

SIDPEC

Company Report

31 May 2010



Present Valuation Implies too Bearish a Scenario

- YTD SIDPEC has given better returns than regional petrochemical peers in absolute terms and when compared to the local index
- Market is banking on an unrealistic scenario of a 25% fall in petrochemical prices and operating rates of 85% at SIDPEC or a 30% fall in prices
- SIDPEC is much more defensive than regional peers given its lower dependency on exports, low beta, and higher dividend yields; we reiterate our Buy rating and TP of EGP16.7/share (56% upside)

Outperformance compared to regional petrochemical peers: Year-to-date (YTD) SIDPEC has given better returns than major global petrochemical companies, and has outperformed the local market index as well. However, in the last four weeks SIDPEC has fallen sharply and has also underperformed compared to Egypt's index. This sharp fall sets it up nicely for recovery in the coming weeks given its better defensive business operations, lower dependency on exports, higher dividend yields and natural currency hedge.

Market is over-discounting oil prices and ignoring margin defensiveness: SIDPEC's current share price implies crude oil prices of less than USD60/bbl based on a historical relationship between oil prices and SIDPEC's share price. The market also seems to be ignoring the fact that SIDPEC's margins are much more defensive than other regional peers because SIDPEC's feedstock price is linked to petrochemical prices and is floating in nature rather than fixed.

Current price implies too bearish an outlook: To justify the current valuation, petrochemical prices need to fall by over 30% along with a hefty reduction in operating rates in the long term. Reduction in operating rates to below 95% looks unlikely in the long term given that the company has never operated below this level even under crisis conditions in 2008 and 2009.

Minimal risk to dividends: Our sensitivity analysis shows that even under an extremely bearish scenario, SIDPEC's dividend yield would still hold itself above 8%. Even if prices fall by 20%, SIDPEC's dividends this year would be higher than last year's dividend of EGP1.25/share.

Valuation: SIDPEC currently trades at a PE multiple of 6.9x against our estimated fair PE multiple of 10.0x. We use a weighted average to arrive at SIDPEC's target price by assigning a 50% weight to the market-based relative valuation and 50% to the DCF valuation.

KPIs (EGP mn)	2009a	2010e	2010c	2011e
Revenue	1,683	1,948	2,004	1,998
EBITDA	815	941	1,025	988
EBITDA Margin	48%	48%	51%	49%
Net Income	759	862	859	769
EPS	1.45	1.64	1.64	1.46
EPS Growth	-24%	13%	13%	-11%
P/E	7.20	6.82	6.85	7.65
EV/EBITDA	5.50	5.20	4.78	4.95
Dividend Yield	16%	11%	13%	12%

Buy

Target Price (EGP)	16.7
Market Price (EGP)	10.7
Upside	56.0%

Listed on	EGX
Bloomberg Code	SKPC EY
Reuters Code	SKPC.CA

Market Cap (EGP mn)	6,038
Market Cap (USD mn)	1,098

Net cash (EGP mn)	985
Enterprise Value	5,053

Foreign Own. Limit	-
Foreign Own. Level	-
Daily Turn. (EGP mn)	23.0
Daily Turn. (USD mn)	4.1

Shareholder Structure

Free Float	23.0%
Social Insurance	31.0%
ECHEM	20.0%
Others	26.0%

Price Performance Chart



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* Disclaimer: See page 7

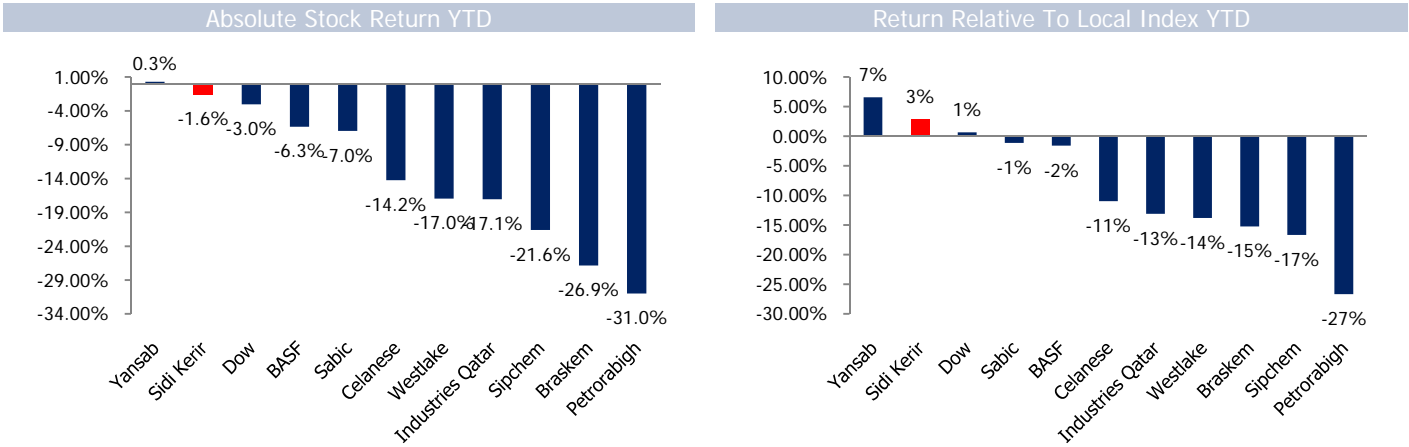


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Stock Returns: Outperforming peers

SIDPEC is outperforming its regional petrochemical peers on the basis of YTD return generated. It has not only given better absolute returns but has also outperformed the local index YTD. As shown in chart 1 SIDPEC's performance is better than all other major petrochemical companies except Yansab.

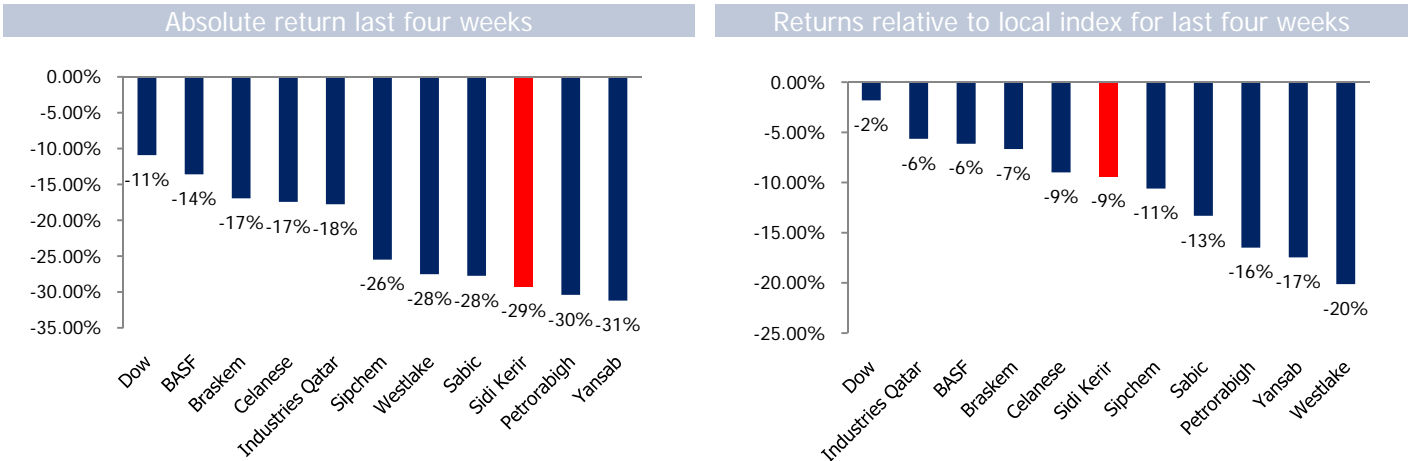
Chart 1: YTD Performance of Petrochemical Companies



Source: Reuters, HC Research

The sharp fall in SIDPEC prices is very much in line with other regional petrochemical peers. During the past four weeks, the stock has plunged 30% mainly driven by the macroeconomic developments and forced selling by index managers because of the removal of SIDPEC from the MSCI Egypt index. However, when compared to the local index SIDPEC has performed better than all of its regional peers except Industries Qatar.

Chart 2: Last Four Weeks Performance of Petrochemical Companies



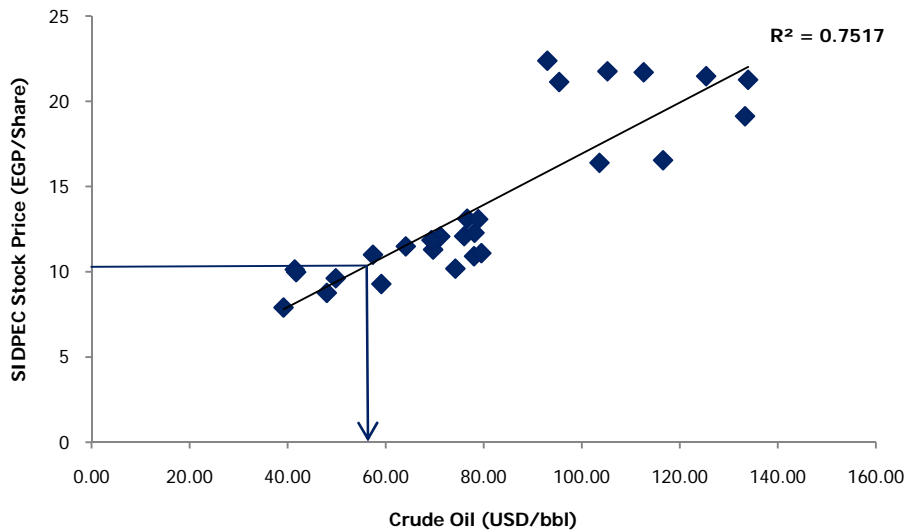
Source: Reuters, HC Research

Current SIDPEC Stock Price: Over-discounting oil prices and ignoring margin maintenance ability

SIDPEC's share price implies crude oil prices of less than USD60/bbl, clearly over-discounting the fall in crude oil prices. The market is also ignoring the fact that given its floating cost structure, SIDPEC's margins are much more stable than regional peers.

Like all the other regional petrochemical companies, SIDPEC's share price also has a tight correlation with crude oil given the subsidized nature of its feedstock. However, its feedstock cost is not fixed and moves in tandem with petrochemical prices. Hence, if there is any correction in petrochemical prices SIDPEC's feedstock prices would also fall, thereby helping it maintain margins unlike other regional producers who generally see a greater contraction in margins as the price of crude oil falls.

Chart 3: SIDPEC Share vs. Crude Oil Correlation



Source: Bloomberg, HC Research

Fundamentally unrealistic scenario is currently banked into prices

If we look at fundamentals like petrochemical prices, operating rates, and the exchange rate, the market seems to be banking on too bearish a scenario. Table 1 shows the sensitivity analysis of SIDPEC's share price to petrochemical prices and operating rates.

The current share price could only be justified if petrochemical prices fall 25% along with operating rates of c.85% or if petrochemical prices drop more than 30%. The likelihood of either of these taking place is unlikely, especially the fall in operating rates to below 90% as SIDPEC has never operated its plants below 95% capacity irrespective of the global economic situation.

Table 1: SIDPEC Share Price Sensitivity to operating Rate And Petrochemical Price Correction

Petrochemical Prices	Operating Rates				
	85%	90%	95%	97%	99%
-30%	10.6	11.0	11.4	11.5	11.6
-25%	11.3	11.8	12.2	12.4	12.5
-20%	12.1	12.6	13.1	13.3	13.4
-15%	12.8	13.4	13.9	14.1	14.3
-10%	13.6	14.2	14.8	14.9	15.1
-5%	14.3	14.9	15.6	15.7	15.9
0%	15.0	15.6	16.3	16.5	16.7
5%	15.6	16.4	17.1	17.3	17.5
10%	16.3	17.0	17.8	18.0	18.3

Source: HC Research

A high dividend yield is one of the star attractions of this stock and table 2 shows the sensitivity analysis of the dividend yield to operating rates and petrochemical price change. As the table shows, even in an extremely bearish scenario, the stock's dividend yield would still be c.8%, which can still be considered attractive. Even if prices fall by more than 20% for the rest of year, SIDPEC's dividend this year would still be higher than last year's EGP1.25/share.



Table 2: SIDPEC's Dividend Yield Sensitivity to Operating Rate And Petrochemical Price Correction

Petrochemical Prices	Operating Rates				
	85%	90%	95%	97%	99%
-30%	8.2%	8.5%	8.9%	9.0%	9.1%
-25%	8.9%	9.3%	9.7%	9.9%	10.0%
-20%	9.7%	10.1%	10.6%	10.7%	10.8%
-15%	10.4%	10.9%	11.4%	11.5%	11.6%
-10%	11.1%	11.6%	12.1%	12.3%	12.4%
-5%	11.8%	12.3%	12.9%	13.1%	13.2%
0%	12.4%	13.0%	13.6%	13.8%	14.0%
5%	13.0%	13.7%	14.3%	14.5%	14.7%
10%	13.6%	14.3%	15.0%	15.2%	15.4%

Source: HC Research

Another factor that could impact SIDPEC's the profitability is the depreciation of the EUR. There is a natural currency hedge for SIDPEC as weakness in the EUR would be more than compensated for by the strength in the USD. The risk of EUR depreciation arises from the revenue exposure of the company to Europe. The company does not need to sell in EUR, it can very well have its selling contracts in USD as well. To make a case for worst-case currency exposure we assume all European exposure of c.30% of sales is denominated in EUR. To complete the worst-case-scenario analysis we have kept the USD rate constant and depreciated the EUR which affects 30% of our revenue estimates to ascertain the impact on the share price.

Table 3 shows our sensitivity analysis of a EUR depreciation and petrochemical price change to the target price. All calculations were done assuming a more likely 95% operating rate.

Table 3: SIDPEC Share Price sensitivity to Extent to EUR Depreciation and Petrochemical Price Correction

Petrochemical Prices	Depreciation in EUR from 1.23USD/EUR Level				
	0%	-5%	-10%	-15%	-20%
-30%	11.36	11.21	11.05	10.89	10.63
-25%	12.23	12.06	11.89	11.72	11.44
-20%	13.1	12.9	12.72	12.54	12.23
-15%	13.93	13.73	13.53	13.34	13.01
-10%	14.75	14.53	14.32	14.12	13.77
-5%	15.55	15.31	15.09	14.87	14.51
0%	16.32	16.08	15.85	15.61	15.23
5%	17.07	16.82	16.58	16.33	15.93
10%	17.8	17.54	17.28	17.03	16.61

Source: HC Research

Note: All the calculation in the table is carried out at 95% operating rates

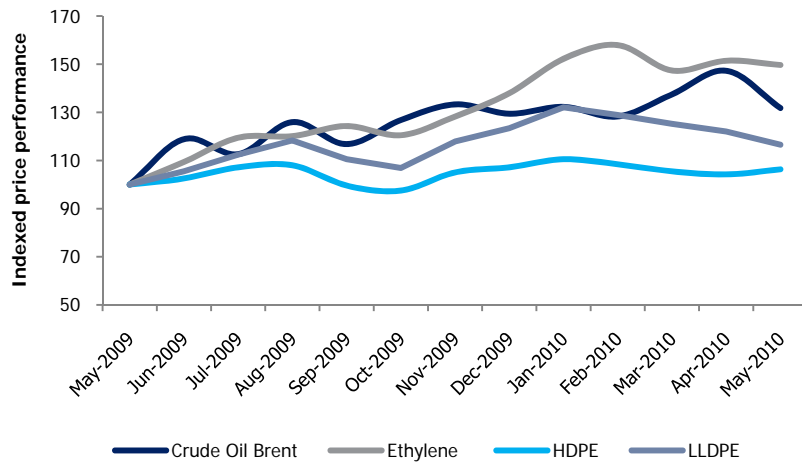
Pricing Outlook: Downside risk but large correction looks unlikely

Petrochemical prices have softened since February 2010 mainly due to a fear of a slowdown in Chinese demand and the startup of many large petrochemical complexes, which increase supply pressure. The recent correction in crude oil prices has increased the downside risk to prices but the large correction in prices looks unlikely given that this year petrochemical prices did not go up along with crude oil.

As shown in chart 4, ethylene and PE prices have been on gentle downward trend since the beginning of the year despite crude oil gaining strength in the first four months of this year. Hence the recent fall in crude oil prices does not warrant a sharp correction in petrochemical prices. The means the recent 20% correction in crude oil prices does not necessarily imply that petrochemical prices also revised down by the same amount as the petrochemical market has largely ignored the recent appreciation of crude oil.

In the petrochemical market, most contracts are a month long, but many European contracts cover a whole quarter. Hence, the petrochemical market takes a long-term view rather than being influenced too much by the short-term price correction. If the seller believes that oil prices are going to remain at this level for a fairly long time then only a large correction in petrochemical prices materializes.

Chart 4: Indexed Price Performance of Crude Oil and Petrochemical Products of SIDPEC



Source: CMAI, HC Research

Going forward, with a weak global recovery and large supply additions, we expect petrochemical prices to remain under pressure. We are already factoring in weaker price assumptions. Going forward we forecast a 3% decline in QoQ PE prices and almost no price increase for the next year. Having said that, the price risk is the most important source of risk for SIDPEC's earnings, and it is currently on the downside.

SIDPEC Target Price

We use a weighted average to arrive at a target price for SIDPEC. We assign 50% weight to the market-based relative valuation and 50% to the DCF valuation, giving equal weight to the value from fundamentals and investors' risk tolerance. We maintain our Buy rating on the stock with TP of EGP16.7/share (56% upside).

Table 4: Target Price of SIDPEC

Valuation Approach	Fair Value	Weight	Weighted Value
Market-Based PE Multiple	16.4	50%	8.2
DCF	17.0	50%	8.5
Target Price			16.7
Current Market Price			10.7
Upside Potential			56%

Source: HC Research



Summary of Financials

In EGP million	2006	2007	2008	2009	2010e	2011e	2012e	2013e	2014e
Income Statement									
Revenue	1,969	2,084	2,119	1,683	1,948	1,998	2,126	2,280	2,409
Revenue Growth		6%	2%	-21%	16%	3%	6%	7%	6%
EBITDA	1,202	1,332	1,127	815	941	988	1,073	1,187	1,310
EBITDA Growth		11%	-15%	-28%	15%	5%	9%	11%	10%
EBIT	1,030	1,164	959	648	774	821	906	1,020	1,143
EBIT Growth		13%	-18%	-32%	19%	6%	10%	13%	12%
Net Income	1,001	1,166	1,003	759	862	769	852	966	1,090
Earnings per Share (EPS)									
Earnings per Share (EPS)	1.91	2.22	1.91	1.45	1.64	1.46	1.62	1.84	2.08
EPS Growth		16%	-14%	-24%	13%	-11%	11%	13%	13%
Dividend per Share (DPS)	1.28	1.79	2.10	1.70	1.25	1.39	1.24	1.38	1.56
Dividend Payout Ratio	67%	94%	95%	89%	86%	85%	85%	85%	85%
Dividend Yield (%)	6%	9%	11%	16%	13%	14%	12%	14%	16%
Margins									
EBITDA Margin	61%	64%	53%	48%	48%	49%	50%	52%	54%
EBIT Margin	52%	56%	45%	39%	40%	41%	43%	45%	47%
Net Income Margin	51%	56%	47%	45%	44%	38%	40%	42%	45%
Balance Sheet									
Cash and Cash Equivalents	1,288	1,427	1,166	985	1,702	2,069	2,619	3,237	3,910
Total Debt	150	14	9	4	0	0	0	0	0
Net Debt	966	1,247	1,152	976	1,698	2,069	2,619	3,237	3,910
Net PP&E	1,468	1,305	1,145	994	802	655	510	367	392
Total Assets	3,422	3,424	3,385	2,633	3,116	3,340	3,766	4,262	4,971
Shareholder Equity	3,422	3,424	3,385	2,633	3,116	3,340	3,766	4,262	4,971
Book Value per Share	4.59	5.02	4.83	4.45	4.82	5.25	6.04	6.96	8.31
LTD/(LTD + Equity)	-6%	-1%	0%	0%	0%	0%	0%	0%	0%
Cash Flow Statement									
Operating Cash Flow per Share	2.72	2.49	1.98	1.52	2.66	2.14	2.33	2.60	2.89
Distributable Cash Flow per Share	2.67	2.49	1.96	1.49	2.63	2.10	2.29	2.56	2.85
CAPEX/Sales	1%	0%	0%	1%	1%	1%	1%	1%	1%
Depreciation/Sales	9%	8%	8%	10%	9%	8%	8%	7%	7%
Dividends Paid	(671)	(940)	(1,104)	(956)	(656)	(732)	(653)	(724)	(821)
Key Ratios									
Current Ratio	3.31	4.11	3.70	21.47	6.10	7.19	8.42	9.76	11.49
Return on Capital (ROC)	34%	37%	33%	26%	31%	24%	24%	24%	23%
Return on Equity (ROE)	42%	44%	40%	32%	34%	28%	27%	26%	25%
Return on Assets (ROA)	31%	33%	28%	23%	28%	22%	22%	21%	21%



Rating Scale

Recommendation	Upside
Buy	Greater than 20%
Hold	-5% to 20%
Sell	Less than -5%

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