

Saudi Basic Industries Corp. (SABIC)

Despite SABIC's strong financial position in terms of assets and liquidity, we expect that SABIC profitability will remain under pressure given the lowered demand and prices, amid the coronavirus pandemic.

18 June 2020

Recommendation	Underweight
Current Price (17-06-2020)	SAR89.0
Target Price (52 Weeks)	SAR77.4
Upside/ (Downside)	(13.1%)
Shariah Compliance	Pass

Key Points

We initiate our coverage for SABIC with an Underweight recommendation and 52 weeks target price at SAR77.4; this represents a downside potential of 13.1%.

- SABIC's revenues from all operating segments continued to decline due to the pressure in selling price and lower demand since 2019, which was further exacerbated by COVID-19 this year.
- The company's total revenues plunged by 17.5% Y-o-Y to reach SAR30,825mn in Q1 2020 compared to SAR37,370mn in Q1 2019. Additionally, SABIC recorded impairment provisions worth SAR1.1bn. Consequently, the company recorded a net loss of SAR676mn in Q1 2020, compared to the net income in SAR4,980mn in Q1 2019.
- The global shutdowns in light of the Coronavirus pandemic, lead to significant disruptions in supply chains worldwide, coupled with travel restrictions, which lead to a significant drop in demand in the Oil sector. The news of the second wave of Coronavirus in China is bound to disrupt the reboot of economic activity, further pressuring the demand. We expect that Saudi Arabia Gross Domestic Product, whether Oil or Non-Oil GDP to decrease during 2020.
- Not only is the pandemic's duration uncertain, but the economic recovery also will not fast. It will need time until the people's state of anxiety begins to fade, and the emergence of indicators that are confirming the positive transformation, such as the success of the economic openness after the shutdown months. Consequently, SABIC's H1 2020 DPS is the lowest in a decade; the DPS cut was expected given ample supply and a negative demand outlook.
- We expect that SABIC's profitability will continue declining in the medium term until signs of an economic recovery start to appear.

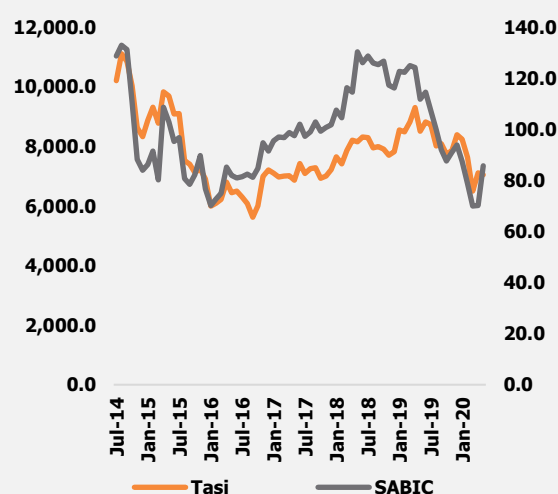
Key Growth Catalysts

- SABIC Ambitious Investment Strategy.
- SABIC's Stake in Clariant AG.

Key Risk Factors

- Negative Impact of the Coronavirus Pandemic.
- US-China Trade Dispute.

Reuters Code	2010.SE
Bloomberg Code	SABIC: AB
52 Weeks High	SAR120.6
52 Weeks Low	SAR61.9
Market Cap	SAR267.0bn
P/E	172.8
EPS	SA0.52
Last Dividends	SAR4.4
AVG Value Traded	SAR4.8bn



Company Analysis

SABIC Establishment

- Saudi Basic Industries Corporation (SABIC) was established in 1976, and the company headquarters is located in Riyadh in Saudi Arabia. The purpose of the establishment of SABIC was to make use of the hydrocarbon mineral resources available in Saudi Arabia and convert them into value-added industrial products and contribute to the development of the manufacturing, construction, and agricultural industries sectors. SABIC stocks were listed in the Saudi main index (Tadawul) in 2010.
- The Saudi government owns 70.0% form SABIC through h the Public Investment Fund (PIF), and the other 30.0% were free float. In March 2019, Saudi Aramco signed an agreement to purchase Public Investment Fund share with a value of USD69.1bn (SAR259.1bn, determined based on the share price of "SABIC" that was equivalent to SAR123.39). Following the outbreak of the Coronavirus and the significant decline in SABIC's value by more than 40.0% due to the drop in oil prices, Aramco was seeking to adjust the value of the deal. In recent events, the oil giant Aramco has completed its acquisition of a 70% stake in SABIC with a (second) extension in the payment period. Under the new terms between the PIF and Aramco, Aramco will pay the PIF in installments, beginning in August this year through to April 2028.
- The company provides a large number of products, including chemicals, specialized consumer plastics, agricultural nutrients and minerals, and the company has more than 33,000 employees. SABIC ranked the 4th worldwide among petrochemical producers, with a total production capacity of 75.3mn metric tons in 2018. Accordingly, SABIC became a world leader in the field of diverse petrochemical production, looking to increase its innovation and provide high-quality services

Key Shareholders

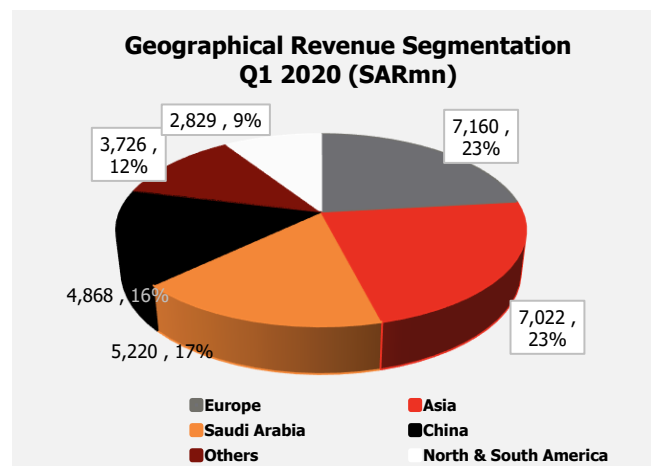
Name	Ownership (%)
Aramco	70.0%
Free Float	30.0%

Source: Tadawul

SABIC at Glimpse

Geographical Revenue Segmentation

- Since its inception, SABIC acquired a large number of local and international companies with operations reaching more than 50 countries around the world (North & South America, Europe, the Middle East, Asia).
- SABIC's total revenues are divided into 6 regions. Revenue showed a decrease across all regions during Q1 2020.
- SABIC's revenues from Europe, which contributes 23.2% out of the company total revenues, decreased by 17.9% Y-o-Y to reach SAR7,160mn in Q1 2020 compared to SAR8,724mn in Q1 2019.
- Revenues generated from Asia (excluding China) decreased by 14.4% Y-o-Y to reach SAR7,022mn in Q1 2020 compared to SAR8,208mn in Q1 2019. Worth mentioning that SABIC revenues from Asia contribute 22.8% out of the company's total revenues in Q1 2020.
- Revenues generated from operations in Saudi Arabia showed a decrease of 19.5% Y-o-Y to reach SAR5,220mn in Q1 2020 compared to SAR6,486mn in Q1 2019. While revenues generated from China decreased by 22.6% Y-o-Y, reaching SAR4,868mn in Q1 2020 compared to SAR6,291mn in Q1 2019.
- North & South America's revenues decreased by 11.9% Y-o-Y to reach SAR2,829mn in Q1 2020 compared to 3,211mn in Q1 2019. Operations in other countries' revenues decreased by 16.3% Y-o-Y to reach SAR3,726mn in Q1 2020 compared to SAR4,451mn in Q1 2019.



Company Analysis

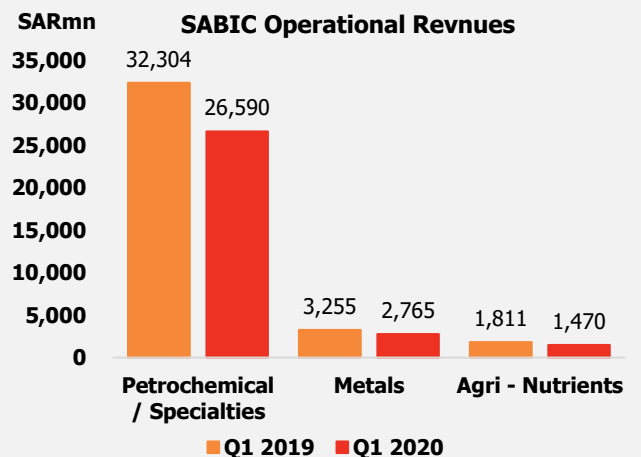
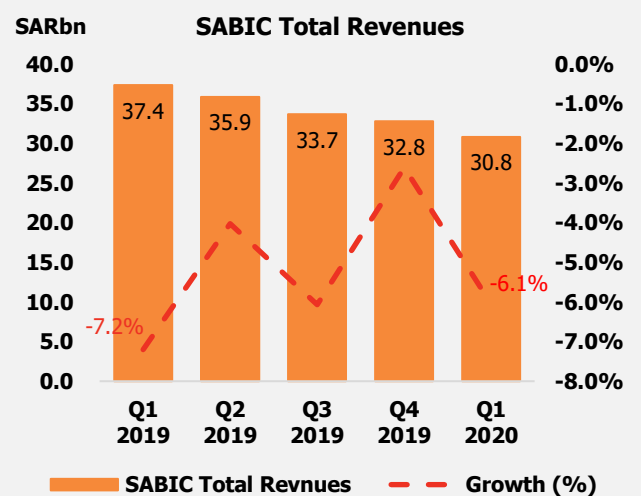
SABIC at Glimpse Cont'd

Operational Revenue Segmentation

- SABIC Total revenues showed a decrease of 17.5% Y-o-Y to reach SAR30,825mn in Q1 2020 compared to SAR37,370mn in Q1 2019. The decrease in the total revenues was due to a decrease in all the company's business segments.

SABIC's total revenues are divided into three main segments, as follows:

- Petrochemicals & Specialties segment** Petrochemicals are produced from hydrocarbon raw materials (feedstock), including ethane and propane, while Specialties include polymer technologies, and innovative process technologies. The increase in demand for urea products as a result of Indian tenders and the American spring season helped increase the SABIC's sales volume of urea products by 6.0% Y-o-Y. Additionally, there was a slight increase in Polyethylene demand due to the increase in the demand for flexible packaging and medical supplies. Nevertheless, Petrochemical & Specialties still showed a decrease of 17.7% Y-o-Y to reach SAR26,590mn in Q1 2020 compared to SAR32,204mn in Q2 2019 due to the low prices during the quarter.
- Agri – Nutrients segment** includes the production of a group of fertilizers, including ammonia and phosphates. This segment showed a decrease of 18.8% Y-o-Y to reach SAR1,470mn in Q1 2020 compared to SAR1,811mn in Q1 2019 due to a combination of low prices and weak demand.
- Metals Segment** is the production of steel products and long products such as rebar. Metal segment revenues also showed a decrease of 15.1% Y-o-Y to reach SAR2,765mn in Q1 2020 compared to SAR3,255mn in Q1 2019 due to weak demand.



Cash Dividends

- Despite the difficult economic conditions and the decline in the company's profits, SABIC is still seeking to maintain its cash distribution to shareholders. SABIC announced a distribution of SAR2.2 per share as cash dividends (22.0% out of the company's total capital) for H2 2019. Additionally, the company distributed SAR2.2 per share for H1 2019. As a result, the total cash dividend distributed in 2019 is SAR4.4 per share (44.0% out of the company total capital). Moreover, SABIC declared its lowest interim dividend since H1 2010, with H1 2020 DPS of SAR 1.5/share (-32% y/y) (15% out of the company's total capital).



Company Analysis

Key Growth Catalysts

SABIC Ambitious Investment Strategy

- Despite challenging conditions in the global economy, SABIC is always seeking to continue its growth strategy to enhance efficiency and improve the company's financial performance. SABIC always seeks sustainability by controlling its costs. Moreover, the company is keen on continually improving its financial performance by increasing its domestic and international investment.
- SABIC announced the establishment of the largest carbon collection plant in the world through its subsidiary company. It is expected that the new plant will be able to collect and purify up to 500,000 metric tons of carbon dioxide resulting from ethylene glycol production processes.
- In 2018, SABIC entered an agreement with a recycling company to recycle 60,000 tons of the Bag House Dust (BHD) SABIC generated to be sold to zinc oxide producers – initiating environmentally responsible disposal of waste as well as turn cost into revenue.
- SABIC signed a 7-year partnership agreement with Emerson to implement and adopt digital transformation programs and improve production levels.
- As a result of the company's investment expansion both domestically and internationally, SABIC brand value showed an increase to reach USD4.3bn in 2020, according to Brand Finance Agency, which specialized in strategic consulting. Moreover, Forbes announced a list of the 2000 strongest companies around the world based on the value of assets, market value, net profit, and revenue with equal proportional weights. SABIC ranked in the second position in Saudi Arabia companies after Saudi Aramco, while it ranked in the third position in the Arab countries, and 212 globally.
- We expect that SABIC will continue its ambitious investment plans despite the challenges that it is facing. According to the company CEO, SABIC will reduce its costs, but it will exclude the financing of new projects that have reached their final stages.

Top 5 Arab Companies on Forbes Global 2000 List

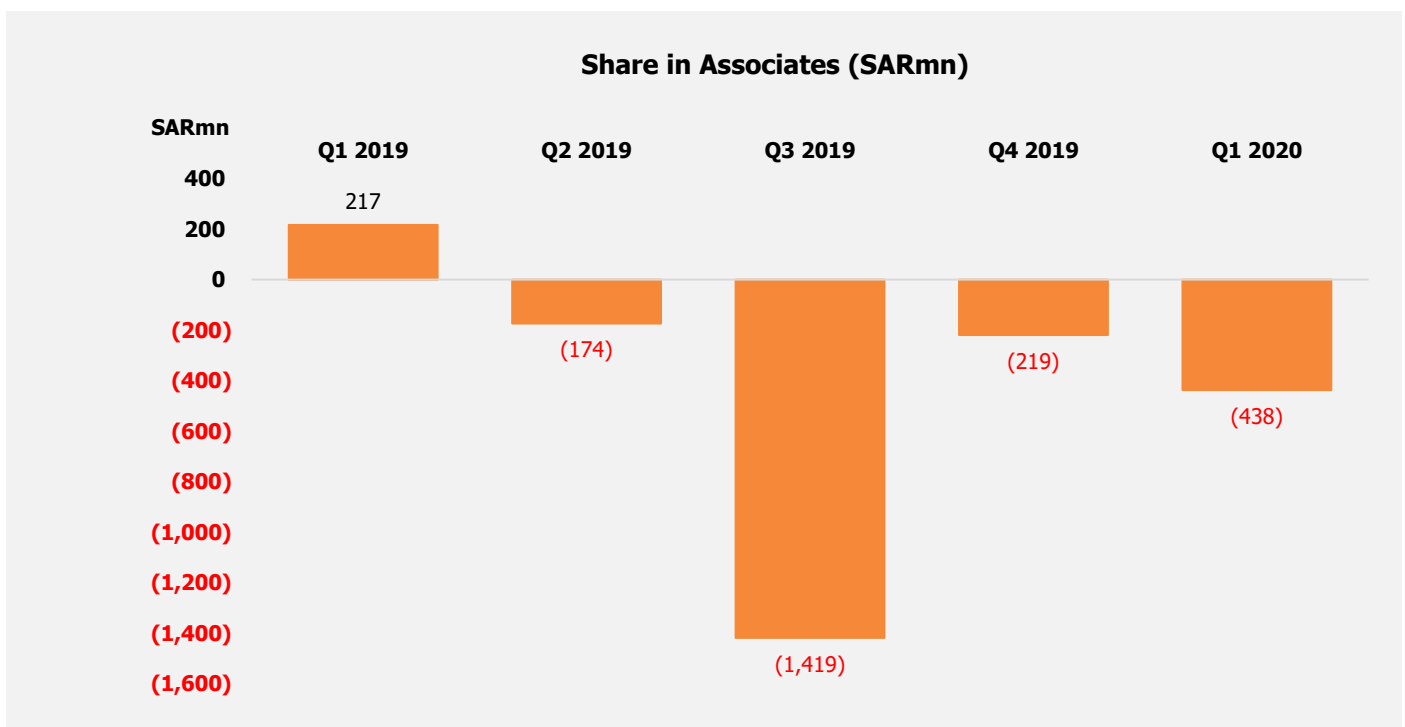
Middle East Rank	Global Rank	Company Name	Country	Sales*	Net Income*	Assets*	Market Value*
1	5	Saudi Aramco 	KSA	329.8	88.2	398.3	1,684.8
2	190	QNB 	Qatar	15.9	3.9	264.9	43.7
3	212	SABIC 	KSA	37.3	1.5	83.4	59.8
4	303	FAB 	UAE	8.9	3.1	227.4	34.4
5	335	STC 	KSA	14.6	2.9	32.1	48.3

*All values are in USD bn

Company Analysis

SABIC's stake in Clariant AG

- In March 2020, SABIC purchased additional shares in Clariant AG, raising its stake from 25% to 31.5%. As part of the company's growth strategy to achieve a leadership position among global peers. Despite previously recording a SAR1.5bn as provisions in Clariant AG, the company is expected to benefit significantly from its increased stake in Clariant AG.
- Clariant AG was established in 1995 in Switzerland, and its main activity to produce and develop, and the distribution of specialized chemicals provides practical solutions to agricultural chemicals, in addition to owning 80 factories worldwide, and its production capacity is 4mn metric tons per year. On June 16th, Clariant AG announced a breakthrough in polypropylene (PP) catalyst technology with a phthalate-free catalyst that can also provide superior properties and improve plant output. The news is expected to significantly boost the value of the Swiss company, potentially leading to a reversal in SABIC's provisions.



Company Analysis

Key Risk Factors

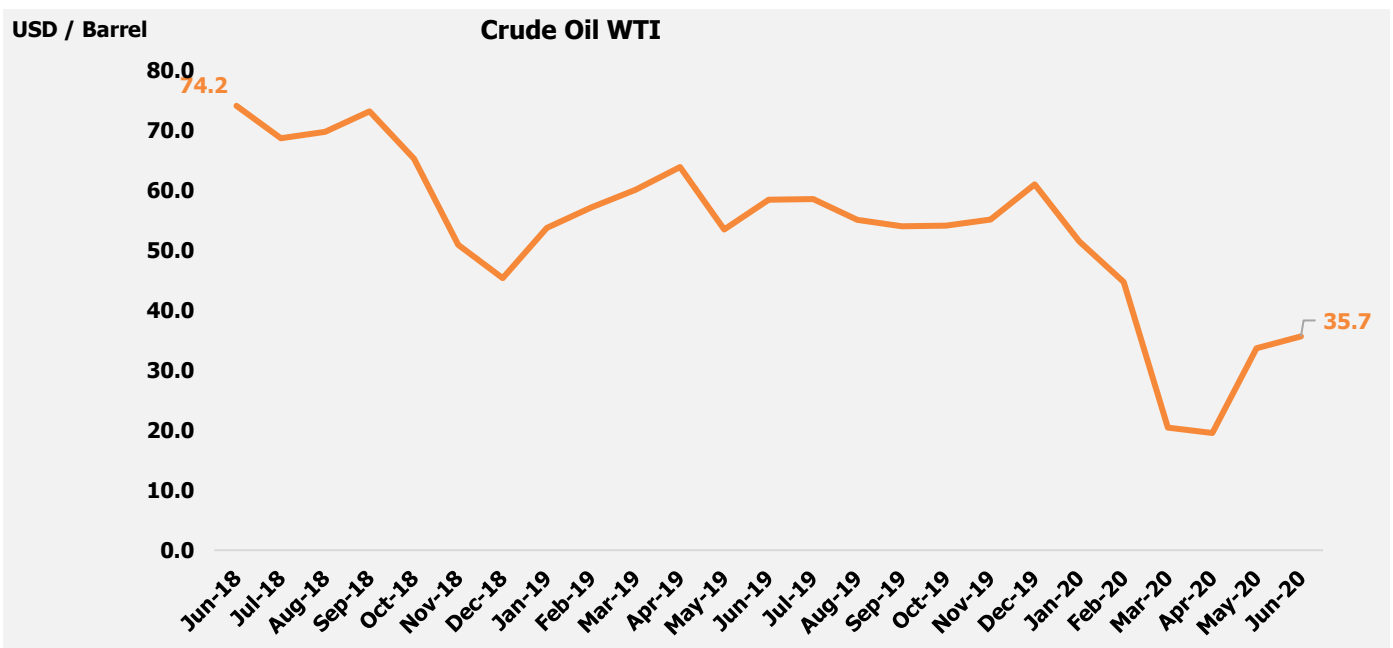
The Negative Impact of the Coronavirus Pandemic

- The spread of the Coronavirus (COVID- 19) in China, which later evolved into a global pandemic, resulted in lockdowns, factory shutdowns, and travel restrictions worldwide. The impact of the COVID-19 crisis on the petrochemicals industry varies across the value chain with major end-use segments like automotive and construction taking a hit. However, demand from packaging and medical applications are helping the industry stay afloat. Nevertheless, the economic shutdowns globally, lead to a severe demand crunch in 2020. The oil and gas industry is no stranger to world economic turmoil; and recently it has brought the industry to a whole new low. Global oil prices crashed down with Brent crude recording USD20.39 on April 21st, as a result of the coronavirus pandemic, which in turn has led to an imbalance in the global oil supply and demand equilibrium. This has created a domino effect impacting the global oil industry and, consequently, affecting the petrochemical industry. The oil sector is currently witnessing its darkest days in over a decade. Moreover, the failure of OPEC+ production cuts agreement and Oil prices have reached unprecedented low numbers. According to the International Energy Agency (IEA), global oil demand is forecasted to be cut by 1.1mb/d during 2020, assuming a return to normal operations in H2 2020. China's demand already fell by 1.8mb/d Y-o-Y with global demand down 2.5mb/d.
- The economic misery enveloping the world, deepened by the crash in oil prices, is expected to have a lasting impact on the medium term. However, the demand growth of key end-use petrochemicals is expected to recover gradually in the coming two years as a rebound in global economic activity is foreseen, following a drastic dip in 2020. Moreover, falling crude oil prices are likely to boost the petrochemical industry, offering investment opportunities. According to the 2018's International Energy Agency (IEA) Report on the petrochemical industry, petrochemical feedstock accounts for 12% of global oil demand, and this share is expected to increase as demand for plastics, fertilizers, and other petrochemical-based products increases. Being the 4th biggest petrochemical company in the world, there is no question that SABIC is currently facing a major challenge with the drop in demand amid the pandemic. However, it is bound to benefit parallel to the recovery in economic activity worldwide.

Company Analysis

US-China Trade Dispute

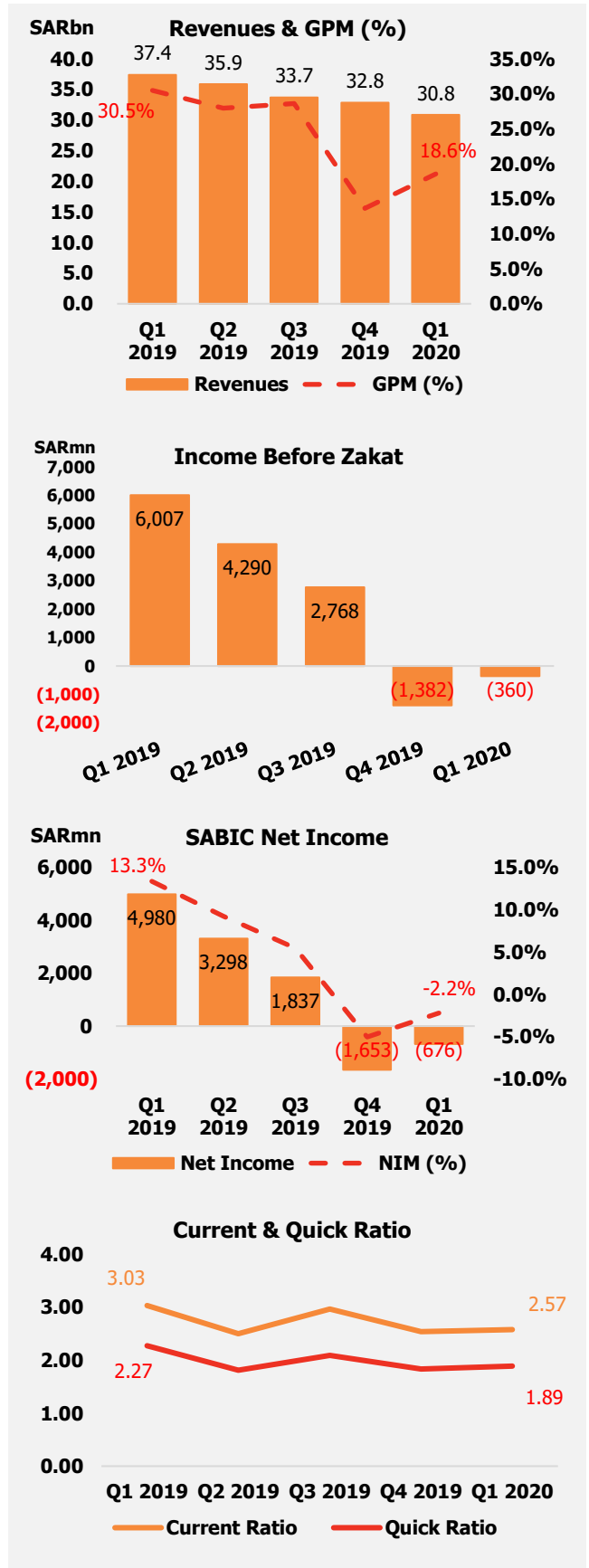
- The US-China trade war is yet another factor that caused an imbalance on a global macroeconomic level, especially in the global petrochemical prices. The trade war started in March 2018, when the US president announced the imposition of three round tariffs on more than 6,000 Chinese imports, which China has responded in kind. The back and forth trade war between the countries resulted in a decreased demand for petrochemical products in the US. Coupled with the US efforts to increase the number of plants, the supply of Petrochemicals increased, which ultimately resulted in a significant drop in global petrochemical prices. However, the coronavirus pandemic added yet another twist to the trade war. In light of the pandemic, the world witnessed a rise of nationalism in both the US and China, especially after the US President announced that China is responsible for the spread of the Coronavirus and that the virus was manufactured in Chinese factories. Existing political constraints may imply that little will be achieved in terms of structural reforms. That being said, the Coronavirus has an unpredictable effect on the general trade environment, especially that the duration of the outbreak is unknown. A fundamental shift in global supply is not farfetched at this point; however, the reboot of manufacturing, despite a possible second wave of infections, reflects the Chinese government's determination to avoid a large-scale reorganization of global supply chains from happening.
- There is a general uncertainty around the US-China Trade war, which is leading to significant fluctuation in the demand and supply dynamics of the petrochemical industry. In light of the fresh wave of coronavirus infections in Beijing, China's economic recovery is facing strong headwinds, which prolongs the uncertainty for the petrochemical industry even further. Like its peers, SABIC has been hit hard by a prolonged trade war between the US and China, which has stifled demand for the chemical product, leading to further pressure in SABIC's profitability.



Company Analysis

Financial Results

- SABIC Total revenues showed a decrease of 17.5% Y-o-Y to reach SAR30,825mn in Q1 2020 compared to SAR37,370mn in Q1 2019. The decrease was due to the general crunch in demand and the drop in oil prices. The drop in SABIC revenues wasn't due to a decrease in efficiency; it was the general theme of the industry during the quarter.
- SABIC's gross profit showed a dramatic decrease representing 49.8% Y-o-Y to reach SAR5,723mn in Q1 2020 compared to SAR11,390mn in Q1 2019. The drop in gross profit resulted in a drop in Gross Profit Margin (GPM) by 11.9% Y-o-Y to reach 18.6% in Q1 2020 compared to 30.5% in Q1 2019.
- SABIC was able to maintain its SG&A, but due to the decrease in the company's total revenues, however, SABIC's EBIT decreased by 92.3% Y-o-Y to reach SAR476mn in Q1 2020 compared to SAR6,153mn in Q1 2019.
- SABIC's Share from Associates recorded a loss by SAR438mn in Q1 2020 compared to SAR217mn in Q1 2019. Moreover, the company's finance costs increased by 19.0% Y-o-Y, reaching SAR384mn in Q1 2020 compared to SAR323mn in Q1 2019. On the other hand, SABIC's other Expenses improved during Q1 2020 recording SAR14mn compared to SAR41mn in Q1 2019.
- SABIC's Income Before Zakat decreased by 106.0% Y-o-Y to reach a loss by SAR360mn in Q1 2020 compared to SAR6,007mn in Q1 2019.
- Zakat Expense decreased by 22.2% Y-o-Y and Income Tax recorded an income by SAR209mn in Q1 2020 after it has recorded a loss of SAR352mn in Q1 2019.
- SABIC's net income reported a dip representing 113.6% Y-o-Y, as it reported a loss of SAR676mn in Q1 2020 compared to SAR4,980mn in Q1 2019.
- Despite the decrease in SABIC's current assets by 12.4% Y-o-Y and increase in current liabilities by 3.1% Y-o-Y, SABIC still enjoys a strong financial performance and liquidity. SABIC's current ratio decreased, reaching 2.57 in Q1 2020 compared to 3.03 in Q1 2019, while the quick ratio decreased, reaching 1.89 in Q1 2020 compared to 2.27 in Q1 2019. Despite the decrease in SABIC's current and quick assets ratios, they are still relatively high. Moreover, SABIC successfully slightly decreased its debt to assets ratio during Q1 2020, reaching 16.3% compared to 16.4% in Q1 2019.



Valuation Rational

DCF Valuation

	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	17,407	21,532	28,924	34,681	39,693	21,532
Operating CF	19,560	21,151	26,956	33,151	38,210	21,151
Capex	(12,716)	(13,178)	(15,083)	(16,458)	(19,651)	(13,178)
FCFF	6,843	7,974	11,873	16,693	18,559	7,974
Stub Period (FCF to be discounted)	5,156	7,974	11,873	16,693	18,559	7,974
PV (FCFF)	4,823	6,820	9,266	11,862	11,982	6,820
WACC	9.26%	<p>We have valued SABIC using DCF approach, considering a cost of equity is equal to 9.8% (based on a risk-free rate of 4.38%, market risk premium 7.30%, Beta of 0.77).</p> <p>Based on the DCF valuation, the fair price of SABIC share price is SAR77.4, which is lower than the traded value by 13.1%.</p>				
Perpetuity Growth	3.00%					
PV-FCFF	44,752					
PV-TV	185,785					
Net Debt	(11,447)					
Less: End of services benefits	(18,637)					
Add: Investments	31,669					
Intrinsic Values	232,121					
Shares Outstanding	3,000					
Equity value per share	77.4					
CMP (17-06-2020)	89.0					
Upside / (Downside%)	(13.1%)					

Financial Projection

Local Peers	Country	Code	Market Price (SR)	Market Cap (SRBN)	P/E	Revenue (SRMN)	Net Income (SRMN)
Sabic	KSA	2010	88.7	266.1	172.2	133,195	1,546
Yansab	KSA	2290	51.7	29.1	36.2	5,738	804
Safco	KSA	2020	79.7	33.2	23.1	3,297	1,436
Advanced	KSA	2330	51.0	11.0	15.7	2,482	701
Petrochem	KSA	2002	24.1	11.6	21.6	6,930	538
SIIG	KSA	2250	19.4	8.7	34.6	6,930	253
SIPCHEM	KSA	2310	14.2	10.4	78.7	5,722	132
Tasneee	KSA	2060	10.1	6.8	(3.7)	3,019	(1,843)
Saudi Kayan	KSA	2350	8.6	12.9	(13.5)	8,880	(956)
NAMAA Chem.	KSA	2210	18.2	0.4	(108.9)	498	(4)
Chemanol	KSA	2001	7.1	0.9	(10.1)	527	(84)

Financial Ratios	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Return on Average Assets (%)	9.9%	2.7%	0.1%	1.8%	4.9%	7.2%	8.9%
Return on Average Equity (%)	14.8%	3.9%	0.1%	2.6%	6.9%	10.0%	12.2%
Earnings Before Zakat Margin (%)	21.1%	8.4%	0.3%	5.8%	12.3%	15.3%	17.2%
Net Income Margin (%)	18.9%	6.1%	0.2%	4.4%	10.0%	13.2%	15.1%
Revenue Growth (%)	12.9%	(17.4%)	(21.6%)	5.8%	17.8%	11.1%	10.8%
EPS	10.6	2.8	0.1	1.7	4.5	6.7	8.4

Income Statement	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Revenues	169,128	139,737	109,499	115,888	136,537	151,726	168,135
Cost of Revenues	(111,287)	(104,217)	(87,314)	(87,721)	(99,116)	(106,973)	(117,078)
Gross Profit	57,841	35,520	22,185	28,167	37,421	44,752	51,056
SG&A Expenses	(21,561)	(20,687)	(19,072)	(19,133)	(19,242)	(20,757)	(21,674)
Income from Main Operations	36,280	14,833	3,113	9,034	18,179	23,996	29,382
Net Income for The Period	31,885	8,463	226	5,127	13,636	20,072	25,338

Balance Sheet	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Total Current Assets	107,588	94,961	80,340	73,023	74,234	75,497	79,068
Total Non-Current Assets	212,123	215,405	212,657	207,528	205,648	205,985	209,936
Total Assets	319,711	310,366	292,997	280,551	279,881	281,482	289,004
Total Current Liabilities	37,881	37,447	33,007	33,082	36,376	38,462	41,164
Total Non-Current Liabilities	60,394	61,667	57,513	51,866	46,266	40,709	35,190
Total Liabilities	98,274	99,114	90,520	84,948	82,642	79,170	76,354
Total Liabilities and Equity	319,711	310,366	292,997	280,551	279,881	281,482	289,004

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

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