Limited (Jacobs). IMC also uses proprietary technologies including Johnson Matthey catalyst systems and a Methanol Casale S.A. Axial Radial Converter (ARC).

The feedstock is natural gas, for which it has a 30-year long-term agreement with Saudi Aramco signed in 2001. The contractual rate is USD 0.75/mmbtu on our estimates.

JAMC, which holds around 35% shares of IMC, markets approximately 80% of the company's methanol. JAMC markets Sipchem's methanol outside the Middle East, while Sipchem markets the remaining 20% methanol in the Middle Eastern region. IMC provides methanol to JAMC at the prevailing market rates.

Sipchem has used part of the methanol generated at its plant to manufacture acetic acid since the commissioning of the acetyl complex.

International diol company (IDC)

IDC is a limited liability company established in 2002 in Jubail Industrial City. It produces petrochemicals such as butanediol (BDO), tetrahydrofuran (THF) and gamma-butyrolactone (GBL). IDC has a production capacity of 75,000TPA and production commenced in March, 2006. The company has a paid-in capital of SAR 431mn.

Sipchem holds a majority stake of 53.9% in IDC. The government holds 19.1% in IDC through the Public Pension Agency. The remaining stake is held by different companies from Saudi Arabia, the UK and the US. IDC produces commodity chemicals such as butanediol (BDO), tetrahydrofuran (THF) and gamma-butyrolactone (GBL), with total capacity of 75,000TPA. Butanediol is used industrially as a solvent and in the manufacture of various plastics and fibres.

IDC's production technology is provided by Davy Process Technology Limited of the UK, while the upstream technology is provided by Huntsman Corporation and UOP LLC.

IDL uses methanol, butane and hydrogen as feedstock for the production of butanediol. Butane is supplied by Saudi Aramco at a discount to the market rate. This acts as a source of cost advantage for the company.

Most of IDC's products are marketed in the international markets, mainly Europe and Asia, by Vinmar International Limited, US, and Will & Co B.V., of the Netherlands. The off-take is linked to the market price.

International gases company (IGC)

IGC is a limited-liability company established in May 2005 with its plant at Jubail Industrial City of Saudi Arabia. The IGC plant has a production capacity of 340ktpa of carbon monoxide and paid-in capital of SAR 425mn.

The technology for the plant is procured and supplied by LSTK contractor Lurgi AG (Germany). Sipchem holds a majority stake of 72% in IGC. 25% of its stock is held by National Power Company and 3% by the Ministry of Endowment.

IGC will use natural gas as feedstock for the production of carbon monoxide by using the methane steam reforming technology.

Carbon monoxide is used as a fuel as well as a reducing agent in the chemical industry. IGC will supply all the CO it produces to IAC for the production of acetic acid.

International acetyl company (IAC) & International vinyl acetate company (IVAC)

IAC is a limited liability company established in January 2006 with its plant at Jubail Industrial City of Saudi Arabia. The company produces acetic acid and acetic anhydride. The IAC plant has an acetic acid capacity of 460,000TPA and acetic anhydride capacity of 50,000 TPA. The company has a paid-in capital of SAR 1,680mn. The plant's technology is provided by Eastman Chemicals Co, US.

IVAC is a limited-liability company established in January 2006 with its plant at Jubail Industrial City. The IVAC plant is set to have a vinyl acetate monomer (VAM) capacity of 330,000TPA. The company has a paid-in capital of SAR 1680mn.

The technology for the plant is being sourced from DuPont with Sipchem and Helm AG participating in the off-take VAM produced by IVAC for marketing.

Sipchem holds a majority stake of 76% in IAC & IVAC. 10% of the stock is held by Helm Arabia of Germany, 11% by Ikarus and 3% by the Ministry of Endowment. Helm Arabia is a special-purpose company established in Hamburg, Germany. It is a JV between Helm AG of Germany, a leading multinational producer and distributor of petrochemical products, and Thales International Offsites, a subsidiary of Thales Company of France, a leading international electronics and systems group. IAC will use methanol, carbon monoxide and hydrogen as feedstock for the production of acetic acid and acetic anhydride. It will use methanol produced by IMC and carbon monoxide produced by IGC.

Acetic acid is used in the production of chemicals such as vinyl acetate, pure terephthalic acid and acetate esters. Acetic Anhydride on the other hand is used for the production of cellulose acetate, which is in turn used for filters, fabrics, etc. Acetic anhydride is also used for the production of cellulose acetate polymers, including cellulose acetate molding resin, cellulose acetate propionate and cellulose acetate butyrate. In addition, it is widely used to add the acetyl group in the synthesis of surfactants, drugs, pesticides, dyes and additives. VAM is an intermediate for products like polyvinyl acetate, used mainly for adhesives. Polyvinyl acetate resins are thermoplastic copolymers that are used for making emulsion products. These are used for the production of paints, adhesives, paper coatings and textile treatments.

Sipchem and Helm AG will offtake the acetic acid and acetic anhydride to be produced by IAC.

Earnings profile highlights

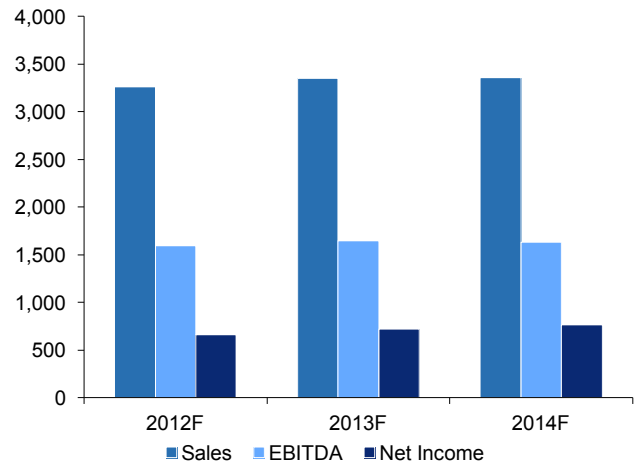
Revenues. According to our forecasts, revenues total SAR 3.3bn in 2012F. We see the pricing environment as relatively stable in the methanol and acetyl segments, but VAM margins bear a risk to the upside.

EBITDA. In our estimates, 2012F EBITDA is SAR 1.6bn and long-term normalised EBITDA is SAR 1.4bn. We estimate an EBITDA margin of 48.8% for 2012F and longer-term margins of 48% (2014F).

Debt. Under our calculations, net debt falls from SAR 2.1bn (2011) to SAR 0.350bn by end-2013. Sipchem's financing rate is likely to edge lower in 2012F with the issuance of a sukuk priced at very attractive terms (sub 3% in current environment). The effective average interest rate in 2011 was 3.5% as per our calculations. With the construction of a new EVA complex underway, the debt reduction might be slower than our model suggests. However in light of the uncertainities regarding final specifications, we believe it is prudent to consider the company's investment thesis without the EVA expansion.

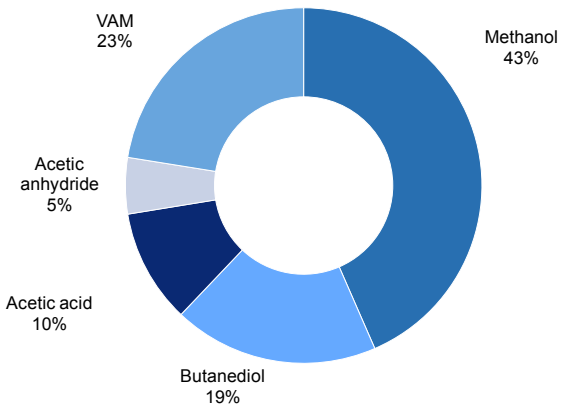
Cash flow. We believe 2012F cash earnings will come at SAR 1.37bn. At current prices, the enterprise free cash flow yield in 2013F is 14% (not discounted). The longer-term (2014F) stable enterprise free cash flow yields are in the order of 16% (not discounted). The ROIC of the assets in our longer-term (2015F) stable cash flow scenario is at 12%.

Figure 143: Key Forecasts (in SAR mn)



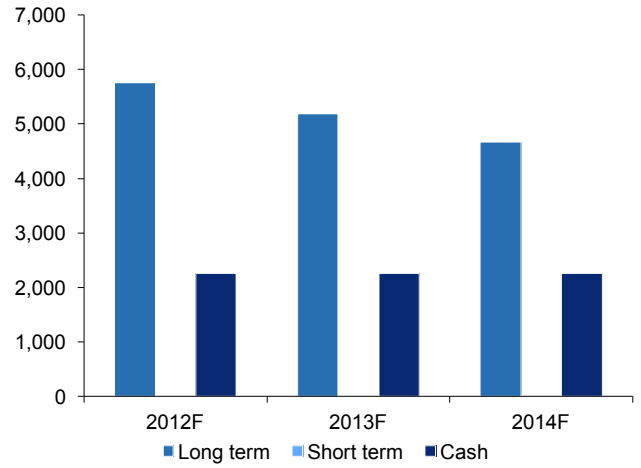
Source: VTB Capital Research

Figure 144: EBITDA Composition (2012F)



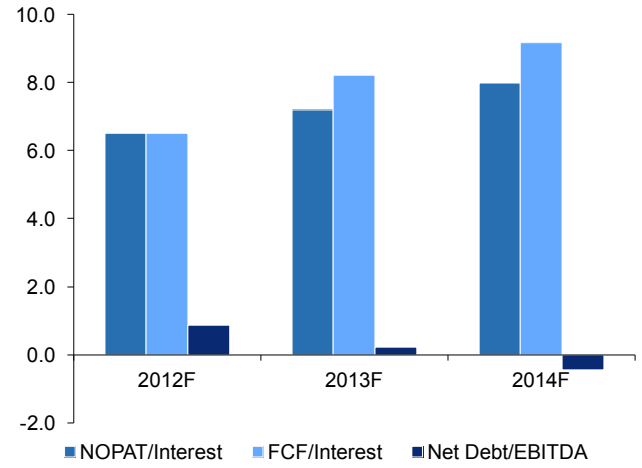
Source: VTB Capital Research

Figure 145: Debt (in SAR mn)



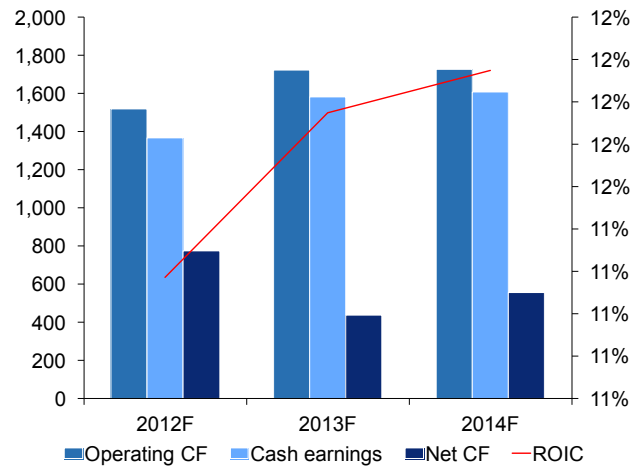
Source: VTB Capital Research

Figure 146: Debt Service Ratios



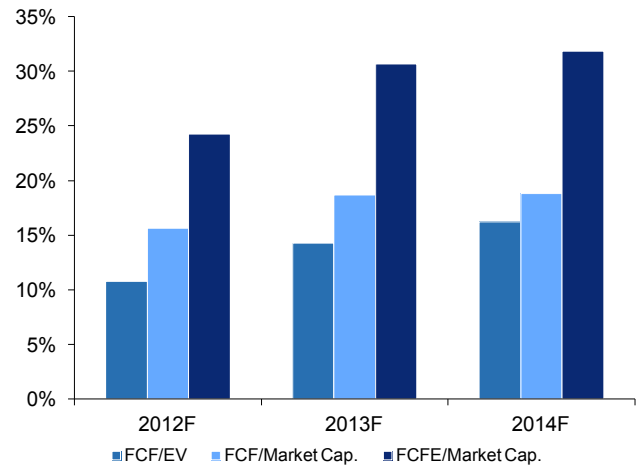
Source: VTB Capital Research

Figure 147: Cash Flows (in SAR mn)



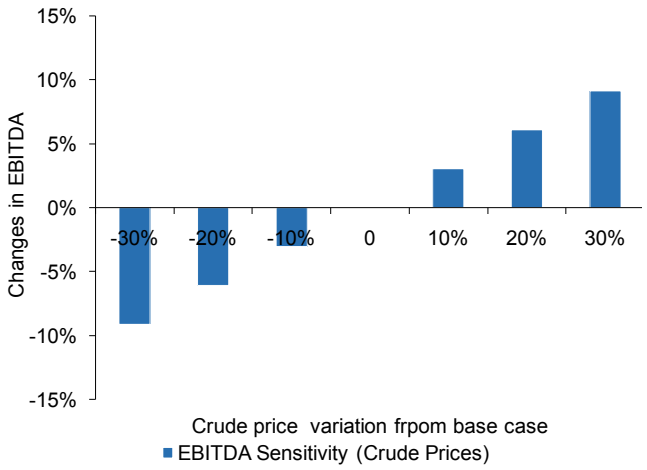
Source: VTB Capital Research

Figure 148: FCF and FCFE Yields



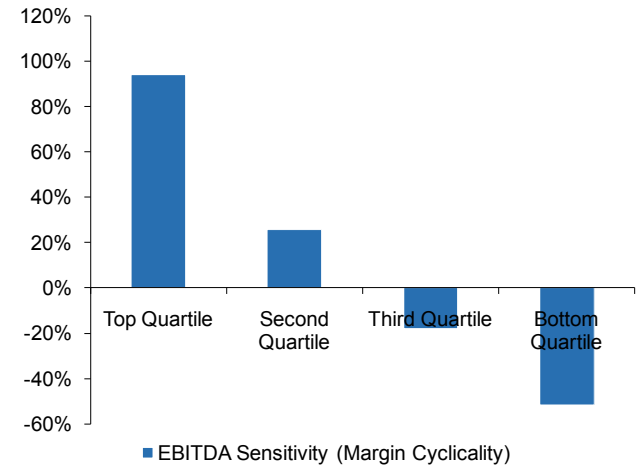
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 149: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 150: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 151: Income Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	3,324,385	3,262,734	3,353,062	3,359,403	3,353,643
EBITDA	1,767,925	1,593,000	1,644,119	1,633,915	1,611,230
D&A	465,950	490,035	484,891	477,486	467,094
EBIT	1,301,976	1,102,965	1,159,228	1,156,429	1,144,135
Finance Costs	(181,492)	(173,194)	(164,490)	(148,022)	(133,204)
Other income (expense)	10,968	22,485	46,094	94,493	193,710
PBT	1,131,452	952,256	1,040,832	1,102,899	1,204,641
Net income before minorities	1,131,452	952,256	1,040,832	1,102,899	1,204,641
Share of minorities	399,756	314,245	343,474	363,957	397,532
Income before Zakat	731,696	638,012	697,357	738,942	807,110
Zakat	(25,798)	22,495	24,588	26,054	28,457
Net income	705,898	660,507	721,945	764,996	835,567
Adjusted net income (pre-exceptionals)	705,898	660,507	721,945	764,996	835,567
Number of shares ('000)	366,667	366,667	366,667	366,667	366,667
EPS	1.9	1.8	2.0	2.1	2.3
Adjusted EPS (pre-exceps)	1.9	1.8	2.0	2.1	2.3
DPS	-	0.5	0.6	0.6	0.7
Payout ratio (%)	*0%*	*30%*	*30%*	*30%*	*30%*

Source: Company data, VTB Capital Research

Figure 152: Balance Sheet
(Figures in '000 SAR, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	9,807,702	9,679,027	9,500,260	9,262,313	8,967,194
Intangibles	73,146	104,139	148,264	211,086	300,526
Investments	184,869	184,869	184,869	184,869	184,869
Total non-current assets	10,065,716	9,968,034	9,833,393	9,658,268	9,452,589
Cash	3,629,881	4,406,187	4,842,934	5,397,572	6,116,477
Accounts receivable	687,909	703,369	700,077	701,095	700,912
Inventories	281,081	175,761	177,895	178,195	178,011
Total current assets	4,598,871	5,285,316	5,720,906	6,276,862	6,995,400
TOTAL ASSETS	14,664,587	15,253,350	15,554,298	15,935,130	16,447,989
Debt	15,785	13,417	11,404	9,694	8,240
Accounts payable	774,895	589,427	619,403	620,758	619,082
Other	526,610	526,610	526,610	526,610	526,610
Total current liabilities	1,317,290	1,129,454	1,157,418	1,157,062	1,153,932
Debt	5,758,518	5,758,518	5,182,666	4,664,399	4,197,959
Other	567,251	567,251	567,251	567,251	567,251
Total non-current liabilities	6,325,769	6,325,769	5,749,918	5,231,651	4,765,211
Minorities	1,391,308	1,705,552	2,049,027	2,412,984	2,810,515
Shareholders' Equity	5,630,220	6,092,575	6,597,936	7,133,433	7,718,330
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**14,664,587**	**15,253,350**	**15,554,298**	**15,935,130**	**16,447,989**

Source: Company data, VTB Capital Research

Figure 153: Cash Flow Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	1,767,925	1,593,000	1,644,119	1,633,915	1,611,230
Working capital change	183,833	(95,608)	31,134	37	(1,309)
Other	20,949	22,485	46,094	94,493	193,710
Cash earnings ex zakat and interest	1,972,707	1,519,877	1,721,347	1,728,445	1,803,631
Zakat	(25,798)	22,495	24,588	26,054	28,457
Net interest paid	(181,492)	(173,194)	(164,490)	(148,022)	(133,204)
Operating cash flow	1,765,417	1,369,179	1,581,445	1,606,476	1,698,884
CAPEX	(703,430)	(361,361)	(306,125)	(239,540)	(171,975)
Intangibles	(13,895)	(30,993)	(44,125)	(62,822)	(89,440)
Acquisitions (net of disposals)	(182,959)	-	-	-	-
Other	(94,517)	-	-	-	-
Cash flow before financing	770,616	976,825	1,231,195	1,304,115	1,437,469
Financing cash flows	1,238,621	(200,520)	(794,448)	(749,476)	(718,564)
Net borrowing	1,296,705	(2,368)	(577,864)	(519,977)	(467,894)
New equity	91,367	-	-	-	-
Dividends	-	(198,152)	(216,584)	(229,499)	(250,670)
Other	(149,451)	-	-	-	-
Net Cash Flow	2,009,238	776,305	436,747	554,638	718,905

Source: Company data, VTB Capital Research

Initiation of coverage

Saudi Arabian Fertiliser Company

An expensive cash cow

HOLD

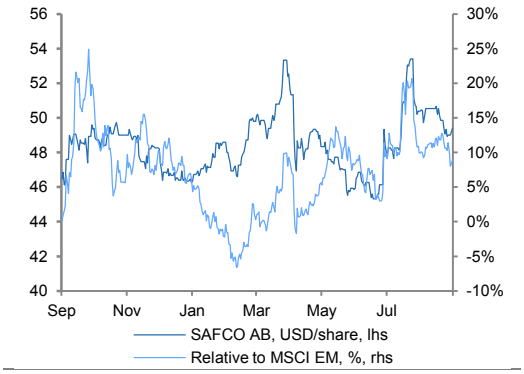
Primary ticker: SAFCO AB

Currency: SAR

Stock Data

Last price	185.25
Last price date	09 Sep 2012
Target price	175.00
Target price established	04 Sep 2012
Upside/(downside), %	-6%
52 week price range	170.00 - 200.25
Market cap, USD / SAR mn	12,349 / 46,313
EV, USD / SAR mn	11,298 / 42,370
# shares outstanding, mn	250
Free float	40%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	-2.0%	8%	6%	54%
Price relative	-1.8%	1%	11%	40%
ADTV (USD mn)	4.73	6.03	7.17	8.56

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	10.9x	12.3x	14.2x	13.4x
EV/EBITDA, x	10.4x	11.1x	12.5x	11.6x
P/B, x	5.4x	5.0x	4.6x	4.2x
FCF yield, %	8.2%	7.2%	6.9%	7.0%
DY (ords), %	2.2%	2.1%	2.3%	2.2%
Net sales	5,051	5,312	4,771	4,957
EBITDA	3,990	3,832	3,291	3,477
Net income	4,110	3,779	3,265	3,465
Net sales, chg	33%	5%	-10%	4%
EBITDA, chg	39%	-4%	-14%	6%
Net income, chg	40%	-8%	-14%	6%
EPS	16.44	15.11	13.06	13.86
DPS (ord.)	3.94	3.85	4.24	4.13
BPS	32.84	36.92	40.45	44.19
EBITDA margin, %	79.0%	72.1%	69.0%	70.1%
ROE, %	50%	41%	32%	31%
Net Debt	(3,101)	(3,942)	(5,045)	(6,023)
ND/EBITDA, x	(0.8x)	(1.0x)	(1.5x)	(1.7x)

Source: Bloomberg, Company data, VTB Capital Research

Saudi Arabian Fertiliser Company (SAFCO) is a unique pure play urea producer with production costs among the lowest globally. The company is located in Jubail, Saudi Arabia and has a total urea production capacity of 2.7mtpa of urea and 2mtpa of ammonia. We are initiating coverage of SAFCO with a Hold recommendation and a TP of SAR 175. Safco has historically traded at an average 35% premium to the sector and is locally preferred for its high payout ratios (approaching 100%). We prefer to play Safco via SABIC, which owns 43% of the company.

Feedstock cost advantage. The key differentiator for Safco, as for most of the MENA petrochemicals, is the feedstock cost advantage. The entire product line has a feedstock cost of USD 0.75/mmbtu.

Urea prices likely to be supported by corn shortages. In terms of utility value, the urea price cap is likely to move to USD 688/tonne against forward corn prices of 7.97/bu. We thus see urea margins remaining in the second quartile in the short term, but new supply from IQ and OCI is likely to put pressure on prices and margins in 1Q13F and limit further upside.

Marginal producer's cash costs. The Ukrainian urea industry is arguably the marginal urea producer and hence a key price setter. We believe that the marginal producers' urea floor price is at USD 250/t (excluding facility cost of USD 50/ton). We see further upside from current levels limited on account of the lag effect of urea application

Indian demand growth might decelerate. In our view, considering the deteriorating fiscal situation in India and the extent of the burden of fertilizer subsidies of 0.75% of GDP, domestic subsidies are likely to be impacted. Furthermore with urea to DAP application ratios four times higher than optimum, the incremental urea application has only a marginal benefit.

Valuation. We value Safco via a multiples-based method with a generic sector 12m forward EV/EBITDA of 8x. We have placed Safco at a 30% premium to the sector to account for the historical premia as well as unique stock specific investment dynamics related to balance sheet strength and investor profile. The stock has historically traded at elevated multiples due to its unique positioning (payout ratios are close to 100%) in the insulated Saudi equities market (foreigners account for less than 10% of traded value). The support from domestic pension and income seeking institutions (GOSI has a 16.7% stake, amongst the highest in the market in any stock) provides support to the elevated valuations. Our normalised EBITDA estimate is SAR 3.48bn. Using a net debt assumption of SAR -4.6bn (Safco is cash positive), we arrive at a Target Price of SAR 175. Safco trades at a 2013F P/E of 14.2x against peers at 9.4x. On 2013F EV/EBITDA, the company trades at 12.5x against peers at 5.8x. The ROE is reduced by a negative net debt.

Risk. Changes in commodity prices present a margin volatility risk.

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VTB Capital Facts & Forecasts

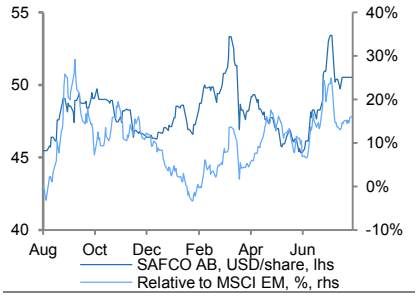
Company country & sectors
Materials / Commodity Chemicals

Saudi Arabian Fertilizer Company

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
SAFCO AB	SAR	185.25	175.00	Hold

Share price performance, 12-mo



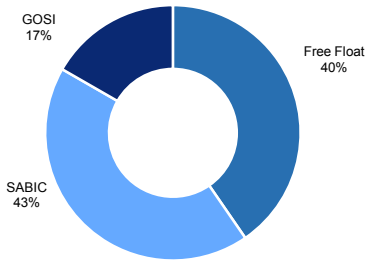
Company description

Saudi Arabian Fertilizer Company (Saudi Arabia) – A pure play urea fertilizer company operating in Saudi Arabia.

Company website

http://www.safco.com.sa

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 4 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	250.0	250.0	250.0	250.0	250.0	250.0
Avg market cap	34,748	44,610	46,313	46,313	46,313	46,313
EV	32,844	41,509	42,370	41,268	40,289	39,287
Ratios & analysis						
P/E, x	11.9x	10.9x	12.3x	14.2x	13.4x	13.3x
EV/EBITDA, x	11.4x	10.4x	11.1x	12.5x	11.6x	11.3x
P/B, x	4.9x	5.4x	5.0x	4.6x	4.2x	3.9x
Dividend yield (ords), %	2.1%	2.2%	2.1%	2.3%	2.2%	2.2%
EPS	11.73	16.44	15.11	13.06	13.86	13.92
CFPS	9.22	16.46	15.25	14.72	14.85	15.00
Free CFPS	9.85	14.61	13.30	12.86	12.96	13.11
DPS (ords)	2.99	3.94	3.85	4.24	4.13	4.14
Payout ratio (ords), %	25.5%	24.0%	25.4%	32.5%	29.8%	29.7%
BPS	28.54	32.84	36.92	40.45	44.19	47.95
Revenues growth, %	38%	33%	5%	-10%	4%	-
EPS growth, %	69%	40%	-8%	-14%	6%	0%
EBITDA margin, %	75.7%	79.0%	72.1%	69.0%	70.1%	70.1%
Net margin, %	77.4%	81.4%	71.1%	68.4%	69.9%	70.2%
ROE, %	41.1%	50.1%	40.9%	32.3%	31.4%	29.0%
ROIC, %	52.8%	75.8%	70.4%	64.4%	70.3%	72.9%
Capex/Revenues, %	-7%	4%	4%	4%	4%	4%
Capex/Depreciation, x	(1.1x)	0.6x	0.7x	0.6x	0.7x	0.7x
Net debt/Equity, %	-27%	-38%	-43%	-50%	-55%	-59%
Net debt/EBITDA, x	(0.7x)	(0.8x)	(1.0x)	(1.5x)	(1.7x)	(2.0x)
Net interest cover, x	n/a	n/a	n/a	n/a	n/a	n/a
Income statement summary						
Revenues	3,789	5,051	5,312	4,771	4,957	4,957
Cost of sales	(852)	(972)	(1,387)	(1,396)	(1,393)	(1,393)
SG&A and other opexp.	(68)	(89)	(93)	(84)	(87)	(87)
EBITDA	2,869	3,990	3,832	3,291	3,477	3,477
Depreciation & amortization	(247)	(314)	(322)	(304)	(287)	(272)
Operating profit	2,622	3,677	3,510	2,987	3,190	3,205
Non-operating gains /(exp.)	371	511	340	340	340	340
EBIT	2,622	3,677	3,510	2,987	3,190	3,205
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	2,993	4,188	3,850	3,327	3,530	3,545
Income tax	(61)	(78)	(72)	(62)	(66)	(66)
Minority interests	-	-	-	-	-	-
VTBC Net income	2,932	4,110	3,779	3,265	3,465	3,479
Cash flow statement summary						
Cash flow from operations	2,304	4,114	3,813	3,681	3,713	3,751
Working capital changes	(610)	(59)	(288)	111	(38)	-
Capex	264	(201)	(212)	(191)	(198)	(198)
Other investing activities	210	284	(66)	(69)	(73)	(76)
Free cash flow	2,462	3,653	3,326	3,215	3,240	3,278
Share issue (reacquisition)	-	-	-	-	-	-
Dividends paid	(3,250)	(3,000)	(2,758)	(2,384)	(2,529)	(2,540)
Net change in borrowings	(237)	(193)	-	-	-	-
Other financing cash flow	-	-	-	-	-	-
Movement in cash	(709)	1,005	841	1,102	978	1,002
Balance sheet summary						
Cash and equivalents	2,256	3,261	4,102	5,205	6,183	7,185
PP&E	3,243	3,195	3,020	2,842	2,688	2,549
Goodwill	147	85	85	85	85	85
Investments	1,269	1,319	1,385	1,454	1,527	1,603
Other assets	1,463	1,466	1,777	1,618	1,673	1,673
Total assets	8,379	9,326	10,369	11,204	12,155	13,095
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	892	956	979	932	948	948
Total liabilities	1,245	1,116	1,139	1,092	1,108	1,108
Total shareholder's equity	7,134	8,210	9,230	10,112	11,047	11,987
Minority interest	-	-	-	-	-	-
Net working capital	926	806	1,094	983	1,021	1,021
Net Debt	(1,903)	(3,101)	(3,942)	(5,045)	(6,023)	(7,025)
Capital	8,398	9,135	9,820	10,522	11,307	12,182

Company profile

Saudi Fertilisers Company (SAFCO) is one of the largest global producers of urea and ammonia with an installed capacity of c.2.7mmt of urea and 2.1mmt of ammonia. SABIC has a 43% ownership in SAFCO and GOSI owns close to 17%. The remaining 40% is owned by various other investors.

SAFCO manufactures urea and ammonia, both of which are nitrogen-based fertilisers. Fertilisers are synthetic nutrients vital for agriculture, as they provide soil with nutrients such as nitrogen, potassium, phosphorus etc, which get depleted due to repeated farming on a piece of land. Fertilisers are one of the most effective methods of increasing agricultural yields and are widely used. The most commonly used fertilisers are ammonia, urea, potash, calcium ammonium nitrate, DAP etc.

Products

Ammonia. Ammonia is a commonly used nutrient and is also important as a feedstock for the production of other nitrogenous fertilisers such as urea. Ammonia manufactured by SAFCO is primarily used for the production of Urea, Phosphatic/Compound/Liquid fertilisers and Melamine. Any excess is sold in the international markets.

The primary target market is Asia, and it accounts for 80% of SAFCO's ammonia sales, while Africa, America and Australia make up for the rest of the ammonia sales.

Urea. Urea, derived from ammonia is the most popular nitrogen fertiliser and is water soluble. While it is used as an important feedstock in the chemicals industry, the primary use of urea remains as a fertiliser. Close to 13% of the production is sold in GCC markets, while Asia accounts for 34% of sales. North America, Australia and Africa account for the remaining 53% of sales.

Figure 154: Capacity and production assumptions

	Installed Capacity (ktpa)			Production (ktpa)		
	2012F	2013F	2014F	2012F	2013F	2014F
Urea	2,700	2,700	2,700	2,835	2,835	2,835
Ammonia	2,020	2,020	2,020	2,121	2,121	2,121

Source: VTB Capital Research

Industry structure is distorted by subsidies

Global urea production is in the order of 145mtpa, of which less than 45mtpa is actually traded. Furthermore, in several large importing markets, such as India, the government provides a subsidy for urea production. Hence, the marginal sites' operating rates are not a function of the cash-cost curve. Furthermore, China, which operates a dual tariff regime on exports, has the potential to be a large swing factor either way and the export tariffs are more important than simple cash cost positioning.

Upside risk in short term but medium term outlook is hazy

Urea price cap moves higher with corn futures. The cap on urea prices is placed by the cost benefit analysis of marginal application. Higher corn prices imply a higher potential return (beyond optimum application levels), increasing urea demand and providing a fillip to urea prices. With Dec,12 corn futures at USD 7.97/bu, the cap on urea prices has moved up to USD 688/tonne. While a cap does not necessarily imply that the prices will be realised, it does provide an element of upside risk.

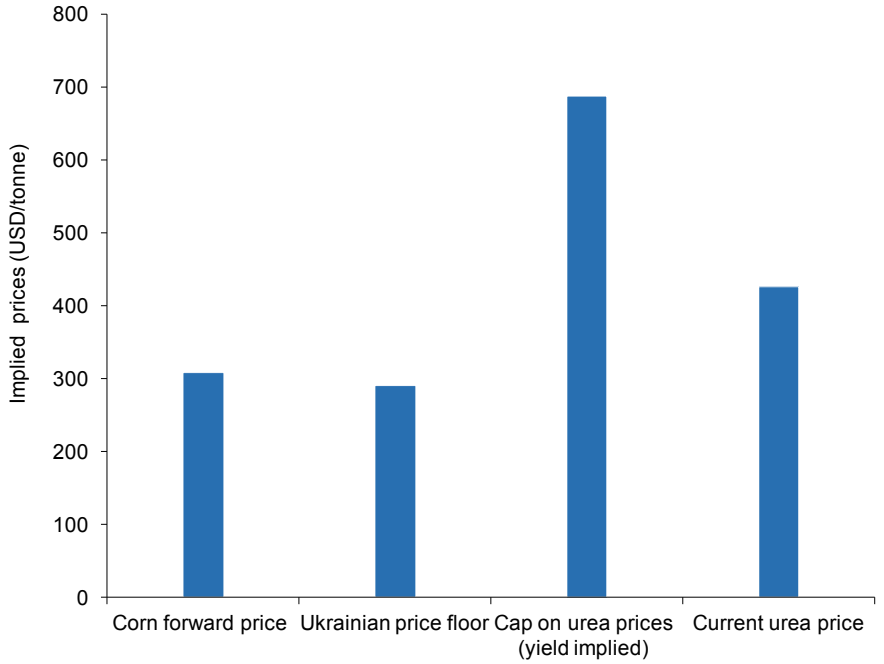
Marginal producers' cost offers some relief. Ukraine is arguably the marginal urea producer and hence a key price setter. We believe the marginal producers' urea floor price is set to be pushed USD 40/tonne lower due to domestic consolidation and Ukraine's benign relation with Russia. The domestic industry is becoming increasingly consolidated under Group DF, which controls over c.73% of domestic ammonia capacity and c.60% of domestic urea capacity. Ukraine has also developed a more benign relationship with Russia, which allows it to secure potentially cheaper natural gas supplies from Gazprom.

Figure 155: Major Ukranian producers of urea

Plant	Ammonia (ktpa)	Urea (ktpa)	Acquisition date	Held by
OPZ Odessa	900	720	Not yet acquired	Govt of Ukraine
Dniproazot	500	700	Not yet acquired	Privat group
Rivneazot	600		Legacy Ostchem holding	Group DF
Stirol	1,500	1,000	September, 2010	Group DF
Cherkassy	630	650	March, 2011	Group DF
Severodonetsk	1,000	500	February, 2011	Group DF
Total	5,130	3,570		
Share of Group DF	73%	60%		

Source: Company data, VTB Capital Research

Figure 156: Urea price – Trading range



Source: VTB Capital Research

Earnings profile highlights

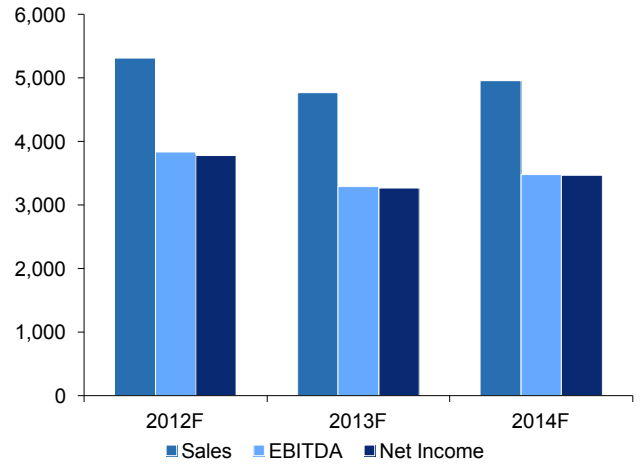
Revenues. We are forecasting revenues of SAR 5.3 billion in 2012F. We expect revenues to decline c10% in 2013F, before stabilising at SAR 4.95 billion from 2014F. The 2013F decline is primarily predicated upon falling urea prices with new supply from OCI and IQ leading to supply side pressures. If the current grain demand supply gap persists, we might need to revisit our estimates in near future.

EBITDA. We expect EBITDA of SAR 3.8 billion for 2012F and long term normalised EBITDA at SAR 3.47bn. We expect EBITDA to reduce by 14.1% in 2013F due to lower forecast prices of urea and ammonia in 2013F. We estimate EBITDA margins falling from current levels of 72.1% to 69% in 2013F due to margin pressures induced by falling prices.

Debt. Safco is a cash positive company and finished 2011 with a cash positive position of SAR 3.1bn. SAFCO has a highly robust balance sheet position, with expected 2012F cash of SAR 4.1 billion against a total debt of SAR 160 million for 2012F. Out of this, we expect long term debt and short term debt to be equal at SAR 80 m. With near term demands on capex likely to be limited (even with the recently announced urea plant) we see little scope for significant cash expenditure. With no near term visibility on capital expenditures for capacity expansion, we expect to see a continued strong stream of dividend payments in the short term.

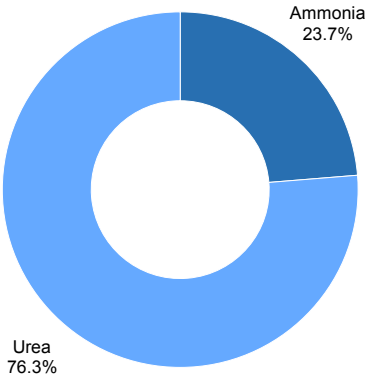
Cash flow. We believe 2012F cash earnings to come at SAR 3.8bn with operating cash flow for 2012F estimated at SAR 3.88bn. At current prices, the equity free cash flow yield for 2012F is estimate at 7%. We see enterprise free cash flow yields at 8% and considering the low book value of historical assets, the return on invested capital at 78% in 2012F and minimum forecast ROIC at 71% in 2013F.

Figure 157: Key Forecasts (in SAR mn)



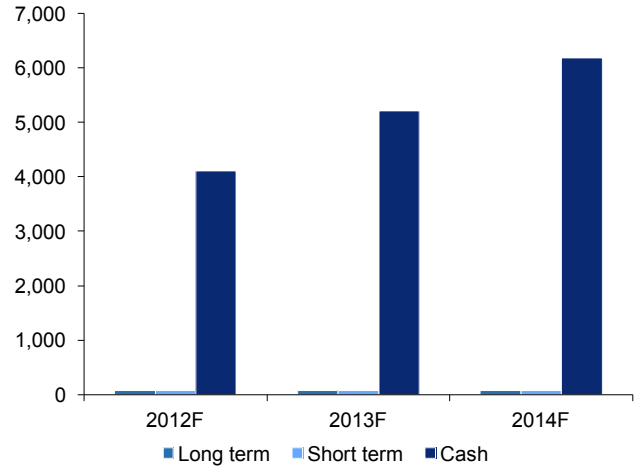
Source: VTB Capital Research

Figure 158: EBITDA Composition (2012F)



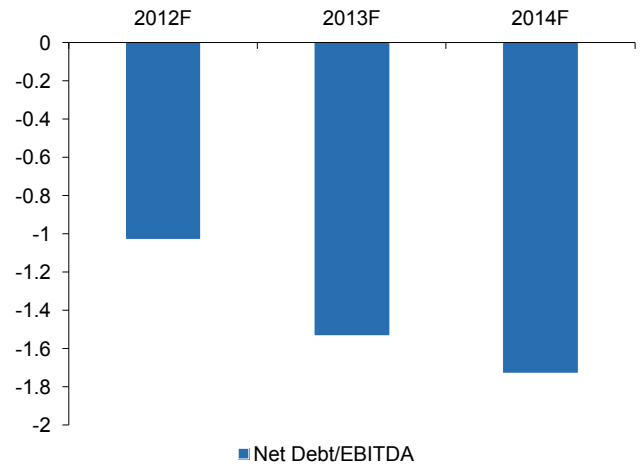
Source: VTB Capital Research

Figure 159: Debt (in SAR mn)



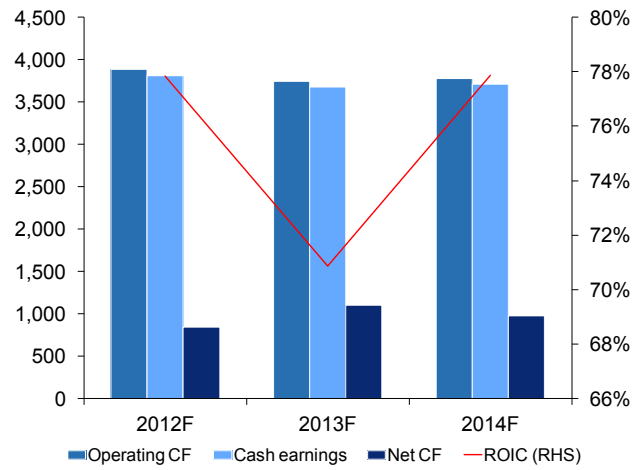
Source: VTB Capital Research

Figure 160: Debt Service Ratios



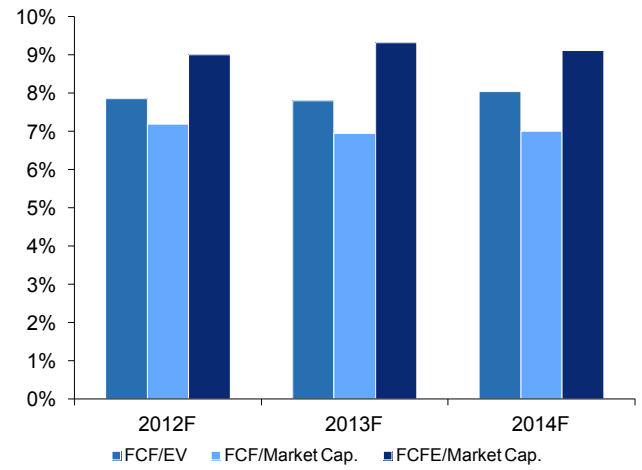
Source: VTB Capital Research

Figure 161: Cash Flows (in SAR mn)



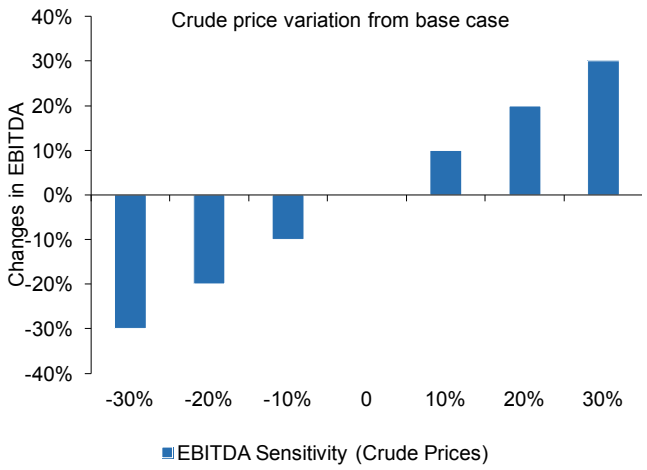
Source: VTB Capital Research

Figure 162: FCF and FCFE Yields



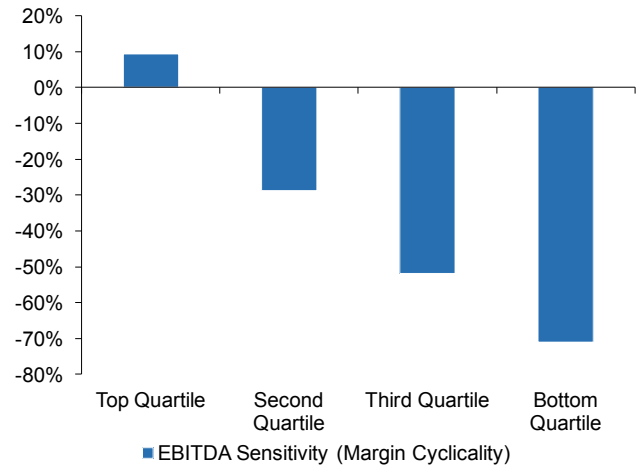
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 163: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 164: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 165: Income Statement
(Figures in SAR mn, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	5,051	5,312	4,771	4,957	4,957
EBITDA	3,990	3,832	3,291	3,477	3,477
D&A	314	322	304	287	272
EBIT	3,677	3,510	2,987	3,190	3,205
Finance Costs	-	-	-	-	-
Other income (expense)	511	340	340	340	340
PBT	4,188	3,850	3,327	3,530	3,545
Taxes	78	72	62	66	66
Effective tax rate (%)	0	0	0	0	0
Net income before minorities	4,110	3,779	3,265	3,465	3,479
Share of minorities	-	-	-	-	-
Gains/(losses)/(deconsolidation)/ Discontinued income	-	-	-	-	-
Net income	4,110	3,779	3,265	3,465	3,479
Adjusted net income (pre-exceptionals)	4,110	3,779	3,265	3,465	3,479
Number of shares (mn)	250	250	250	250	250
EPS	16.4	15.1	13.1	13.9	13.9
Adjusted EPS (pre-exceps)	16.4	15.1	13.1	13.9	13.9
DPS	12.0	11.0	9.5	10.1	10.2
Payout ratio (%)	73%	73%	73%	73%	73%

Source: Company data, VTB Capital Research

Figure 166: Balance Sheet
(Figures in SAR mn, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	3,195	3,020	2,842	2,688	2,549
Intangibles	85	85	85	85	85
Investments	1,319	1,385	1,454	1,527	1,603
Other	19	19	19	19	19
Total non-current assets	4,618	4,509	4,400	4,319	4,256
Cash	3,261	4,102	5,205	6,183	7,185
Accounts receivable	875	921	827	859	859
Inventories	372	637	573	595	595
Other	199	199	199	199	199
Total current assets	4,708	5,860	6,804	7,837	8,839
TOTAL ASSETS	9,326	10,369	11,204	12,155	13,095
Debt	80	80	80	80	80
Accounts payable	441	464	417	433	433
Other	-	-	-	-	-
Total current liabilities	521	544	497	513	513
Debt	80	80	80	80	80
Other	515	515	515	515	515
Total non-current liabilities	595	595	595	595	595
Minorities	-	-	-	-	-
Shareholders' Equity	8,210	9,230	10,112	11,047	11,987
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**9,326**	**10,369**	**11,204**	**12,155**	**13,095**

Source: Company data, VTB Capital Research

Figure 167: Cash Flow Statement
(Figures in SAR mn, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	3,990	3,832	3,291	3,477	3,477
Working capital change	(59)	(288)	111	(38)	-
Other	260	340	340	340	340
Cash earnings ex zakat and interest	4,192	3,884	3,743	3,779	3,817
Tax paid	(78)	(72)	(62)	(66)	(66)
Net interest paid	-	-	-	-	-
Operating cash flow	4,114	3,813	3,681	3,713	3,751
CAPEX	(201)	(212)	(191)	(198)	(198)
Intangibles	-	-	-	-	-
Acquisitions (net of disposals)	-	65	65	65	65
Other	284	(66)	(69)	(73)	(76)
Cash flow before financing	4,198	3,600	3,486	3,508	3,542
Financing cash flows	(3,193)	(2,758)	(2,384)	(2,529)	(2,540)
Net borrowing	(193)	-	-	-	-
New equity	-	-	-	-	-
Dividends	(3,000)	(2,758)	(2,384)	(2,529)	(2,540)
Other	-	-	-	-	-
Net Cash Flow	1,005	841	1,102	978	1,002

Source: Company data, VTB Capital Research

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Initiation of coverage

Saudi Kayan Petrochemical Company

Least favoured stock in our universe

SELL

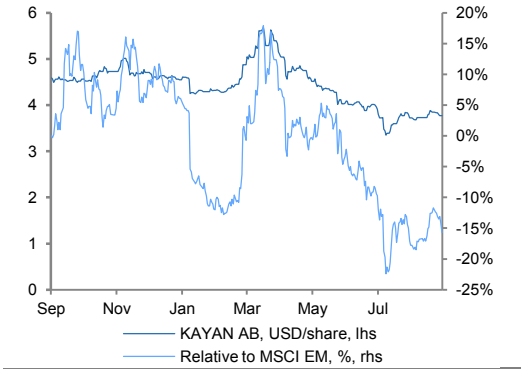
Primary ticker: KAYAN AB

Currency: SAR

Stock Data

Last price	14.15
Last price date	05 Sep 2012
Target price	9.10
Target price established	12 Sep 2012
Upside/(downside), %	-36%
52 week price range	12.55 - 21.30
Market cap, USD / SAR mn	5,660 / 21,225
EV, USD / SAR mn	12,882 / 48,310
# shares outstanding, mn	1,500
Free float	35%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	1.4%	-7%	-18%	-1%
Price relative	1.6%	-13%	-14%	-10%
ADTV (USD mn)	6.31	12.34	44.46	62.07

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	neg	38.9x	16.0x	12.7x
EV/EBITDA, x	n/m	14.6x	11.5x	10.1x
P/B, x	1.8x	1.3x	1.3x	1.2x
FCF yield, %	-20.0%	13.4%	16.4%	18.9%
DY (ords), %	-	-	1.2%	1.6%
Net sales	2,403	11,392	12,643	12,666
EBITDA	396	3,304	3,986	4,254
Net income	(250)	546	1,323	1,677
Net sales, chg	n/a	374%	11%	0%
EBITDA, chg	-2,877%	735%	21%	7%
Net income, chg	1,613%	-318%	142%	27%
EPS	(0.17)	0.36	0.88	1.12
DPS (ord.)	-	-	0.18	0.22
BPS	10.14	10.51	11.21	12.11
EBITDA margin, %	16.5%	29.0%	31.5%	33.6%
ROE, %	-2%	3%	8%	9%
Net Debt	29,041	27,085	24,743	21,936
ND/EBITDA, x	73.4x	8.2x	6.2x	5.2x
Net int. cover, x	(0.6x)	1.6x	2.6x	3.0x

Source: Bloomberg, Company data, VTB Capital Research

Saudi Kayan Petrochemical Company (Kayan) is a commodity petrochemical producer based in Jubail, Saudi Arabia. The company started commissioning its plants in late 2010 and we expect all units to be operational by 2013F. We are initiating coverage of Saudi Kayan with a Sell recommendation and TP of SAR 9.1.

Delays and more delays. With the original commissioning schedule delayed by more than 12 months and intermittent operations of newly commissioned units, we believe Kayan's project profile bears an elevated operational risk until commissioning of all units is completed. The risk is purely a function of the nature of a start-up and operating ramp-up risks.

Debt load onerous. With 2012F net debt to market cap hovering around 121%, the debt load is relatively high. Coupled with lower margin expectations, debt servicing abilities would also edge lower.

Valuations are full and more. We believe that any upside from current valuations would involve a structural improvement in sector cash margins and there are several other relatively attractive opportunities available in the sector without the risk profile of Kayan.

Consensus has been and continues to be in denial. We believe consensus and to some extent our margin assumptions are too upbeat and face severe rerating risks in the future. We believe the anamoly is caused by a flawed understanding of ploycarbonate cash margins, which are likely to be below 30%. Even while we have a Sell recommendation on Kayan, our assumptions are likely to be too upbeat and there is a distinct possibility of further downside to both our earnings and valuation.

Financing rates to edge higher impacting bottom line. The original debt profile (at the IPO time) had repayments starting up in 2012. With Kayan incurring operating losses in Q2 and operational stability far from given, we believe the refinancing represents a risk of escalation in financing costs.

Visibility on total debt load is still unclear. With payments tied to project milestones and LDPE commissioning yet to commence, we believe the final debt load will only be visible by 2013F.

Valuation. We value Kayan via a multiples-based method with a generic sector 12m forward EV/EBITDA of 8.0x. Our normalised EBITDA estimate is SAR 4.2bn. Using a net debt assumption of SAR 25.5bn we arrive at a Target Price of SAR 9.1. Kayan trades at a 2013F P/E of 16x against peers at 11.7x. On 2013F EV/EBITDA, the company trades at 11.5x against peers at 6.2x. We believe the market has not yet grasped the extent of cost overruns in the project and their effect on equity valuation. We believe that once the plant delivers a full quarter of design performance, the visibility of operational earnings would present a potential downside risk to current valuations.

Risks. Key downside risks relate to the start-up of the LDPE plant and achieving stable operating rates across the process stream.

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VTB Capital Facts & Forecasts

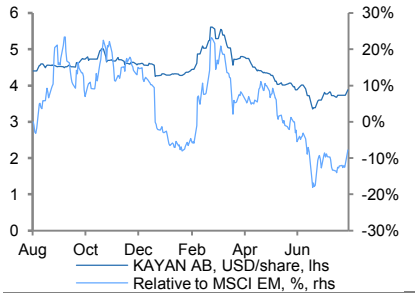
Company country & sectors
Materials / Commodity Chemicals

Saudi Kayan

Prices as of: 5 September 2012

Tickers	CCY	Current	12mo TP	Rating
KAYAN AB	SAR	14.15	9.10	Sell

Share price performance, 12-mo



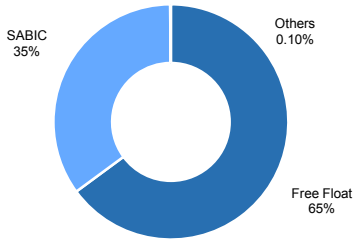
Company description

Saudi Kayan (Saudi Arabia) – A Saudi commodity chemical manufacturer producing a range of aliphatic and aromatic products along with specialized polycarbonates.

Company website

http://www.saudikayan.com

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 11 September 2012

IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	1,500	1,500	1,500	1,500	1,500	1,500
Avg market cap	27,704	26,781	21,225	21,225	21,225	21,225
EV	52,826	55,822	48,310	45,968	43,161	40,379
Ratios & analysis						
P/E, x	neg	neg	38.9x	16.0x	12.7x	12.3x
EV/EBITDA, x	neg	n/m	14.6x	11.5x	10.1x	9.5x
P/B, x	1.8x	1.8x	1.3x	1.3x	1.2x	1.1x
Dividend yield (ords), %	-	-	-	1.2%	1.6%	1.6%
EPS	(0.0097)	(0.17)	0.36	0.88	1.12	1.15
CFPS	(1.84)	(1.41)	1.46	1.82	2.26	2.25
Free CFPS	(4.99)	(3.57)	1.89	2.32	2.67	2.66
DPS (ords)	-	-	-	0.18	0.22	0.23
Payout ratio (ords), %	-	-	-	20.0%	20.0%	20.0%
BPS	10.31	10.14	10.51	11.21	12.11	13.03
Revenues growth, %	n/m	n/m	374%	11%	0%	-
EPS growth, %	-14%	1,613%	-318%	142%	27%	3%
EBITDA margin, %	n/a	16.5%	29.0%	31.5%	33.6%	33.4%
Net margin, %	n/a	-10.4%	4.8%	10.5%	13.2%	13.6%
ROE, %	-0.1%	-1.6%	3.5%	7.9%	9.2%	8.8%
ROIC, %	0.0%	-0.3%	3.5%	5.5%	6.6%	7.0%
Capex/Revenues, %	n/a	61%	54%	31%	27%	11%
Capex/Depreciation, x	n/a	3.2x	3.3x	2.2x	2.0x	0.8x
Net debt/Equity, %	162%	191%	172%	147%	121%	98%
Net debt/EBITDA, x	(1,763.5x)	73.4x	8.2x	6.2x	5.2x	4.5x
Net interest cover, x	n/a	(0.6x)	1.6x	2.6x	3.0x	3.2x
Income statement summary						
Revenues	-	2,403	11,392	12,643	12,666	12,666
Cost of sales	-	(1,908)	(7,616)	(8,133)	(7,887)	(7,910)
SG&A and other opexp.	(14)	(100)	(472)	(524)	(525)	(525)
EBITDA	(14)	396	3,304	3,986	4,254	4,232
Depreciation & amortization	-	(463)	(1,874)	(1,792)	(1,715)	(1,642)
Operating profit	(14)	(67)	1,430	2,193	2,539	2,589
Non-operating gains /(exp.)	-	(5)	(8)	(14)	(24)	(42)
EBIT	(14)	(67)	1,430	2,193	2,539	2,589
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	(14)	(176)	546	1,323	1,677	1,728
Income tax	0	(74)	-	-	-	-
Minority interests	-	-	-	-	-	-
VTBC Net income	(15)	(250)	546	1,323	1,677	1,728
Cash flow statement summary						
Cash flow from operations	(2,758)	(2,110)	2,184	2,725	3,396	3,381
Working capital changes	(1,748)	(2,616)	(236)	(389)	3	11
Capex	(1,189)	(1,470)	(6,206)	(3,959)	(3,407)	(1,390)
Other investing activities	-	-	-	-	-	-
Free cash flow	(7,485)	(5,352)	2,840	3,477	4,005	3,989
Share issue (reacquisition)	-	-	-	-	-	-
Dividends paid	-	-	-	(265)	(335)	(346)
Net change in borrowings	6,976	3,421	(634)	(629)	(624)	(620)
Other financing cash flow	-	-	-	-	-	-
Movement in cash	(1,505)	(1,746)	1,322	1,712	2,182	2,162
Balance sheet summary						
Cash and equivalents	967	469	1,791	3,503	5,686	7,848
PP&E	40,557	37,363	35,717	34,178	32,716	31,327
Goodwill	-	134	134	-	-	-
Investments	-	4,159	4,159	4,159	4,159	4,159
Other assets	1,950	4,564	4,950	5,461	5,482	5,493
Total assets	43,474	46,689	46,751	47,301	48,043	48,827
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	1,922	1,966	2,117	2,238	2,262	2,285
Total liabilities	28,012	31,477	30,992	30,485	29,885	29,287
Total shareholder's equity	15,463	15,212	15,758	16,816	18,158	19,540
Minority interest	-	-	-	-	-	-
Net working capital	1,654	3,388	3,645	4,046	4,053	4,053
Net Debt	25,122	29,041	27,085	24,743	21,936	19,154
Capital	16,726	16,137	16,348	17,226	18,418	19,735

Company profile

Saudi Kayan petrochemical company, also referred to as Kayan, was established in 2005, with a paid-up capital of SAR 12bn. Kayan produces ethylene and propylene derivative compounds as well as aromatics. The plant is located at the Jubail industrial site in Saudi Arabia and commenced commercial production in 3Q11.

Saudi Kayan is a JV between SABIC and Al Kayan Petrochemical Company. The effective free float is 35%. Kayan professes to have state of the art and well proven technological design with licenses and contracting works awarded to well known domain operators.

Figure 168: Licensing and Contractors

Production Unit	License/Contracting
Olefins	KBR
Benzene	Axens
HDPE	Basell
LDPE	Basell
EO/EG	SABIC/Scientific Design
Polypropylene	Basell
Acetone recycling	Mitsui
Polycarbonate	Asahi

Source: Company data

Figure 169: Production technology

Products	Production technology
Methyl amine	Davy
DMF	Davy
Ethanol amine	Oxiteno
Choline chloride	Balchem
Ethoxylates	Oxiteno
Phenol/Acetone	KBR
Bisphenol A	Badger Shaw
Cumene	Badger

Source: Company data

Figure 170: Capacity and production assumptions

	Installed capacity (ktpa)			Production (ktpa)		
	2012F	2013F	2014F	2012F	2013F	2014F
Polypropylene	350	350	350	280	280	280
HDPE	400	400	400	360	360	360
LDPE	300	300	300	0	150	300
MEG	650	650	550	650	650	550
Polycarbonate	260	260	260	234	234	234
Acetone	150	150	150	80	80	80
Ethanolamine	109	109	109	90	90	90
Dimethyl formamide	50	50	50	45	45	45
Choline chloride	20	20	20	18	18	18

Source: VTB Capital Research

Project financing: Delays and Overruns

The original project cost estimate at the time of the IPO and the source of funds are as detailed below. However, the debt load went from an anticipated SAR 22.5bn to SAR 29bn in 2011 due to cost over-runs. All funding tranches, except for SIDF, were to receive payments starting June 2011. However, delays and a pushback on the start-up schedule have moved repayments by 12 months. Even so, the annual debt repayment requirements are likely to be in excess of SAR 1.8bn and account for c.54% of medium-term EBITDA (2014F) ex financing costs. Under such an operating requirement, we expect a dividend payout is an unlikely possibility for an extended period of time.

Figure 171: Original cost schedule (in bn SAR)

	Cost
EPC	29.8
Development Cost	2.9
Financing Costs	2.3
Primary Working Capital	2
Debt Service Reserves	0.5
Total	37.5

Source: Company data

Figure 172: Sources of funds (in bn SAR)

Source	Funds
Equity	15
Loans	22.5
Total	37.5

Source: Company data

Original debt terms

Public Investment fund facility (PIF). Commission is payable on drawn principal at LIBOR plus margin and repayable in 24 semi-annual equal instalments starting from June 2011.

Islamic facility. An SPV, Saudi Kayan Assets Leasing Company Limited, holds the Islamic financier's interest in the co-owned assets, which will be leased to the company at an annual rent of LIBOR plus margin until the project is completed. Under the forward lease agreement, Saudi Kayan will purchase the interests of the Islamic financier over a period of 12 years, starting from June 2011.

Commercial facility. The company has a commercial facility with a syndicate of banks, of which SAR 819mn has been withdrawn up to December 2008. Commission is payable on the principal drawn at LIBOR plus margin and repayable in 24 semi-annual unequal instalments over a period of 12 years, starting from June 2011.

Export credit agency facility. The company has entered into four ECA-based facilities, of which three are with a syndicate of banks and one is provided by an export credit agency on a direct funding basis. Repayment is in 24 unequal instalments on a semi-annual basis, commencing from June 2011. Commission is payable on loans drawn down calculated at LIBOR plus margin.

Islamic working capital facility. The company has entered into an Islamic finance facility to cater for working capital requirements.

SIDF. The principal is repayable in 14 unequal instalments on a semi-annual basis starting from 30 December 2012.

Earnings profile highlights

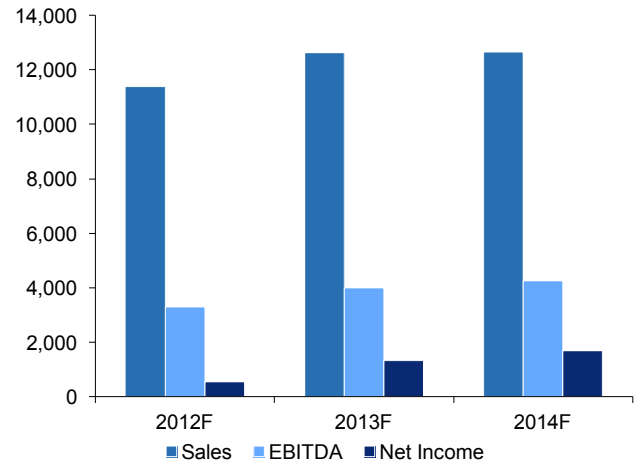
Revenues. Under our forecasts, revenues come in at SAR 11.4bn in 2012F, with revenues peaking at SAR 12.6bn in 2013F. The 11% jump in 2013F revenues is primarily on account of the LDPE plant start-up in 2013F and delays would present a risk to our estimates. We believe there are severe downside risks to the scheduled ramp up and our revenue forecasts

EBITDA. We expect 2012F EBITDA of SAR 3.3bn and long-term normalised EBITDA of SAR 4.2bn. Our cost estimates are conservative. We estimate an EBITDA margin of 29% for 2012F rising to 22.6% by 2014F on account of operational leverage and higher utilisation rates.

Debt. According to our calculations, net debt to falls from SAR 29.04bn (2011) to SAR 24.7bn by end-2013. While the financing environment might appear benign on account of low LIBOR levels, a severe reduction in operating rates could lead to EBITDA falling short of debt servicing and originally envisaged repayment requirements which would lead to refinancing and in all likelihood push up financing costs. Our interest cost assumption is 3% for 2012F, but is at the risk of being higher.

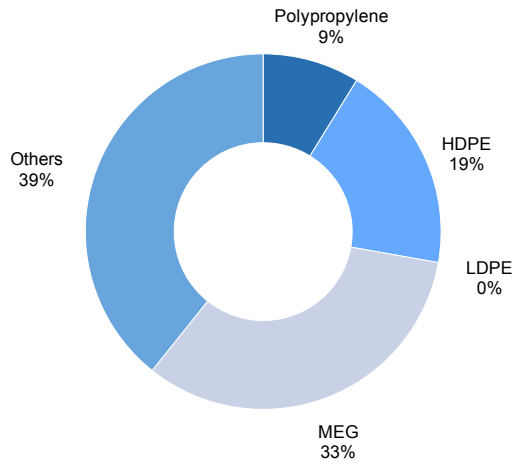
Cash flow. In our view, cash earnings will turn positive in 2012F at SAR 2.2bn, with complete commissioning and ramp up. At current prices, the equity free cash flow yield in 2013F is 25% (not discounted). The longer-term (2014F) stable equity free cash flow yields are in the order of 15% (not discounted). While these yields might seem attractive *prima facie*, they are underpinned by a high debt load. The ROIC of the assets in our longer term (2015F) stable cash flow scenario is at 7.2%.

Figure 173: Key Forecasts (in SAR mn)



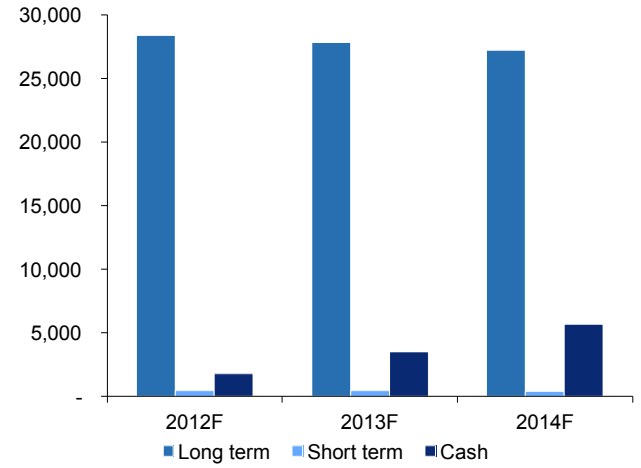
Source: VTB Capital Research

Figure 174: EBITDA Composition (2012F)



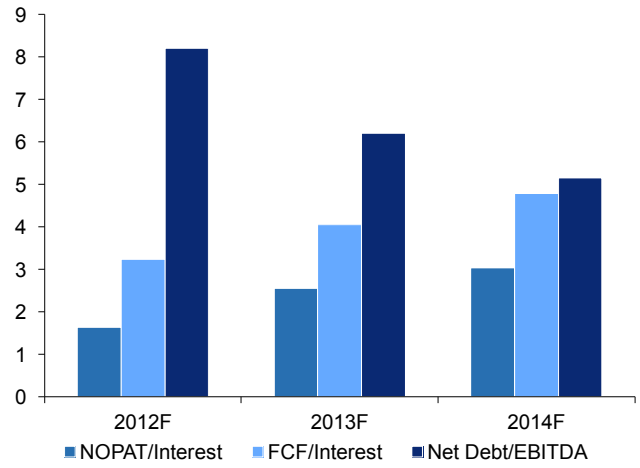
Source: VTB Capital Research

Figure 175: Debt (in SAR mn)



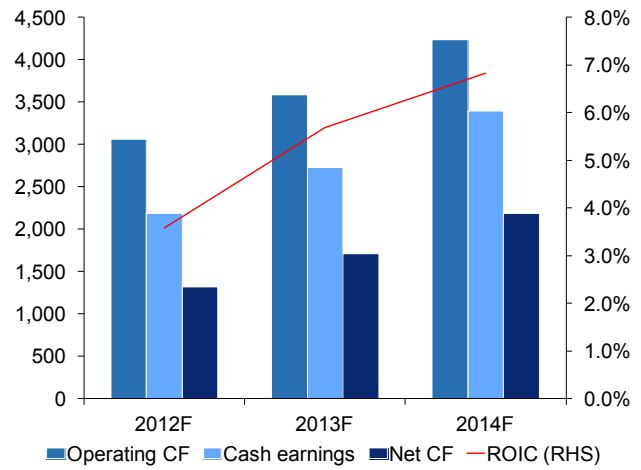
Source: VTB Capital Research

Figure 176: Debt Service Ratios



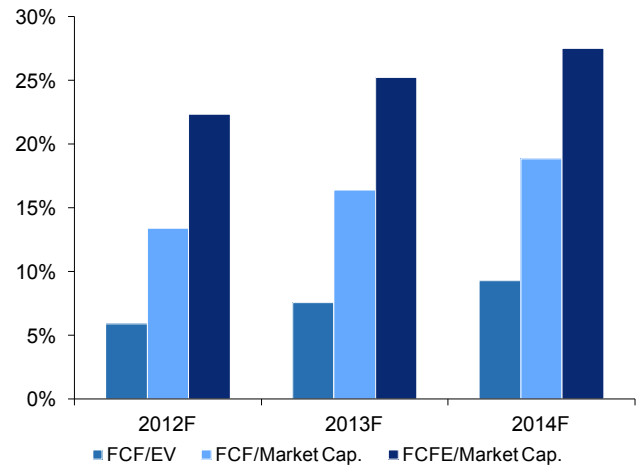
Source: VTB Capital Research

Figure 177: Cash Flows (in SAR mn)



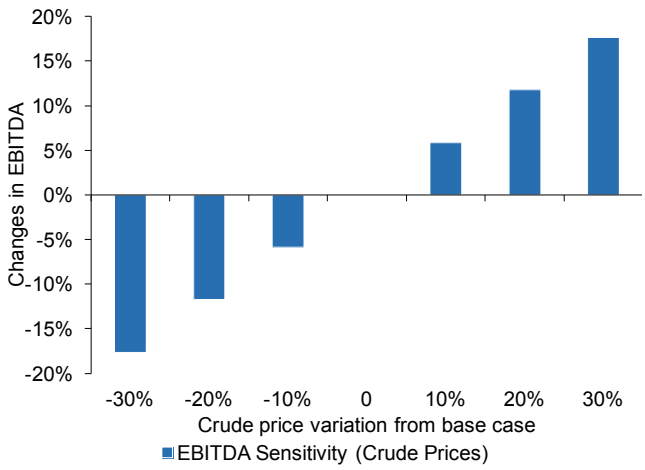
Source: VTB Capital Research

Figure 178: FCF and FCFE Yields



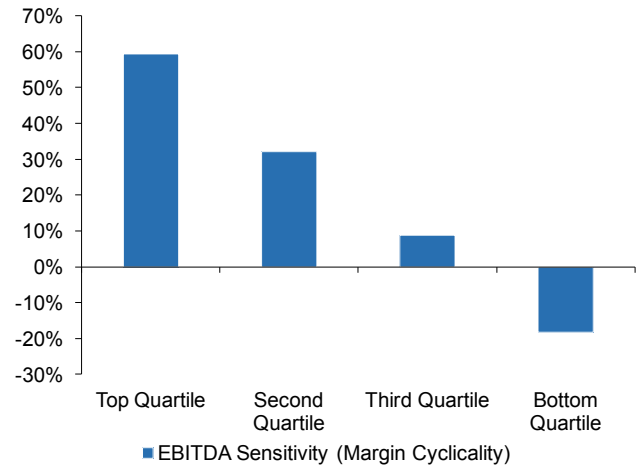
Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Figure 179: EBITDA Sensitivity (Brent Crude Prices)



Source: VTB Capital Research

Figure 180: EBITDA Sensitivity (Margin Cyclicality)



Source: VTB Capital Research

Financial Statements

Figure 181: Income Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	2,403,406	11,391,502	12,642,552	12,665,958	12,665,958
EBITDA	395,671	3,303,540	3,985,617	4,254,337	4,231,528
EBIT	(67,137)	1,429,688	2,193,439	2,539,115	2,589,401
Finance Income (Expense)	(113,172)	(875,789)	(856,836)	(838,033)	(819,366)
Other income (expense)	(4,527)	(7,922)	(13,864)	(24,262)	(42,458)
PBT	(175,782)	545,976	1,322,740	1,676,820	1,727,577
Taxes	(74,469)	-	-	-	-
Net income	(250,251)	545,976	1,322,740	1,676,820	1,727,577
Adjusted net income (pre-exceptionals)	(250,251)	545,976	1,322,740	1,676,820	1,727,577
Number of shares ('000)	1,500,000	1,500,000	1,500,000	1,500,000	1,500,000
EPS	(0.2)	0.4	0.9	1.1	1.2
Adjusted EPS (pre-exceps)	(0.2)	0.4	0.9	1.1	1.2
DPS	-	-	0.2	0.2	0.2
Payout ratio (%)	0%	0%	20%	20%	20%

Source: Company data, VTB Capital Research

Figure 182: Balance Sheet
(Figures in '000 SAR, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2012F	2013F	2014F	2015F
PP&E	35,717,118	34,177,792	32,715,889	31,327,080
Intangibles	133,550	-	-	-
Investments	4,159,006	4,159,006	4,159,006	4,159,006
Other	31,918	31,918	31,918	31,918
Total non-current assets	40,041,592	38,368,716	36,906,813	35,518,004
Cash	1,790,952	3,503,409	5,685,880	7,847,748
Accounts receivable	2,847,876	3,160,638	3,166,490	3,166,490
Inventories	1,708,725	1,896,383	1,899,894	1,899,894
Other	361,508	372,353	383,524	395,030
Total current assets	6,709,061	8,932,783	11,135,787	13,309,161
TOTAL ASSETS	46,750,653	47,301,499	48,042,599	48,827,165
Debt	476,649	428,984	386,086	347,477
Accounts payable	911,320	1,011,404	1,013,277	1,013,277
Other	1,085,895	1,107,613	1,129,765	1,152,361
Total current liabilities	2,473,864	2,548,001	2,529,128	2,513,114
Debt	28,399,112	27,817,629	27,236,147	26,654,664
Other	119,399	119,399	119,399	119,399
Total non-current liabilities	28,518,511	27,937,028	27,355,546	26,774,063
Shareholders' Equity	15,758,278	16,816,470	18,157,926	19,539,987
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**46,750,653**	**47,301,499**	**48,042,599**	**48,827,165**

Source: Company data, VTB Capital Research

Figure 183: Cash Flow Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	395,671	3,303,540	3,985,617	4,254,337	4,231,528
Working capital change	(2,616,435)	(235,799)	(389,463)	3,492	11,090
Other	264,112	(7,922)	(13,864)	(24,262)	(42,458)
Cash earnings ex zakat and minorities	(1,956,652)	3,059,819	3,582,290	4,233,567	4,200,160
Zakat	(377)	-	-	-	-
Net interest paid	(152,919)	(875,789)	(856,836)	(838,033)	(819,366)
Operating cash flow	(2,109,948)	2,184,030	2,725,454	3,395,534	3,380,794
CAPEX	(2,324)	(227,830)	(252,851)	(253,319)	(253,319)
Intangibles	(3,092)	-	133,550	-	-
Acquisitions (net of disposals)	(3,051,162)	-	-	-	-
Cash flow before financing	(5,166,526)	1,956,200	2,606,153	3,142,215	3,127,475
Financing cash flows	3,420,777	(634,443)	(893,695)	(959,745)	(965,606)
Net borrowing	3,420,777	(634,443)	(629,147)	(624,381)	(620,091)
Dividends	-	-	(264,548)	(335,364)	(345,515)
Net Cash Flow	(1,745,749)	1,321,757	1,712,458	2,182,470	2,161,868

Source: Company data, VTB Capital Research

Initiation of coverage

Saudi Arabian Mining Company

Cost overruns might dilute returns on equity

SELL

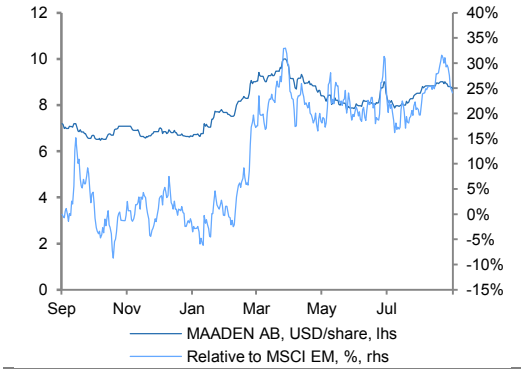
Primary ticker: MAADEN AB

Currency: SAR

Stock Data

Last price	32.70
Last price date	09 Sep 2012
Target price	28.00
Target price established	10 Sep 2012
Upside/(downside), %	-14%
52 week price range	24.25 - 37.50
Market cap, USD / SAR mn	8,066 / 30,248
EV, USD / SAR mn	14,798 / 55,497
# shares outstanding, mn	925
Free float	33%
Benchmark Index (MXEF)	939.51

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	2.5%	11%	21%	114%
Price relative	2.7%	4%	26%	94%
ADTV (USD mn)	3.94	5.53	11.19	23.49

Key financial highlights

Fiscal year end	12/11	12/12F	12/13F	12/14F
P/E, x	56.9x	19.6x	14.3x	10.6x
EV/EBITDA, x	50.9x	17.8x	13.6x	10.8x
P/B, x	1.2x	1.4x	1.2x	1.1x
FCF yield, %	-17.3%	-14.8%	-6.2%	8.0%
DY (ords), %	-	-	-	-
Net sales	1,514	4,776	6,506	8,872
EBITDA	861	3,122	4,261	5,183
Net income	413	1,546	2,116	2,860
Net sales, chg	114%	215%	36%	36%
EBITDA, chg	394%	262%	36%	22%
Net income, chg	-4,599%	274%	37%	35%
EPS	0.45	1.67	2.29	3.09
DPS (ord.)	-	-	-	-
BPS	21.50	23.68	26.72	30.86
EBITDA margin, %	56.9%	65.4%	65.5%	58.4%
ROE, %	2%	8%	10%	12%
Net Debt	14,624	19,525	21,992	19,776
ND/EBITDA, x	17.0x	6.3x	5.2x	3.8x
Net int. cover, x	58.7x	6.6x	6.8x	22.3x

Source: Bloomberg, Company data, VTB Capital Research

Saudi Arabian Mining Company (Maaden) is a mineral exploration company that explores and develops the non-oil resources of Saudi Arabia and enjoys strong state backing (50% owned directly by PIF, an entity belonging to Ministry of Finance). From its historical presence in Gold mining, the company is diversifying into DAP production (2012) and aluminium (production slated for 2014 in our estimates). The presence in these segments is a result of efforts at vertically integrated downstream development of upstream resources of the phosrock deposits from Jalamid and the bauxite reserves of Az Zabirah. We are initiating coverage of Maaden with a Sell recommendation and TP of SAR 28. We expect capex overruns to dilute returns for equity shareholders.

A quasi pure phosphate fertiliser play. We estimate the phosphate segment to contribute to 88% of company's equity valuation and consider the company to be primarily a phosphate fertiliser play.

Best in class cash cost positioning across all segments. Except for gold, where we estimate Maaden's competitiveness to be in the top quartile, cash cost competitiveness in both phosphate and aluminium is in the top decile.

Strong sovereign support. The Ministry of Finance – through its undertaking, the PIF – exercises control over 50% of Maaden's equity. In addition, it has also provided 33% of the total committed debt funding for Maaden (on very attractive terms at sub 100bp spreads to LIBOR). The PIF has constructed enabling infrastructure (railway to transfer ore to processing facilities, port at Ras Al Khair for shipments) for Maaden.

Cost overruns a concern. The initial cost estimate for the phosphate project was USD 3.1bn (2008) and we estimate cost overruns at north of 40% of original estimates. With the scope of the aluminium project initially projected at USD 6.74bn (2008), the cost overruns are likely to dampen equity returns.

Valuation. We value Maaden via a multiples-based method with a generic sector 12m forward EV/EBITDA of 8.0x. We utilize a 5% discount to arrive at a benchmark 12m forward EV/EBITDA of 7.6x. The discount essentially reflects the sector multiple divergence across fertilizers, aluminium and gold segments weighed on an EBITDA basis. Our normalised EBITDA estimate is SAR 6.3bn. Using a net debt assumption of SAR 19.5bn and a minorities value estimate of SAR 5.3bn, we arrive at a fair value based Target Price of SAR 7.3. Excluding a net debt of SAR 19.5bn, which is likely to be potentially higher and minorities' stake of SAR 5.3bn, we arrive at a Target Price of SAR 28. Maaden trades at a 2013F P/E of 14.3x against peers at 9.4x. On 2013F EV/EBITDA, the company trades at 13.6x against peers at 5.8. The extent of apparent overvaluation is a function of the slow ramp-up of the DAP plant (2014F) in our estimates, the longer dated aluminium project schedule (2015F) and the lack of full earnings in 2013F from these major projects.

Risk. We see risks around high silica content and poor ore quality for the phase 2 bauxite refinery as undesirable. We see cost overruns at the Aluminium project as a major execution risk.

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VTB Capital Facts & Forecasts

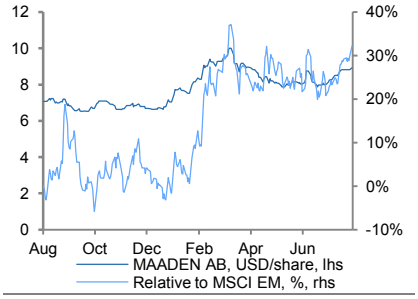
Company country & sectors
Materials / Commodity Chemicals

Saudi Arabian Mining Company

Prices as of: 9 September 2012

Tickers	CCY	Current	12mo TP	Rating
MAADEN AB	SAR	32.70	28.00	Sell

Share price performance, 12-mo



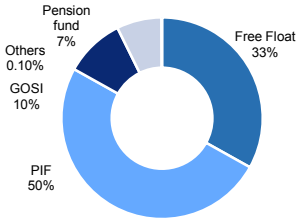
Company description

Saudi Arabian Mining Company (Saudi Arabia) – The largest mining and non oil mineral explorer in Saudi Arabia operating in gold and phosphate segments. Future segments include a world scale vertically integrated aluminium smelter

Company website

http://www.maaden.com.sa

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Digvijay Singh / +971 4 377 0819

Last model update on: 10 September 2012

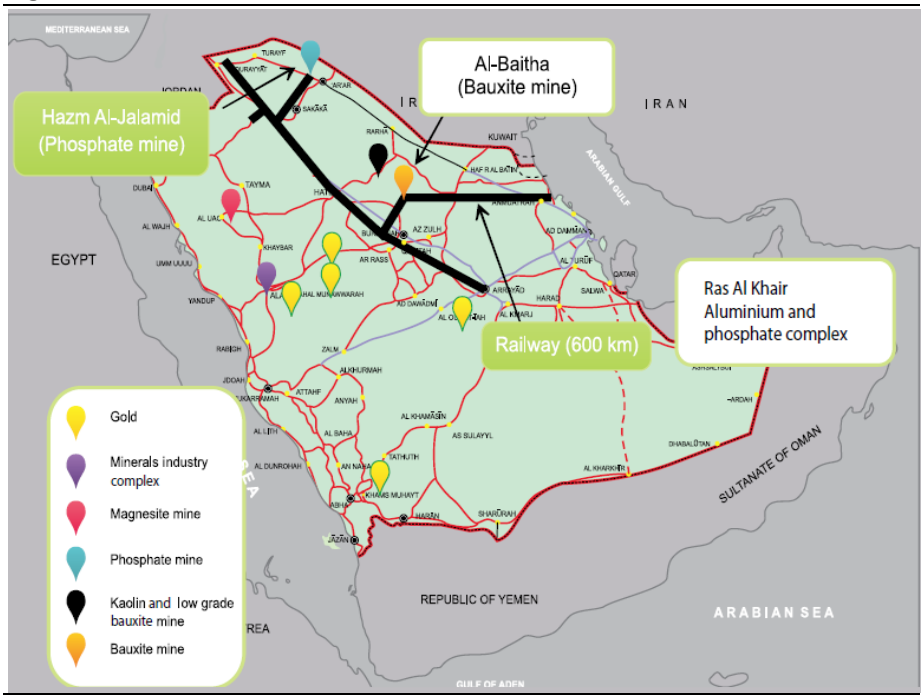
IFRS	2010	2011	2012F	2013F	2014F	2015F
Company data						
Weighted avg # shares, mn	925.0	925.0	925.0	925.0	925.0	925.0
Avg market cap	17,959	23,500	30,248	30,248	30,248	30,248
EV	34,369	43,848	55,497	57,964	55,748	52,734
Ratios & analysis						
P/E, x	neg	56.9x	19.6x	14.3x	10.6x	7.9x
EV/EBITDA, x	n/m	50.9x	17.8x	13.6x	10.8x	7.6x
P/B, x	1.0x	1.2x	1.4x	1.2x	1.1x	0.9x
Dividend yield (ords), %	-	-	-	-	-	-
EPS	(0.0099)	0.45	1.67	2.29	3.09	4.12
CFPS	0.13	0.10	1.06	2.11	2.68	3.61
Free CFPS	(5.62)	(4.40)	(4.83)	(2.04)	2.62	3.68
DPS (ords)	-	-	-	-	-	-
Payout ratio (ords), %	-	-	-	-	-	-
BPS	20.22	21.50	23.68	26.72	30.86	36.37
Revenues growth, %	11%	114%	215%	36%	36%	42%
EPS growth, %	-102%	-4,599%	274%	37%	35%	33%
EBITDA margin, %	24.7%	56.9%	65.4%	65.5%	58.4%	54.5%
Net margin, %	-1.3%	27.3%	32.4%	32.5%	32.2%	30.2%
ROE, %	-0.1%	2.4%	8.3%	10.2%	12.2%	14.0%
ROIC, %	-0.5%	1.6%	5.9%	7.4%	8.8%	11.7%
Capex/Revenues, %	737%	291%	123%	69%	4%	3%
Capex/Depreciation, x	54.6x	22.7x	27.7x	18.0x	1.2x	1.4x
Net debt/Equity, %	57%	74%	89%	89%	69%	50%
Net debt/EBITDA, x	61.3x	17.0x	6.3x	5.2x	3.8x	2.4x
Net interest cover, x	n/a	58.7x	6.6x	6.8x	22.3x	16.7x
Income statement summary						
Revenues	707	1,514	4,776	6,506	8,872	12,642
Cost of sales	(321)	(482)	(1,500)	(2,054)	(3,428)	(5,374)
SG&A and other opexp.	(211)	(171)	(154)	(191)	(261)	(372)
EBITDA	174	861	3,122	4,261	5,183	6,896
Depreciation & amortization	(95)	(194)	(212)	(249)	(276)	(275)
Operating profit	79	667	2,910	4,012	4,907	6,621
Non-operating gains /(exp.)	114	2	2	2	2	2
EBIT	79	667	2,910	4,012	4,907	6,621
Net interest income/(exp.)	-	-	-	-	-	-
Profit before tax	193	658	2,473	3,428	4,690	6,228
Income tax	(207)	(120)	(450)	(623)	(853)	(1,132)
Minority interests	(5)	(125)	(477)	(689)	(978)	(1,283)
VTBC Net income	(9)	413	1,546	2,116	2,860	3,813
Cash flow statement summary						
Cash flow from operations	122	96	977	1,956	2,481	3,341
Working capital changes	36	(406)	(1,259)	(1,097)	(1,632)	(2,030)
Capex	(5,206)	(4,410)	(5,883)	(4,479)	(321)	(383)
Other investing activities	(456)	(178)	(42)	(44)	(46)	(49)
Free cash flow	(5,203)	(4,074)	(4,470)	(1,889)	2,428	3,401
Share issue (reacquisition)	4,734	6,061	-	-	-	-
Dividends paid	-	-	-	-	-	-
Net change in borrowings	357	638	6,117	24	24	25
Other financing cash flow	-	1	48	50	52	55
Movement in cash	(449)	2,208	1,215	(2,444)	2,240	3,039
Balance sheet summary						
Cash and equivalents	2,922	5,044	6,260	3,816	6,057	9,096
PP&E	20,195	29,691	35,380	39,577	39,589	39,663
Goodwill	-	448	430	413	396	381
Investments	2,093	842	884	928	974	1,023
Other assets	9,507	7,549	8,985	10,041	11,355	13,229
Total assets	34,717	43,574	51,938	54,776	58,371	63,392
Interest bearing debt	1,264	925	590	410	260	195
Other liabilities	2,401	4,021	4,246	4,255	3,989	3,889
Total liabilities	16,009	23,690	30,031	30,064	29,822	29,747
Total shareholder's equity	16,573	16,986	18,532	20,649	23,509	27,321
Minority interest	2,134	2,897	3,374	4,063	5,041	6,324
Net working capital	(434)	(299)	721	1,568	2,936	4,690
Net Debt	10,686	14,624	19,525	21,992	19,776	16,763
Capital	17,837	17,911	19,122	21,059	23,769	27,517

Company profile

Saudi Arabian Mining Company (Maaden) was incorporated as a Saudi joint stock company in March 1997 with the intention of setting up a state sponsored mineral exploration company exploring and developing the non-oil resources of Saudi Arabia. The four product segments are:

- **Phosphate.** This product segment is operated via a JV with SABIC (the petrochemical behemoth). The operating entity was incorporated in September 2007 as Maaden Phosphate Company with Maaden holding a 70% equity stake. The ore is mined from Al Jalamid deposits with a processing centre at Ras Al Khair, where the DAP manufacturing plants are located. The beneficiation is carried out at Jalamid itself.
- **Gold & Base Metals.** This segment is operated by Maaden Gold and Base Metals Company based out of Jeddah and with Maaden's ownership stake at 100%. The company is operating five mines, developing one prospect and has five advanced exploration projects.
- **Aluminium.** This is a future product segment, which is also operated via three JVs. The operating entities are Maaden Aluminium Company, Maaden Bauxite and Alumina Company and Maaden Rolling Company. The JV partner is Alcoa with Maaden's equity stake at 74.9% in each of the companies. The Al Baitha site holding the Az Zabirah deposits is the bauxite source and the smelter and refinery are to be based at Ras Al Khair.
- **Other minerals.** Maaden is also involved in other industrial minerals such as caustic soda production (which will be used for leeching bauxite) in the aluminium project, magnesia extraction and others. The segment is primarily operated by Maaden Industrial Minerals Company wherein Maaden has a 100% ownership.

Figure 184: Mine & Plant location

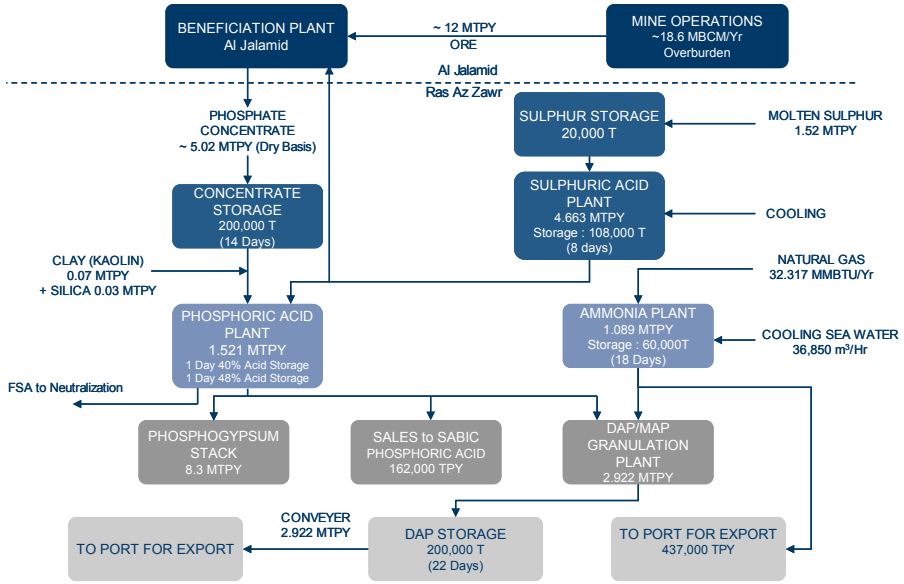


Source: Company data

Phosphates

DAP (Di Ammonium Phosphate) is the most widely used phosphate fertiliser and is used as a nutrient for crops. We illustrate the DAP value chain below.

Figure 185: DAP process flow



Source: Company data

Exploration and license acreage. There are three principal deposits encompassed in Maaden's mineral base viz Al Jalamid, Al Khabra and Umm Wu'al.

The phosphate bearing Thaniyat member of the Jalamid formation encompasses 32.7 sq km with an overburden of 8 to 15mn. Maaden's exploration license pre 2008 extended across 10,000 sq km, although we expect the rationalisation of the acreage to be submitted back to the government.

The total measured phosphate resource across the three deposits is 924mmt, with proven reserves at Jalamid alone at 223.3mmt. If Jalamid is taken as a benchmark, the total proven reserves across the three sites are likely to be of the order of 387mmt, enough to sustain DAP production for 32 years. The P2O5 grade in proven reserves at Jalamid has been an average of 20.86%. The variance across the three sites is high with the lower end of the P2O5 concentration at Umm Wu'al at 14%.

Mining & processing

The mining plant depends on two phosphate beds with a surface mining of 11Mtpa from the upper bed. The ore beneficiation plant utilises a SAPC process. The plant design is based on an annual production rate of 5Mtpa of rock concentrates with a 33% dry P2O5 content and a concentrate yield of 40%. Phosco will own and operate the concentrate loading facility, but the North South Railway will run and operate the rail tracks into the site. The processing facility comprises of four major units:

- **Sulphuric Acid Plant.** Outotec/Lurgi technology is utilised by Outotec with a design capacity of 4.66mtpa of 98.5% purity sulphuric acid. There are three sulphur oxidation lines with production capacity of 4500 t/day and an intake of 1,505t/day of sulphur. The sulphur is supplied by Saudi Aramco from domestic sources at an attractive price (sub USD 50/tonne). Sulphur is converted to sulphuric acid via a three-stage process involving the conversion of sulphur to sulphur dioxide followed by a catalytic conversion to sulphur trioxide and then by hydration produce sulphuric acid.

- **Phosphoric Acid Plant.** Phosphoric acid is produced via Yara's technology and the design capacity is 1.52mtpa. The plant is based on hemihydrate process, and process design involves three 1,460t/day of phosphoric acid lines with an overall 1.52mtpa of 48% P2O5 acid. The raw material is 5.02mtpa of phosphate concentrate and 4.49mtpa of sulphuric acid. The 40% P2O5 acid concentration is achieved in three evaporators and then fed to the DAP plant.
- **Ammonia Plant.** The design is based on Uhde's process, a proven technology with a 99.8% ammonia content at 1.09mtpa. The excess ammonia from the project (437ktpa) is expected to be exported within the region initially and utilised for enhanced production of DAP at a later stage.
- **DAP Plant.** Incro's Mixed Process is the process technology and the contract was awarded to Intecsa Ingeniera Industrial SA, Initec Energia SA and Dragados Gulf Construction. The DAP plant is designed to produce 2.92mtpa of DAP with four DAP units each having a 2,250t/day of production capacity. The DAP will have 18% N, 46% P2O5 content by weight and MAP will have a content of 11% N and 52% P2O5. There is complete flexibility as to the extent of production of DAP or MAP.

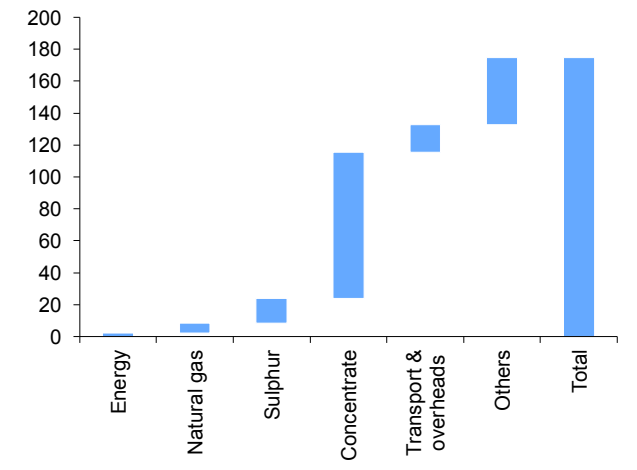
Utilities

The utilities infrastructure involves a power generation plant utilising steam generated from the sulphuric acid plant, a desalination facility and cooling facility. The power plant is also connected to the national grid for power train stability and surplus export.

Production cash cost

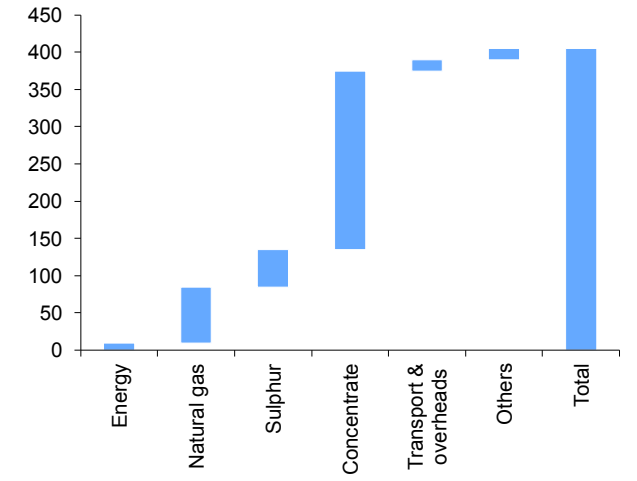
We conservatively estimate Maaden's DAP cash cost of production at USD 174/tonne, while the cost for a median non integrated producer lies at USD 405/tonne with a range of USD 330/tonne to USD 413/tonne.

Figure 186: Maaden: DAP cash cost (USD /tonne)



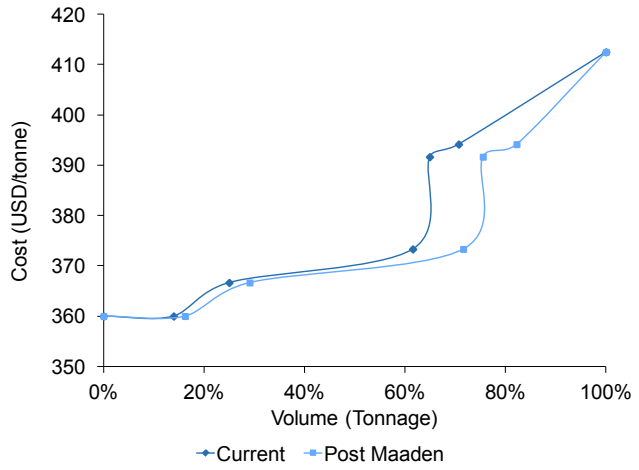
Source: VTB Capital Research

Figure 187: Median non Integrated producer: DAP cash cost (USD /tonne)



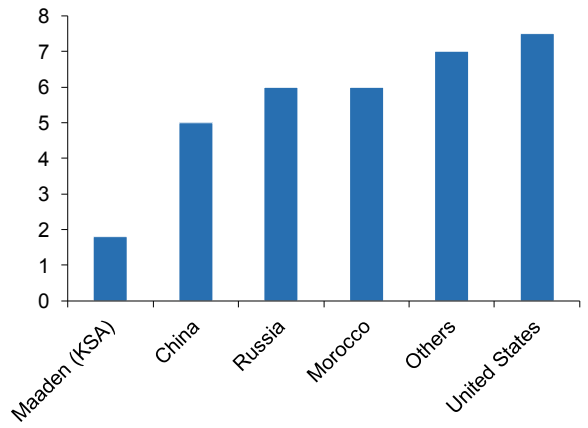
Source: VTB Capital Research

Figure 188: Non integrated DAP cash cost curve



Source: VTB Capital Research

Figure 189: DAP export volumes (m tonnes 2012F)

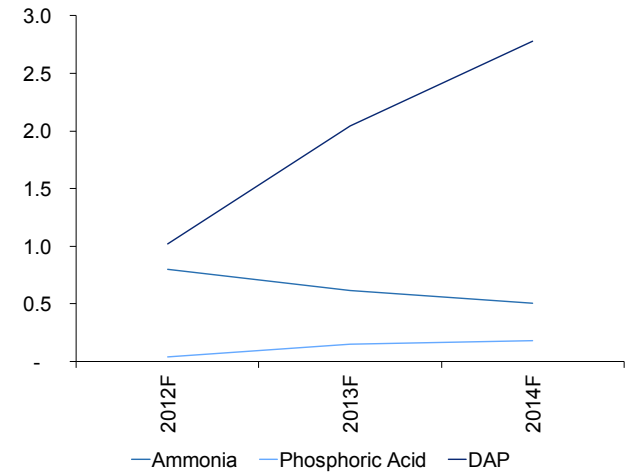


Source: Potashcorp, VTB Capital Research

Production schedule and forecasts

While the project's start up was in 2011, commercial sales of DAP did not take off until 2012. We estimate a complete ramp-up of operations occurring by 2013F. We maintain constant long-term prices and cost assumptions for 2.92mtpa of DAP output with a 500ktpa of ammonia excess and 181ktpa of phosphoric acid excess available for sale. The phosphate project is expected to provide revenues of SAR 5.9bn and EBITDA of SAR 3.9bn in a mature phase of operations.

Figure 190: Phosco: Production estimates (m tonnes)



Source: VTB Capital Research

Figure 191: Phosco: Revenues & EBITDA (SAR mn)

Source: VTB Capital Research

Project Financing

The project's capex outlay was initially estimated at USD 3.1bn (2008) by the company. Of this, however, we estimate that debt was to account for 70% or USD 2.17 (c.SAR 8bn) of the project mix. The total facilities granted to Maaden Phosphate Company (MPC) stood at SAR 14.95bn (December 2011). We believe the likelihood of all these facilities being drawn by MPC are high. The total debt load on Maaden stood at SAR 19.7bn (December 2011) and of this SAR 18.9bn was longer term in nature. The initial estimate of total equity required by the project, in our view, was USD 0.93bn or SAR 3.4bn.

Gold

Maaden's gold operations involve a relatively simple value chain starting from ore exploration to mine development, processing and sales.

License acreage

The most expensive and the potentially most lucrative acreage is the Bulghah acreage as seen in the table below. Some of the acreage might have been surrendered back to the government but our latest update of records dates to 2008.

Figure 192: Historical acreage (as of 2008)

	Date of grant	Date of expiry	Acreage (sq. km)	Annual rent ('000 SAR)
Mahd Ad Dahab	14/11/1988	13/11/2028	10.3	110
Al Amar	13/09/1997	12/09/2027	5	50
Bulghah	05/11/2001	04/11/2029	39	390
Sukhaybarat	14/11/1988	13/11/2018	50	60
Al Hajar	21/05/1998	20/05/2028	6	60

Source: Company data

Mining & processing

Gold was historically the pivotal operational segment for the company until the phosphate segment was operationalised. Maaden received an exploration license for Ad Duwayhi in 1998 and has over the years extended the exploration to Zalim, As Suk, Ar Rjum, Mansourah and Masarrah. Current mining operations are conducted at the Mahd Ad Dahab, Al Amar, Bughlah, Hajr and Sukhaybarat (only processing).

Figure 193: Gold mining operational details

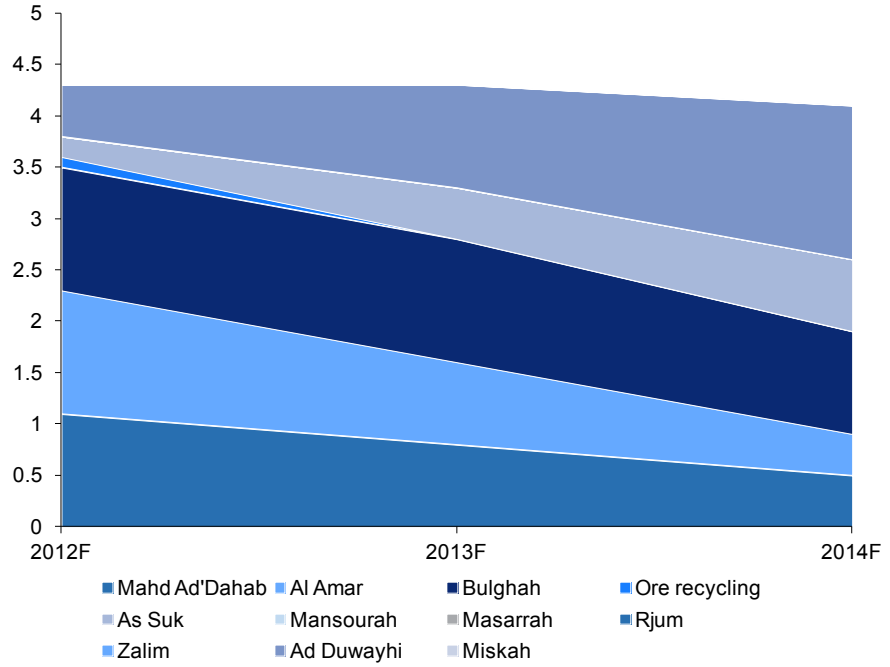
	Grade(g/tonne of ore)		Net reported cash cost/oz		Ounces sold	
	2011	2010	2011	2010	2011	2010
Mahd Ad Dahab	8.2	8.4	237	238	47,746	49,556
Al Amar	9.3	8.4	264	256	54,086	46,236
Bulghah	0.7	0.8	631	668	33,946	
Sukhaybarat	1.2	1	657	657	5,976	11,911
Al Hajar	0.9	0.9	848	778	5,901	9,192

Source: Company data, Cash costs exclude govt. severence fees

Gold Reserves & Production Profile

The key aspect of the production evolution is the on-streaming of new production assets which counteracts the expected decline in production from existing mines. Ad Duwayhi is expected to be fully ramped up by 2014F while Zalim, Rujm, Masarrah and Mansourah are expected to be operationalised from 2015F onwards.

Figure 194: Maaden Gold production profile (in tonnes of Au)



Source: VTB Capital Research

Figure 195: Ore reserves (Dec 2011)

	Proven	Grade (g/t)	Probable	Grade (g/t)	Total	Grade (g/t)
Mahd Ad'Dahab	0.44	11.29	0.57	9.36	1.01	10.15
Al Amar	0.54	8.38	1.39	7.35	1.99	7.51
Bulghah	0.2	0.81	14.03	0.84	15.5	0.77
Sukhaybarat	-	-	1.12	0.7	1.12	0.7

Source: Company data

Figure 196: Mineral resources (Dec 2011)

	Measured (m tonnes)	Grade (g/t)	Indicated (m tonnes)	Grade (g/t)	Inferred (m tonnes)	Grade (g/t)	Total (m tonnes)	Grade (g/t)
Mahd Ad'Dahab	0.47	16.77	0.65	14.04	0.58	8.58	1.7	12.92
Al Amar	0.72	10.57	1.24	11.74	0.7	9.24	2.66	10.76
Bulghah	-	-	25.13	0.65	38.68	0.58	63.81	0.61
Sukhaybarat	-	-	4.39	1.16	4.25	1.45	8.63	1.3
As Suq	-	-	8.1	1.82	0.5	1.11	8.6	1.78
Ad Duwayhi	8.98	2.38	10	3.87	11.6	1.22	30.6	2.43
Mansourah	-	-	25.6	2.14	0.8	2.14	26.4	2.14
Masarrah	-	-	14.2	2.17	2.6	2.09	16.8	2.16
Zalim	-	-	-	-	10.8	1.7	10.8	1.7
Ar Rjum (Al Wasimah)	-	-	45.4	1.22	9.2	1.26	54.6	1.23
Ar Rjum (Um Al Na'am)	-	-	20.4	1.64	0.02	2.23	20.4	1.64
Bir Tawillah	-	-	97.7	0.54	0.1	0.47	97.8	0.54
Al Humaymah	-	-	13.2	1.03	41	1	54.2	1.01

Source: Company data

Production cash cost curve

We estimate Maaden's cash costs of production to rise from USD 377/Au oz in 2012F to USD 425/ Au oz by 2014F driven by declining mineral production and poorer grade evolution at its core mines, currently under production. The 2011 net cash cost was reported at USD 385/Au oz. These costs do not include any severance fees that might need to be paid to the government. Of the three major mines, two (viz Bulghah and Mahd Add Dahab) continue to see grade decline, even while the cash cost of extraction has remained relatively stagnant. The ore grade in new projects under evaluation is on average 33% lower grade than current grade (as per December 2011 data).

Project Financing

We estimate a total capex (investment and maintenance) of USD 130mn up to 2014F prior to the start-up of new mines. We expect capex to be driven by a 70% debt portion and 30% of equity via internal cash flows.

Mine Longetivity: Reserve conversion assumptions

We are assuming a relatively modest degree of reserve conversion at most sites and are upbeat about Rjum and Ad Duwayhi on account of the modest exploration efforts so far and to bring the conversion rates in line with historically achieved rates on mines where advanced exploration has been undertaken such as Mahd Ad' Dahab.

Aluminium

License acreage

The mining zone for bauxite is categorised into North, Central and South Zones which outcrop along a NW-SE strike length of 105km on either side of Az Zabirah (north of Qibah). The proven ore resource sampling in the latest Mineral Extraction Report was restricted to South zone which is considered to have sufficient resources for the project. The South zone mining license is valid for a 30 year period starting 2006 and we expect that there is likely to be some rationalisation of acreage to control exploration costs.

The bauxite resources have been subjected to a number of mineral studies from HATCH Kaiser Engineers (2003), Betchel (2004-2005), SMG Consultants (2005) among others. There appears to be a consensus among the Mineral Extraction consultants on the total potential of mineral resources being in the order of 380Mt, providing a mining life of over 100 years.

Mining & processing

The company expects to mine the bauxite layer via a shovel and truck operation at Az Zabirah. The overburden ranges up to 20mn, as per the company. Maaden is working on increasing the shovel size from the rated 10 cubic metres to 14 cubic metres and of the ripper size from D9 to D10 or D11, which would help raise bauxite production from 3.5mtpa to 4mtpa. The bauxite ore is to be transported from Az Zabirah to the refinery at Ras Al Khair by the North South Railway. The Al Baitha bauxite deposit is located c.600 km north west of Riyadh and 550 km from Ras Al Khair (formerly Ras Al Khair). The deposit is approximately 65 km south of the Az Zabirah mine. The mineral resources and ore reserve calculations were done internally by management and are not certified to be JORC compliant.

Figure 197: Ore reserves (not JORC compliant)

	Proven (m tonnes)	Probable (m tonnes)	Total (m tonnes)
Az Zabirah			
Low grade bauxite	3.023	3.53	6.55
High silica grade bauxite	0.87	1.8	2.67
Al Baitha			
Alumina grade	56.5	55.8	56
Silica grade	8.5	10.6	9.8

Source: Company data

Refining

High reactive silica content increases delivered alumina costs

The refining process is expected to be state of the art with a digestive extraction step at 280C for maximum efficiency. The company expects to lower capex intensity by reducing the process flow rating and increasing yield. Risks remain with high silica content (8% SIO2) and scale deposition. The power plant will supply the process steam and caustic soda will be locally sourced via a Maaden JV. The high silica content is likely to result in elevated requirements for caustic soda (c 150 kg/tonne of alumina) compared to other refineries with a higher grade ore.

The project consultants foresee 150ktpa of excess alumina available post the aluminium conversion on the nameplate 1.4mtpa capacity of refinery. We believe that Maaden is likely to upgrade the refining capacity to 1.6mtpa to utilise excess alumina.

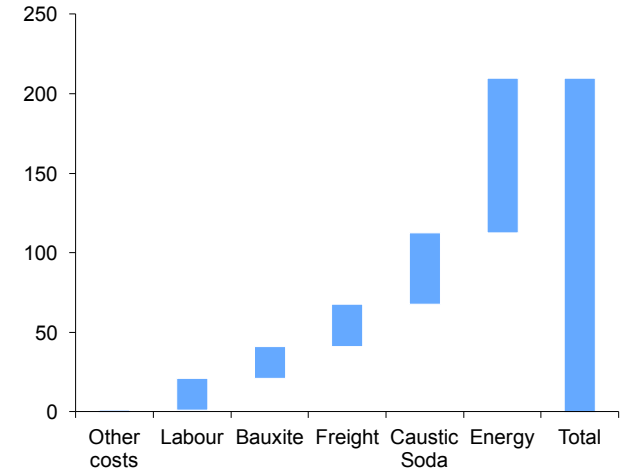
Utilities

The total generating capacity of the aluminium project power plant is estimated to be 2GW with spare capacity of400 MW. Process water at Az Zabirah will be pumped from an aquifer and transported over 25 km.

Cash costs of delivered alumina

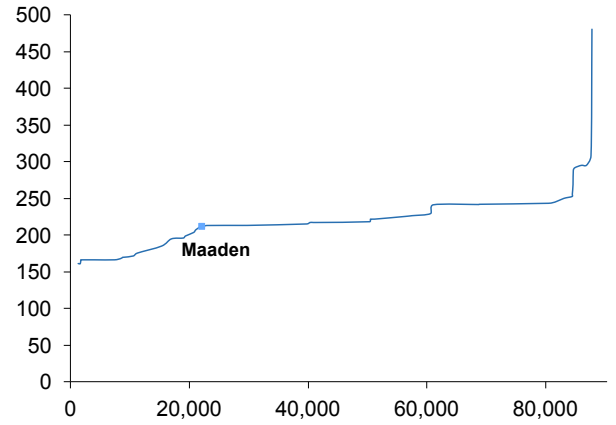
We estimate Maaden's delivered alumina cash cost at USD 220/tonne which would place Maaden at the 61 percentile in terms of global cash cost competitiveness. The relatively worse off standing is on account of reactive silica, in our view. High Silica content (8% SiO2) is likely to reduce flow rates, consume caustic soda in excess of 150 kg/tonne of alumina and increase maintenance capex affecting both cash costs of production and more importantly plant availability rates.

Figure 198: Alumina cash cost (C1, USD /t)



Source: VTB Capital Research

Figure 199: Global Alumina cash cost (C1, USD /t) curve

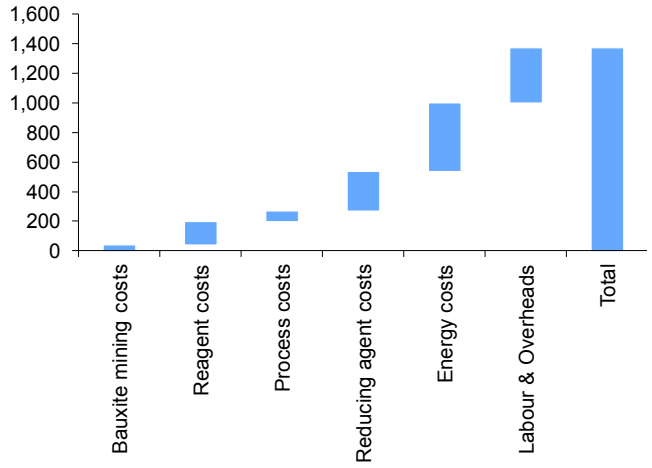


Source: VTB Capital Research

Aluminium cash cost: Top quartile competitiveness...

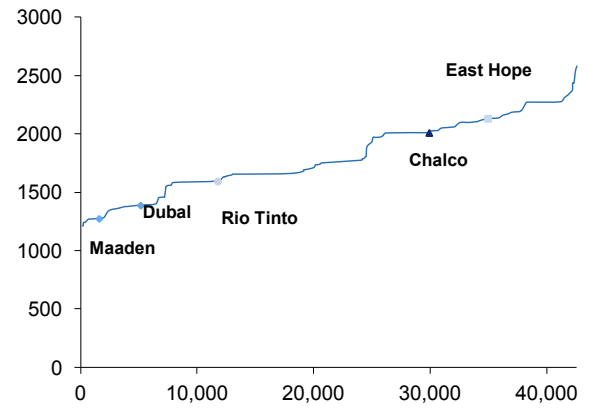
We estimate C1 cash cost of aluminium production at USD 1329/tonne which would place Maaden at the 93 percentile in terms of production cash cost competitiveness (on a global capacity scale). If we were to ascribe the source of competitiveness between upstream refining vs. downstream smelter, we must consider that the cash costs of delivered alumina (the intermediate for aluminium conversion) is at the 58 percentile in on a global capacity scale. Thus the project's competitive advantage lies in low conversion costs of alumina to aluminium and in the downstream smelter segment, in our view.

Figure 200: Aluminium cash cost (C1, USD /tonne)



Source: VTB Capital Research

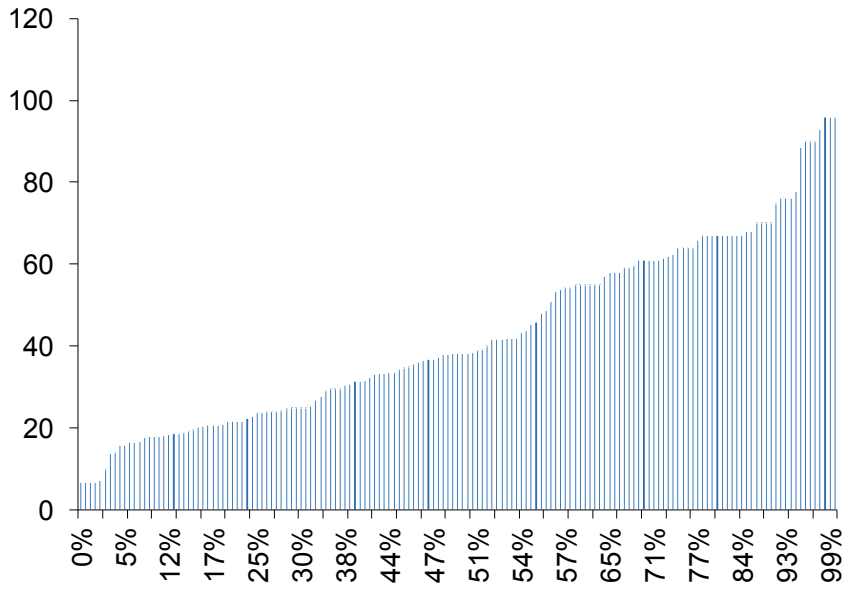
Figure 201: Global Al cash cost (C1) curve



Source: Company data, VTB Capital Research

Maaden's energy costs are estimated to be USD 24/MW hr which would place it at the 76 percentile in terms of cash cost competitiveness (on a global capacity scale). Geographically, Maaden's low energy costs are very competitive except for CIS (Russia and former USSR republics).

Figure 202: Global smelter energy tariff (MW USD/hr, volume percent)



Source: VTB Capital Research

Project Financing

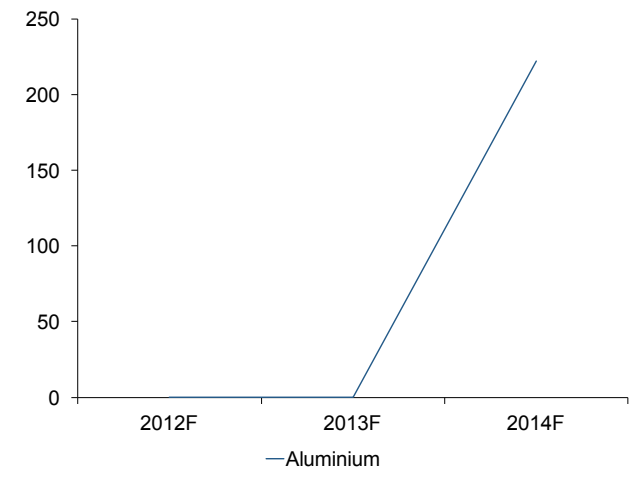
The project's initial capex outlay was USD 6.74bn (2008), but we estimate the actual costs to be c.USD 10bn. We estimate debt to be 70% of the financing mix.

In terms of the schedule, we forecast USD 2bn of investment capex in 2012F and USD 1.5bn in 2013F. We expect these numbers to be at the low end of the plausible range and hence there is a distinct possibility of an overrun of capex.

Production schedule and forecasts

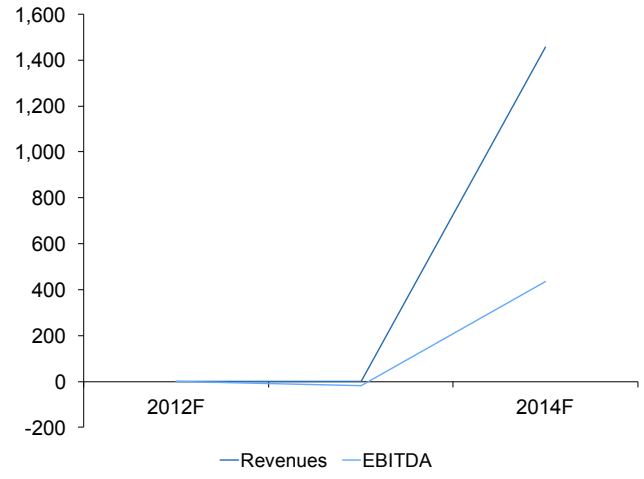
We conservatively estimate a start-up in 2014F with complete ramp-up of operations occurring by 2016F. We maintain constant long-term prices and cost assumptions for 740ktpa of aluminium output with 320ktpa of saleable alumina, providing total revenues of SAR 6.6bn and EBIT of SAR 2.5bn in a mature phase of operations. We expect the project to start with the smelter operating on externally sourced alumina in 2014F and domestic bauxite source being utilised completely from 2015F.

Figure 203: Aluminium: Volumes ('000 tonnes)



Source: VTB Capital Research

Figure 204: Aluminium: Revenues & EBITDA (SAR mn)



Source: VTB Capital Research

Earnings profile highlights

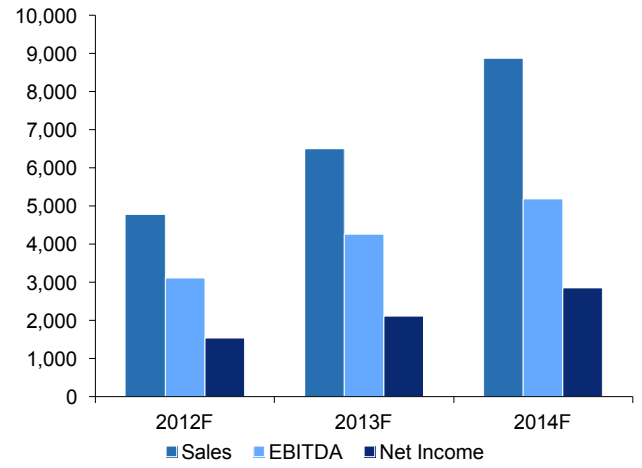
Revenues. Under our forecasts, revenues come in at SAR 4.8bn in 2012F with revenues peaking at SAR 8.8bn by 2014F post the commissioning of the phosphate project. The 215% growth in 2011-12E revenues is primarily on account of a ramp-up of DAP operations. We are factoring in a DAP capacity utilisation for 2012F to average out at 35%.

EBITDA. We expect 2012F EBITDA of SAR 3.1bn, reaching SAR 5.2bn post full commissioning of the DAP project. We estimate an EBITDA margin of 65.4% for 2012F. The commissioning of the aluminium facility is set to place downward pressure on margins, even though the incremental aluminium segment EBITDA upon full operationalisation is SAR 3bn, in our estimates (by 2016F)

Debt. According to our calculations, net debt is set to increase from SAR 14.6bn (2011) to peak at SAR 21.2bn by end-2013. While the financing environment might appear benign on account of strong government support and historical low costs, we expect full financing costs to be at 3% in 2012F. Our capex assumptions are conservative to account for project delays and associated cost inflation.

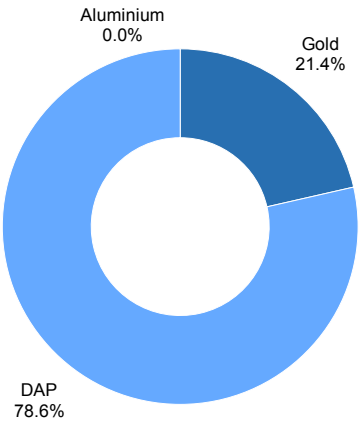
Cash flow. In our view, cash earnings will total SAR 976.8mn in 2012F, rising to SAR 2.5bn after the complete ramp up of the DAP facility. At current prices, the equity free cash flow yield in 2013F is -6% (not discounted). The longer-term (2014F) stable equity free cash flow yields are in the order of 11% (not discounted). The negative yield in 2012F is on account of investments for the aluminium refinery. The composite ROIC of the assets is expected to reach 8% by 2014F.

Figure 205: Key Forecasts (in SAR mn)



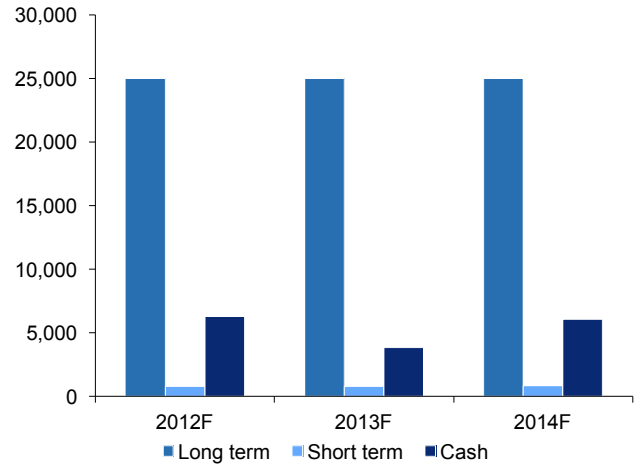
Source: VTB Capital Research

Figure 206: EBITDA Composition (2012F)



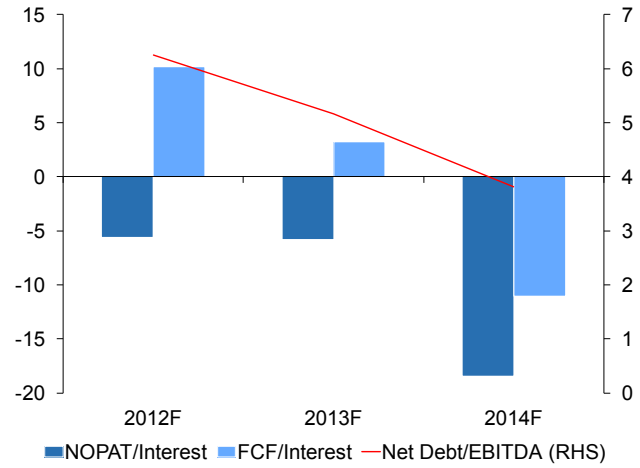
Source: VTB Capital Research

Figure 207: Debt (in SAR mn)



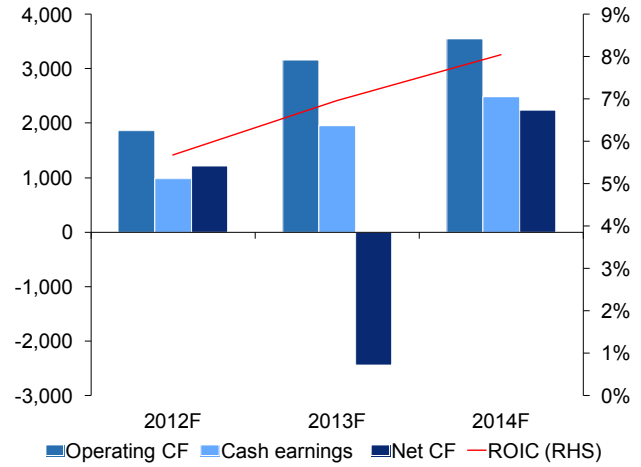
Source: VTB Capital Research

Figure 208: Debt Service Ratios



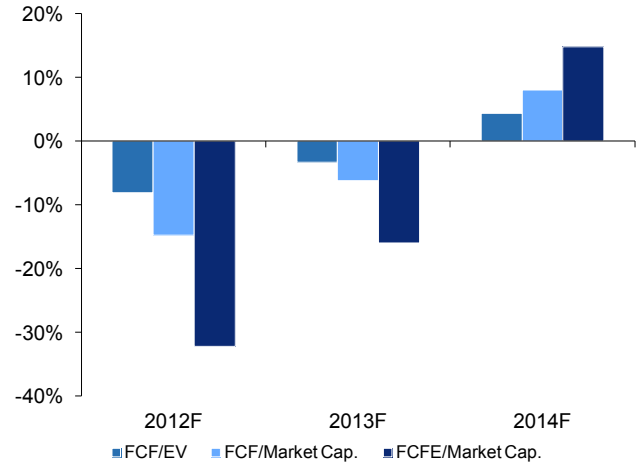
Source: VTB Capital Research

Figure 209: Cash Flows (in SAR mn)



Source: VTB Capital Research

Figure 210: FCF and FCFE Yields



Source: the BLOOMBERG PROFESSIONAL™ service, VTB Capital Research

Financial Statements

Figure 211: Income Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Income Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
Revenues	1,514	4,776	6,506	8,872	12,642
EBITDA	861	3,122	4,261	5,183	6,896
D&A	194	212	249	276	275
EBIT	667	2,910	4,012	4,907	6,621
Finance charges	(11)	(439)	(586)	(220)	(396)
Other income (expense)	2	2	2	2	2
Taxes	120	450	623	853	1,132
Net income before minorities	538	2,023	2,805	3,837	5,096
Share of minorities	125	477	689	978	1,283
Net income	413	1,546	2,116	2,860	3,813
Adjusted net income (pre-exceptionals)	413	1,546	2,116	2,860	3,813
Number of shares (M)	925	925	925	925	925
EPS	0.4	1.7	2.3	3.1	4.1
Adjusted EPS (pre-exceps)	0.4	1.7	2.3	3.1	4.1
Payout ratio (%)	0%	0%	0%	0%	0%

Source: Company data, VTB Capital Research

Figure 212: Balance Sheet
(Figures in '000 SAR, except per share data or if specified otherwise)

Balance Sheet (YE Dec)	2011	2012F	2013F	2014F	2015F
PP&E	29,691	35,380	39,577	39,589	39,663
Intangibles	448	430	413	396	381
Investments	842	884	928	974	1,023
Total non-current assets	30,980	36,694	40,918	40,960	41,067
Cash	5,044	6,260	3,816	6,057	9,096
Accounts receivable	482	382	455	532	632
Inventories	562	1,772	2,413	3,291	4,690
Other	6,505	6,831	7,172	7,531	7,907
Total current assets	12,593	15,245	13,857	17,411	22,325
TOTAL ASSETS	43,574	51,938	54,776	58,371	63,392
Debt	762	785	809	833	858
Accounts payable	1,342	1,433	1,301	887	632
Other	1,728	1,814	1,905	2,000	2,100
Total current liabilities	3,833	4,032	4,015	3,721	3,591
Debt	18,906	25,000	25,000	25,000	25,000
Other	951	999	1,049	1,101	1,156
Total non-current liabilities	19,858	25,999	26,049	26,101	26,156
Minorities	2,897	3,374	4,063	5,041	6,324
Shareholders' Equity	16,986	18,532	20,649	23,509	27,321
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**43,574**	**51,938**	**54,776**	**58,371**	**63,392**

Source: Company data, VTB Capital Research

Figure 213: Cash Flow Statement
(Figures in '000 SAR, except per share data or if specified otherwise)

Cash Flow Statement (YE Dec)	2011	2012F	2013F	2014F	2015F
EBITDA	861	3,122	4,261	5,183	6,896
Working capital change	(406)	(1,259)	(1,097)	(1,632)	(2,030)
Other	(161)	2	2	2	2
Cash earnings ex zakat and interest	294	1,865	3,165	3,553	4,869
Tax paid	(186)	(450)	(623)	(853)	(1,132)
Net interest paid	(11)	(439)	(586)	(220)	(396)
Operating cash flow	96	977	1,956	2,481	3,341
CAPEX	(4,410)	(5,883)	(4,479)	(321)	(383)
Acquisitions (net of disposals)	-	-	50	50	50
Other	(178)	(42)	(44)	(46)	(49)
Cash flow before financing	(4,491)	(4,949)	(2,517)	2,164	2,959
Financing cash flows	6,700	6,164	74	77	80
Net borrowing	638	6,117	24	24	25
New equity	6,061	-	-	-	-
Other	1	48	50	52	55
Net Cash Flow	2,208	1,215	(2,444)	2,240	3,039

Source: Company data, VTB Capital Research

Appendix 1: Petrochemical Product Groups

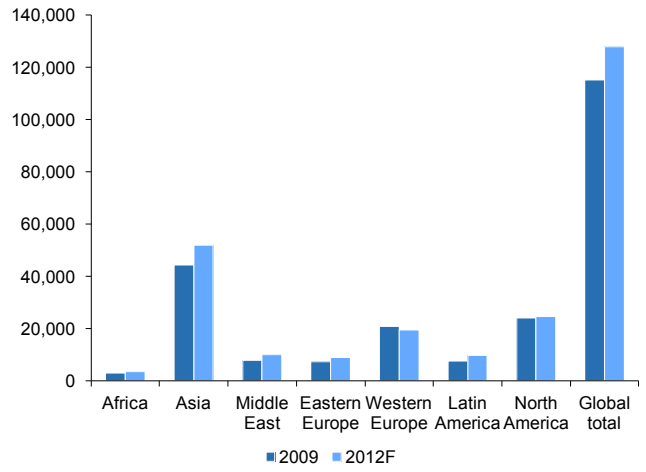
Ethylene derivative

Derivatives. The primary derivatives comprise of product groups where the ethylene subunit (monomer) is a dominant constituent of the polymer chain. Examples from the category are LDPE including LDPE (low density polyethylene), HDPE (high density polyethylene), LLDPE (linear low density polyethylene). The secondary derivatives comprise of product groups wherein the ethylene subunit is one of two or three important subunits in the end product's molecular structure. Examples from the category are MEG (monoethylene glycol), Ethanolamine, VAM (vinyl acetate monomer) and Choline Chloride among many others.

Feedstock cost structure. The effective raw material cost is a function of raw material pricing and raw material (feed) composition (which might vary from 100% ethane cracker to 40% ethane cracker unit). Ethane itself is priced at USD 0.75/mmbtu in Saudi Arabia; a range of USD 1.5–2.5/mmbtu in Qatar. Propane (as one of the precursors to ethylene) is priced at a discount ranging between 28% to 31.25% in Saudi Arabia.

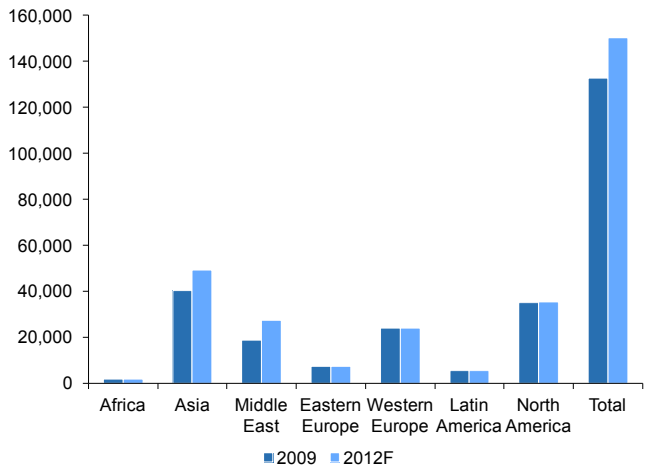
Common applications. While polyethylene plastic bags are ubiquitous, other applications are refillable bottles, food packaging, shrink wrapping, insulation packaging, films, insulation layers, water pipes etc.

Figure 214: Ethylene: Global demand (ktpa)



Source: VTB Capital Research

Figure 215: Ethylene: Global capacity (ktpa)



Source: VTB Capital Research

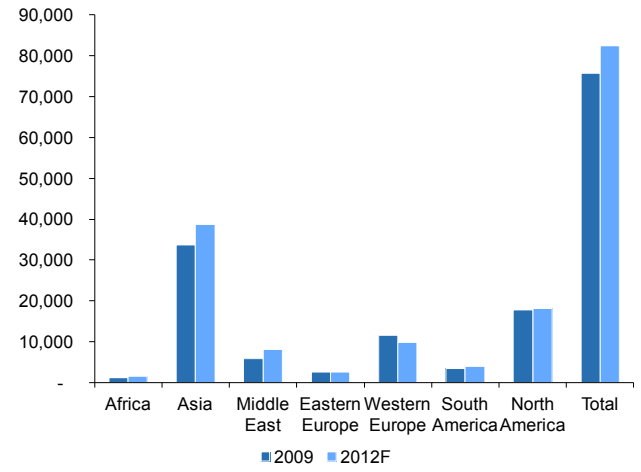
Propylene derivative

Derivatives. Propylene derivatives comprise of products where the propylene (C_3H_6) subunit (monomer), is the most important building block of the polymer chain or molecular unit. Examples are polypropylene and propylene oxide (which might also be used as an intermediary).

Feedstock cost structure. The propane feedstock in Saudi Arabia is priced at a discount (ranging between 28% to 31.25%) to netback for Japanese naphtha prices. Qatar does not currently produce propylene derivatives, although plans are afoot for the same.

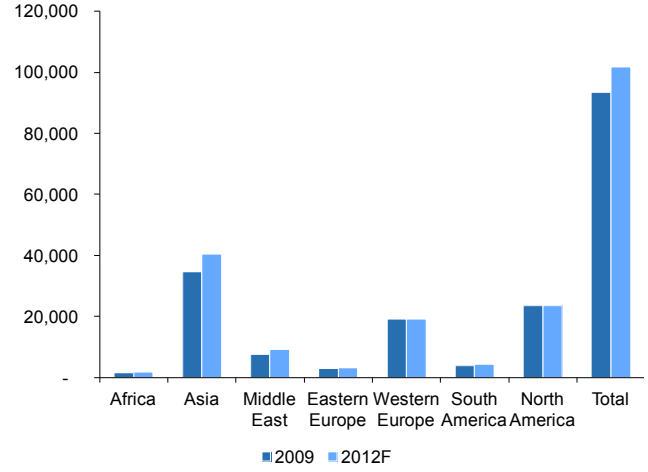
Common applications. Important applications are in carpeting fibres which have seen an upsurge in demand lately, resins (auto parts), packaging, insulation, plastic mouldings etc. More than 62% of global propylene production is utilised to produce various grades of polypropylene, the most versatile bulk polymer amongst the entire polymer spectrum.

Figure 216: Propylene: Global demand (ktpa)



Source: VTB Capital Research

Figure 217: Propylene: Global capacity (ktpa)



Source: VTB Capital Research

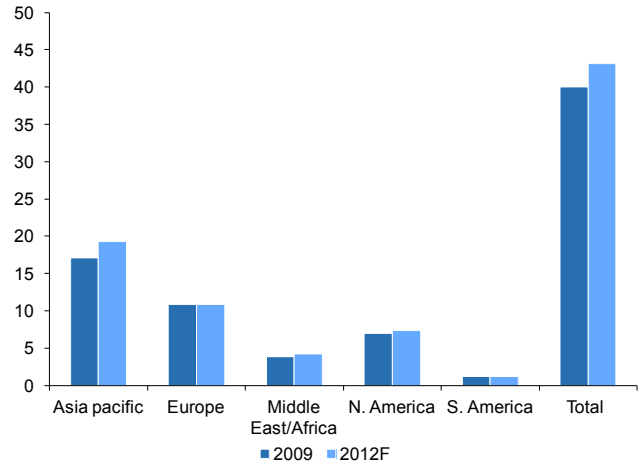
Hydroxyl derivative

Derivatives. The hydroxyl derivatives segment comprise of downstream products wherein methanol (CH_3OH) is an important precursor and/or key properties are dependent of the presence of single and multiple (OH) units on the base building blocks. Key derivatives, both primary and secondary comprise of acetic acid, acetic anhydride, VAM, formaldehyde, MTBE etc..

Feedstock cost structure. Methane is priced in energy equivalent terms (USD /mmbtu) at levels similar to ethane in both Saudi Arabia and Qatar.

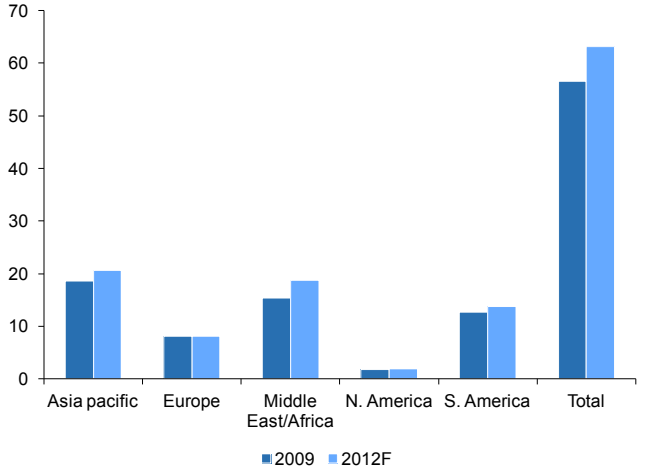
Common applications. Important applications include use of methanol in fuel blending, and use of other derivatives as solvents, antifreeze applications, building materials etc.

Figure 218: Methanol demand by regions



Source: VTB Capital Research

Figure 219: Global methanol installed capacity (ktpa)



Source: VTB Capital Research

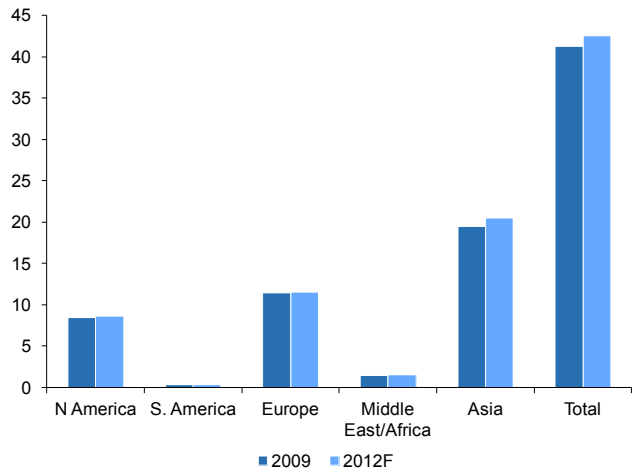
Aromatic derivative

Derivatives. This product group comprises of closed ring (alkenes) hydrocarbons such as benzene (C_6H_6) and benzene based derivatives such as benzene alkylates.

Feedstock cost structure. In the aromatics segment, the raw material costs advantage in raw materials hardly extends beyond 10%, a level insufficient from export competitiveness' perspective. Hence in the recent wave of petrochemical capacity expansion in Middle East the aromatic component was less than 10%.

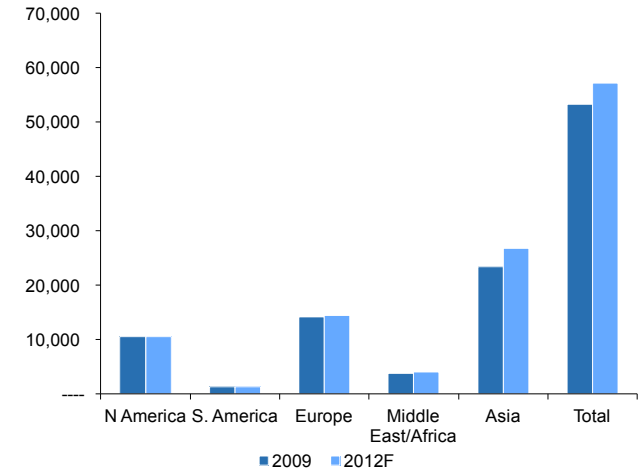
Common applications. Textile materials, dyes, crop chemicals such as pesticides, industrial agents such as detergents etc.

Figure 220: Benzene demand by region (ktpa)



Source: VTB Capital Research

Figure 221: Global Benzene installed capacity (ktpa)



Source: VTB Capital Research

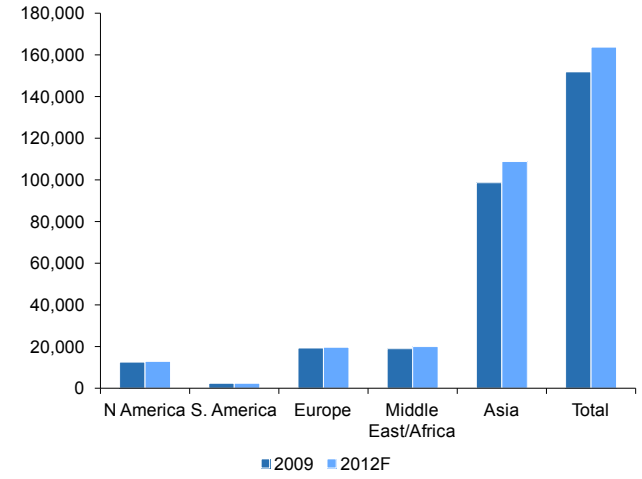
Nitrogenous derivatives

Derivatives. This product group comprises of nitrogen based derivative compounds and consist mainly of Ammonia, urea, melamine and UAN. The link between petrochemicals (carbon based) and this group of compounds is that methane, an organic compound is utilised to produce hydrogen free radicals need for the production of ammonia, which is further converted to urea and from there to melamine and UAN.

Feedstock cost structure. The raw material methane is available at the same energy pricing level as ethane (detailed above). While most global producers of ammonia utilise relative cheap sources of gas, the feedstock advantage ranges to a minimum discount of 50% on marginal producer's raw material cost.

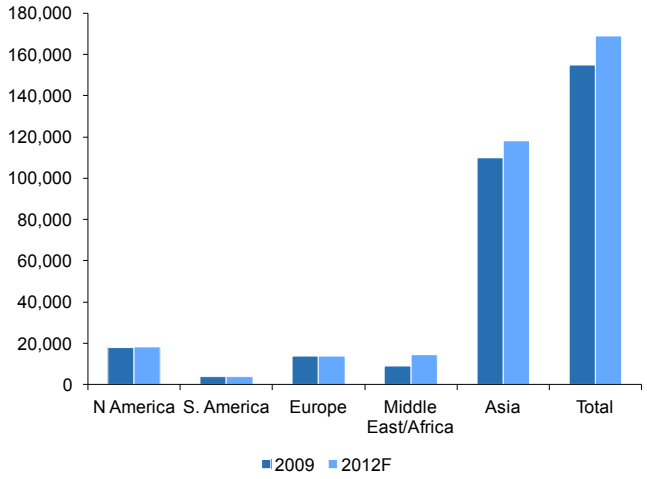
Common applications. The main application is the use of urea and UAN as primarily fertilisers and of ammonia as an industrial chemical.

Figure 222: Urea demand by regions (mtpa)



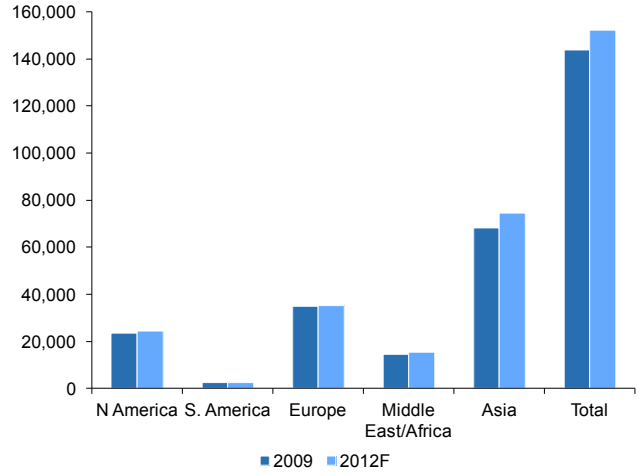
Source: VTB Capital Research

Figure 223: Global Urea installed capacity (ktpa)



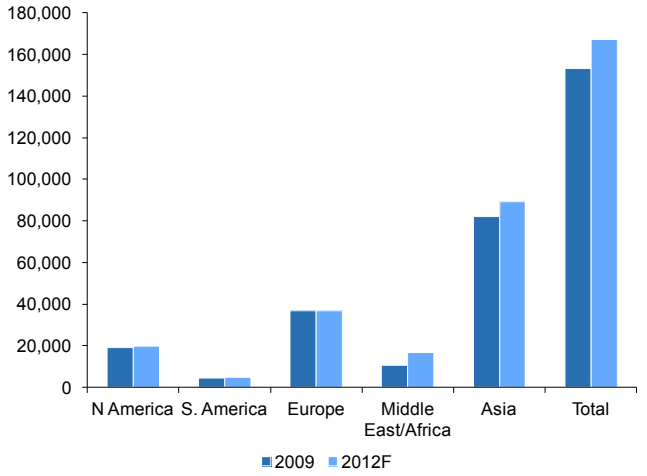
Source: VTB Capital Research

Figure 224: Ammonia demand by region (mtpa)



Source: VTB Capital Research

Figure 225: Ammonia installed capacity (ktpa)



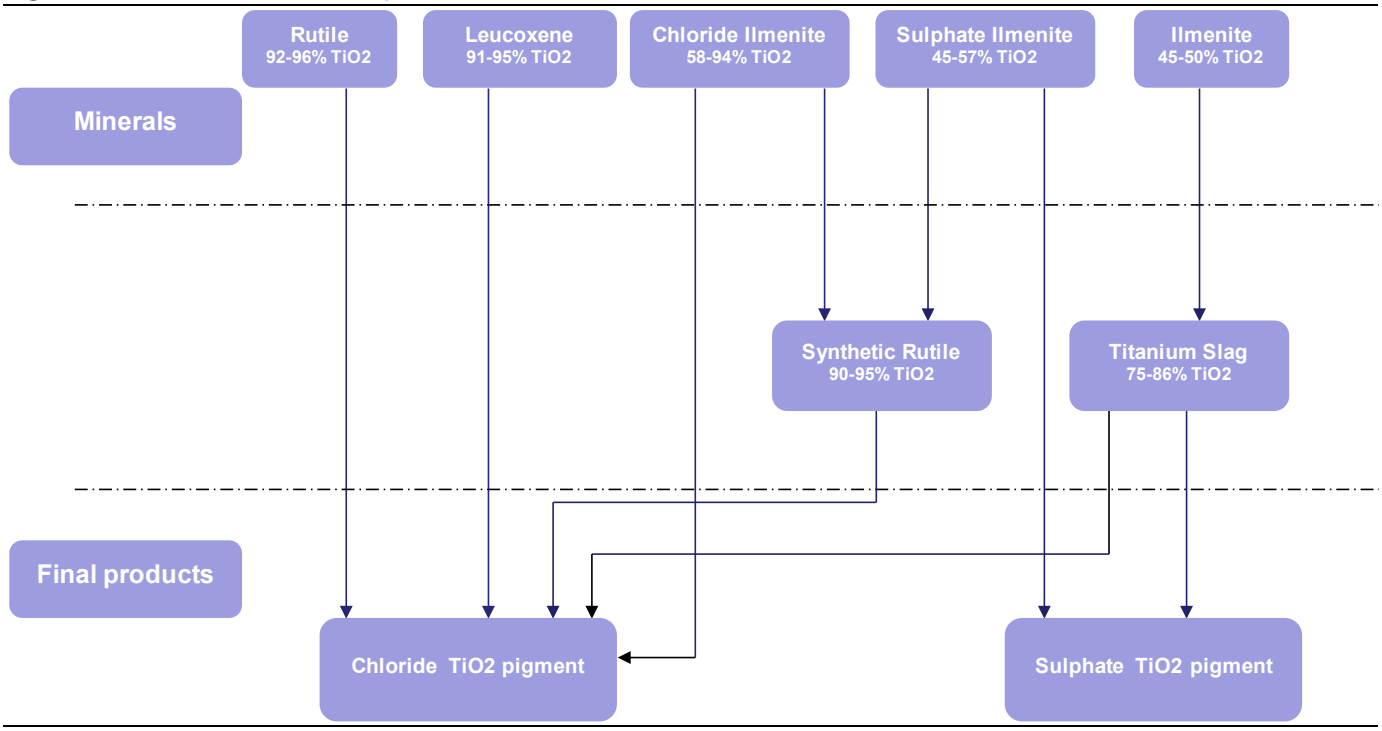
Source: VTB Capital Research

Appendix 2 – Titanium Dioxide Value Chain

Introduction

Titanium dioxide has a high refractive index (2.61), is inorganic (lack of carbon) in source and derived from heavy mineral sands with rutile and ilmenite ores. Other sources for the pigment are titanium slag, leucoxene, and synthetic rutile. The most common application of TiO2 is as a pigment to produce white colour in paints, plastics and other substances.

Figure 226: Mineral conversion processes



Source: VTB Capital Research

The raw material

The ore for TiO_2 (Titanium dioxide) is mined from mineral sands with a heavy concentration of Ilmenite & Rutile ores. Ilmenite ore contains 45-65% TiO2 on average, while 95% TiO2 content can be obtained from rutile ores. Ilmenite is found in several geographical regions and large deposits have been found in Australia, South Africa, Brazil, Madagascar, India and the US. The rutile ore is more scarce, hence fetches a premium and is produced primarily in US, South Africa and Australia. The proven reserves of rutile stand at 42 million tonnes and production has hovered around 600 ktpa in 2011. Close to 80% of the production comes from Australia even though the proven reserve base in Australia is only 43% of global total.

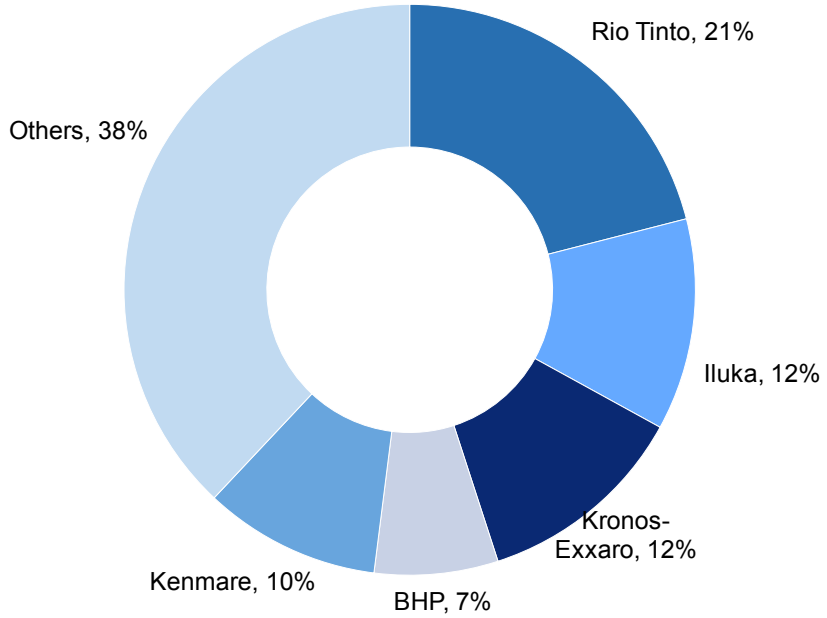
Ilmenite is the most commonly available TiO2 ore, with global known reserves of 650 million tons, and global production of 6 mtpa. Ilmenite has much lower TiO2 content than Rutile, varying from 45% to 65%. Based on the TiO2 content, Ilmenite is graded into three different categories:

- Chloride grade (>58% TiO2 content) – used as Chloride process feedstock.
- Sulphate grade (<58% TiO2 content) – used as Sulphate process feedstock.
- Feedstock for slag (<50% TiO2).

Ilmenite can be concentrated to yield higher-value feedstocks. There are three commercially available upgraded feedstocks: synthetic Rutile, chloride and sulphate slag. The content in each are as follows:

- Synthetic Rutile – 88–95% TiO2 content
- Chloride Slag – 85–95% TiO2 content
- Sulphate Slag – 80% TiO2 content

Figure 227: Ilmenite and Rutile production (2011)



Source: VTB Capital Research

The top five producers account for nearly 62% of Ilmenite & Rutile supplies globally. We estimate the 2011 global production of Ilmenite and rutile at 6.9 mtpa. Rio Tinto is one of the largest suppliers of TiO2 feedstock, with important operating sites at QIT Fer et Titane (Canada), Richards Bay Minerals (South Africa) and QIT Madagascar Minerals (Madagascar).

Figure 228: TiO2 Mineral supply ('000 tonnes)

	2008	2009	2010	2011	2012F	2013F	2014F
Sulphate Ilmentite	3,187.7	3,409	4,128	4,962	5,142	5,352	5,457
Chloride Ilmenite	1,381.4	989	1,144	1,104	1,131	1,146	1,171
Rutile	625.16	550	725	819	830	825	805
Leucoxene	122.14	155	141	123	159	167	168
Synthetic rutile	785.22	738	682	550	595	631	634
Cloride Slag	1,560	1,617	1,892	1,950	1,960	1,960	1,985
Sulphate Slag	1,199	639	772	766	760	777	766
Total	8,861	8,097	9,484	10,275	10,577	10,858	10,986
Total Ilmenite and rutile	5,194	4,948	5,997	6,886	7,102	7322	7,432

Source: US Geological Survey, VTB Capital Research

Processing

The processing of TiO2 from ore or other feedstock is done by two commercial processes:

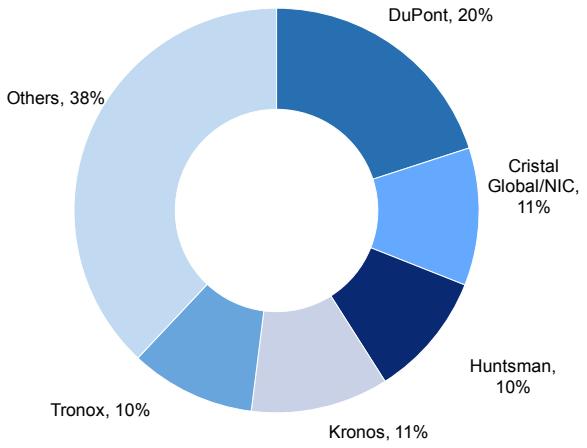
- **Sulfate process.** The older of the two processes and without major IP barriers, the process involves treatment of ore with sulphuric acid as the primary step. The impurities, primarily metals such as iron and magnesium are removed at this stage. Thereafter the concentration of TiO2 is increased via a succession of steps. Nucleation & calcination are used pre crystallisation to produce the desired crystal structure, anatase or Rutile. Anatase crystals (that can only be produced through the sulphate process) are used in paper and lower-quality paints. Bottom

quartile (in cash cost terms) producers have a higher proportion of sulphate process plants generally due to higher processing costs associated with the process.

- **Chloride process.** This is a relatively modern process and has significant IP barriers enforced via plant licenses. The raw material is primarily the higher quality rutile ore. This process itself also produces higher-quality output, not just in terms of concentration but also particle size. The generic process involves treating the ore with chlorine gas at high temperatures in a dry environment to produce titanium tetrachloride, which is quite toxic. Oxidising TiCl4 yields intermediate TiO2. The pigments produced through the chloride process are brighter, and are hence preferred by paint manufacturers. Most of the new capacities in recent years have been rutile based due to the end product premium.

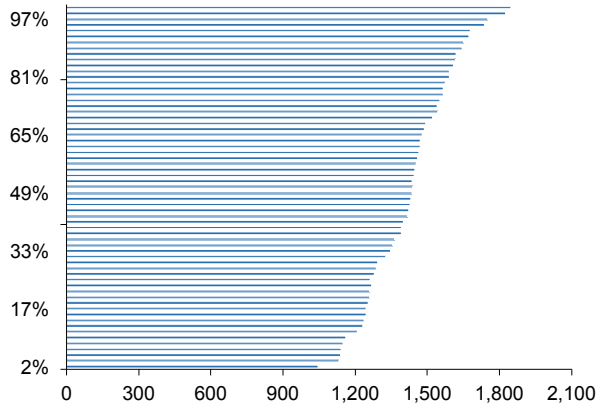
Cost curve. DuPont and Cristal Global are the major companies with top quartile cash cost of production. As per our estimates, average Chloride process costs are close to USD 1,440/tonne, and the average Sulphate process costs are close to USD 1,720/tonne.

Figure 229: TiO2 Producers: % of global nameplate capacity (2011)



Source: VTB Capital research

Figure 230: TiO2 Processors: Cash Cost Curve



Source: IBMA, Ti Insight, LLC, VTB Capital research

End user

The end product from TiO2 processing is rutile or anatase crystal based pigments. As mentioned earlier, the anatase is the lower quality crystal, with lower refractive index and is less attractive as the level of whiteness it produces is a far match from that produced by rutile crystals. Rutile, due to its superior refractive index, also has a higher brightness and opacity and often has a bluish tint.

The largest use for TiO2 pigments is in the paints and coatings industry (60%). The white colour in paints is a function of the high reflective power of TiO2 pigment. The paints and coatings industry typically uses Rutile crystals, which provide a better quality and are also required in lower volumes than their anatase peers. 26% of the TiO2 pigment usage derives from plastics which are followed by paper (9%), ink (6%) among others.

The transformation of the value chain and the concentration of profitability and pricing power upstream has been driven by the surge in Asian demand post the 2008 crisis. North America's share in overall demand for TiO2 pigments has dropped from 35.5% in 1990 to 19% in 2011E, while the European Union's share has reduced from 30% to 21% over the same period. On the other hand, demand from Asia Pacific has nearly doubled over this period, and in 2011E accounted for nearly 44% of global demand for TiO2 pigments.

To grasp the increase in absolute terms, Chinese demand has grown from less than 200ktpa to 1040 ktpa over the course of last 11 years. While domestic production has increased to match the demand growth, the strict IP barriers in chloride process has led to a bifurcated market in ore (ilmenite rutile spread) and the crystals (anatase vs. rutile crystals). The premium process, the premium ore have more than doubled their spreads over the lower quality counterparts.

Figure 231: World TiO2 supply ('000 tonnes)

	2008	2009	2010	2011	2012F	2013F	2014F
TiO2 Units							
Australia	1,613	1,287	1,372	1,575	1,585	1,574	1,524
South Africa	1,181	1,161	1,093	1,034	1,044	1,054	1,064
Other Africa	248	340	461	561	722	820	835
Canada	1,111	726	1,123	1,188	1,190	1,192	1,195
China	658	806	896	994	986	1,005	1,010
Other Europe	565	417	536	622	632	632	632
US	184	148	191	167	152	152	152
ROW	489	515	629	693	746	762	775
Total TiO2 units	6,050	5,400	6,300	6,834	7,057	7,192	7,187
TiO2 Grade							
Sulfate grade TiO2	2,450	2,097	2,544	2,984	3,062	3,189	3,207
Chloride grade TiO2	2,040	1,686	1,864	1,920	2,025	2,039	1,981
Chloride slag share	1,560	1,617	1,892	1,930	1,970	1,964	2,000
Total	6,050	5,400	6,300	6,834	7,057	7,192	7,187

Source: US Geological Survey, VTB Capital Research

Disclosures

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Restricted	0	0%
Under Review	1	1%
	112	**100%**

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Hold	2	25%
Sell	0	0%
Restricted	0	0%
Under Review	0	0%
	8	**100%**

Source: VTB Capital Research as at 31 August 2012

Price Targets

VTB Capital Research employs a Discounted Cash Flow (DCF) model as its principal valuation framework for estimating the fair and target prices of stocks. The central metric is fair current Enterprise Value (EV), which is obtained on the basis of Free Cash Flow to Firm (FCFF) discounted at a constant company-specific Weighted Average Cost of Capital (WACC).

Conflicts Management Arrangements

VTB Capital Research has been published in accordance with our conflict management arrangements, which are available here.

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