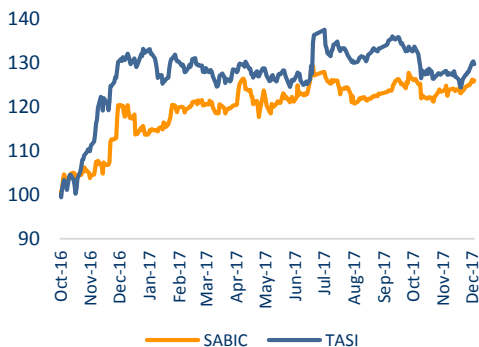


**Initiation Coverage**
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<b>Recommendation</b>	<b>Neutral</b>
Current Price (SAR)	101.40
Target Price (SAR)	105.91
Upside/Downside (%)	4.45%

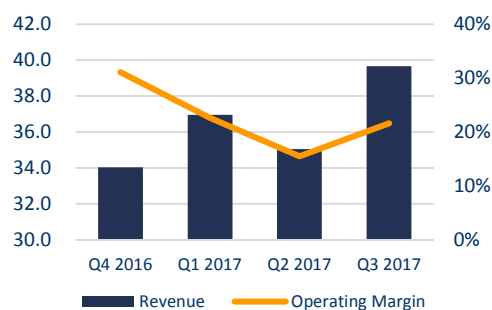
*As of December 05, 2017*
**Key Data (Source: Bloomberg)**

Market Cap (SAR bn)	302.7
52 Wk High (SAR)	105.4
52 Wk Low (SAR)	90.5
Total Outstanding shares (in bn)	3.0
Free Float (%)	24.1%

**SABIC Vs TASI (Rebased)**


Price Performance (%)	Absolute	Relative
1m	-1.2	-0.2
6m	-2.9	-1.0
12m	-6.1	-6.1

Major Shareholders (%)	%
Public Investment Fund	70.0%
General Organization for Social Insurance	5.7%
Saudi British Bank	0.2%

**Quarterly Sales (SAR bn) and Operating Margin**

*Source: Bloomberg, Company Financials, Falcom Research; Data as of 05<sup>th</sup> December 2017*

SABIC's 3Q17 earnings beat consensus with net income rising to SAR 5.74bn (+59% QoQ, +40% vs. consensus and +11% YoY). The performance in 3Q17 primarily reflected higher selling prices and volumes compared to the year-ago period. Margins moved higher to 35.6% as all segments performed well.

SABIC's large-scale, diversified operations and strong government backing are key positives. However, our neutral stance on the stock is based on oversupply in the petrochemicals market, the lack of near-term volume enhancements, and concerns over feedstock price hikes in KSA.

**Petrochemical prices likely to see some pressure**

During 2011–16, global ethylene and propylene consumption rose at a CAGR of 3% and 7%, respectively, with Asia emerging as the key growth engine for demand. However, increased supply is likely to outpace future demand growth amid China's plans to raise its ethylene capacity by 71% and propylene capacity by 21%, in addition to aggressive shale-driven investments in the US. This would contribute to a bearish price outlook for SABIC's products.

**No significant volume enhancements in near term**

SABIC's project pipeline includes an ethane steam cracker plant in partnership with Exxon Mobil (on the US Gulf Coast), a direct oil-to-chemical plant with Aramco, and a CTO plant with Shenhua (in China). All three projects are being set up as 50:50 joint ventures. However, none of these projects are likely to come on stream within the next 5 years, limiting volume growth prospects.

**Inorganic growth to offset weaker oil prices**

The company is expected to benefit from a number of plant startups and acquisitions. The USD 3.4bn EPDM rubber JV with Exxon, the USD 1.4bn MMA JV with Mitsubishi, the purchase of the SADAF JV from Shell, and recent talks to acquire Grasim in India would enhance earnings.

**Multi-year input cost tailwind begins to fade**

Historically, low prices of key raw materials have been a key margin tailwind for SABIC. Ethane prices increased to USD 1.75/mmbtu at the start of 2016 from USD 0.75/mmbtu previously. Even after the hike, ethane prices in KSA are significantly below those in the US and Europe. However, we believe the discounted feedstock-driven growth is slowing down and there is a potential for further feedstock price hikes in KSA.

**Balance sheet position ideal to fund growth and support dividends**

SABIC enjoys a healthy balance sheet position, with cash of SAR 49.8bn as of 3Q17. The company's net debt/EBITDA ratio declined to 0.2x in 2016 from 0.8x in 2012. The company's recent announcements to spend USD 3bn to USD 10bn on acquisitions over the next five years in agri-nutrients and specialties are well justified by its balance sheet strength, which could further support the high dividend payout.

**Valuation:** We valued SABIC using the DCF approach to arrive at a fair value of SAR 105.9 per share. We considered WACC at 8.8% with a terminal growth rate of 1.5%.

	2016	2017e	2018e	2019e
Revenues (SAR bn)	132.8	165.9	172.6	179.7
Operating Profit (SAR bn)	26.8	34.3	37.7	38.4
EPS (SAR)	5.9	8.2	9.4	9.5
Operating Margin (%)	20.2%	20.7%	21.8%	21.4%
RoE (%)	12.4%	15.7%	16.3%	15.5%
D/E (x)	0.31	0.23	0.15	0.12
P/E (x)	15.4x	12.3x	10.8x	10.6x
Price/BV (x)	0.9x	1.0x	1.0x	0.9x
EV/EBITDA (x)	9.4	7.6	6.7	6.4

*Source: Company Financials, Falcom Research*

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## Valuation Summary

### Explanation of the valuation methodology and assumptions

We valued SABIC using the DCF approach to arrive at a fair value of SAR 105.9 per share. We considered WACC at 8.8% with a terminal growth rate of 1.5%.

In relative terms, SABIC is trading at 1yr forward PE of 14.4x, showing a premium of 8.8% to its sector peers and close to 13% to Tadawul All Share Index.

SAR Mn	FY 2016A	FY 2017E	FY 2018E	FY 2019E	FY 2020E	
EBIT	26,778	34,349	37,657	38,357	38,788	
Taxes	(3,000)	(2,830)	(3,226)	(3,268)	(3,322)	
Depreciation, amortization and impairment	14,860	13,810	14,496	15,358	16,418	
Changes in working capital	1,100	(6,888)	(1,156)	(651)	375	
Net capital expenditure	(13,098)	(16,481)	(17,147)	(21,559)	(26,505)	
<b>Free Cash Flow to firm</b>	<b>26,641</b>	<b>21,960</b>	<b>30,624</b>	<b>28,238</b>	<b>25,755</b>	
Discount Factor		1.0	0.9	0.8	0.8	
<b>PV of free cash flow to firm</b>		<b>22,089</b>	<b>27,983</b>	<b>23,715</b>	<b>19,880</b>	
<b>Net Present Value (A)</b>					<b>93,668</b>	
<b>PV Terminal Value (B)</b>					<b>276,418</b>	
<b>Assumed Terminal Growth Rate</b>					<b>1.5%</b>	
<b>Discount Rate</b>					<b>8.8%</b>	
<b>Enterprise Value (A+B)</b>	<b>370,086</b>	<b>WACC Assumptions</b>				
<b>Total Cash</b>	49,846	Risk free rate				2.5%
<b>Total Debt</b>	59,349	Market returns				11.8%
<b>Minority Interest</b>	42,849	Beta				0.9x
<b>Equity Value in SAR mn</b>	<b>317,734</b>	<b>Cost of equity</b>				<b>13.1%</b>
<b>Number of shares in mn</b>	3,000	<b>Post tax cost of debt</b>				<b>2.3%</b>
<b>Target Price in SAR per share</b>	<b>105.9</b>	Weight of equity in capital structure				60.0%
<b>CMP in SAR as on December 05<sup>th</sup> 2017</b>	<b>101.4</b>	Weight of debt in capital structure				40.0%
<b>Upside/(Downside) to current market price</b>	<b>4.4%</b>	<b>WACC</b>				<b>8.8%</b>

Source: Company Financials, Falcom Research Estimates

### Risks

#### Upside Risks:

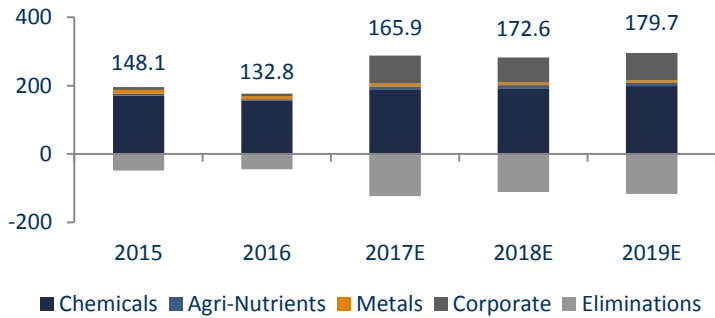
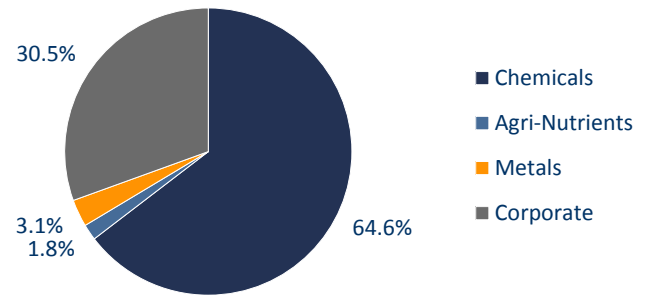
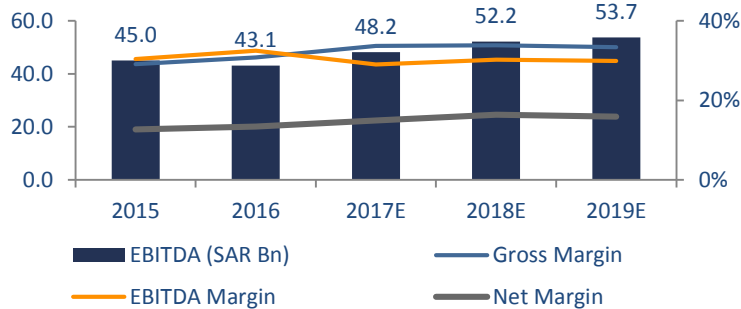
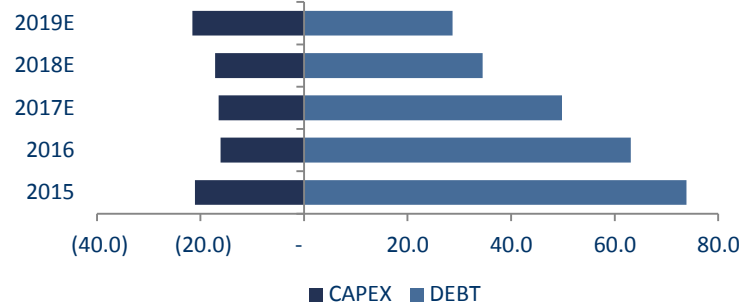
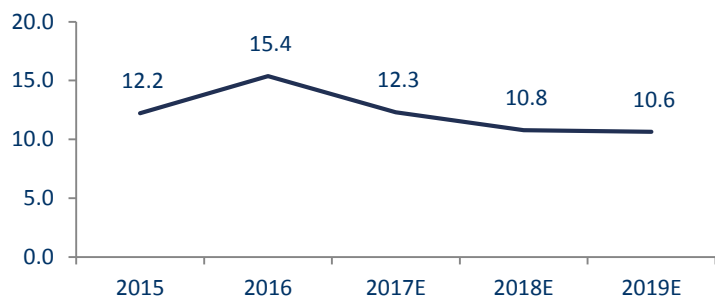
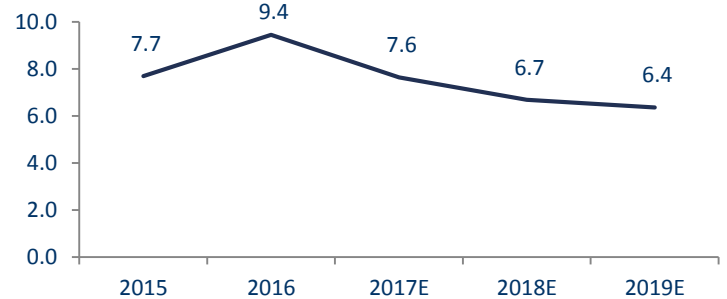
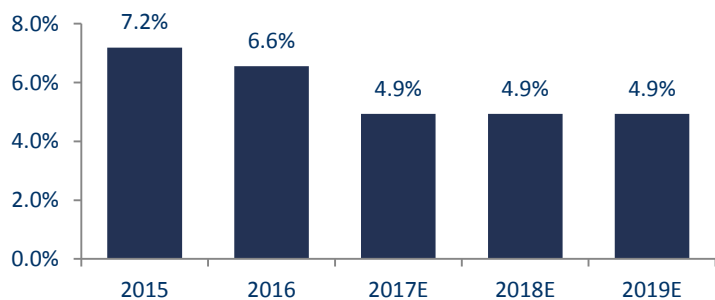
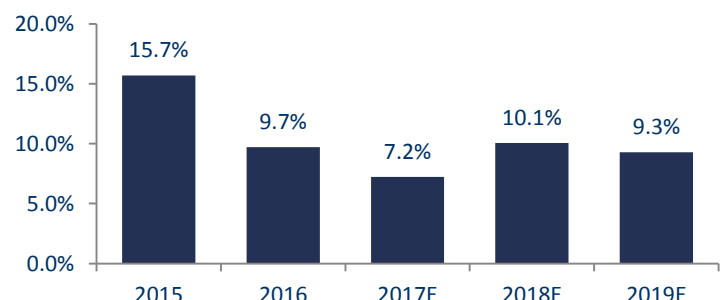
- Similar to SADAF, if SABIC can buy out its remaining interest in JVs at a low cost it could result in higher earnings.
- Increase in oil wells discovery could prove positive and may result in a positive impact.
- Possible inclusion of SABIC in MSCI EM index would lead to greater interest in the stock, which would push the prices up.

#### Downside Risks

- M&A and overspending risks: Considering the company's recent investment announcements, any high cost acquisition with low returns (that do not add to long-term value) could be a potential risk. Overspending on inorganic growth could result in lower dividends.
- SABIC's profitability depends highly on prices of oil and oil constituents (chemicals). Higher oil and gas prices could impact the company's overall margins due to increase in raw material prices.
- The Saudi government provides gas allocations to SABIC at fixed subsidized prices and there has been a hike in these prices recently. Tightened government revenue might make it difficult for the government to subsidize SABIC at historical levels, resulting in increase in cost and lower margins.

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**Key Charts**
**Revenue (SAR bn)**

**Revenue Split (9 months 2017)**

**EBITDA & Margins**

**CAPEX and Total Debt**

**Price to Earnings**

**EV/EBITDA**

**Dividend Yield**

**Free Cash Flow Yield**


Source: Falcom Research Estimates

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**Summary Financials**

P&L (SAR mn)	2016	2017e	2018e	2019e
Sales	132,827	165,864	172,559	179,655
Gross Profit	40,910	55,912	58,364	59,915
EBITDA	43,106	48,159	52,153	53,715
EBIT	26,778	34,349	37,657	38,357
Associates	876	878	879	881
Net Interest	(1,690)	(997)	(690)	(574)
Other	2,085	2,200	2,552	2,258
PBT	28,049	36,429	40,398	40,921
Zakat	3,000	2,830	3,226	3,268
Minorities	(7,210)	(8,850)	(8,966)	(9,082)
Net Income	17,839	24,749	28,207	28,571
EPS	5.9	8.2	9.4	9.5
DPS	6.0	5.0	5.0	5.0

BS (SAR mn)	2016	2017e	2018e	2019e
Cash	40,248	46,696	41,312	42,790
Current Assets	67,378	63,488	64,716	66,248
Fixed Assets	170,350	173,022	175,672	181,873
Intangibles	12,926	13,387	13,387	13,387
Total Assets	313,855	319,279	317,798	327,033
Current Liabilities	28,168	33,170	33,242	34,123
Short Term Debt	13,212	11,916	11,916	11,916
Long Term Debt	49,898	37,940	22,595	16,785
Shareholders Equities	202,079	214,681	228,474	242,638
Total Liabilities	313,855	319,279	317,798	327,033

CF (SAR mn)	2016	2017e	2018e	2019e
Operating Cash Flow	38,601	50,647	50,789	52,131
Working Capital Changes	1,100	(6,888)	(1,156)	(651)
Cash Flow from Operating Activities	39,701	43,759	49,633	51,480
Capex	(13,690)	(16,942)	(17,147)	(21,559)
Cash Flow from Investing Activities	(4,217)	(3,060)	(16,292)	(20,703)
Changes in Debt	(10,588)	(13,254)	(15,345)	(5,811)
Dividends	(14,914)	(15,002)	(15,002)	(15,002)
Cash Flow from Financing Activities	(33,367)	(34,251)	(38,725)	(29,300)

Source: Bloomberg, Company Financials, Falcom Research

Growth	2016	2017e	2018e	2019e
Revenue	-10.3%	24.9%	4.0%	4.1%
EBITDA	-4.2%	11.7%	8.3%	3.0%
Operating profit	-6.1%	28.3%	9.6%	1.9%
PBT	-0.1%	32.3%	14.0%	1.3%
Net Income	-5.0%	38.7%	14.0%	1.3%

Ratios (%)	2016	2017e	2018e	2019e
Gross Margin	30.8%	33.7%	33.8%	33.4%
EBITDA Margin	32.5%	29.0%	30.2%	29.9%
EBIT Margin	20.2%	20.7%	21.8%	21.4%
Net Margin	13.4%	14.9%	16.3%	15.9%
ROE	8.8%	11.5%	12.3%	11.8%
ROCE	9.8%	12.5%	13.8%	13.7%
ROA	5.7%	7.8%	8.9%	8.7%
Debt/Equity	0.31	0.23	0.15	0.12
Net Debt/EBITDA	0.53	0.07	(0.13)	(0.26)
FCF Yield	9.7%	7.2%	10.1%	9.3%
Dividend Yield	6.6%	4.9%	4.9%	4.9%

Valuation	2016	2017e	2018e	2019e
PE	15.4	12.3	10.8	10.6
PB	0.9	1.0	1.0	0.9
EV/EBITDA	9.4	7.6	6.7	6.4
EV/EBIT	5.9	5.4	4.8	4.5
EV/Sales	1.9	1.6	1.5	1.4

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Advanced Petrochemical Co	13.2	11.6
Yanbu National Petrochemicals Co	14.2	9.3
Saudi Arabia Fertilizers Co	18.7	14.5
Saudi Kayan Petrochemical Co	12.9	8.8
National Industrialization Company	13.7	7.2
Saudi Industrial Investment Group	8.7	7.6
National Petrochemical Company	12.3	8.6
<b>Saudi Basic Industries</b>	<b>14.4</b>	<b>7.4</b>
<b>Sector Median</b>	<b>13.2</b>	<b>8.8</b>
<b>TASI</b>	<b>12.7</b>	<b>10.0</b>

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## Falcom Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

**Overweight:** The Target share price exceeds the current share price by  $\geq 10\%$ .

**Neutral:** The Target share price is either more or less than the current share price by 10%.

**Underweight:** The Target share price is less than the current share price by  $\geq 10\%$ .

**To be Revised:** No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services Research.

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