



Q1 2015 Update

Share Price (EGP): 13.06

Sector: Petrochemicals

Target Price (EGP):13.32

Country: Egypt

Upside: +2.03%

Date: June 14, 2015

Recommendation: Hold

Issuing HOLD recommendation with a Target Price**of EGP 13.32 per share on Declining Industry' s Fundamentals**

The global petrochemical market has been suffering due to the decline in the global oil price, despite the overall increase in the quantity of output produced and sold. This, in addition to the Egyptian government imposing greater costs on feedstock through removal of subsidies on energy has weighed heavily on the performance of Sidi Kerir. As a result, in a wait of the future prospects due to the company' s engagement in several Mega projects, we recommend a HOLD on Sidpec' s stock, with a target price of EGP 13.32

Profits reduced on the back of lower sales prices

Sidpec revealed weak results in Q1 2015 mainly due to the average 60% drop in the price of petrochemical products (whose prices are directly linked to the global oil price). Revenues registered EGP 554 Million in Q1 of 2015, 9.31% lower than that in the same period last year. In details, the price of ethylene in Egypt declined by 5.7% from 2013 to 2014, and then declined by 40.40% from its value in 2014 to Q1 2015 (\$771.10/ton in Q1 2015 compared to \$1293.87/ton in 2014). On the other hand, the price of polyethylene rose from 2013 to 2014 by 2.5% backed by stronger local sales partially waving the downward pressure caused by the falling international prices. However, it lost 24.48% of its value from 2014 to Q1 2015 to settle at \$1197.62/ton. We expect the price of both ethylene and polyethylene to remain low during 2015, as long as the average oil price remains near its current levels. The narrowing spread between the oil and gas prices results in increased competition between the gas-based and the oil-based petrochemical companies, as the difference in their production costs shrinks. Hence, we estimate Sidpec' s revenues to register EGP 2,397 million in 2015.

Higher costs of production narrowed the profit margins

COGS as a % of revenues increased during Q1 2015 significantly to reach 65.79%, the highest among all quarters since 2013. Consequently, profits decreased by 27% from Q1 of 2014 to Q1 2015 to settle at EGP 167 Million. We believe that the company' s cost structure has changed following the lift of energy subsidies in Egypt, which entails a smaller gross margin averaging 35%. We expect 2015' s profits to be lower than 2014 and estimate them at EGP 648 million by year-end.

Participation in Several Projects Boosting the company' s future outlook

The company still has some potential for the coming years, backed by its 20% contribution to EthydcO project, which is an ethylene producing facility in Egypt. In addition, the company announced its recent plan to expand its ethylene production by opening a new facility in Port Said after the agreement it made with Egyptian Petrochemicals Holding Company to supply Sidpec with 150,000 to 200,000 tons per year of ethane and propane mix. However, the boost in its margins will not be recognized in the near future, rather we expect the company to incur large capital expenditures in the coming two years before any result materializes.

Share Data

Bloomberg Symbol	SKPC.EY
Reuters Symbol	SKPC.CA
Market Cap (EGP million)	6,856.5
Number of Shares	525,000,000
Free Float	27.76%
Price-to-Earnings	6.88
Price-to-Book	2.55

Share Performance

1 Month Return	-2.17%
3 Month Return	-13.62%
6 Month Return	-18.02%
12 Month Return	-27.24%
52 Week Range	12.9-20.2

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Performance Indicators

	2011	2012	2013	2014	2015e
Revenues (in EGPm)	2,383	2,214	3,081	2,980	2,397
Gross Income (in EGPm)	1,175	1,088	1,692	1,407	839
Gross Margin	49.30%	49.13%	54.92%	47.21%	35%
Net Income (in EGPm)	890	870	1,299	997	648
Profit Margin	37.3%	39.3%	42.1%	33.4%	27.1%
EPS	1.69	1.66	2.47	1.90	1.23

Source: Sidi Kerir Petrochemicals, Blominvest

Recommendation:

We recommend a hold on Sidi Kerir' s shares with a target price of EGP 13.32, using DCF Model. Our recommendation is based on the company' s performance which showed tighter profit margins on the back of higher production costs and lower sales prices. Thereby, we believe this will be the new normal in the petrochemical industry in light of the current oil price and the narrowing oil/gas ratio, which lost Sidi Kerir some of its advantage in exports compared to companies that use oil as a feedstock. However, the depreciating Egyptian pound and the large local market for Sidi Kerir will both contribute to its sustainability despite expected lower profits for year 2015, noting that the company remains debt free. In addition, a solid dividend payment ratio characterizes the company which has historically distributed around 80% of its profits over the past 4 years.

Moreover, the company' s shares remained undervalued compared to its peers both in Egypt and the MENA region, which registered P/E ratios of 12.65 and 12.21, respectively.

Economy' s Outlook in Egypt:**Positive Growth Expectations from the IMF:**

According to the recent IMF projections, Egypt GDP growth is expected to reach 4% in 2015 and 4.4% in 2016. This optimistic view is backed by the recent structural reforms imposed by the government, in addition to the macroeconomic stabilization plans, which are expected to raise the confidence in the market and to reduce the budget deficit. The IMF' s view on the labor market is also optimistic, with its belief that unemployment rates will decrease from 13.4% in 2014 to 13.1% and 12.5%, in 2015 and 2016 respectively.

On the other hand, The IMF forecasts a rise in the inflation rate to 10.3% for 2015 and further rising to 10.5% in 2016, compared to 10.1% in 2014. Inflation rate slowed to 10.96% y-o-y by April 2015 from 11.51% in March, as the depreciation of the pound pushed up imported inflation.

Conflicting forces weighing on the country' s inflation rate:

Regarding the energy sector, the drop in the global oil price put a downward pressure on the country' s inflation rate. However, the rise in the price of natural gas (which is considered the bulk of electricity generation in Egypt) outweighed the positive impact of oil price decrease and thereby kept the power prices elevated. We recall that the government imposed the first structural reform by lifting its subsidies on energy in July 2014.

Depreciation characterized the Egyptian Pound:

The shortage of foreign currency has been one of the weak points of the Egyptian market. However, backed by the recent contributions from Saudi Arabia, Kuwait, and UAE totaling \$6 Billion, the foreign reserves at the Central Bank rose to \$20.52 Billion by the end of April after registering \$15.2 Billion in the month before. The expected continuous inflow of foreign investments backed by the successful economic summit (which took place in Sharm el Sheikh during 13th and 15th of March this year) will help maintain this trend and allow the Central Bank to preserve the power of its currency. Worth noting that the Central Bank has been continuously trying to weaken the foreign currency black market which has

been gaining a lot of strength since the 2011 revolution. Most recently, the Central Bank decided to place a ceiling on the amount of dollars that can be deposited in banks daily and monthly (\$10,000 and \$50,000 respectively). In fact, a recent interview with the central bank governor, Hisham Ramez, revealed that the bank is not planning on raising the ceiling for cash deposits in US dollars any time soon.

Currently, the Egyptian Pound is trading at 7.53 to the U.S. Dollar in the official market based on the most recent auction on Thursday 28th of May 2015, while trading at 7.67 to the U.S. Dollar in the black market.

Egypt' s stock market performance witnessed mixed signals:

The Egyptian Cabinet' s decision to delay the 10% tax on capital gains, which was approved in April 2015, led to the stock market' s impressive recovery, with the EGX 30 going up by 6.5% in one day on May 18, 2015 to close at 8,798 points. Worth mentioning that this decision was strongly criticized by the International Monetary Fund which believed that this delay means higher tax burdens will be applied on consumers.

On a side note, MSCI Emerging Markets Small Cap index has included Sidi Kerir to replace Maridive & Oil Services.

Impact of narrowing oil to gas ratio on the petrochemical industry:

Globally, naphtha which is derived from oil, is a more common feedstock used in the petrochemical industries compared to natural gas (such as ethane). However, considering the fact that ethane is more dominant in the MENA region compared to Asia and Western Europe, the latter is more commonly used in the MENA region than oil.

The attractiveness of one feedstock compared to the other is based on the oil to gas ratio. The higher the ratio, the higher the price of oil compared to natural gas making the latter more competitive. Currently, due to the decline in the oil price, this ratio has been narrowing ever since June 2014.

Sidi Kerir' s operations rely mostly on natural gas (ethane-propane mix) provided by GASCO at a subsidized price. When the cost advantage evaporates due to the falling oil price and the rising natural gas price in the country, it becomes more challenging for the company to compete at the level of its exports, especially with other regional companies that rely on oil for production or that enjoy lower gas costs (such as Saudi Arabia).

Outlook on the global price of oil:

As mentioned previously, the company' s profits are highly sensitive to the global price of oil. In the past few months, the price of oil has been fluctuating. From Mid-March till Mid-May 2015, the price of oil increased by around 18% due to the aggressive declining of the oil rigs in USA. As a result of that, Saudi Arabia is trying to bring the prices back down to maintain its market share, so throughout March Saudi Arabia shipped higher barrels of oil compared to any other month since November 2005. As a result, the price of oil declined by 5.24% during the month of May. Looking ahead, future contracts on oil with respective maturities of July 15th, August 15th and September 15th 2015 are trading at \$65.37, \$65.93, and \$66.38 per barrel. This indicates the stable outlook expected in the oil market for the coming period.

Relative Valuation:

Petrochemical Industry in Egypt:

Ticker	Name	YTD %	P/E	Market Cap (in USD Million)
Average			12.65	
SKPC EY Equity	Sidi Kerir Petrochemicals Co	-13.97%	6.88	898.64
AMOC EY Equity	Alexandria Mineral Oils Co	-24.22%	11.00	522.47
PACH EY Equity	Paints & Chemicals Industries	+5.53%	24.04	124.48
MICH EY Equity	Misr Chemical Industries	-17.99%	8.69	42.36
RUBX EY Equity	Rubex Plastics	+1.06%	-	6.50

Date: June 14, 2015.

Source: Bloomberg

Selected Petrochemical Companies in the MENA:

Ticker	Country	Name	YTD %	P/E	Market Cap (in USD Million)
Average			12.21		
SCCO AB Equity	KSA	Saudi Chemical	+42.76%	18.53	1,378.15
ALCO AB Equity	KSA	Alujain Corporation	+44.07%	11.91	430.65
BPCC KK	Kuwait	Boubyan Petrochemicals Co	-3.08%	10.19	1,061.96
ALQURAIN KK	Kuwait	Qurain Petrochemicals Co	+0.99%	6.85	742.63
IKARUS KK	Kuwait	Ikarus Petroleum Industries	-4.05%	13.59	370.06

Date: June 14, 2015.

Source: Bloomberg

Compared to its peers in Egypt, Sidi Kerir shares are undervalued, with an average P/E for the industry in Egypt of 12.65 compared to the company' s PE ratio of 6.88

Compared to its peers in the MENA region, the company' s shares are also undervalued, with an average P/E for the regional peers of 12.21 compared to the company' s P/E ratio of 6.88.



Regional Stock Markets Performance:

Stock Markets	YTD %	Market Cap (in USD Million)
Abu Dhabi	+0.96%	123,223.70
Amman	-0.86%	29,820.23
Beirut	+1.41%	12,572.53
Bahrain	-4.63%	51,929.88
Dubai	+8.30%	107,435.93
Egypt	-1.61%	66,095.30
Kuwait	-3.81%	97,303.15
Muscat	+2.25%	24,871.84
Qatar	-3.62%	175,221.49
Saudi Arabia	+15.74%	592,340.19
Tunisia	+10.63%	9,595.99

Date: June 14, 2015.

Source: Zawya

Sidi Kerir Petrochemicals:

Historical and Projected Income Statements:

In EGP Million	2011	2012	2013	2014	2015e
Revenue	2,383	2,214	3,081	2,980	2,397
COGS	(1,208)	(1,126)	(1,389)	(1,573)	(1,558)
Gross Income	1,175	1,087.7	1,692	1,407	839
General/Administrative Expense	43	42	47	51	41
Selling and Distribution expense	10	12	15	16	12
Other Operating Income	94	122	2	7	7
Other operating expense	1	4	5	5	5
Operating Income	1,215	1,152	1,627	1,342	788
Interest Expense	0	0	0	0	0
Interest income	0	0	77	88	98
Other income/expense	(29)	(11)	9	9	7
Currency Valuation Differences	0	0	71	32	30
Net Income Before Taxes	1,186	1,142	1,744	1,431	923
Income tax	303	268	446	437	276
Tax / Zakat Provision	(7)	4	(1)	(3)	(2)
Net Income to Shareholders	889.3	869.7	1,298.0	996.6	647.9

Source: Sidi Kerir Petrochemicals, Blominvest

Quarterly Performance Indicators:

	Q1 2013	Q1 2014	Q1 2015
Revenues (in EGPM)	716	600	544
Gross Income (in EGPM)	391	288	186
Gross Margin	54.57%	47.94%	34.21%
Net Income (in EGPM)	317	229	167
Profit Margin	44.24%	38.14%	30.70%

Source: Sidi Kerir Petrochemicals

Historical Balance Sheets

<i>In EGP Million</i>	2011	2012	2013	2014
Current Assets				
Cash and cash equivalents	1,173	1,125	1,643	1,632
Current Receivables	219	220	237	176
Total Inventory	271	242	262	272
Due from Sister Companies/Associates	575	655	618	279
Other Current Assets	65	48	62	57
Total Current Assets	2,303	2,289	2,821	2,416
Non-Current Assets				
Fixed Assets	688	653	595	541
Projects Under Construction	18	8	8	6
Real Estate Investments	0	15	15	15
Total Long term Investments	176	395	674	953
Other Non-Current Assets	7	8	7	8
Total Non-Current Assets	889	1,078	1,300	1,523
Total Assets	3,192	3,367	4,121	3,939
Current Liabilities				
Current Portion of Long Term Debt	0	0	0	0
Accounts Payable	297	258	515	289
advances from customers				18
Accrued Expenses/ + provisions for employees and deposits	0	0	0	242
Due to Sister Companies	239	500	548	484
Other Current Liabilities	138	122	153	192
Total Current Liabilities	674	880	1,215.8	1,224
Non-Current Liabilities				
Long Term Debt	0	0	0	0
Deferred Taxes	25	29	28	25
Total Non-Current Liabilities	25	29	28	25
Total Liabilities	699	909	1,244	1,249
Legal reserves/ Provisions	540	536	528	630
Capital				1,050
Retained earnings				1,010
Total Shareholders' Equity	1,953	1,922	2,349	2,690
Total Liabilities & Equity	3,192	3,367	4,121	3,939

Source: Sidi Kerir Petrochemical, Blominvest



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Equity Rating Key

Recommendations are based on the upside (downside) between our 12-month Fair Value estimate and the current Market Price.

Buy: Fair Value higher than Market Price by at least 20%

Accumulate: Fair Value higher than Market Price by 10% to 20%

Hold: Fair Value ranges between -5% to +10% in relation to Market Price

Reduce: Fair Value lower than Market Price by 5% to 15%

Sell: Fair Value lower than Market Price by at least 15%

Risks are based on share price volatility along with qualitative factors such as the nature of the business, the country risk and sensitivity to a single event. single

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