

Initiation Coverage
June 08, 2018

Recommendation	Overweight
Current Price (SAR)	27.8
Target Price (SAR)	30.6
Upside/Downside (%)	11.1%

As of June 07, 2018
Key Data (Source: Bloomberg)

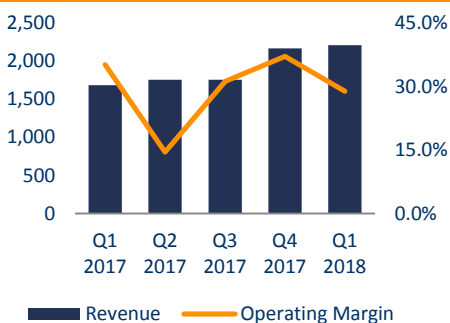
Market Cap (SAR bn)	12.49
52 Wk High (SAR)	28.55
52 Wk Low (SAR)	18.44
Total Outstanding shares (in mn)	450.0
Free Float (%)	82.91%

SIIG vs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	-1.3%	-4.0%
6m	44.1%	28.0%
12m	39.9%	27.0%

Major Shareholders (%)

Public Pension Agency	10.67%
General Organization for Social Insurance	5.80%

Quarterly Sales (SAR mn) and Operating Margin


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 07th June, 2018

In 1Q18, Saudi Investment Group (SIIG) reported revenues worth SAR 2.2bn, a 31.2% YoY increase. The revenue growth was mainly driven by higher volume and increase in average selling prices of key products. However, net profit declined 35.7% YoY to SAR 199.0mn mainly due to lower income from associates and higher operating expenses from its subsidiary National Petrochemical Company. In FY 2017, the Company recorded 21.4% YoY growth in revenues to SAR 7.4bn primarily driven by higher average selling prices of products. Gross margins increased to 30.7% in 2017 compared to 26.5% in 2016 led by an increase in gross profit of its subsidiary National Petrochemical Company (Petrochem). SIIG's net profit for FY 2017 was SAR 1,004.1mn compared to SAR 82.8mn in 2016. The significant increase of net profit was attributed to an increase in the profits on projects managed jointly with Jubail Chevron Phillips (JCP) and Saudi Chevron Phillips (SCP) and an increase in other income. In FY 2017, the Company sold its 50% stake in loss making Petrochemical Conversion Co. Ltd. (PCC) business for SAR 31mn.

Increasing crude oil prices, higher utilisation rates and higher demand of petrochemical products from China are the key positive trends for the company. In addition, a healthy balance sheet and high FCF yield make the stock a good investment bet. After a scheduled maintenance in 1Q18, JCP and SCP plants have restarted functioning and are expected to push net profit higher in the current year. Based on these factors we assign an 'overweight' rating to the stock, with a target price of SAR 30.6.

Surging oil prices, high demand to support prices

SIIG through its subsidiaries is a key producer of propylene and polypropylene (PP) in Saudi Arabia. An increase in propylene and PP prices led by increasing oil prices and growing demand from China and the Indian subcontinent has resulted in a positive revenue growth for the company. As per the Chemical Economics Handbook (HIS), the demand for PP will increase 25% by 2022 from the current levels. SIIG's petrochemical business is expected to benefit from this trend and we expect revenues to grow at 3.5% CAGR from 2017-2021E.

Favourable price environment and anti-pollution measures by China to drive gross margins

China's policy to reduce pollution has forced inefficient factories to shut down, reducing the supply of petrochemical products. China has also imposed 25% tariff on 44 industrial and chemical raw materials imported from the US. These factors are expected to result in higher demand for imported petrochemical products from GCC countries and would lead to higher spreads and gross margins for SIIG.

Strong operational performance is expected to continue into 2018

The Company's operating margins has significantly improved to 28.9% in 1Q18, supported by operational improvements, despite periodic plant shutdowns. Operations at Saudi Chevron Phillips (SCP) and Jubail Chevron Phillips (JCP) plants were re-started in March 2018 after the completion of scheduled maintenance work. Increasing profits from associates companies and higher operating margins bodes well for the future performance of the company.

Healthy balance sheet and high FCF yield provides valuation comfort

SIIG has aggressively reduced its debt to SAR 9.7bn in 1Q18 from SAR 14.1bn in 2014. The Company maintains a healthy cash balance of SAR 3.3bn and its net debt/EBITDA ratio improved to 2.2x in 2017 from 5.0x in 2016. We believe, healthy balance sheet and strong FCF yield provides the financial flexibility to undertake capacity expansion plan and support the high dividend payout.

Valuation: We valued SIIG using the DCF Approach to arrive at a fair value of SAR 30.6 per share. We considered WACC at 9.4%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E	2021E
Revenues (SAR bn)	7.4	8.7	8.9	8.6	8.4
Operating Profit (SAR bn)	2.2	2.3	2.4	2.4	2.2
EPS (SAR)	2.2	2.2	2.3	2.3	2.2
Operating Margin (%)	29.5%	26.0%	26.5%	27.5%	26.5%
D/E (x)	0.7	0.7	0.6	0.5	0.5
RoE (%)	7.5%	6.7%	6.3%	5.8%	5.1%
P/E (x)	8.6	12.6	12.0	12.0	12.7
Price/BV (x)	0.6	0.8	0.8	0.7	0.6
EV/EBITDA (x)	7.2	8.2	7.7	7.5	7.6

Source: Company Financials, FALCOM Research

Initiation Coverage

June 08, 2018

Valuation Summary

Explanation of valuation methodology and assumptions

We valued Saudi Industrial Investment group using the DCF Approach to arrive at a fair value of SAR 30.6 per share. We considered WACC at 9.4% with a terminal growth rate of 2.0%. In relative terms, SIIG is trading at 1yr forward P/E of 12.6x, at a discount of 12.7% to its sector peers and at a discount of 7.5% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E
EBIT	2,170	2,254	2,355	2,364	2,238
Taxes	(253)	(249)	(261)	(262)	(246)
Depreciation, amortization and impairment	914	945	981	1,015	1,049
Changes in working capital	(621)	(754)	(268)	(116)	(197)
Net capital expenditure	(88)	(693)	(799)	(773)	(760)
Free Cash Flow to firm	1,503	1,503	2,007	2,228	2,084
<i>Discount Factor</i>		0.9	0.9	0.8	0.7
PV of free cash flow to firm		1,424	1,738	1,764	1,508
Net Present Value (A)					6,434
PV Terminal Value (B)					20,785
Assumed Terminal Growth Rate					2.0%
Discount Rate					9.4%
Enterprise Value (A+B)	27,219	WACC Assumptions			
Total Cash	3,330	Risk free rate	3.1%		
Total Debt	9,657	Market returns	8.5%		
Minority Interest	7,109	Beta	1.4x		
Equity Value in SAR mn	13,783	Cost of equity	14.9%		
Number of shares in mn	450	Post tax cost of debt	3.6%		
Target Price in SAR per share	30.6	Weight of equity in capital structure	51.3%		
CMP in SAR as on June 07th, 2018	27.8	Weight of debt in capital structure	48.7%		
Upside/(Downside) to current market price	11.1%	WACC	9.4%		

Source: Company Financials, FALCOM Research Estimates

Risks

Upside Risks:

- Higher-than-expected product selling prices can significantly increase top line and bottom line.
- Rising crude prices and escalation in China-US trade war would increase the non-US exports to China which would positively impact the top line of petrochem producers in GCC countries.

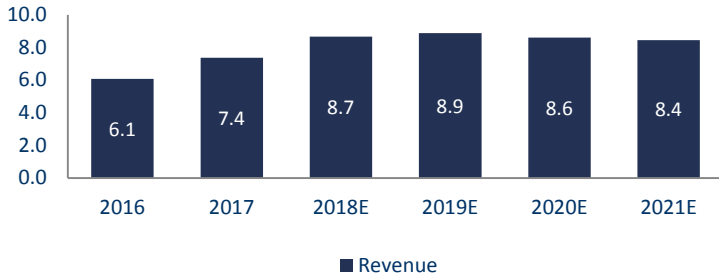
Downside Risks

- Lower than expected earnings from associates might hurt SIIG's net income and margins.
- Weaker-than-expected capacity utilization could weigh on revenue growth.
- Reduction between the propane (feedstock) and propylene (product) spread would impact the company's margins.

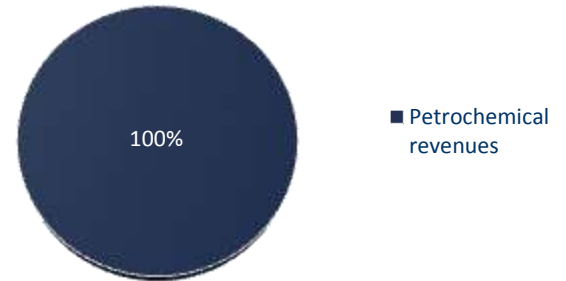


Key Charts

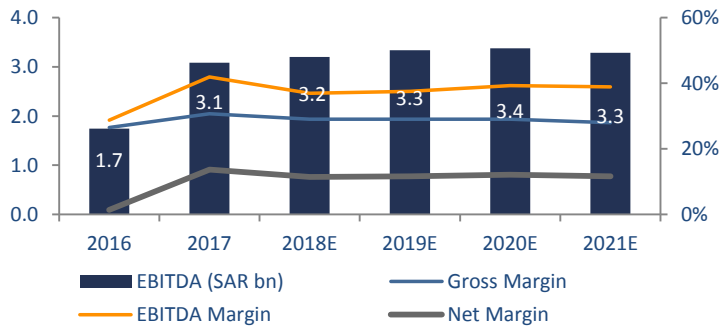
Revenue (SAR bn)



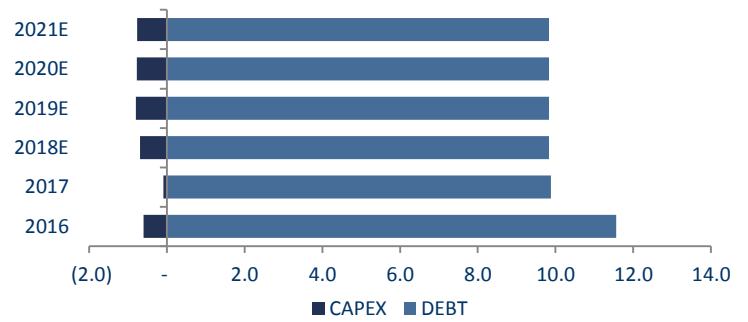
Revenue Split (2017)



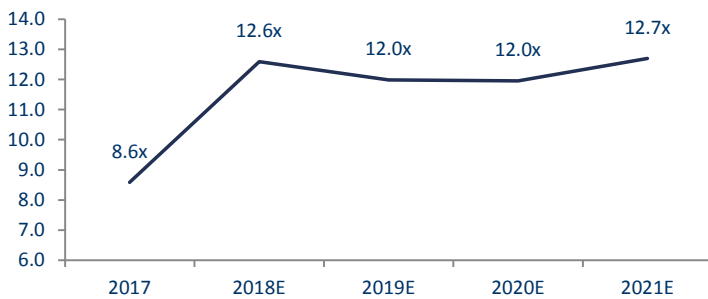
EBITDA & Margins



CAPEX and Debt (SAR bn)



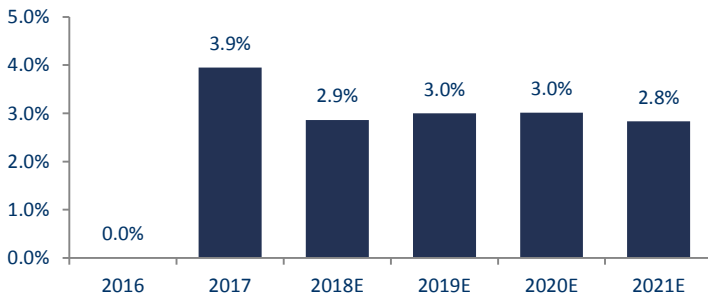
Price to Earnings



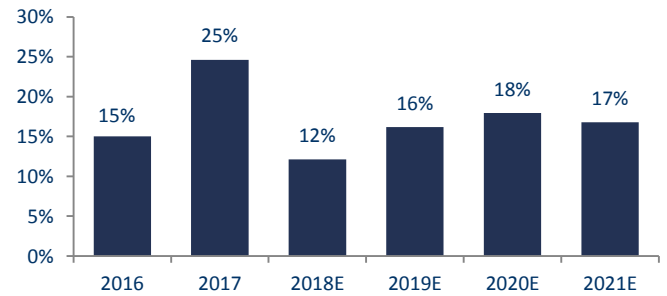
EV/EBITDA



Dividend Yield



FCF Yield



Source: FALCOM Research Estimates

Initiation Coverage

June 08, 2018

Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	7,364	8,661	8,883	8,593
Gross Profit	2,264	2,512	2,576	2,492
EBITDA	3,083	3,199	3,336	3,380
EBIT	2,170	2,254	2,355	2,364
Associates	609	609	667	732
Net Interest	(269)	(268)	(268)	(268)
Other	177	87	89	86
PBT	2,109	2,073	2,176	2,182
Zakat	(253)	(249)	(261)	(262)
Minorities	(852)	(838)	(879)	(882)
Net Income	1,004	987	1,036	1,039
EPS	2.2	2.2	2.3	2.3
DPS	0.8	0.8	0.8	0.8

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	3,107	3,704	4,893	6,274
Current Assets	6,654	8,207	9,684	11,155
Fixed Assets	16,072	15,820	15,639	15,397
Intangibles	-	-	-	-
Investments in Joint projects	2,470	2,708	2,969	3,255
Total Assets	25,312	26,855	28,412	29,928
Current Liabilities	3,035	3,145	3,207	3,223
Short Term Debt	1,368	1,359	1,401	1,443
Long Term Debt	8,514	8,471	8,429	8,387
Shareholders Equities	13,320	14,789	16,331	17,878
Total Liabilities & Shareholders' Equity	25,312	26,855	28,412	29,928

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	2,320	2,667	2,891	2,931
Working Capital Changes	(621)	(754)	(268)	(116)
Cash Flow from Operating Activities	1,699	1,913	2,623	2,815
Capex	88	693	799	773
Cash Flow from Investing Activities	632	(909)	(1,061)	(1,060)
Changes in Debt	(1,717)	(52)	-	-
Dividends	(340)	(355)	(373)	(374)
Cash Flow from Financing Activities	(2,057)	(407)	(373)	(374)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue Growth	21.4%	17.6%	2.6%	-3.3%
EBITDA Growth	76.6%	3.8%	4.3%	1.3%
Operating profit Growth	133.8%	3.9%	4.5%	0.4%
PBT Growth	202.0%	-1.7%	5.0%	0.3%
Net Income Growth	1112.9%	-1.7%	5.0%	0.3%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	30.7%	29.0%	29.0%	29.0%
EBITDA Margin	41.9%	36.9%	37.6%	39.3%
EBIT Margin	29.5%	26.0%	26.5%	27.5%
Net Margin	13.6%	11.4%	11.7%	12.1%
ROE	7.5%	6.7%	6.3%	5.8%
ROCE	9.7%	9.5%	9.3%	8.9%
ROA	4.0%	3.7%	3.6%	3.5%
Debt/Equity	0.7	0.7	0.6	0.5
Net Debt/EBITDA	2.2	1.9	1.5	1.1
FCF Yield	24.6%	12.1%	16.2%	17.9%
Dividend Yield	3.9%	2.9%	3.0%	3.0%

Valuation	2017	2018E	2019E	2020E
PE	8.6x	12.6x	12.0x	12.0x
PB	0.6x	0.8x	0.8x	0.7x
EV/EBITDA	7.2x	8.2x	7.7x	7.5x
EV/EBIT	10.2x	11.6x	11.0x	10.7x
EV/Sales	3.0x	3.0x	2.9x	2.9x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Advanced Petrochemical	14.3x	10.6x
Saudi Kayan Petrochemical	14.5x	9.1x
Saudi International Petrochemical Company	12.5x	7.4x
Saudi Basic Industries	16.4x	8.3x
Yanbu National Petrochemicals	14.9x	9.8x
National Petrochemical Company	13.0x	8.7x
Saudi Industrial Investment Group	12.6x	8.2x
Sector Median	14.4x	8.9x
TASI	13.6x	9.7x

Initiation Coverage

June 08, 2018

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.

FALCOM Financial Services

Contact us on the below phone numbers:

Customer Services: 8004298888

Brokerage Services: 920004711

Fax or Email us at the below number:

Fax: +966 11 2032546

Email: addingvalue@falcom.com.sa

Mail us at the following address:

P.O. Box 884

Riyadh 11421

Kingdom of Saudi Arabia

Disclaimer and Risks Warning:

The information in this report was compiled from various public sources believed to be reliable and whilst all reasonable care has been taken to ensure that the facts stated in this report are accurate and that the forecasts, opinions, future prices and expectations contained herein are fair and reasonable, FALCOM makes no representations or warranties whatsoever as to the accuracy of the data and information provided and, in particular, FALCOM does not represent that the information or expected future prices in this report is complete or free from any error. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any financial securities. Accordingly, no reliance should be placed on the accuracy, fairness or completeness of the information or the expected prices contained in this report. FALCOM accepts no liability whatsoever for any loss arising from any use of this report or its contents, and FALCOM shall not be in any way responsible for the contents hereof. Opinions, forecasts or price projections contained in this report represent FALCOM's current opinions or judgment as at the date of this report only and are therefore subject to change without notice. There can be no assurance that future results, prices or events will match any such opinions, forecasts or prices projections which represent only one possible outcome and these price estimates may not occur in the future whatsoever. Further, such opinions, forecasts or price projections are subject to certain risks, uncertainties and assumptions that have not been verified and future actual results or events could differ materially. Any value or price, or income from, any investments referred to in this report may fluctuate and/or be affected by changes. Past performance is not necessarily an indicative of future performance. Accordingly, investors may receive back less than originally invested amount. This report provides information of a general nature and does not address the circumstances, objectives, and risk tolerance of any particular investor. Therefore, the person who obtain a copy of this report should understand that this report is not intended to provide personal investment advice and does not take into account his/her financial situation or any specific investment objectives or particular needs which he/she may have. Before making an investment decision the investors should seek advice from an independent financial, investment and/or other required advisers due to the investment in such kind of securities may not be suitable for all recipients. This research report might not be reproduced, nor distributed in whole or in part, and all information, opinions, forecasts and price estimates contained; are protected by the intellectual property laws, copyright and publishing rules and regulations applied in the Kingdom of Saudi Arabia.

All rights reserved.

FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.