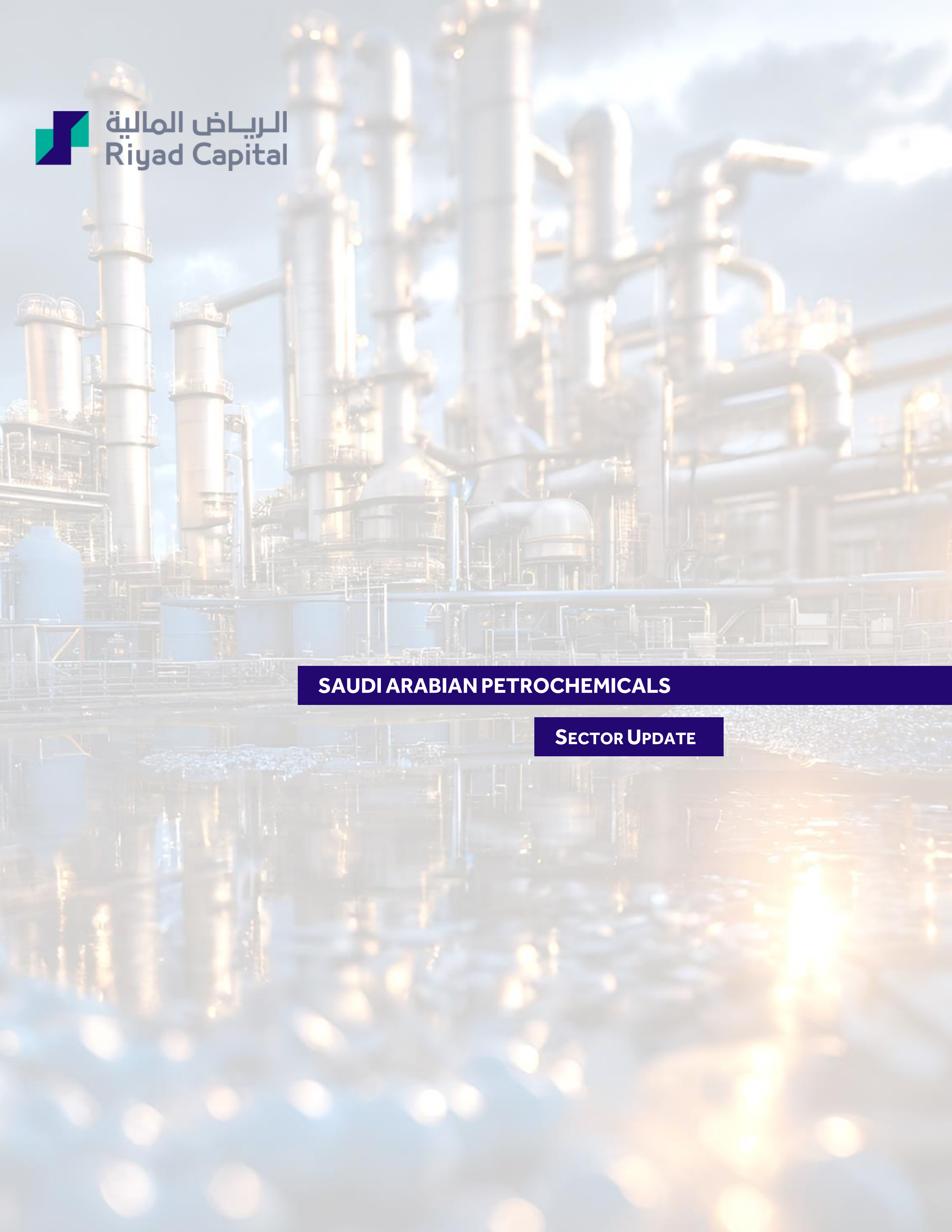

الرياض المالية
Riyad Capital

SAUDI ARABIAN PETROCHEMICALS

SECTOR UPDATE

Near-Term Soft Pricing, Challenges for Domestic Firms

Equity Research | MENA Chemicals

Rating: NEUTRAL

Petrochemical Prices 1Q24
(US$ / mt)

Chemical	Price 1Q24	Q/Q%	Y/Y%
Propane (Aramco)	$ 627	3.3%	(9.4%)
Butane (Aramco)	$ 637	2.9%	(9.4%)
Naphtha	$ 687	3.9%	(0.1%)
Benzene	$ 1,002	12.1%	8.1%
Ethylene	$ 893	4.4%	4.1%
Propylene	$ 810	(0.4%)	(10.3%)
Styrene	$ 1,092	4.8%	0.4%
Methanol (Methanex)	$ 391	5.4%	(7.3%)
Methanol (China)	$ 292	3.9%	(8.2%)
MTBE	$ 910	(0.5%)	(1.2%)
Acetic Acid	$ 483	(6.0%)	(2.4%)
Butyl-A	$ 1,308	3.5%	(10.0%)
LDPE	$ 1,027	5.4%	(4.6%)
LLDPE	$ 939	2.4%	(5.3%)
HDPE	$ 954	0.3%	(4.1%)
Polypropylene (PP)	$ 882	1.3%	(7.3%)
Polystyrene (PS)	$ 1,215	3.2%	(1.2%)
Polyvinyl Chloride (PVC)	$ 770	0.8%	(12.3%)
Polycarbonate	$ 1,751	(1.8%)	(9.0%)
Tio2 (Asia)	$ 3,608	(1.0%)	(5.2%)
Tio2 (Europe)	$ 3,401	(0.7%)	(7.3%)
Tio2 (America)	$ 4,200	(3.0%)	(7.1%)
Ethylene Vinyl Acetate (EVA)	$ 1,296	(2.3%)	(28.3%)
Spot MEG - China	$ 539	11.8%	4.9%
MEG (SABIC)	$ 804	(4.9%)	(8.5%)
Purified Terephthalic Acid (PTA	$ 766	0.4%	(0.4%)
Bisphenol A (BPA)	$ 1,270	(2.0%)	(2.3%)
Vinyl Acetate Monomer (VAM)	$ 959	9.5%	(14.8%)
Acrylic Acid	$ 952	(4.2%)	(16.9%)
Urea	$ 357	(1.7%)	(4.8%)
Ammonia	$ 342	(33.6%)	(48.8%)
DAP	$ 590	(0.3%)	(10.3%)

Summary: In 1H24, Saudi Aramco announced an increase in fixed feedstock costs for the domestic petrochemical and cement industries, the most relevant changes were the prices of dry gases, Ethane and Methane, which had not been increased since 2016. The effect on Petrochemical producers was as expected, the majority of companies in our coverage universe announced estimated increases to their cost structure; subsequently followed by lower profitability in 1Q24 (Figure 9). However, these estimated impacts to the COGS and operating expense structures of corporates in our coverage have come during a period where multiple factors are contributing to a market under pressure. We believe, that the changes in the Petrochemical Industry from 2022-2024e should give investors pause, as well as legitimate concerns about the future of the sector; as production costs have risen and demand remains soft for many key commodity chemicals, negatively affecting prices. In our view, there is a genuine sea change underway, which will shift the entire global petrochemical demand curves permanently; while The Kingdom's largest non-oil export will be caught in the middle, to adapt and overcome.

Highlights:

- **Global demand recovery does not appear solid:** Macro demand remains relatively weak, global PMI indicators continue to signal lower production levels in key end-markets, such as China and the United States (Figure 3). Although we do recognize there has been some recovery in global commodity chemical prices from some particularly lower periods, we also note that higher interest rates, lower demand for housing construction in the United States and other major projects globally, will continue to hamper demand for key end-products such as such as Ethylene, Polyethylene, and Polypropylene.

- **Outlook for 2024:** Outlook from the Riyad Capital Economic Desk for 2024e is for interest rates to remain relatively flat for most OECD countries, especially those in the United States, where we do not see much need or desire for the Fed to change its current course. Although this is our expectation, we do recognize this will have a dampening effect on demand for housing and other key industrial projects which will have a similar effect on the demand for commodity chemicals. Given these factors, we do not expect major commodity chemical prices to rise significantly in 2024, and as a consequence, we believe that the chemical producers in The Kingdom will have continued lower profitability. Reactions could result in restructuring, cost-cutting initiatives, and a focus on utilizing particular plants and feedstocks which are more advantageous to their margins, volumes, and product pricing.

- **Our take:** Soft prices are continually having an impact on major producers, coupled with the economic growth drivers in the global chemical industry remaining weaker than previous years. In our view, the near-term performance of Saudi Petrochemical firms will be muted. Investors should be cautious, understand that valuations could remain lower for the short-term, and act accordingly based on global-macro related risks and uncertainties.

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Key Commodity & Chemical Prices

	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24E	3Q24E
Core Feedstocks (US$/mt)							
Propane	692	523	468	607	627	592	580
Butane	703	516	458	619	637	594	565
Naptha	688	602	642	661	687	689	675
Benzene	927	879	889	894	1,002	1,061	1,095
Fixed Feedstocks (US$/mmbtu)							
Methane	1.25	1.25	1.25	1.25	1.75	1.75	1.75
Ethane	1.75	1.75	1.75	1.75	2.50	2.50	2.50
Basic & End-Product Chemical Prices (US$/mt)							
Ethylene	858	839	785	855	893	857	820
Propylene	903	829	766	813	810	820	825
Styrene	1,088	1,008	1,024	1,042	1,092	1,155	1,195
Polypropylene	951	885	849	871	882	927	950
LDPE	1,077	968	956	974	1,027	1,062	1,080
LLDPE	992	944	945	917	939	947	960
HDPE	995	963	964	951	954	959	970
Fertilizers (US$/mt)							
Urea	375	304	370	363	357	295	310
Ammonia	668	274	294	515	342	297	330
Diammonium Phosphate (DAP)	658	520	503	592	590	518	500
Spreads (US$/mt)							
HDPE - Naptha Spread	307	361	322	290	267	270	295
PP - Naptha Spread	263	283	207	210	195	238	275
PP - Propane Spread	259	362	381	264	255	335	370
Polystyrene - Benzene Spread	303	290	242	283	213	248	220
HDPE - Ethylene Spread	137	124	179	96	61	102	150
PP - Butane Spread	248	369	391	252	245	333	385
LDPE - Naptha Spread	389	366	314	313	340	373	405
LLDPE - Naptha Spread	304	342	303	256	252	258	285

Figure 1 Source: Argaam, Bloomberg, Riyad Capital

Macro Demand for Chemical End-Markets

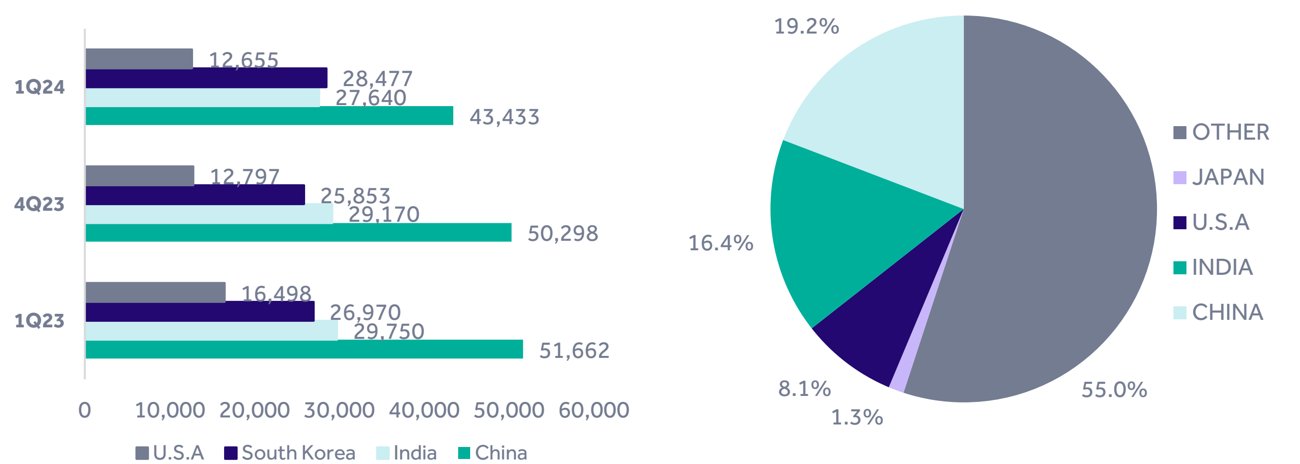
Macro Indicators for Saudi Arabian Petrochemicals

The bottom line is that Saudi Arabia is a major exporter of chemical products worldwide, making the vast petroleum resources produced by The Kingdom and its competitive pricing in feedstocks (example: propane etc.), a natural complement and support system to drive the country's trade globally. This means petrochemicals, especially commodity chemicals, are a staple export for The Kingdom; however, this also means that local petrochemical companies are reliant on end-markets in other major geographies.

Pricing a Function of Global Demand and Supply

The chemical product prices depicted in Figure 1, are correlated with the profits and revenues of Saudi Petrochemical companies in our coverage universe, while the prices themselves are heavily dependent on the supply and demand factors in global economies. Indeed, the pricing environment over the past year (1Q23-1Q24), has been mixed with positive price appreciation of Ethylene +4.1% Y/Y, while also negative price fluctuations in 1H24 of Propylene and Polypropylene of -10.3% and -7.3% Y/Y, respectively. The soft pricing environment is further illustrated by reviewing some of the major chemical prices in a wider historical context, as some are still, despite increases in price YTD (Example: Styrene +0.4% Y/Y), discounted when compared to their previous peaks (Example: US$1,153 / MT, Styrene, 2021). These prices are largely driven by demand, which is a function of purchasers and their appetite for replenishing their inventories of particular chemicals, making global demand signals paramount for chemical market analysis.

Figure 2: Q/Q Non-Gulf Exports by Country (SAR mln) & Percentage (%) Of Total Chemical Exports FY2023



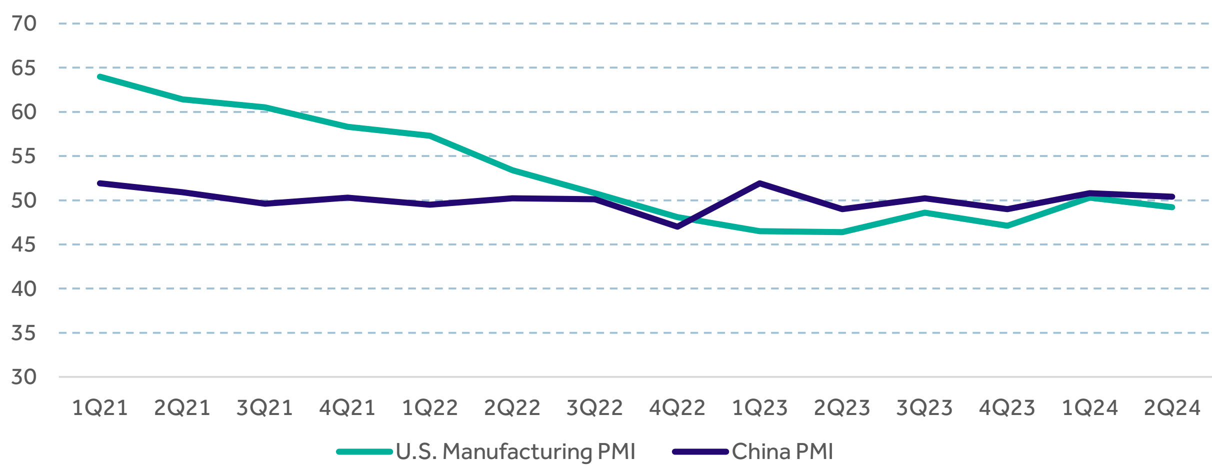
Source: GASTAT, Riyad Capital

According to GASTAT, the highest concentration of exports outside of the GCC (SAR mln) are sent to South Korea, the USA, India, and unsurprisingly, China (Figure 2); with the latter, dominating the non-oil, chemical exports of The Kingdom (19.2%). While the levels of exports overall (Figure 2) are not vastly different Q/Q, we do notice there has been some slippage on a Y/Y basis, which can provide us some insight into recent economic activity and a general measurement of the pulse of global chemical demand in end-markets; specifically, those relevant to Saudi Arabian petrochemical producers.

PMI Indicators Remain Muted Globally

The Kingdom of Saudi Arabia boasts the largest economy in the GCC, at least in terms of its GDP, but given the concentration of its major industries (oil, petrochemicals, etc.), exports to other major economies are integral to its growth and overall productivity. Indeed, as mentioned previously, major economies represent key drivers in both global chemical demand and a demand signal for Saudi Arabia's domestic chemical producers. As of the beginning of 2024 and continuing into 2Q24, chemical demand from the world's largest importers has been muted, with major export markets (Figure 2) such as The United States and China (Figure 3), remaining contracted from previous peaks in FY2021. PMI monitoring is imperative for gauging global chemical demand signals, given the ubiquitous nature of commodity chemicals in construction, manufacturing of automotive vehicles, and producing regular household items, petrochemicals are closely tied to GDP fluctuations and overall economic production.

Figure 3: Quarterly PMI For United States & China 1Q2021-2Q2024



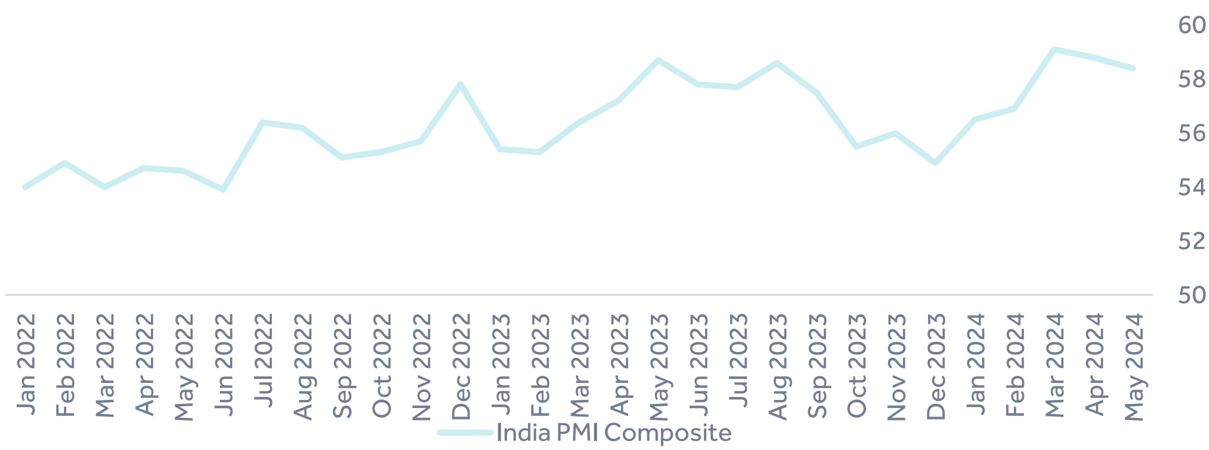
Source: Bloomberg, Riyad Capital

As indicated by the PMI's of both the United States and China (Figure 3), we unfortunately cannot garner any positive demand signals at this time. Especially given the current interest rate environment, which is an indicator for housing demand in global economies like the United States; in our view, these indicators do not have the potential to increase by a material level in the foreseeable future. The same appears to be the case for the quarterly PMI data from Japan (Figure 5), which also shows lower activity in 1H2024 when compared with previous periods. While we do not that other PMI indicators, such as the monthly PMI for India (Figure 4), a major importer of Saudi products is more promising.

Other End-Market PMI Indicators are Mixed

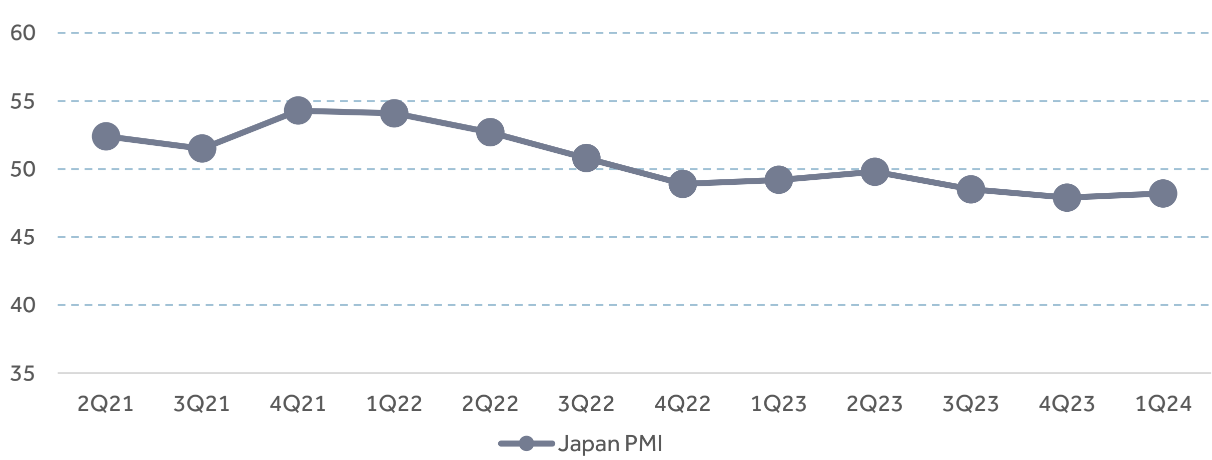
India, is the second-most major end-market for Saudi Arabia's exports, specifically petrochemicals, and moreover, a major importer of fertilizers. India's drivers include: a large population (over 1 bln citizens), growing market economy, and infrastructure development projects. Examples of major infrastructure projects, include, but are not limited to: the Mumbai Trans Harbor Link (Sea Bridge) and the Mumbai Metro Rail. The rail project will after completion, be fully underground and have 27 stations and interchange junctures linking it to the Suburban railway, Monorail, and the Metro-1. These projects will support chemical demand and economic drivers of the country's fast-growing GDP (+7% Y/Y FY23). These factors make the PMI activity of India particularly relevant, while not as dominant as China, a higher PMI in India is a positive sign for The Kingdom's Petrochemical Producers. Japan, while a major recipient of Saudi chemical exports, does so on a smaller scale than India, the United States, and China, but is also relevant. As previously highlighted, Japan's PMI remaining lower than previous quarters in 2023, 2022, and 2021, implies in our view, there is no positive conclusion about potential demand pickup in the near future.

Figure 4: Indian Monthly Composite PMI 2022-1H24



Source: Bloomberg, Riyad Capital

Figure 5: Japan Quarterly PMI 2Q2021-1Q2024

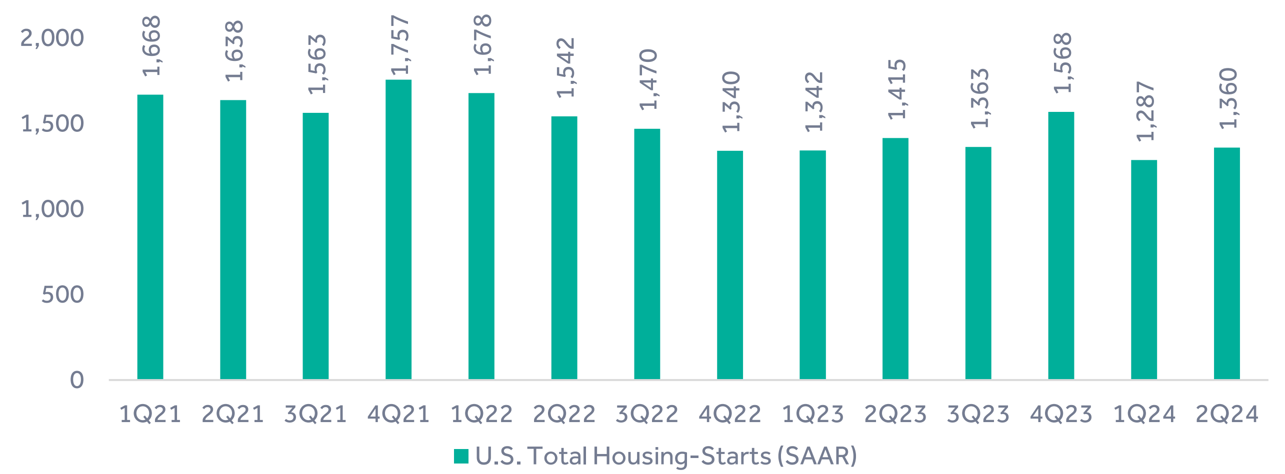


Source: Bloomberg, Riyad Capital

Total Construction Worldwide

While not the most relevant demand metric for Saudi petrochemical producers, we still believe it is important to give a wider scope for our analysis, which includes housing construction in the United States (Figure 6). Understandably, given the higher interest rate environment in the United States post FY2023, housing-starts remain softer than in previous quarters. Lower housing construction in the United States simply translates to lower demand for sealants, cement, adhesives, fertilizers, and countless other everyday products which are all generated from petrochemicals; produced by The Kingdom's key industry. Other major economy housing-start data from Bloomberg paints a similar picture, with lower numbers than in previous years, further dampening demand for the global Petrochemical Industry.

Figure 6: U.S. Total Housing-Starts 1Q2021-2Q2024



Source: Bloomberg, Riyad Capital

Growing Capacity in China

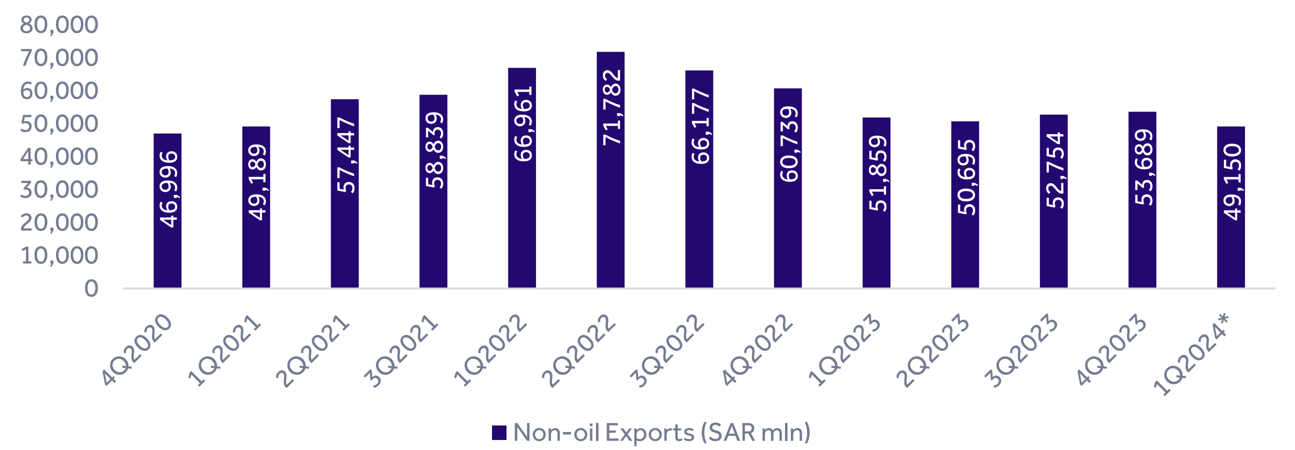
Since 2020, Chinese firms, have steadily grown their capacity to produce commodity chemicals, in a move to reduce their dependency on imports. This has spurred foreign investment interest in the global economic power, with major European players such as BASF, making commitments to invest in mainland China. Indeed, during their 1Q24 conference call, BASF's management provided an update on the construction of its MG (methyl-glycols) plant they have constructed in Zhanjiang, China. Investments like this represent a potential sea change in the global chemical industry, as China seeks to diversify its access to chemicals and produce more domestically, driving greater investment into the Country, whilst reducing the demand for imports. Our take is that this is a key theme in the long-term, akin to global supply in the semi-conductor / wafer industry, the Chinese government is planning for the future, having already witnessed international pressure for companies to not sell China key chip manufacturing components (e.g., ASML Holding); this desire to produce domestic chemicals is likewise a rational move to reduce reliance on foreign production. We also believe that domestic capacity increases in China are here to stay, which will shift the chemical demand curve, permanently. Saudi firms that lean in to this new shuffling of the global gameboard will benefit the most and have a brighter long-term outlook. We also view investments in China, such as Aramco's acquisition of 10% interest in Rongsheng Petrochemical Co. ltd., as a key example of potential opportunities for The Kingdom's petrochemical producers.

The Homefront – Saudi Arabia Petrochemicals

Saudi Petrochemicals are Over-Indexed in Non-Oil Exports

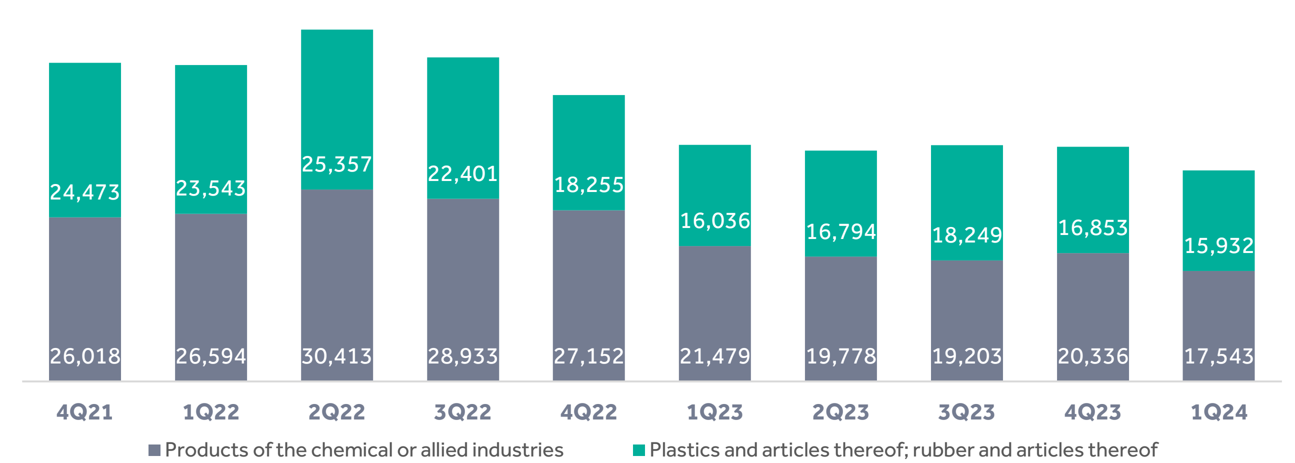
According to GASTAT, the most important non-oil export in The Kingdom, is chemical 'products', which constitutes 25.1% of the total non-oil exports in 1Q24; which represented a -18.3% decrease Y/Y (from 1Q23). GASTAT maintains a relatively granular data library, from which we can begin to generate deeper insights about petrochemical producer trends, opportunities, and challenges; Figure 7 and Figure 8 illustrate perfectly the recent decline in exports. Chemical exports specifically also show this trend persisting into 2024; given macro changes we believe this will continue.

Figure 7: Non-Oil Exports 4Q2020-1Q2024(*Preliminary Data) (SAR mln)



Source: GASTAT, Riyad Capital

Figure 8: Exports of Chemicals & Plastic Q/Q 4Q21-1Q24 (SAR mln)



Source: GASTAT, Riyad Capital

Major Shifts Call for Adaption

The increasing Chinese capacity for petrochemical production, higher interest rates in the US and other major economies, which have a negative secondary effect on construction and key end-markets like housing (Figure 6), are not a constructive environment. Moreover, the global slowdown in GDP growth in Europe and North America are not supporting demand for Saudi Petrochemical firms either; calling for further investment, adaption, and emphasis on a cautious strategy moving forward as pressure mounts.

Saudi Arabian Petrochemical Profitability

Our coverage universe has continued to suffer from reduced profitability, mostly due to a combination of higher feedstock costs and/or a reduction in end-product chemical prices (Figure 1); both of which are key drivers of petrochemical producers' profitability. However, we also note that some firms which had scheduled plant shutdown in 2023 or in early 2024, which have restarted, means that some Y/Y comparisons are moot. Therefore, we leveraged 3Q23 for comparison purposes, while also noting firms which have had shutdowns during their 1Q24 fiscal period, could have an over-indexed impact on 1Q24 performance (Example: Advanced).

Figure 9: Coverage Universe Profitability Table (SAR mln)

	Gross Profit (SAR mln)		Profitability Change
	1Q24	3Q23	
SABIC	5,860.0	6,340.0	(8%)
SABIC-AGRI	988.0	1,226.0	(19%)
SIPCHEM	480.1	458.0	5%
SIIG	N/A	N/A	N/A
ADVANCED	27.0	122.0	(78%)
TASNEE	19.6	156.0	(87%)
YANSAB*	228.6	(44.0)	N/A
KAYAN	(274.8)	(121.0)	(127%)
Average	**1,047**	**1,162**	**(52%)**

Source: Company Filings, Tadawul, Riyad Capital
*Note: *YANSAB excluded from Calculation based on significant shutdowns*

Our View of the Current Environment

Saudi firms face pressure from increasing supply glut, with the highest impact coming from current and future capacity growth in China. This is further supported by soft demand from other key export markets like the United States (Figure 3) and Japan (Figure 5). Some firms have adapted by attempting to expand their capacity, such as Advanced and Sipchem. While other Saudi Arabian producers have invested in diversification outside of traditional end-markets. For example, SIIG invested US$ 70 mln in UniBio International, a biotech company focused on bioprotein production. This potential project would use dry gas to produce more bioproteins. In our view, this is a strategic move developed to support SIIG's traditional products to weather soft global demand, showcasing foresight.

Potential Risks

Chemical volumes are linked with industrial production, while input costs are closely tied to energy prices (e.g., natural gas.). Thus, risks to our forecasts and ratings are; recessionary pressures in end-markets or improvement in overall GDP (domestic or international, depending on overseas exposure), a surge or decline in energy prices, and a sharp deterioration or improvement in Chemical-intensive manufacturing production.

What We Are Looking For

Our focus in a market with soft pricing and uncertainty is firms with a strong capital position, meaning its overall cash liquidity, including but not limited to: having term deposits as a hedge against interest rate shocks or scheduled/unscheduled shutdowns, portfolios of end-products which are diversified, and the ability to navigate higher feedstock costs (strong margins). In our view, these are positive parameters for an uncertain global environment, where the only certainty is change. We highlight Sipchem as our top pick in the sector right now.

Rating	Buy
12- Month Target Price	SAR 43

SAHARA INTERNATIONAL PETROCHEMICAL CO. (SIPCHEM)

Price as on Jun-23, 2024	SAR 29.4
Upside to Target Price	46.3%
Expected Dividend Yield	5.1%
Expected Total Return	51.4%

Market Data

52 Week H/L	SAR 39.3/29.1
Market Capitalization	SAR 21,560 mln
Shares Outstanding	733 mln
Free Float	89%
12-Month ADTV	2,026,243
Bloomberg Code	SIPCHEM AB

Diversified Portfolio - Watch for Shutdowns in 2Q24

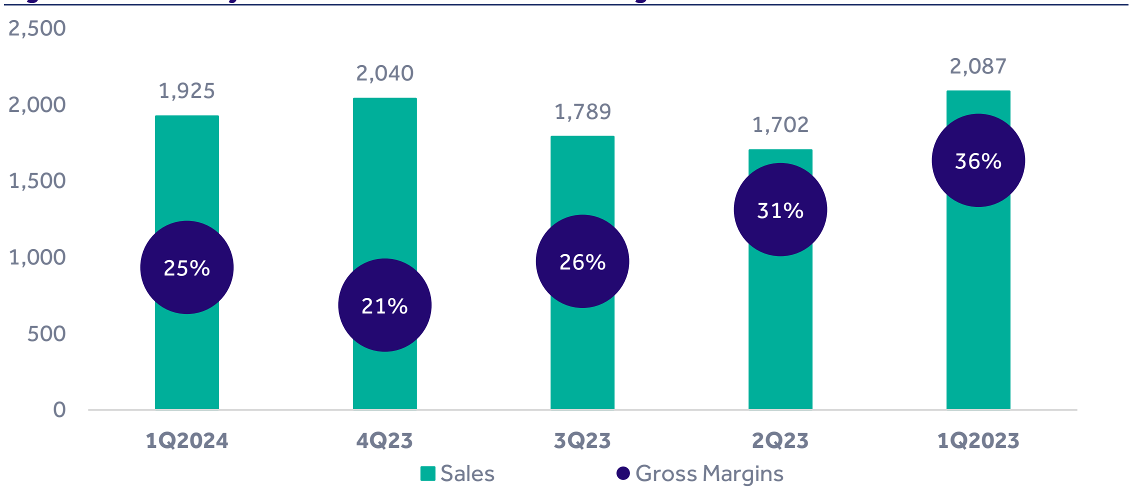
Strong Capital Position & Diversified Products

Sipchem ended the first quarter of 2024 with SAR 1.54 bln in cash & equivalents, this was compared to SAR 1.50 bln in 4Q23, which we believe is a testament to conservative capital allocation; which given current market conditions is what we desire in a preferred investment in the space. We also view Sipchem's planned Ethylene cracker plant expansion as positive, although we do recognize the current macro demand uncertainty is a potential challenge to the Company. Further, commentary from management post-1Q24 was also positive, highlighting further investment in improving some bottlenecked areas in their current subsidiaries and plants, as well as further progress on the Company's future blue ammonia plant in Jubail Industrial City (capacity of 1.2 mln tons/year).

Upcoming Shutdowns

For 2Q24, investors need to be aware of the scheduled shutdowns for 3 of Sipchem's plants: IVC, IGC, and IAC; this maintenance period will begin on May 1, 2024, and based on management's commentary, we estimate it will be completed on May 29, 2024.

Figure 10: Quarterly Historical Revenues & Gross Margins



Source: Company Filings, Tadawul, Riyad Capital

1Q24 Performance

Slightly lower recorded revenues of SAR 1.9 bln in 1Q24 (-8% Y/Y, -3% Q/Q), which was in-line with our estimate of SAR 2.0 bln, driven by a mix of some higher sales prices and measurably lower sales volumes; which is a key indicator for demand in end-markets. However, we also note that Q/Q gross profits and gross margins improved, which given the uncertain market environment, we consider above average. Despite Sipchem's lower results Y/Y (in comparison to FY2023), our outlook for Sipchem is positive and we believe that its management team has made conservative financial decisions, as evidenced by Sipchem's strong cash position and reduction in debt Y/Y. Overall, the free cash flow generation in 1Q24, positive earnings, and continued growth initiatives outlined by Sipchem's management drive our reiteration of our confidence.

Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than +15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors
For any feedback on our reports, please contact research@riyadcapital.com

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