ADVANCED PETROCHEMICAL CO.

PETROCHEMICAL KINGDOM OF SAUDI ARABIA

CURRENT PRICE	**SAR 25.00**
FAIR VALUE	**SAR 31.76**
RECOMMENDATION	**ACCUMULATE**

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SECTOR COVERAGE

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NAVIGATING AMID OPPOSING FORCES

HAZY PICTURE – COUPLED WITH A FLOOD OF CAPACITIES

The petrochemical industry still lacks visibility owing to the hazy picture surrounding global demand and the excess supplies to enter the over-supplied markets in the near-term. As petrochemical demand is highly a function of GDP growth and as the extent or shape of the recovery on a global macro-economic level is still debatable, we believe that the increase of the oversupplies will draw an unprecedented picture of the petrochemical industry.

ENERGY COSTS – GLIMMER OF LIGHT?

Energy costs have been a strong driver of petrochemical prices in the past, even during times of weak demand and sufficient supplies. However, the aggressive capacity additions in the Middle East and China will challenge the role that energy costs have played historically.

TODAY'S STATE- JUST A CHAPTER IN A BOOK

The petrochemical business is of a cyclical nature, thus downturns are highly expected during its long-term time frame. Projects in this industry are built with 20-30 year life-spans, thus the state of the petrochemical industry today is just one of the many chapters in a book.

CHINA – THE DEMAND DRIVER AND SUPPLY RIVAL

China, a key market for petrochemicals, received last year a fiscal stimulus package of around USD 586 billion, the bulk of which is being used for industrial restructuring. The nation's infrastructure-led economic growth is expected to spark the demand for petrochemicals and pour back some confidence in the market.

In parallel, China is rising as a major supply rival to the Middle East as the lion share of global capacity additions will be in this East Asian nation, where 20.6 million tons/year of petrochemical capacities will be added during 2008-2011. In turn, a battle for power between the Middle East and Asia is expected to swell.

REGION'S PRODUCERS – WELL POSITIONED TO BENEFIT FROM A RECOVERY

Middle-East producers are in a more competitive position than their global peers owing to their modern world-scale assets, state-of-the-art technology, strong balance sheets, close proximity to end markets, and a leading feedstock cost advantage, the combination of which translates into superior profit margins. Thus, earnings of Mid-east producers will recover faster than those of their global competitors.

A GREEN FIELD PROJECT

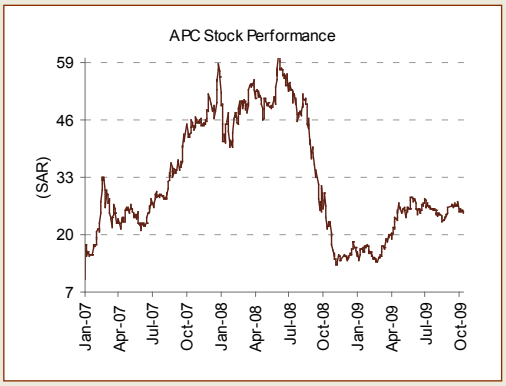
Advanced Petrochemical Company (APC) is a green field project at an early stage of production. The company is therefore less exposed than its peers, that are long-standing producers, to the risks generated by the global financial crisis. APC's book is relatively immune to key risks such as inventory write-downs/offs and restructuring charges, giving the company a competitive edge amid volatile times.

CLEARLY A VALUE STOCK

We believe that APC's stock price does not reflect the intrinsic value of a company operating in a petrochemical hub and enjoying a major cost advantage. APC's stock today offers investors an upside potential of 27.04%, given its current price of SAR 25.00 and an estimated fair value of SAR 31.76.

STOCK DATA

Price (SAR)	25.00
Market Cap (SAR 000)	3,534,375
Free Float	95.72%
Av. Monthly Liquidity (SAR 000)	1,026,328
52-week High (SAR)	28.60
52-week Low (SAR)	13.05
PE 09 (E)	27.32
PE 10 (E)	22.49
PB	2.15



Year	2008	2009 E	2010 E	2011 E	2012 E	2013 E
EPS (SAR)	1.49	0.91	1.11	1.25	1.34	1.49
Dividend Yield	2.00%	3.00%	3.64%	4.09%	4.38%	4.89%

INVESTMENT RATIONALE

HAZY PICTURE – COUPLED WITH A FLOOD OF CAPACITIES

The petrochemical industry still lacks visibility owing to the hazy picture surrounding global demand and the excess supplies that will enter the over-supplied markets in the near-term, where global production capacity already exceeds global consumption. As petrochemical demand is highly a function of GDP growth and as the extent or shape of the recovery on a global macro-economic level is still debatable, we believe that the increase of the oversupplies in the market will draw an unprecedented picture of the petrochemical industry.

With European and American players facing an extremely tough environment, which may eventually lead several of them to exit the market, the battle for power will swell between the Middle East and Asia, specifically China. As for the focal destination for petrochemicals, China is set to become the ultimate market, especially for Middle Eastern materials, as this emerging economy has still not reached a self-sufficiency level.

ENERGY COSTS – GLIMMER OF LIGHT?

Energy costs have been a strong driver of petrochemical prices in the past, even during times of weak demand and sufficient supplies. The petrochemical cycle reached its peak during 2008, a year of record oil prices and major over-supply in the petrochemical market.

Although oil prices are expected to average around the USD 80/bbl through 2010 and 2011, and global GDP growth is projected to show a modest recovery of 3.1% in 2010 and 4.2% in 2011[1], and in turn a healthier demand curve for petrochemicals is expected to develop, the aggressive capacity additions in the Middle East and China will challenge the role that energy costs have played historically. The big question that lies ahead is: To what extent will energy costs retain their dominant role in driving petrochemical prices in view of the significant capacity additions to come on-stream through 2011?

TODAY'S STATE- JUST A CHAPTER IN A BOOK

The petrochemical business is of a cyclical nature, thus downturns are highly expected during its long-term time frame. Projects in this industry are built with 20-30 year life-spans, thus the state of the petrochemical industry today is just one of the many chapters in a book. Long-term strategy is still solidly in place, as the players have extended investment horizons. The tide will return, however will be of a smaller scale.

CHINA – THE DEMAND DRIVER AND SUPPLY RIVAL

China, the world's third largest economy and a key market for petrochemicals, received last year a fiscal stimulus package of CNY 4 trillion (c USD 586 billion), of which CNY 3.7 trillion (c USD 542 billion) is being used for industrial restructuring. The State Council has developed support plans for 10 industries, among which the petrochemical industry, to fuel the economy. These government plans will strongly stimulate the petrochemical sector. Moreover, the IMF has projected a real GDP growth for China of 8.5%, 9.0% and 9.7% for 2009-2011, further brightening the prospects of the petrochemical industry.

However, in parallel, China is rising as a major supply rival to the Middle East as the lion share of global capacity additions will be in this East Asian nation, where 20.6 million tons/year of petrochemical capacities will be added during 2008-2011.

FOOTNOTES

[1] International Monetary Fund (IMF) projections, October 2009

INDIA – ANOTHER KEY PLAYER ON THE PETROCHEMICAL FRONT

India's polymer demand is projected to more than double, from 5.4 million mt/year in 2007 to 12.5 million mt/year in 2012. However, even with the significant investments taking place in its domestic petrochemical industry, it is expected that India will still have to import polymers to meet domestic demand with the GCC as the most likely region of origin. Furthermore, according to the latest IMF projections, India's real GDP growth is expected to be 5.4%, 6.4% and 7.3% for 2009-2011, adding support to the demand for petrochemicals.

CONFIDENCE - SLOWLY RETURNING

The restocking of inventories, which were depleted during the economic turmoil period, has begun amid concerns that petrochemical prices might increase further on expected higher energy costs. This has resulted in consumption creeping back up. Furthermore, according to Chemical Week[2], "second-half economic forecasts issued recently by ACC and German chemical industry association VCI (Frankfurt) called an end to demand declines but warned of slow recovery". Such forecasts of market stability have poured some confidence back into the industry.

IPEX– 56.1% UP FROM 2009 LOW

The petrochemical industry has already shown signs of a recovery, with the IPEX[3], as of October 2009, recording a gain of 56.1% from its low in February 2009. With crude oil projected to trade around an average of USD 78.1/bbl and USD 82.3/bbl, for 2010 and 2011, respectively, and with a correlation coefficient of 0.91[4] between the IPEX and crude oil prices, the IPEX is projected to show a y-o-y average growth of 28.2% in 2010 and 3.0% in 2011.

MID-EAST PRODUCERS – COMPETIVELY POSITIONED

The petrochemical industry has enjoyed a protracted epoch of healthy earnings, even with surging energy and EPC costs. The financial upheaval and economic slowdown turned the industry around dragging down its demand, pricing and margins. However, Mid-east producers are in a more competitive position than their global peers owing to their modern world-scale assets, state-of-the-art technology, strong balance sheets, close proximity to end markets, and a leading feedstock cost advantage, the combination of which translates into superior profit margins. Thus, earnings of Mid-east producers will recover faster than those of their global competitors.

The evolution of the Gulf petrochemical scene, combined with a slow recovery in the global macroeconomic conditions, will have many implications for the local and international producers in the years to come. Only players with significant competitive advantages will be able to survive amid the altered and more challenging global market dynamics.

The feedstock price advantage enjoyed by the petrochemical producers in the region, especially in Saudi Arabia, is of material significance as feedstock costs represent almost half of the total production costs of petrochemical products such as polypropylene. The feedstock price advantage in the Kingdom is unmatched.

FOOTNOTES

[2] September 14/21, 2009
[3] ICIS Petrochemical Index "an independent indicator of average change in world petrochemical prices"
[4] Regression analysis based on 3-year monthly data

KINGDOM'S ENERGY STRATEGY – WINDOW OF OPPORTUNITY FOR POLYMER INDUSTRY

Saudi Arabia's energy strategy strongly supports diversification into downstream products. It also promotes investments in export-oriented plastic conversion industries. This strategy will provide polymer producers in particular with ample opportunities for growth. As a result, the Middle East, which to date represents only around 6% of global polypropylene production, is projected to reach a share of around 15% by 2011.

APC – A SELECTED STOCK OF VALUE

Advanced Petrochemical Company (APC) is a green field project at an early stage of production. The company is therefore less exposed than its peers that are long-standing producers to the risks generated by the global financial crisis. APC's book is relatively immune to key risks such as inventory write-downs/offs and restructuring charges.

APC's key product, polypropylene, has shown impressive returns year-to-date and has outperformed most of the other petrochemical products. The popularity of polypropylene, owing to its various competitive advantages, is growing rapidly, enhanced by the various stimulus packages that are being implemented during 2009. Furthermore, as energy costs have proved to be the drivers of propylene and polypropylene prices, and as oil prices are expected to rise over the coming years, polypropylene prices are expected to enjoy a healthy ride (CAGR09E-13E of 7.7%) translating into an important opportunity for APC.

APC aims to diversify its production line of petrochemical products. As a signal of these future plans, the company's board of directors lately approved the change of the company's name from Advanced Polypropylene Company to Advanced Petrochemical Company.

APC's stock today has an estimated fair value of SAR 31.76 based on the FCFE model. In turn, we believe that APC's stock price does not reflect the intrinsic value of a company operating in a petrochemical hub and enjoying a major cost advantage. APC's stock today offers investors an upside potential of 27.04%, given its current price of SAR 25.00.

INDUSTRY ANALYSIS

PETROCHEMICAL INDUSTRY IN THE AFTERMATH

2008 was an extraordinary year for the global petrochemical industry by all means, as it witnessed record highs in oil and petrochemicals prices, as well as the global economic and financial crisis. The sector as a whole was significantly affected, as the demand for such chemicals is largely a function of the automotive and housing sectors and as the US is a major market for this industry. The repercussions of the financial turmoil drained much of the visibility for the petrochemical industry especially that they coincided with the massive capacity additions. The low visibility of this vital industry is attributed to the global macro-economic uncertainty and concerns at a time where excess capacities are expected to enter over-supplied markets, where global production capacity is already in excess of global consumption. As GDP growth is a major determinant of petrochemical demand and as the extent or the shape of the global macro-economic recovery is still debatable, the excess capacities to come onstream in the Middle East and Asia will shape an unprecedented picture of the petrochemical industry.

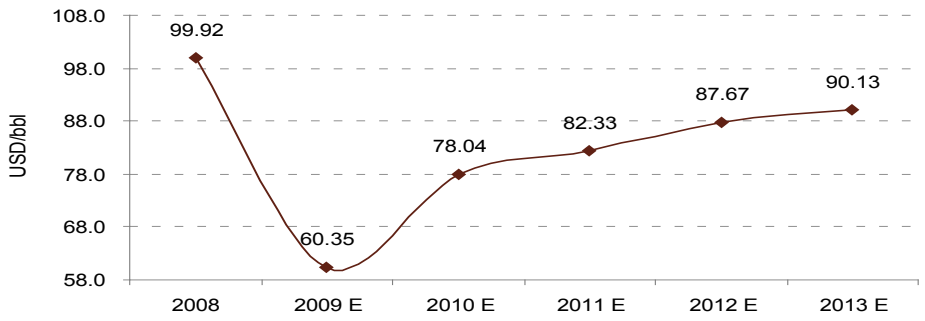
As European and American producers are among the least competitive players in the industry, they will face a very tough environment which is expected to lead several of them to eventually exit the market. Their aging plants will probably not be replaced as the prospects of the petrochemical industry for players based in such regions are no longer attractive (rising oil prices and unfavorable demand and supply dynamics). Furthermore, the profit margins of European and American producers are lower than those of their global peers. These two factors combined will result in a very tough ride for European and American petrochemical producers, tempting the small and least cost-efficient players to just exit the market. These capacity closures should give the industry some breathing space, but only temporarily, as excess capacities from Asia and the Middle East are expected to become operative in the near term, intensifying the battle between these two regions. China is set to become the focal market, especially for Middle Eastern materials, as this emerging economy has still not reached a self-sufficiency level.

However, some kind of respite can be found in two areas:

- The Role Energy Costs Have Played Historically in Driving Petrochemical Prices

Energy costs have been a strong driver of petrochemical prices in the past, even during times of weak demand and sufficient supplies in the market. The petrochemical cycle reached its peak during 2008, the year which witnessed record oil prices in addition to major over-supply in the petrochemical market. Going forward, oil prices are projected to rise gradually to trade close to the USD 90/bbl level.

Figure 1: Oil Price Forecasts

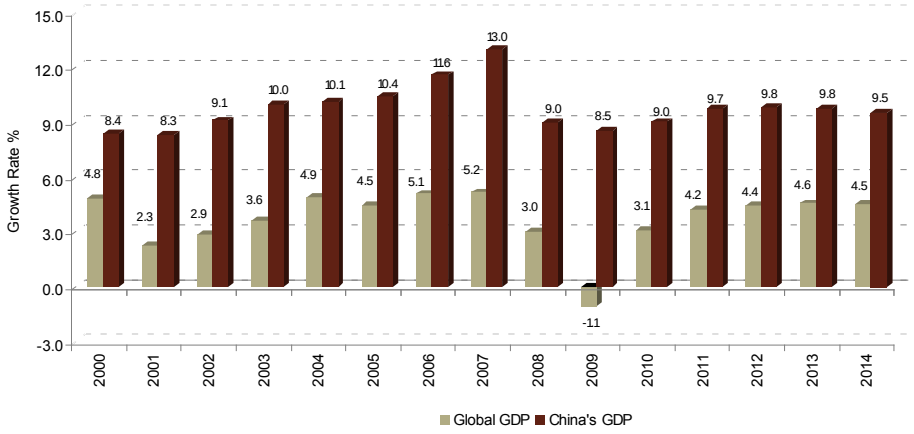


Source: Bloomberg Contributors

The Latest Projections of Global GDP Growth

As previously mentioned, global GDP growth is a major determinant of petrochemical demand. The latest projections by the IMF have indicated a global GDP growth of 3.1%, 4.2% and 4.4% for the years 2010-2012, respectively, brightening the prospects of the petrochemical industry. Furthermore, China, the key market in this industry, is expected to witness GPD growth rates of 9.0%, 9.7% and 9.8% for the years 2010-2012, respectively.

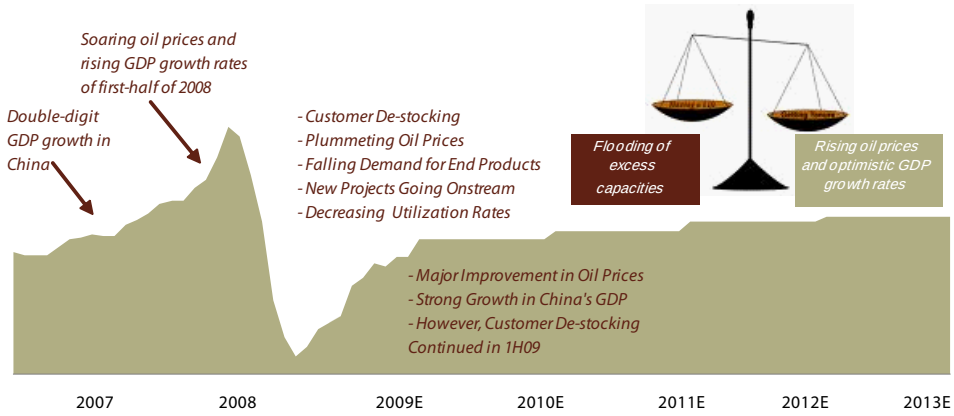
Figure 2: IMF estimates for global and China's GDP growth



Source: IMF, October 2009 figures

Although oil prices are forecasted to rise and a healthier demand curve for petrochemicals is expected to develop from such projected GDP growth rates, the aggressive capacity additions in the Middle East and China will challenge the role that energy costs have played historically as drivers of petrochemical prices. The big question that lies ahead is: To what extent will energy costs retain their dominant role in driving petrochemical prices in view of the significant capacity additions to come on-stream through 2011? Furthermore, the continuous developments of macro-economic events on a global level and specifically in the US, which are deepening the fear of an anemic recovery, coupled with the pending unsolved matters caused by the global financial crisis, are blurring the outlook of the petrochemical industry. Uncertainty and concerns regarding the shape of the economic recovery, whether V-shaped or U-shaped or W-shaped, is still a major hurdle faced by many petrochemical producers.

Figure 3: The Petrochemical Journey



Source: Audi Capital

THE PETROCHEMICAL PERFORMANCE DURING THE CRISIS

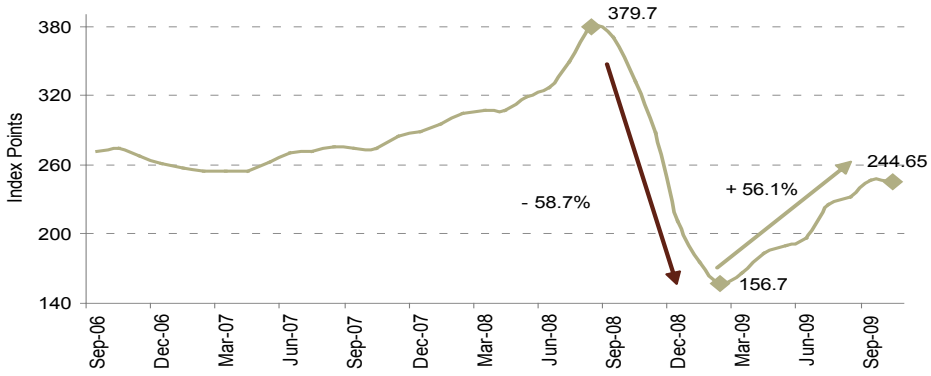
The most turbulent period witnessed by the petrochemical industry was the fourth quarter of 2008, when demand fell dramatically. The nosedive in demand was mainly a result of weaker demand for the underlying products and customer destocking to the absolute minimum, as the industry awaited a plunge in petrochemical contract prices. Consequently, operating rates were reduced to adjust to lower demand levels. According to the Chemical Industry News and Intelligence (ICIS), industry operating rates for the fourth quarter of 2008 averaged close to 65%. Producers struggled to maintain their margins as they were still operating within a cost structure initially set up for a significantly larger order book and production. With globalization on the rise, the economic downturn in the US and Europe has strongly affected key markets for petrochemicals, such as China.

As petrochemical demand severely weakened, petrochemical prices were heavily impacted with the IPEX losing close to 60% of its value between August 2008 till February 2009. The IPEX reached a peak of 379.7 points in August 2008, thereafter falling for six consecutive months to a low of 156.7 points in February 2009. Stability, and the ensuing rebound in petrochemical prices, became apparent in the second quarter of 2009. This was largely driven by China's increased demand for petrochemicals during the second quarter, stimulated by robust domestic consumption. It is important to highlight here that China's GDP grew by 8.9% in the third quarter of 2009, compared to the same period a year ago, confirming strong growth in the Chinese economy.

As of October 2009, the IPEX has recorded a gain of 56.1% from its low in February 2009. The index has been making consecutive gains for seven months, since February 2009, reaching a 10-month high in September 2009. However, lately, the IPEX has fallen by 1% representing its first decrease since February 2009. This minor fall is mainly attributed to lower feedstock prices on the back of softer oil prices.

The correlation between petrochemical and crude oil prices remained significant during 2009 and is the strongest correlation witnessed for the past three years. For 2009, to date, the correlation coefficient between the IPEX and crude oil prices is 0.96, as opposed to 0.91 for the full year 2008 and 0.93 for the full year 2007[5].

Figure 4: ICIS Petrochemical Index



Source: ICIS

HIGHLIGHTING KEY ISSUES AND CHALLENGES

The petrochemical landscape has been evolving incessantly as challenges and developments, within the industry itself and from other related industries, keep arising. Aside from the core of the petrochemical world shifting from West to East towards best cost areas and aside from the industry still attempting to absorb the spillover effects of the global financial crisis, many other key challenges are also occurring, specifically in the Gulf region.

The Gulf region is dealing with a major challenge of feedstock availability at a time when it is becoming a petrochemical hub. At the same time, the rise of its petrochemical industry is being challenged by the development of Asia's petrochemical industry, due to massive investments that have been taking place in China and in India. Not to mention the latest stimulus packages offered by their governments and the national policies that were adopted, partially aimed to support the growth of the industry. Aside from the struggle for power between the Middle East and Asia, that is gradually building up, developments such as India's anti-dumping probe into polypropylene imports and China's anti-dumping probe into methanol imports have popped at a questionable time. Thus, in addition to the reverberations of the global financial crisis, the petrochemical industry is dealing with several interesting issues and challenges.

FOOTNOTES

[5] Regression analysis based on monthly data

FEEDSTOCK OF THE INDUSTRY

Natural gas is a major input in the petrochemical industry in various regions, with naphtha representing the other key input used in other regions. "Ethane, the second largest component of natural gas after methane, is the feedstock of choice in the Middle East and the US", according to Middle East Economic Digest (MEED). In the region, ethane feedstock represents more than 70% of the feedstock used. Naphtha, on the other hand, represents the feedstock of choice in Europe and most of Asia. It is important to note here that, due to the region's significant gas reserves, the gas feedstock provided to Middle Eastern producers is supplied at a large discount to international gas prices. Producers in Saudi Arabia obtain gas feedstock mainly from Saudi Aramco, with whom they have long-term supply contracts, at a fixed price of USD 0.75/mmbtu. In contrast, the price of gas feedstock supplied to producers in Iran, Qatar and the UAE varies between USD 1.25-1.50/mmbtu[6]. Currently, the Henry Hub[7] natural gas spot price trades at around the USD 4.57/mmbtu level thus reflecting the substantial competitive advantage enjoyed by regional producers compared to their international peers. Moreover, as oil-based producers are the main price-setters in the petrochemical industry, any rise in oil prices would directly boost the income of regional producers who operate in a fixed-cost environment. Similarly, any sharp drop in oil prices would dilute this competitive cost advantage and compress their margins, keeping all other variables constant.

Although gas is the feedstock used in the production of petrochemicals, gas prices have not exhibited a strong relationship with petrochemical prices, unlike that between crude oil and petrochemical prices. The correlation coefficient between gas prices and the IPEX severely fluctuated from year to year. A regression analysis on these two variables, based on monthly data since October 2006, resulted in a correlation coefficient of 0.76. This compares to a correlation coefficient of 0.91 for the IPEX and crude oil prices for the same period and based on monthly data. The tighter clustering of points and the narrower band of Figure 5b, compared to Figure 5a, reflect the stronger correlation of petrochemical prices with crude oil prices, opposed to with natural gas prices.

Figure 5a: Correlation between gas and petrochemical prices

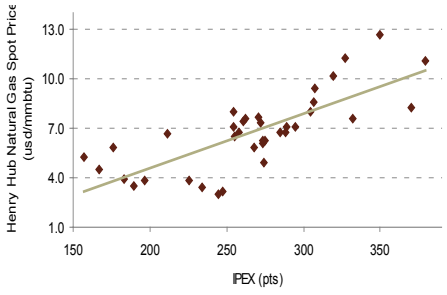
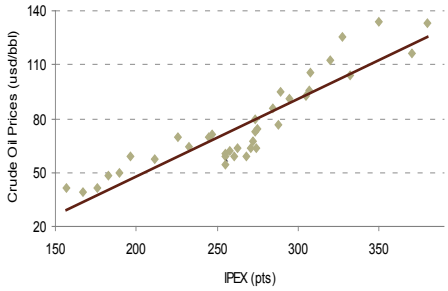


Figure 5b: Correlation between crude oil and petrochemical prices



Source: Bloomberg

Regression analysis is based on monthly data since October 2006 (3-year period)

FOOTNOTES

[6] MEED, 2009

[7] The Henry Hub represents "the delivery point for New York Mercantile Exchange natural gas futures contracts. The ready availability of information on the price of gas and supporting services helps customers trade gas efficiently at prices that reflect market demand and supply" (Energy Information Administration, 2009)

Hence, despite the usage of natural gas as a feedstock for the production of petrochemicals, the movement in gas prices is not a key driver behind the movement of petrochemicals prices. Crude oil prices have proved to be the stronger driver of petrochemical prices and in turn oil-based petrochemical producers will play a larger role in determining petrochemical prices.

Challenge arising from limited ethane feedstock

Due to the limited supplies of ethane feedstock in the Middle East, petrochemical companies are left with no choice but to move to more readily available feedstocks, specifically liquid feedstocks such as naphtha and liquid petroleum gas (LPG). These liquid or heavy feedstocks are derived from oil refining and are thus not exposed to a shortage risk. Ethane supplies are waning across the MENA region, except in Qatar and Iran, which still have rich amounts of gas remaining. The ethane shortage in the region is mainly attributed to its use in so many previously agreed allocations to petrochemical projects[8], in addition to its use as fuel for power stations. The olefins and derivatives complex of Sipchem has been "the last recipient of an ethane allocation letter in Saudi Arabia in mid-2007" (MEED, 2009). It is important to stress that the competitive advantage that ethane holds is not carried by any other feedstock. Yet its limited availability is a growing concern to old and new petrochemical producers in the region. Their turning to more expensive but more readily available liquid feedstocks is a step taken purely out of necessity.

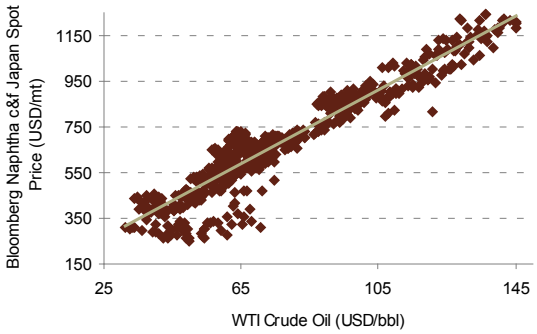
The trend towards liquid feedstocks is already apparent in Saudi Arabia, whereby smaller amounts of ethane and larger amounts of propane and butane are being allocated to petrochemical projects. For example, around 20%-30% of the feedstock allocated to the Saudi Kayan complex is ethane, while the remaining allocated feedstock is purely butane[9]. However, as previously mentioned, liquid feedstocks do not carry the same price advantage that ethane feedstock carries to producers in the region. The prices of liquid feedstocks is based on naphtha prices, which are highly correlated to oil prices (R= 0.95[10]), exhibited by the tight clustering of points and the very narrow band shown in Figure 6. Thus, rising oil prices can lead to notable reductions in the margins of the region's producers when liquid feedstock is used as the key input. Nevertheless, liquid feedstock does carry a certain price advantage in countries such as Saudi Arabia, whereby LPG feedstock such as propane and butane are supplied at a 30% discount to international prices[11]. Naphtha in the Middle East also carries a price advantage of around 10%.

Liquid feedstock has an additional advantage not shared by ethane. Liquid feedstock can be used for the production of a much wider and a more complex range of chemical products, where as the ethane product slate is much more limited. Thus, relying more on these heavy feedstocks in the production processes will lead to a greater diversity in the region's industry and in turn more job opportunities, a challenge faced by many Middle Eastern governments. Moving down the value chain, products become progressively less profitable for petrochemical producers, but more attractive for governments, as the products become more labor-intensive[12].

FOOTNOTES

[8] All ethane to be readily available up to 2012 has already been allotted
[9] MEED, 2009
[10] Regression analysis is based on daily data since October 2006 (3-year period)
[11] 1The legality of offering subsidies on products that are exported is questioned. According to MEED, Riyadh is expected to end subsidizing LPG feedstock in 2012 versus ethane which can retain its price advantage as it is not exported.
[12] Chemicals in the Middle East 2020: Local opportunities and global implications, 2008

Figure 6: Correlation between naphtha and crude oil prices



Source: Bloomberg

Regression analysis is based on daily data since October 2006 (3-year period)

THE STRUGGLE FOR POWER: ASIA VERSUS THE MIDDLE EAST

Most of the new petrochemical production capacity coming onstream in the medium term will originate from Asia, particularly China, and the Middle East. An aggressive battle is developing between these two regions, both distinguished by their own competitive advantages. The Middle East enjoys low feedstock costs, where as Asia benefits from low CAPEX and labor costs. Thus the struggle for power between these two petrochemical giants will be based on these competitive advantages, with signs of a clash already beginning to show through China's latest accusation in regards to Saudi Arabia dumping petrochemical products into its domestic market.

The Middle Eastern Scene of Petrochemicals

The transformation of petrochemical production in the Gulf region began in 2000, and is expected to last until 2016[13]. Diversification well beyond basic chemicals and far down the value chain, coupled with massive volume growth, will shape the petrochemical scene in the region for the medium-long term. Production growth is expected for all products, but most particularly propylene, glycols and polyethylene. The region's aggressive scheme of capacity additions will make it the world's largest exporter of a number of basic materials, such as polypropylene.

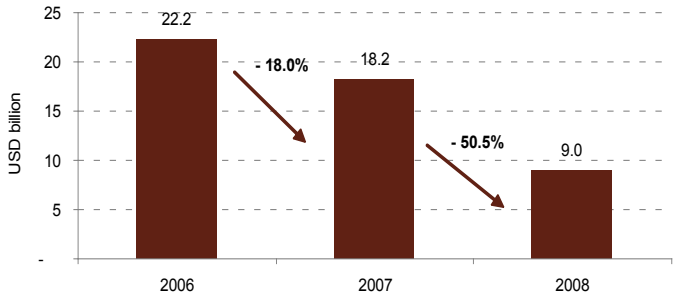
Capacity additions of basic chemicals in the Middle East for 2008-2011 are projected to total to around 18.9 million tons/year[14]. The aggressive production schemes adopted by the region's producers are largely due to their low-cost business model, which in the long-term will tend to drive many of the less competitive plants, specifically those in Europe and the US, out of the market. Saudi Arabia, which has positioned itself as a leading producer and exporter over the past three decades, will continue to lead the expansions. Furthermore, the Kingdom will invest over SAR 172.5 billion to construct three of the largest petrochemical complexes worldwide. These projects, which will employ more than 150,000 engineers and technicians, will increase the country's portfolio to 120 different types of petrochemical and chemical products. The Kingdom is an attractive site for petrochemical investments due to its low-priced natural gas, robust infrastructure and overall substantial cost advantages, in terms of lower average variable and fixed costs.

FOOTNOTES

[13] Gulf Petrochemicals and Chemicals Association (GPCA), 2008
[14] 2009 APIC-CMAI Seminar

However, the pace of announcements of new petrochemical investments in the region has cooled down. This is largely attributed to the prevailing economic uncertainty faced by key economies, which is blurring the outlook for the petrochemical industry and thus hampering production plans for the future. In 2008, engineering, procurement and construction (EPC) contracts valued more than USD 9 billion were awarded in the Gulf region for petrochemical projects, but this was a 50.5% decline over the previous year. The decline is mainly due to the surge in EPC costs at the beginning of 2008, which led clients to postpone their contract awards. Moreover, the shortage in ethane feedstock supply, and the resulting restrictions on allocations, was also a key factor in the delaying of contract awards[15].

Figure 7: EPC contracts for the Gulf



Source: MEED, 2008

As previously mentioned, Saudi Arabia continues to be the regional leader in capacity expansion. It is expanding both its upstream and downstream operations as the government is pushing for economic diversification. Iran will also have notable volume growth in its petrochemical industry, followed by Qatar. The evolution of the Gulf petrochemical scene, combined with weak global macroeconomic conditions, will have many implications for the local and international producers in the years to come. However, major findings reported by the Gulf Petrochemicals and Chemicals Association (GPCA) and McKinsey indicated that "the Middle East chemicals industry is likely to thrive even in a period of global macroeconomic uncertainty"[16]. Thus, it is highly likely that the region will remain a vibrant hub for the industry.

The Chinese Scene of Petrochemicals

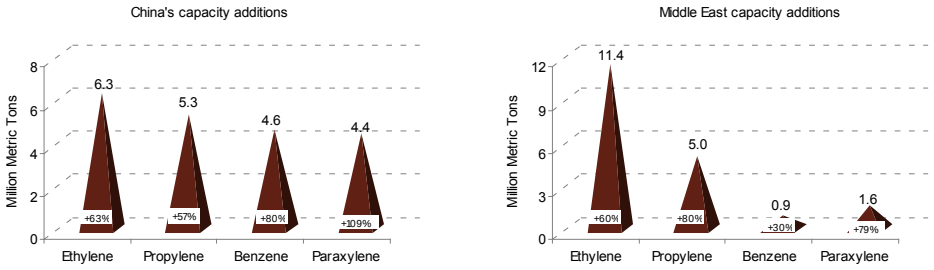
The lion's share in global capacity additions will be in China, whereby 20.6 million tons/year of petrochemical capacities will be added during 2008-2011[17]. China's policy of energy self-adequacy for its petrochemicals industry has led to such huge petrochemical investments on the domestic front. In turn, Chinese petrochemical producers will continue to compete internationally.

Despite its own production push, China continues to be the most important consumer of Saudi petrochemicals. China's rapidly developing economy is the world's largest consumer and importer of many basic materials, such as polypropylene. Its imports are due to its own domestic needs, in addition to the needs for processed products of its American and European export markets.

FOOTNOTES

[15] MEED, 2008
[16] Chemicals in the Middle East 2020: Local opportunities and global implications, 2008
[17] 2009 APIC-CMAI Seminar

Figure 8: Petrochemical Additions 2008-2011



Source: 2009 APIC-CMAI Seminar

Moreover, China's CNY 4 trillion stimulus package will largely support the petrochemical sector, especially since around CNY 3.7 trillion of this package is aimed at industrial restructuring, which will stimulate petrochemical demand. The State Council has developed support plans or stimulus packages for 10 industries (such as the petrochemical, auto, electronics and textile sectors) to fuel the economy. Government support for these industries will stimulate the domestic petrochemical industry by large. Finally, it is worth noting that Chinese producers are even striving to secure more competitive feedstocks in order to improve their cost structure and in turn increase their competitive edge.

On the demand front, China will lead in the consumption growth. Over the past ten years, China's average demand growth for ethylene has been 11% opposed to 1.8% for Western Europe and 1.1% for North America. Moreover, it is estimated that close to two-thirds of the global petrochemical demand growth, for the period 2005 to 2015, will come from Asia with over a quarter of the global demand growth coming specifically from China[18]. China's demand growth will be supported by its domestic capacity additions, reducing its dependency on imports from the Middle East. Consequently, China's imports of petrochemicals in the near future will not be sizeable enough to absorb Middle Eastern surpluses.

An Example of Indirect Governmental Support for the Industry

In February 2009, the Chinese government largely expanded its Rural Home Appliance Subsidy Program (initially launched in December 2007 as a trial program) from three to all of China's rural provinces. Moreover, the latest development stage of the subsidy program included a significant increase in the number of subsidized household appliances which were initially only three items: color TV sets, refrigerators and cell phones. The program was launched nationwide on February 1st, 2009. The latest modified subsidy program offers all rural provinces a subsidy of 13% on the prices of household appliances such as televisions, washing machines, refrigerators and computers. The government plans to pay around USD 2.2 billion in subsidies for home appliance purchases. Such an action is in favor of the petrochemical industry as the program, to date, has largely stimulated demand for home appliances and has indirectly supported demand for products such as polypropylene, polyethylene and polystyrene.

Not surprisingly, China has had extremely high import levels of products such as polyethylene and polypropylene in the first five months of 2009 due to firm local demand. Given China's massive population, the rise in demand for home appliances, especially in the untapped rural market, will play a significant role in offsetting the slowing of export demand. Historically, the Chinese home appliance industry has largely focused on export markets, such as the US and Europe, whose

FOOTNOTES

[18] Chemical Week, 2009

consumption has been hard hit. In addition to shifting the focus of economic growth from exports to domestic demand, the Chinese government hopes that by boosting rural consumption, overall domestic consumption will increase, helping it to maintain the country's economic growth. It is noteworthy to mention that the production growth of appliances for 2008 was only 13.9%, almost half of the 26.1% recorded for 2007[19]. Thus, the subsidy program is expected to improve these figures for 2009.

The Indian scene of Petrochemicals

India is also becoming a key player on the petrochemical front. A national policy has been adopted by the Indian government as an initiative to boost upstream and downstream petrochemical investments. The policy will achieve its objective in several ways, including by increasing local demand and per capita consumption of polymers and plastics. Another major factor is the country's economic development program consisting of USD 492 billion worth of investments in infrastructure projects[20], which will endow the petrochemical sector with ample opportunities.

Furthermore, India's automotive sector is rapidly growing as the nation aims to become a key player in the global automotive industry. Car sales by Indian companies are projected to triple by 2015, surpassing 3 million units, while the production value of the automotive sector will increase to USD 60 billion by 2016[21]. In 2009, the Indian conglomerate Tata Group launched the Tata Nano automobile, sold at a retail price of only INR 100,000 (c USD 1,935). This extremely affordable car will play a significant role in transforming India's automotive industry and in turn the polymer industry. Notably, each Tata Nano entry model is comprised of 16 kg of polymers, where as the upgraded model contains 26 kg of polymers[22].

Given a population that exceeds one billion, India's polymer demand, which is currently only 3% of global demand, is expected to rise significantly. The domestic polymer market is estimated at around 6 million mt/year, with 5 million mt/year supplied locally and the remainder imported[23]. The nation has a consumption of only 5.2 kg of polymers per capita, opposed to China's 20 kg per capita and a global average of 25 kg per capita[24]. Thus, India's consumption of polymers is expected to increase to a level approaching that of other key industrial nations, which in turn will largely boost global consumption of polymers. India's polymer demand is expected to more than double, from 5.4 million mt/year in 2007 to 12.5 million mt/year in 2012. This will position India as the fourth largest polymer market by 2012, following China, the European Union and the US[25].

India's polymer producers are improving their production capacities in anticipation of growing polymer demand. For example, Reliance Industries is increasing its polypropylene capacity by one million mt/year at its Jamnagar facility. By 2013, polypropylene capacity additions to take place in India will total 1.6 million mt/year resulting in a total production capacity of 4.7 million mt/year. As for polyethylene, the other basic polymer, total planned capacity additions of 2.6 million mt/year are expected to take place by 2014. In turn, India's total polyethylene production capacity will amount to 4.6 million mt/year. India's combined production capacities of the basic polymers polyethylene and polypropylene are expected to reach 9.2 million mt/year by 2014, still falling short of the estimated 12.5 million mt/year in demand for the year 2012. Thus, it is expected that India will still have to import polymers to meet its domestic demand, with the GCC most likely being the region of origin. It is important to mention that polymers also include other materials such as polystyrene, polyvinyl chloride and polyethylene terephthalate. However, polyethylene and polypropylene are considered the most widely used polymers thus accounting for the bulk of the polymer category.

FOOTNOTES

[19] ICIS, 2009
[20] World Bank, 2009
[21] Government study; cited by Chemical Week, 2009
[22] Chemical Week, 2009
[23] Reliance Industries; cited by Chemical Week, 2009
[24] Ministry of Chemicals and Fertilizers New Delhi; cited by Chemical Week, 2009
[25] Reliance Industries; cited by Chemical Week, 2009

Figure 9: India's Polymer Industry

Current Production Capacity	Polypropylene (mt/ year)	Polyethylene (mt/ year)	Operational
Reliance Industries	2,750,000	1,050,000	√
Haldia Petrochemicals	300,000	550,000	√
Gail		410,000	√
Total Current Capacity	**3,050,000**	**2,010,000**	
Planned Capacity Additions	**Polypropylene (mt/ year)**	**Polyethylene (mt/year)**	**Onstream date**
Haldia Petrochemicals	150,000	200,000	2009-10
IndianOil	650,000	650,000	2009-10
Gail		100,000	2010-11
HMEL (JV between Hindustan Petroleum and Mittal Energy)	350,000		2011-12
Brahmaputra Cracker and Polymer Ltd.	60,000	220,000	2012-13
ONGC Petro-Additions Ltd.	400,000	1,080,000	2012-13
Gail		300,000	2013-14

Source: Chemical Week, 2009

In February 2009, New Delhi launched an anti-dumping investigation into the polypropylene imports for the nine-month period between April 1st and December 31st 2008. The application was filed by Reliance Industries, with the support of Haldia Petrochemicals. In August 2009, India's Finance Ministry levied provisional anti-dumping duties (ADD's) on the polypropylene imports from Oman, Saudi Arabia and Singapore (for further details, refer to Appendix E).

These Indian allegations can be persuasively viewed as signs of the starting battle between Asia and the Middle East region. This view is further supported by China's latest accusation against Saudi Arabia, alleging that the latter is dumping methanol into the Chinese market.

A CLOSING NOTE

Amidst the aftermath of the global financial crisis, the petrochemical industry is struggling with lower demand and operating rates. These challenges posed by a deep-rooted global recession have coincided with massive capacity being added by start-ups which are ready to swamp the GCC region and Asia, which will lead to an unprecedented oversupply in the industry. Meanwhile, producers need to manage their operating rates until the new capacity is somewhat absorbed and demand rebounds solidly. Furthermore, producers outside Asia, specifically GCC producers, need to begin seeking new destinations for their products, as prime markets such as China and India are striving for a self-sufficiency level.

However, despite this cloudy outlook for the short-term, petrochemical producers still hold onto their long-term growth forecasts and in turn long-term investments. Furthermore, it is believed that these latest economic conditions are going to result in a stronger and fitter petrochemical sector, as consolidation within the industry will be largely in force in light of cheap valuations. In turn, the sector will be well-positioned to benefit from the economic upturn.

AN INSIGHT INTO POLYPROPYLENE

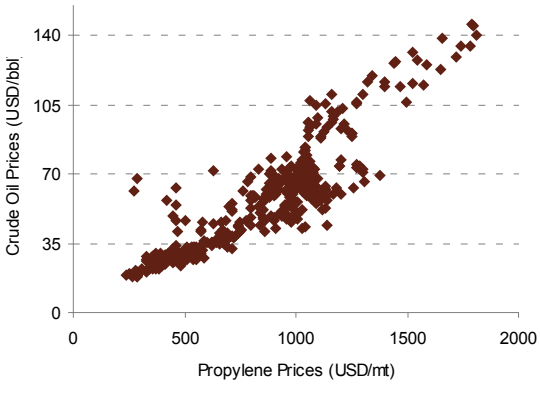
FEATURES OF POLYPROPYLENE

Polypropylene is a basic material that exists everywhere around us. Polypropylene is a thermoplastic[26] polyolefin[27] made from polymerizing the olefin propylene. Propylene is a basic chemical and is one of the base units of petrochemical production. Polypropylene is a very stiff polymer of low-density and high-heat resistance, with good tensile strength and an extensive range of melt-flows. Three different types of polypropylene are utilized commercially:

- Homopolymers
- Copolymers
- Random copolymers

Polypropylene is largely characterized by its competitive price position compared to other thermoplastic polymers. Furthermore, polypropylene is considered an environmentally friendly material. These features have boosted the polymer's popularity and usage, making it a growing substitute of many plastic and even non-plastic materials such as metal, wood and glass. Examples of plastic materials that polypropylene has substituted include polystyrene, polyvinyl chloride, high density polyethylene and polycarbonate. "Historically, polypropylene has seen above average global growth rates of the order of 7-8%/year due to its versatility and relatively low cost position versus other polymers", according to ICIS, who project the polymer's annual growth to continue at close to 6%. The growing popularity of polypropylene has led to rising demand for its feedstock propylene. However, the propylene market has been facing two major challenges. As propylene demand has been growing, additional costly technologies were needed to improve production. This has led to an increase in propylene prices. Furthermore, the surge in oil prices in 2008 has also contributed to the rise in propylene prices, as propylene prices are linked to oil prices. A regression analysis on these two variables has resulted in a correlation co-efficient of 0.90[28].

Figure 10: Correlation between oil and propylene prices



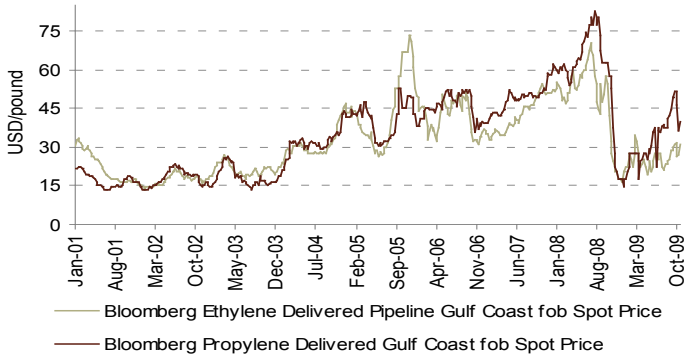
(Regression analysis is based on weekly prices since February 2001)

FOOTNOTES

[26] Thermoplastic: A thermoplastic is a polymer that converts into a liquid when heated and converts to a solid state when cooled. Thermoplastic polymers can be re-melted and re-molded.
[27] Polyolefin: A polyolefin is a polymer; more specifically it is an olefin derivative. According to the ICIS definition, "polymers are long chains of repeating molecules, or monomers, held together by covalent chemical bonds. In most cases, the number of repeating monomers is very large, as much as hundreds of thousands".
[28] Regression analysis based on weekly prices since 2001

These two developments have resulted in propylene prices rising above ethylene prices and in turn diluting propylene's traditional price advantage. Consequently, polypropylene's favorable price advantage, relative to other polymers, has been eroding[29]. A prolonging of such a trend may result in "lower than historic demand growth rates in the future" for the polymer polypropylene, according to Chemical Market Associates Inc. (CMAI)[30], as one of its key advantages would be lost. However, its other advantages will still keep polypropylene among the most popular polymers.

Figure 11: Ethylene and propylene trends



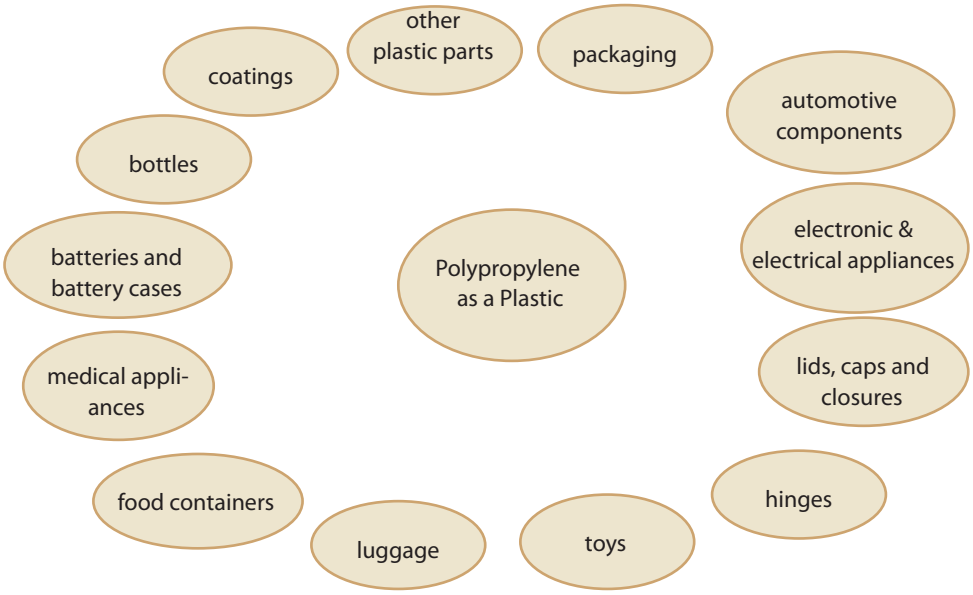
Source: Bloomberg as October 30, 2009

POLYPROPYLENE APPLICATIONS

Polypropylene is used as a plastic and as a fiber in many consumer and industrial products; it is even used in the wire cable, conduit and pipe manufacturing industry. Among polypropylene's most attractive properties for its use in piping systems are its resistance to corrosion and chemical leaching. Its largest single application though is in injection molding[31], translating into the automotive, packaging and consumer product markets.

Polypropylene as a plastic

As a plastic, polypropylene is utilized in many applications such as:



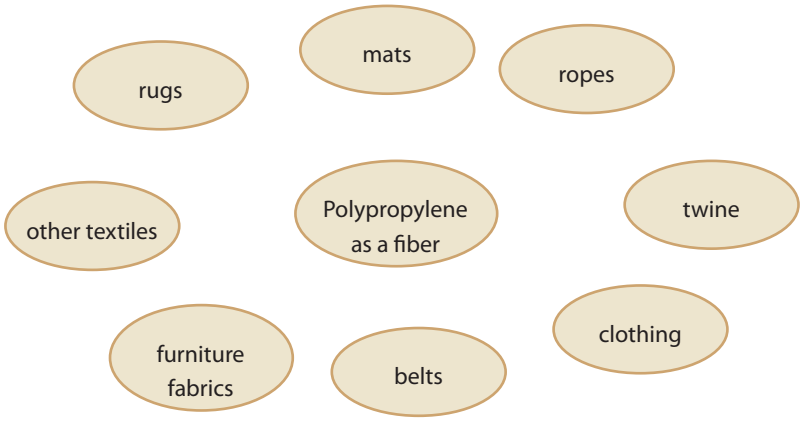
FOOTNOTES

[29] ICIS, 2008
[30] Cited by ICIS, 2008
[31] Injection molding is a plastics manufacturing process, whereby plastic material is injected, melted, molded, cooled and then casted out

Owing to its low density and heat resistance, polypropylene has become the key plastic used by the automobile industry for the manufacture of internal and external automobile body parts. According to ICIS, "polypropylene and its alloys have become the plastic of choice in the automobile market where it can provide substantial weight savings". Polypropylene and its alloys represent more than a third of the plastics in an automobile[32].

Polypropylene as a fiber

The fibers sector represents the second largest market for polypropylene. As a fiber, polypropylene is utilized in textiles, mainly in carpet face yarn (rugs and mats), ropes, twine clothing, belts and furniture fabrics. Fiber markets are witnessing steady growth worldwide despite the ongoing shift away from North America and Western Europe towards Northeast Asia[33].



A REVIEW OF POLYPROPYLENE PRICES

The polypropylene prices are mainly determined by:

- crude oil prices (correlation coefficient of 0.92[34])
- propylene prices (correlation coefficient of 0.90[35])
- tightness of the supply and demand balance
- polypropylene inventory level

Although the polypropylene prices are mainly affected by the above factors, it is important to note that the polypropylene business is also event driven which in turn might result in additional volatility. Moreover, in emerging markets, such as the Middle East and South Asia, the pricing mechanism for polypropylene is largely based on the aggressive responses to tenders for import, which makes prices more volatile.

Polypropylene prices began rebounding during the second week of 2009, after reaching a low of USD 587.5/mt during the last two weeks of 2008 and the first week of 2009. The increase in polypropylene prices was largely due to strong propylene prices and delays in the start-up of new capacities in the Middle East. Domestic demand in some major consuming nations such as Europe and the US remained weak due to the economic slowdown; however, the insatiable demand from Asia resulted in robust export volumes from these nations. The strongest surge in polypropylene

FOOTNOTES

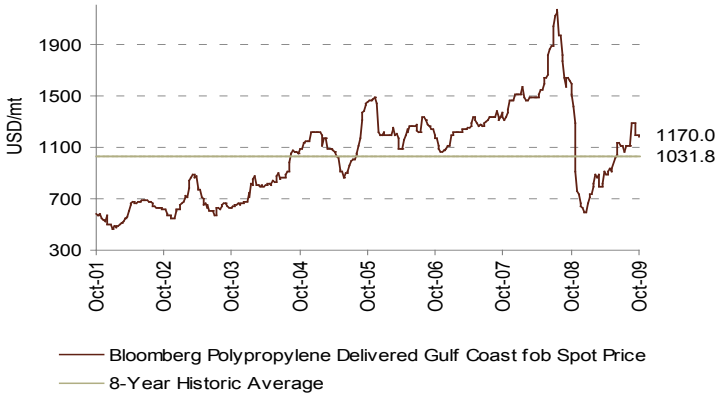
[32] ICIS, 2008
[33] ICIS, 2008
[34] Regression analysis based on weekly data since 2001
[35] Regression analysis based on weekly data since 2001

prices occurred from April to June, owing to tight supply on the back of planned and unplanned plant shutdowns mainly in the Southeast Asian region. Overall, year to date[36], polypropylene prices have rebounded by 99.1%. They have been lately trading at the USD 1,170/mt level, which is about 13.4% higher than the eight-year historic average. It is important to note that, over a period of five months, PP prices lost more than two-thirds of their value, after reaching a peak of USD 2,163/mt on the first of August 2008. This was only expected amid a global economic slowdown, as GDP growth is a major determinant of petrochemical demand. The flattish movement of polypropylene prices during August was due to the summer season and the period ahead of the Holy month of Ramadan, where demand normally declines. Nevertheless, strong price support for polypropylene resumed in September, with an overall price increase of 16.3%, subsequently softening in the period thereafter.

It is unlikely that the rise in polypropylene prices enjoyed by the producers since January will continue in the final two months of the year. This can be largely attributed to:

- the strong competition that will arise from the recent start-up production plants in the Gulf region and in Asia
- the injection of further supply into key markets due to recent plant start-ups in China and Saudi Arabia
- the significant inventory rebuilding that took place when prices were low and which will curb demand in the short-term

Figure 12: Polypropylene Prices



Source: Bloomberg as of October 30, 2009

POLYMER INDUSTRY: A FUNCTION OF THE AUTOMOTIVE INDUSTRY

The global demand for basic polymers is anticipated to rebound as early as 2010. Polyethylene demand is expected to lead the demand recovery of polymers because of its modest immunity to the economic climate, whereas the polypropylene demand recovery is expected to take longer. The state of the US automotive industry is a key variable in the polypropylene demand equation, and its revival is not expected to occur anytime soon. However, some signs of hope have began to emerge in the US automotive industry with developments such as the "cash for clunkers" rebate programme, officially known as the Car Allowance Rebate System (CARS).

FOOTNOTES

[36] As of October 30, 2009

The one month program, which ran from July end till August end 2009, focused on replacing clunkers with newer, more efficient models. The CARS program offered USD 3,500 - USD 4,500 down payment assistance and an auto sales tax deduction, coupled with manufacturer and dealer incentives. The program initially was started with USD 1 billion in funding provided by the US government, however owing to its vast success another USD 2 billion were added. The submission deadline for all "cash for clunkers" applications was August 25, 2009, with rebate applications worth USD 2.877 billion and close to 700 thousand car sales as of that date[37]. The CARS program is expected to have played a major role in improving the auto-industry and stimulating the economy during the second half of 2009. Already inventories were depleted quickly and factories were not able to produce cars fast enough to refill these inventories. Towards August-end, Ford and General Motors announced production hikes for both the third and fourth quarter of 2009 to meet the demand spurred by the CARS program. Thus, production in the automotive industry has received a boost from the rebate program. As per the preliminary analysis by the White House Council of Economic Advisers, the CARS program will "boost economic growth in the third quarter of 2009 by 0.3-0.4 percentage points at an annual rate thanks to increased auto sales in July and August; and sustain the increase in GDP in the fourth quarter because of increased auto production to replace depleted inventories"[38]. Thus, a recovery of the automotive sector, in the medium-to-long term, will provide the polypropylene industry with ample room for growth.

FOOTNOTES

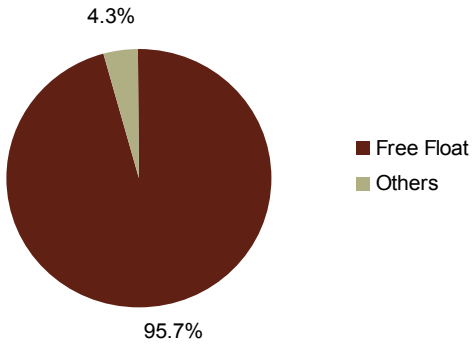
[37] US Department of Transportation, 2009
[38] US Department of Transportation, 2009

COMPANY OVERVIEW

PROFILE

Advanced Petrochemical Company (APC), formerly known as Advanced Polypropylene Company, was founded on October 1st 2005. It is headquartered in Jubail Industrial City and employs around 310 personnel (as of March 2009)[39]. The company went public in December 2006 "as part of the kingdom's requirement that a petrochemical project receiving feedstock from Saudi Aramco must offer shares to the public"[40]. APC currently enjoys a free float rate of 95.72%[41], according to the Tadawul website.

Figure 13: Share Ownership



Source: Tadawul, as of September 2009

Since it went public until today, APC's share capital has remained at SAR 1,413,750,000 divided into 141,375,000 shares of SAR 10/share. The company enjoys a market capitalization of SAR 3.5 billion and a free-floated market capitalization of around SAR 3.4 billion. APC's weight in the Saudi free-float index is about 0.66% and is among the lowest relative to other petrochemical companies listed on the Tadawul[42].

MANAGEMENT

The company's board is presided by Mr. Khalifa Al Mulhim, where as the company's management is headed by Mr. Ali Al-Shaier.

Figure 14: Management Table

Name	Position
Mr. Khalifa Al Mulhim	Chairman
Mr. AbdulMohsen Al Rashid	Member
Mr. Khalid Al Rawaf	Member
Mr. AbdulRahman Al Garawi	Member
Mr. Muayad Al Saleh	Member
Mr. Abdullah Al Obaikan	Member
Mr. Ahmed Al Rajhi	Member
Mr. Mumtaz Khan	Member
Mr. Alex Segers	Member

Source: APC

FOOTNOTES

[39] Zawya, 2009
[40] MEED, 2008
[41] As of September-end, 2009
[42] Market data as of October 30, 2009

OBJECTIVES

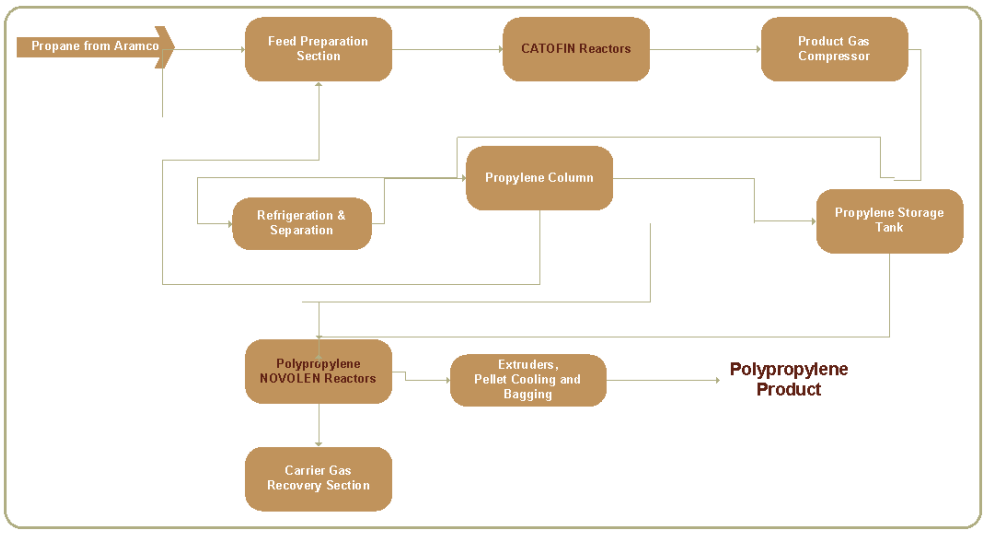
APC is engaged in offering a complete range of polypropylene homopolymers, impact co-polymers and random co-polymers to meet the polymer needs of the following industries:

- automotive
- consumer product (household products and appliances)
- healthcare and medical
- packaging
- textiles

PHYSICAL FACILITIES

APC began trial production at its petrochemical complex in March 2008, with the first non-commercial shipment of polypropylene exported during the last week of that month. The duration of the testing period was 120 days, with commercial production beginning in August 2008. The phase of EPC works totaled 32 months[43] and the construction costs alone exceeded SAR 3 billion[44]. The company's project consists of an integrated propane dehydrogenation and polypropylene complex, enjoying an annual production facility of 450 thousand metric tons of polypropylene. The technologies used by APC are provided by ABB Lummus and Novolen Technology Holdings. The Catofin-ABB Lummus technology converts propane gas, received from Saudi Aramco, into propylene (annual production capacity of 455 thousand metric tons). The Novolen Technology is then utilized to produce the polypropylene (annual production capacity of 450 thousand metric tons), from the propylene gas using a catalyst such as titanium chloride, through two production lines. The first line has an annual production capacity of 180 thousand metric tons of both homopolymer and random copolymer grades. The second line has an annual production capacity of 270 thousand metric tons of homopolymer grades. All of the propylene production will be utilized for polypropylene production.

Figure 15: Production Process



Source: APC

FOOTNOTES

[43] MEED, 2008
[44] APC

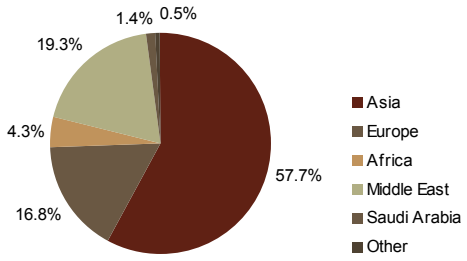
In 2008, APC's production totaled 400,280 mt of propylene and 380,317 mt of polypropylene. The sales volume for 2008 amounted to 319,460 mt of polypropylene. Moreover, the company witnessed impressive export numbers in the month of December of 2008 as it shipped 61,007 mt of polypropylene to regional and global markets.

During 2009, APC halted production twice. Due to maintenance work performed during late March 2009 and up until early April 2009, production was stopped for several days. Then on August 23rd, production at the polypropylene plant was again brought to an unscheduled halt for a period of around one month due to technical reasons. The halt of operations at the plant reduced the availability of polypropylene in the Middle East region[45].

TARGET MARKETS

APC's target markets are mainly Southeast Asia (specifically China), the Middle East and Europe. The Indian market represents only 2.5% to 3.5% of APC's total exports for the year 2008 and 2009.

Figure 16: Target Markets



Source: APC

SUPPLIERS

APC has a Propane Supply Agreement (PSA) with Saudi Aramco for the supply of up to 23,000 barrels per day of propane feedstock for a period of 20 years. However, the propane deliveries "are subject to Aramco's operational constraints and the production policies of the Government of the Kingdom of Saudi Arabia". The propane price, payable by APC, is based on a market-linked formula which provides the company around a 30% discount over the naphtha price in Japan. The price formula is fixed until 2011.

Price = Product Factors * (Price of Naphtha at Japan (C&F Japan) – Freight Cost)

The product factor was 0.687 in 2008 and will gradually increase up to 0.720 in 2011. Beyond 2011, APC expects the product factor to remain at the 0.720 level or to increase moderately.

Another feedstock used by APC is natural gas, also supplied by Saudi Aramco at the prevalent prices in Saudi Arabia. The quantity of natural gas Aramco has committed to is around 15 MMscfd (million standard cubic feet per day).

Another key supplier for APC is the Saudi Electricity Company, with which APC has a Bulk Power Supply Agreement.

FOOTNOTES

[45] Argaam, 2009

COMPETITORS

Prior to 2009, the annual polypropylene production capacity of Saudi Arabia was an estimated 1.8 million metric tons. However with many polypropylene plants becoming operational in 2009, the Kingdom's production capacity of the polymer will increase by a total of 2.7 million metric tons to total 4.5 metric million tons by yearend 2009. It is important to note that the polypropylene facility of Al Waha Petrochemicals will be the last complex to enter production for 2009. With the production facilities of Saudi Kayan and National Petrochemical Company (Petrochem) expected to go onstream by the second half of 2010 and the fourth quarter of 2011, respectively, it is projected that Saudi Arabia's annual polypropylene production capacity will exceed 5 million metric tons[46]. The major polypropylene plants in Saudi Arabia are owned by the following firms:

Figure 17: Saudi Arabia's Polypropylene landscape

Company	Key Shareholder	Annual Production Capacity (000 metric tons)	Status
Ibn Zahr	Sabic (80%)	1,140	Fully operational in Q1/09
Saudi Polyolefins Co.	Tasnee (75%)	720	Fully operational in Q2/09
PetroRabigh	Saudi Aramco (50%)	700	Fully operational in Q2/09
Saudi Kayan Petrochemical Co.	Sabic (35%)	600	Fully operational in 2H/10
Advanced Petrochemical Co.	-	450	Fully operational in Q4/08
Al Waha Petrochemicals	Sahara Petrochemicals (75%)	450	Fully operational in Q4/09
Yanbu National Petrochemical Co.	Sabic (56%)	400	Fully operational in Q3/09
National Petrochemical Industrial Co.	Alujain Corporation (57%)	400	Fully operational in Q3/09
PetroChem	Saudi Industrial Investment Group (50%)	400	Fully operational in Q4/11
Saudi Yanbu Petrochemical Co.	ExxonMobil (50%); Sabic (50%)	260	Fully operational in 2000
Total Capacity by Yearend 2011		**5,520**	

Source: Companies, MEED, Zawya and Tadawul

FOOTNOTES

[46] Audi Capital

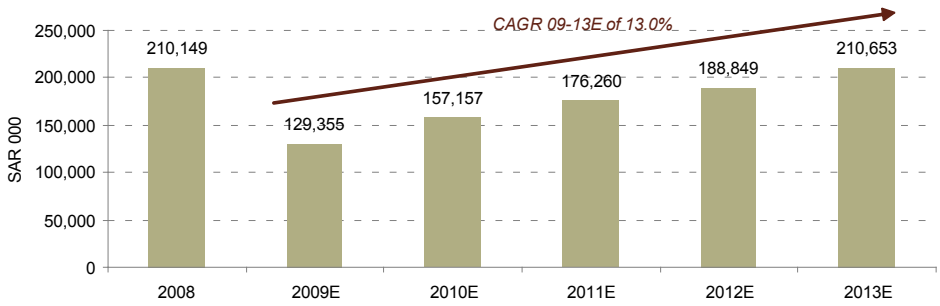
FINANCIAL ANALYSIS

PROFITABILITY

Net earnings for the full year 2008 skyrocketed to SAR 210 million, from SAR 2.2 million for the full year 2007. The significant growth, in 2008, was due to the company's start up of operations coupled with the record prices of polypropylene during the second and third quarter during the year. The marketing and selling strategies of the company also played a major role in the achievement of these impressive figures.

Going forward, APC's net earnings are anticipated to grow at a CAGR09-13F of 13.0%. However, net earnings for 2009 will fall significantly short of those of 2008, as the company had two unscheduled production stoppages which curbed production and sales volume. Furthermore, the estimated average international price of polypropylene for 2009 (USD 1,010.8/mt) is approximately 32.4% below the average price for 2008 (USD 1,496/mt). Net earnings for 2009 are projected to drop by 38.4% from the previous year as a result. Nevertheless, polypropylene production and sales volumes are expected to pick up in the following years amid improved economic conditions and fewer halts in production. This positive outlook, combined with higher polypropylene prices accompanying higher energy prices, will lead to a smooth increase in the company's earnings for the years 2010 till 2013 according to our model.

Figure 18: Earnings Growth



Source: APC, Audi Capital estimates

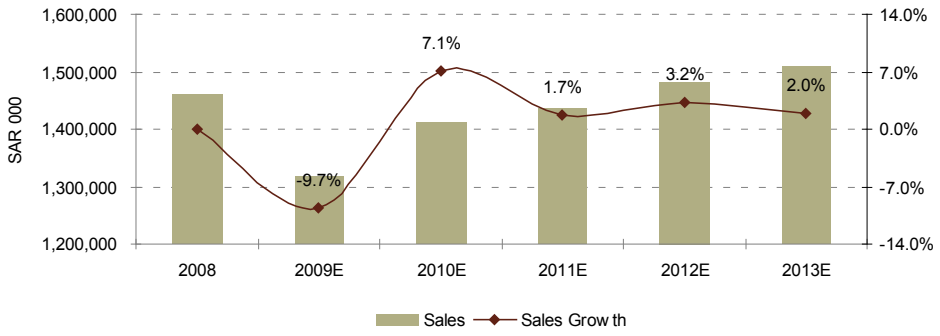
Sales revenues[47] for the full year 2008 amounted to SAR 1,459 million, generated solely from operations during the final nine months of the year. In the third quarter alone, sales of SAR 683 million were reported, representing almost half of the full year sales. Third quarter results were driven by the record highs in polypropylene prices witnessed throughout this period, and in particular at the beginning of August, when polypropylene prices peaked at USD 2,163/mt. The average of polypropylene prices for the third quarter of 2008 was USD 1,870/mt, compared to USD 1,626/mt for the preceding quarter and USD 965/mt for the succeeding quarter. As APC's sales revenues are purely a function of polypropylene sales i.e. of polypropylene prices and operating rates, any rise in polypropylene prices directly boosts the company's top-line number.

FOOTNOTES

[47] According to the company report's summary of revenue recognition "All products are sold to the marketers. Upon delivery to the marketers, sales are recorded at provisional sales prices that are later adjusted based upon actual selling prices received by the marketers from third parties, after deducting the costs of shipping and marketing fees etc. Adjustments are made, as they become known to the Company"

APC is expected to report sales of SAR 1,318 million for the full year 2009, down by 9.7% from the turnover generated in 2008. The lower sales are mainly due to the lower production volumes and lower polypropylene prices estimated for 2009. The company is expected to produce 312,923 tons of polypropylene in 2009, 17.7% less than the 380,317 produced in 2008. Furthermore, this reduced output will be sold at a lower average price compared to 2008. Until 2013, we forecast very moderate growth in APC sales, despite an expected rise in polypropylene prices. The company's limited production capacity growth potential, due to a lack of expansion plans, is expected to restrain the growth in sales that might arise from increases in polypropylene prices. The projected CAGR09-13E in sales of only 3.5% is driven mainly by an increase in polypropylene prices, coupled with an expected expansion of the company's clientele base which will boost sales volumes. It is important to stress that annual production capacity is expected to remain at 450 thousand mt over the forecast horizon. The increase in operating rates, from a 2009E rate of as low as 70% to a 2010-2013E average rate of 85.3%, will lead to larger volumes.

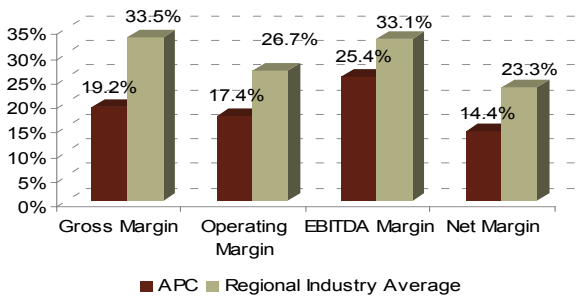
Figure 19: Sales Revenues



Source: APC, Audi Capital estimates

APC enjoyed acceptable profit margins in its first year of operations compared to the region's industry average, which includes competitors that have been operating for years. The largest margin gap, between APC and regional players, was in the gross margin where APC was below the industry average by 1,440 basis points (bps). This was largely due to the company's limited operating history, which resulted in a COGS-to-sales ratio that was above the region's industry average. Furthermore, the company's production costs are heavily dependent on the costs of naphtha, as its only product line is polypropylene, where as most regional producers are reliant on a much diverse set of feedstock, including the widely-used and cheaper ethane. This largely explains the gap between APC and the industry profit margins. It bears repetition that production costs are primarily made up of feedstock costs, followed by electricity costs.

Figure 20: Operational Efficiency and Management Effectiveness (based on 2008 figures)

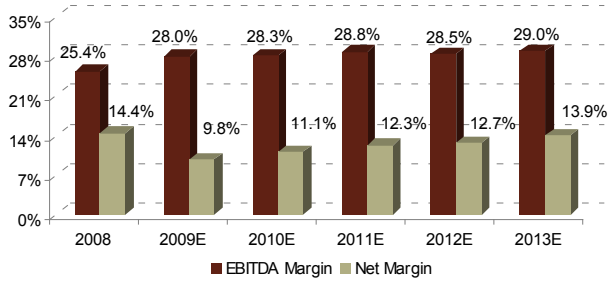


Source: Company reports, Bloomberg

APC's profit margins, except for the EBITDA margin, are expected to contract during 2009 and increase modestly thereafter. The company's net margin in particular is projected to severely contract in 2009, owing to lower sales, higher operating costs and the accounting for Zakat expenses in the company's income statement for the first time. From 2010 onwards, APC's net margin should improve gradually as polypropylene prices rise together with oil prices and operating rates improve.

However, the projected rise in oil prices will also have a negative effect on the company's profitability. Higher oil prices entail higher naphtha prices, which will increase the company's feedstock cost, despite the high probability that the product factor in APC's propane pricing formula will remain at 0.72. Thus, APC's margins will depend on how much the increase in production costs will lag behind the increase in polypropylene prices. Nevertheless, APC's margins are projected to slightly improve in the medium term owing to the company's improved operational efficiencies and management effectiveness, which will allow it to withstand the excess over-supply pressure expected in the petrochemical industry in the medium-term and perhaps shield it from rising competition.

Figure 21: EBITDA and Net Margins

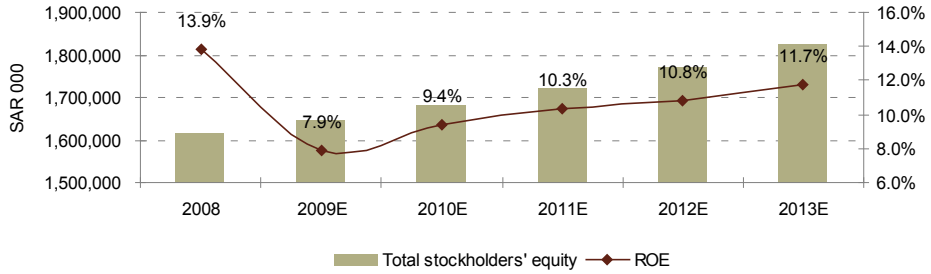


Source: APC, Audi Capital estimates

The big leap in net earnings for 2008, which translated into additional retained earnings of almost SAR 180 million, resulted in a 14.2% y-o-y increase in the company's equity. The strong net earnings of 2008 caused APC's return on equity (ROE) to jump from 0.2% for 2007 to 13.9% for 2008. This is still below the 2008 regional industry average of 19.5%. However, APC only began operations in 2008, where as petrochemical producers such as Sabic and Tasnee have been in the business for many years. The gap between the company's ROE and that of the region's industry is therefore of minor significance. Finally, it is worth noting that APC's sustainable equity growth rate going forward, based on the 2008 retention rate of 66.4%, is 9.2%.

The company's ROE is projected to decline significantly in 2009, owing to weaker company performance and industry fundamentals. Although APC's ROE will start increasing modestly in 2010 onward, this profitability measure is not expected to return to the 2008 level during our forecast horizon.

Figure 22: ROE

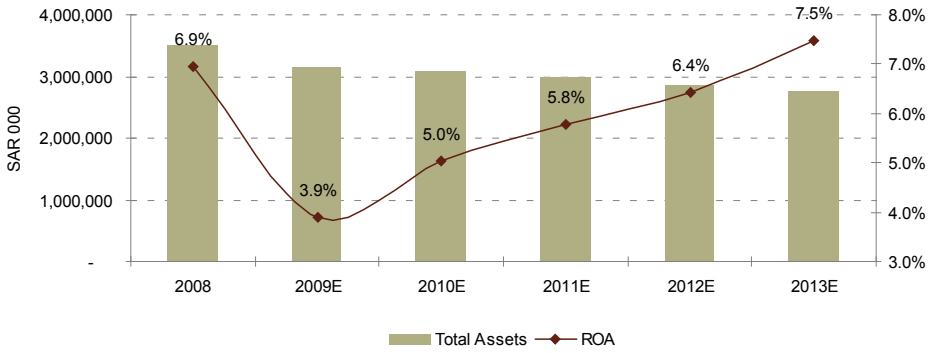


Source: APC, Audi Capital estimates

The increased earnings in 2008 also led to a significant improvement in the company's return on assets (ROA) for the year. However, the growth in earnings was offset to some extent by the swelling of total assets by 37.8%. The average total assets size, as of year-end 2008, was SAR 3,026 million compared to SAR 2,180 as of year-end 2007. APC's ROA jumped from 0.1%, in 2007, to 6.9% in 2008 but remained below the industry average of 10.8%.

APC's ROA is expected to decline to 3.9% in 2009. However, in the long-run, the company's profitability is anticipated to gradually return to the 2008 level and slightly exceed it, based on an improved operating performance and stronger oil prices.

Figure 23: ROA

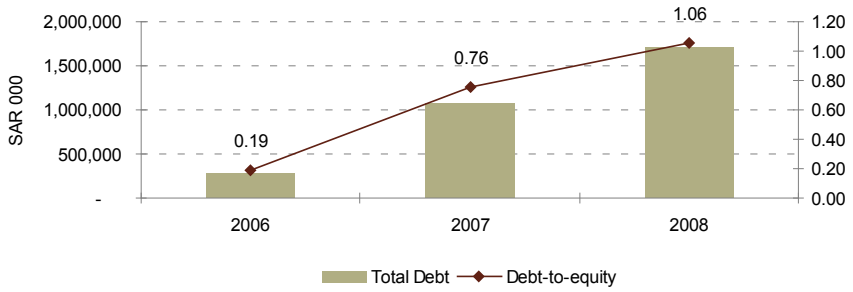


Source: APC, Audi Capital estimates

CAPITAL STRUCTURE

APC's level of debt has risen gradually since the company's inception, with debt totaling SAR 1,713 million at year-end 2008. Over 80% of the company's total debt is long-term, comprised mainly of a Murabaha agreement with Gulf International Bank (GIB) for SAR 1,238 million. Total stockholders' equity as of year-end 2008 was SAR 1,617 million, resulting in a debt-to-equity ratio of 1.06x and a debt-to-capital ratio of 0.51x. As of year-end 2007, the company's debt-to-equity and debt-to-capital ratios were 0.76x and 0.43x, respectively.

Figure 24: Leverage Position



Source: APC

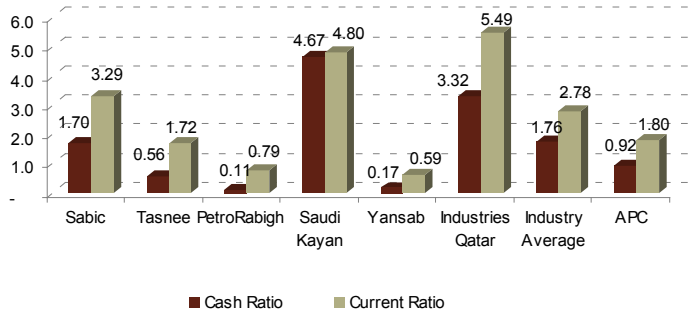
APC's funding commitments, as of year-end 2008, were as follows:

- Short-term loans totaling SAR 312.5 million, comprised of a working capital facility-Tawarq of SAR 187.5 million and the current portion of the GIB Murabaha loan.

- Long-term loans of SAR 1,400 million, consisting of the GIB Murabaha loan of SAR 1,000 million and a facility of SAR 400 million from the Saudi Industrial Development Fund (SIDF). APC obtained the SIDF loan in 2006 and made a first drawdown of SAR 128 million during the same year. The second and third drawdowns totaling SAR 192 million were made in the following year, and the final drawdown of SAR 80 million was made in 2008. The facility will be repaid in 13 semi-annual installments starting July 2010.
  APC signed its SAR 1,238 million Murabaha facility agreement in 2007. It includes a standby facility of SAR 113 million. The loan is to be repaid in 18 semi-annual installments, with the first repayment due six months from the project's completion date.

As of September-end 2009, APC had a debt-to-equity of 0.93x and a debt-to-capital of 0.48x, an improvement from year-end 2008. These ratios reflect APC's highly leveraged capital structure, which is typical for a capital-intensive business such as petrochemicals. The average debt-to-equity ratio and debt-to-capital ratio of key petrochemical companies in the region is around 1.47x and 0.54x, respectively. Thus, APC enjoys a better leverage position than its peers.

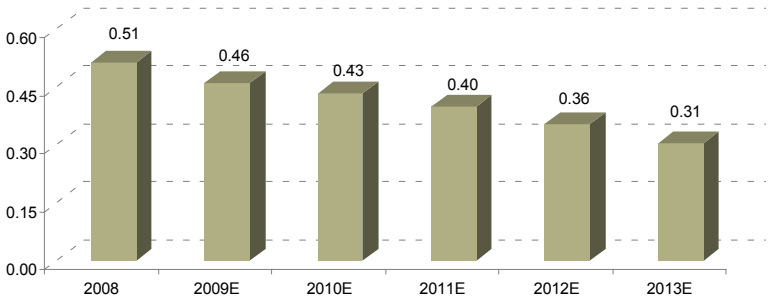
Figure 25: Capital Structure of Key Players in the Region (as September-end 2009)



Source: Company reports

As no expansion plans have been announced, no significant additional debt is expected to be taken. In turn, APC's leverage position is anticipated to improve in the future. Furthermore, the projected growth in APC's production and sales, coupled with an improvement in its margins, will lead to higher cash reserves which will increase the company's ability to pay off its debts.

Figure 26: Capital Structure (Debt-to-capital)

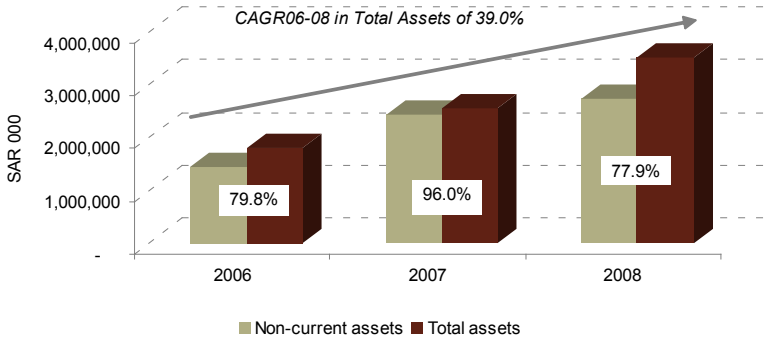


Source: APC, Audi Capital estimates

ASSET COMPOSITION

In a capital-intensive industry such as petrochemicals, companies tend to have a non-current based asset structure. Since its inception, APC's asset structure has been skewed towards fixed assets, which represented close to 80% of the company's total assets as of year-end 2008. The start of operations in 2008 boosted the balance of current assets, specifically the inventory (before and during the start-up) and trade receivables balances, which in turn diluted the relative weight of fixed assets. Furthermore, the loan drawdowns increased the cash balance to around 30% of the total current assets. The y-o-y increase in current assets was more than seven-fold, to a total of SAR 776 million as of year-end 2008. Total assets increased by 37.8%, y-o-y, to SAR 2,731 million by year-end 2008. APC's net operating assets grew by 33.9%, y-o-y, to SAR 3,330 million as of year-end 2008 and in turn reflecting growth in the company's high-quality operating assets.

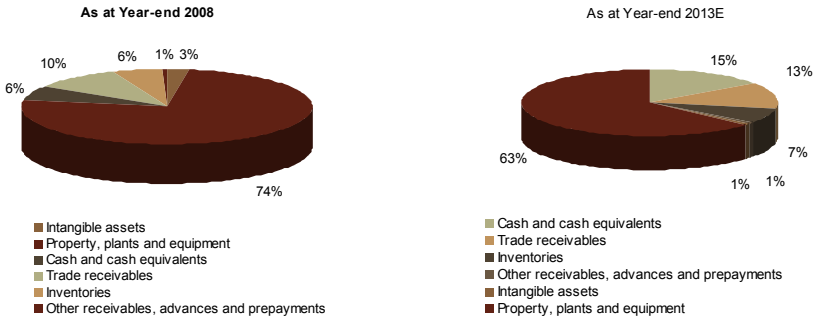
Figure 27: Asset Structure



Source: APC

Property, plants and equipment (PPE) represented 74% of total assets as of year-end 2008, by far the largest constituent. Trade receivables were the second largest component of total assets, albeit with a weight of only 9.8%. However, the weight of PPE in the company's asset book is expected to decrease going forward, as current assets are projected to increase due to growth mainly in the cash and receivables balance.

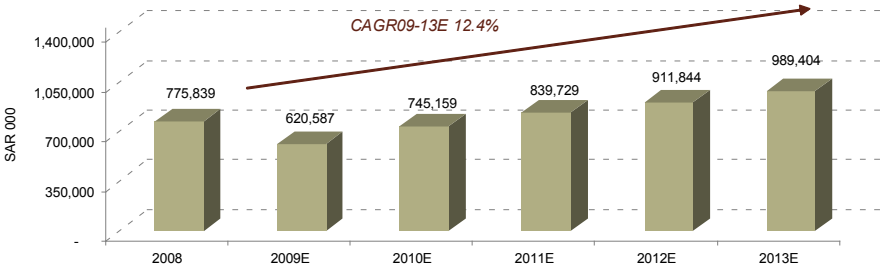
Figure 28: Breakdown of Total Assets



Source: APC, Audi Capital estimates

With a very high dividend pay-out ratio and no announced expansion plans, the company's balance sheet size is projected to contract stable during the period 2009-2013E. The weight of current assets is projected to gradually increase from 19.6% as of year-end 2009 to 35.8% as of year-end 2013. The projected CAGR09-13E for current assets is 12.4%.

Figure 29: Current Assets



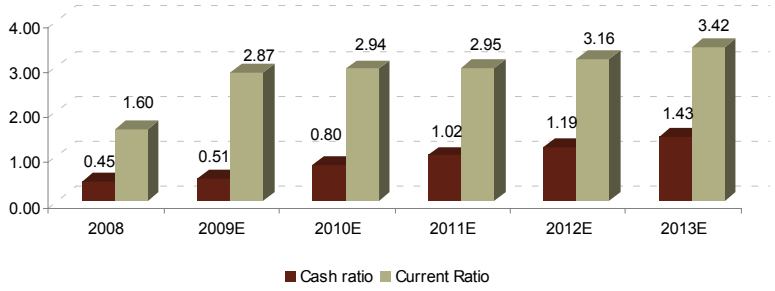
Source: APC, Audi Capital estimates

LIQUIDITY AND UTILIZATION PERFORMANCE

The improvement in liquidity, due to the growth in current assets, during 2008 was offset by significant growth in current liabilities. As current liabilities grew almost nine-fold, the cash ratio plummeted to 0.45x at the end of 2008 from 1.57x at the end of 2007.

Nevertheless, APC's liquidity measures are expected to improve in the near future, as its cash reserves increase. As a result, the company should not face any problems in meeting its short-term obligations during the forecast period.

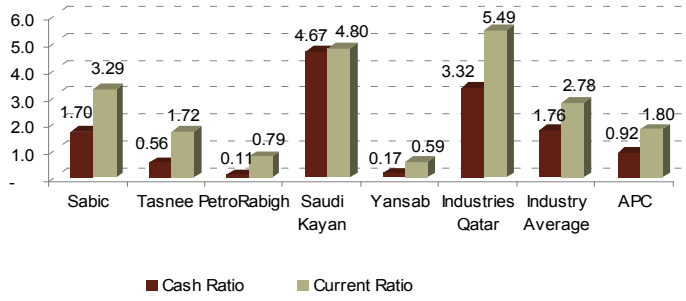
Figure 30: Liquidity Indicators



Source: APC, Audi Capital estimates

As of September-end 2009, APC's liquidity measures had improved from year-end 2008, with the cash ratio in particular showing a fair increase. APC's cash and current ratios were 0.92x and 1.80x, respectively, as September-end 2009, however are below the average cash and current ratios for key petrochemical companies in the region which were 1.76x and 2.78x, respectively. Thus, APC's liquidity position is weaker than that of other major regional players.

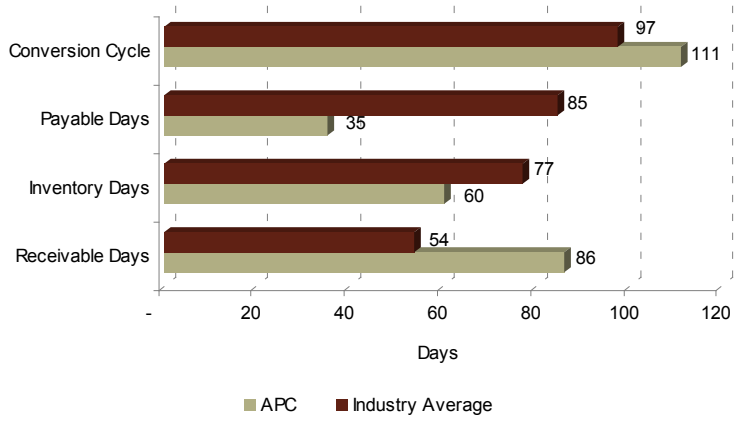
Figure 31: Liquidity Indicators of Key Players in the Region (as September-end 2009)



Source: Company reports

As for the company's receivable and inventory management effectiveness for 2008, APC's turnover of accounts receivables and inventory equaled 4.2x and 6.1x, respectively, translating into 86 and 60 turnover days, respectively. APC's receivable turnover days exceeded the region's industry average turnover by 32 days, indicating a deficiency in the company's receivables collection process. However, its inventory days are below the region's industry average by 17 days, signaling the company's efficiency in managing its inventory. Its payables turnover was 10.3x, resulting in only 35 turnover days and in turn very little time and flexibility for the company to manage its accounts with its suppliers. Furthermore, the region's industry average of payable turnover was 85 days for 2008, emphasizing APC's weak position in settling its bills due to the short time it has. Overall, the cash conversion cycle for APC was 111 days for 2008, indicating a strong need for working capital requirements. However, the company's cash conversion cycle exceeded the industry's only by 14 days, signifying the short excess time that APC's capital is tied up in the business process compared to its peers.

Figure 32: Turnover Measures of Key Players in the Region (as of year-end 2008)



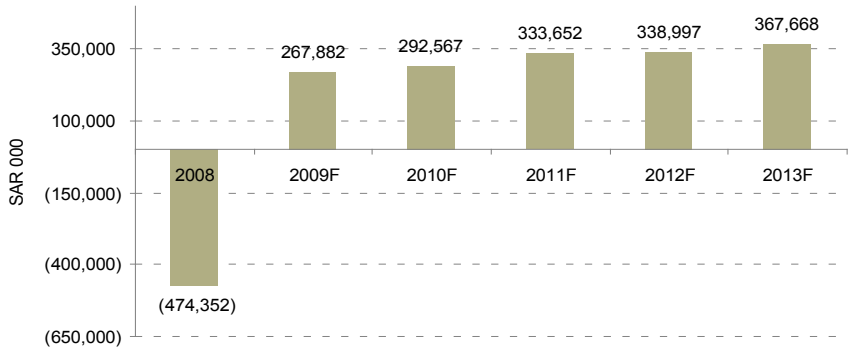
Source: Company reports

In the long run, APC's conversion cycle is expected to remain above 100 days owing to the shy growth in sales projected and very minor improvement in the management of inventories and receivables.

CASH FLOWS

Owing to the company's start-up status and the associated high level of cash outflows, operating and pre-operating cash flows have been negative. The negative operating cash flows, coupled with significant Capex, have resulted in negative free cash flows. In the long run, APC's operating cash flows are projected to improve as a result of higher operating rates, more sales and better management of working capital. With a reduced Capex representing only maintenance capital expenditures, APC's free cash flows will also show an acceptable improvement.

Figure 33: Free Cash Flows



Source: APC, Audi Capital estimates

PEER COMPARISON

APC, in perspective, enjoys comparable financial measures to its global peers. However, in regards to the EBITDA margin and liquidity ratios, APC's measures exceed the average of other international players. Going forward, with APC's competitive cost advantage, a favorable pricing environment and a healthier balance sheet, APC financial ratios are expected to exceed those of its global peers, while closely mirroring those of its regional competitors.

Figure 34: Global Peer Comparison

	Dow Chemical Co.	BASF	Reliance Industries Ltd.	Sinopec Shanghai	Petro-China Co. Ltd	Total SA	Exxon-Mobil Corp.	Industry Average	APC
Gross Margin	9.4%	25.4%	NA	NA	NA	NA	19.7%	18.2%	11.3%
Operating Margin	3.7%	11.3%	12.3%	NA	15.1%	14.8%	15.6%	12.1%	8.9%
EBITDA Margin	7.6%	16.4%	16.0%	NA	23.9%	18.6%	18.5%	16.9%	22.2%
Net Margin	1.0%	4.7%	9.9%	NA	10.7%	6.6%	10.6%	7.3%	5.8%
ROE	3.5%	15.9%	14.5%	NA	15.0%	22.6%	38.5%	18.3%	13.9%
ROA	1.2%	6.0%	7.1%	NA	10.1%	9.1%	19.2%	8.8%	6.9%
Cash Ratio	0.21	0.17	0.60	0.05	0.16	0.36	0.65	0.32	0.92
Current Ratio	1.23	1.31	1.30	0.49	0.85	1.37	1.47	1.14	1.80
Asset Turnover	1.22	1.28	0.72	2.07	0.95	1.38	1.81	1.35	0.48
Receivable Turnover	11.83	7.64	27.71	45.80	48.28	9.32	13.90	23.50	4.23
Receivable Days	31	48	13	8	8	39	26	25	86
Inventory Turnover	8.07	6.96	NA	14.15	NA	NA	30.04	14.80	6.06
Inventory Days	45	52	NA	26	NA	NA	12	34	60
Debt-to-equity	0.84	0.78	0.63	0.73	0.15	0.48	0.08	0.53	0.93
Debt-to-capital	0.46	0.44	0.39	0.42	0.13	0.33	0.07	0.32	0.48

Source: APC, Bloomberg as of October 30, 2009

When compared with its regional peers (excluding Yansab and Saudi Kayan), APC's profitability measures appear much weaker than the average. However, it is important to reiterate that APC is a start-up company whereas peers such as Sabic, Tasnee and Industries Qatar are at an advanced stage of growth, which makes the comparison unreliable.

Figure 35: Regional Peer Comparison

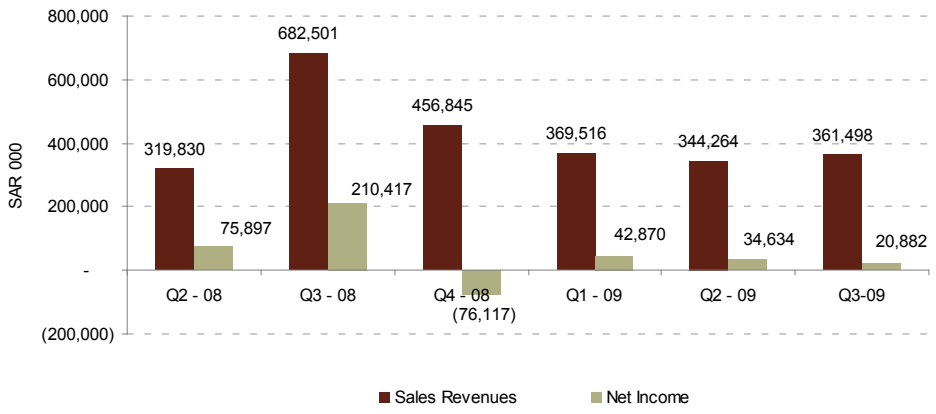
	Sabic	Tasnee	Petro Rabigh	Saudi Kayan	Yansab	Industries Qatar	Industry Average	APC
Gross Margin	30.6%	28.3%	NA	NA	NA	49.3%	36.1%	11.3%
Operating Margin	22.7%	20.6%	NA	NA	NA	47.4%	30.2%	8.9%
EBITDA Margin	32.5%	27.4%	NA	NA	NA	NA	29.9%	22.2%
Net Margin	13.0%	7.0%	NA	NA	NA	46.4%	22.1%	5.8%
ROE	22.7%	6.5%	NA	3.2%	NA	45.6%	19.5%	13.9%
ROA	8.4%	2.2%	NA	2.2%	NA	30.6%	10.8%	6.9%
Cash Ratio	1.70	0.56	0.11	4.67	0.17	3.32	1.76	0.92
Current Ratio	3.29	1.72	0.79	4.80	0.59	5.49	2.78	1.80
Asset Turnover	0.57	0.36	0.17	NA	NA	0.62	0.43	0.48
Receivable Turnover	7.17	5.39	5.57	NA	NA	11.50	7.41	4.23
Receivable Days	51	68	66	NA	NA	32	54	86
Inventory Turnover	4.50	3.43	14.71	NA	NA	3.81	6.61	6.06
Inventory Days	81	107	25	NA	NA	96	77	60
Payable Turn-over	9.07	7.05	1.85	NA	NA	7.38	6.34	10.33
Payable Days	40	52	198	NA	NA	49	85	35
Conversion Cycle	92	122	-107	NA	NA	78	97	111
Debt-to-Equity	0.73	1.46	2.86	1.17	2.27	0.34	1.47	0.93
Debt-to-Capital	0.42	0.59	0.74	0.54	0.69	0.25	0.54	0.48

Source: Company Reports

LATEST PERFORMANCE – 9M09

Following the net loss incurred in the fourth-quarter of 2008, APC's quarterly performance for the first nine months of 2009 somewhat improved driven by the rebound in polypropylene prices. The q-o-q weakening of net earnings in the third quarter of 2009, however, was due to the unscheduled plant stoppage that took place for a one-month period which in turn curbed production and sales volume. In turn, net profits in the third quarter of 2009 amounted to SAR 20.9 million, reflecting a hefty plunge of 39.7% q-o-q. Nevertheless, APC's sales revenues in the third quarter of 2009 improved by 5.0%, q-o-q, due to the gains in polypropylene prices which somewhat diluted the impact of the cut in production volume. Polypropylene prices for the third quarter of 2009 averaged USD 1,153/mt compared to USD 960/mt for the previous quarter, an increase of 20.0%.

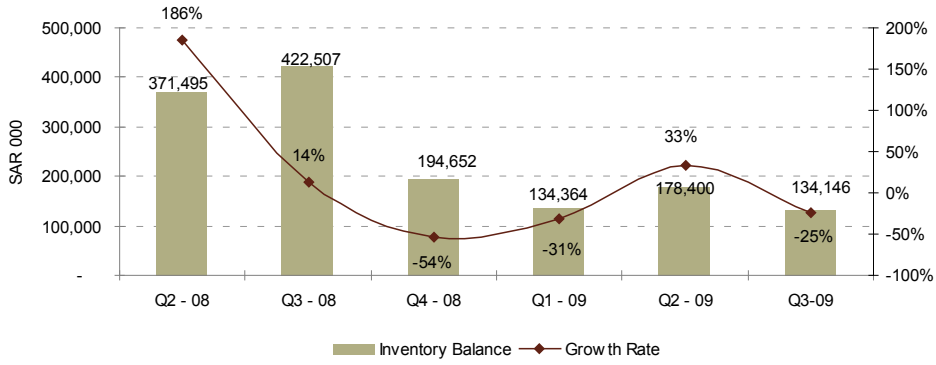
Figure 36: Latest Performance



Source: APC

The inventory balance of APC has been fluctuating over the past seven quarters. Starting April 2009, APC was replenishing its inventory, in light of more favorable macro-economic conditions, which consequently led to an increase of 32.8% in its inventory balance. However, due to the maintenance works that took place in the third quarter of the year, the inventory balance witnessed a sharp drop of 24.8%

Figure 37: Inventory Management



Source: APC

Overall, APC's third quarter results for 2009 deteriorated in comparison with its second quarter results for the year. Its profitability measures significantly contracted on the back of lower production and selling volumes, coupled with higher operational costs especially in light of the 17.8% q-o-q increase in naphtha prices. Naphtha prices for the third quarter of 2009 averaged USD 607.8/mt compared to USD 516.2/mt for the previous quarter. Below is a table summarizing APC's performance measures on a q-o-q basis:

Figure 38: Q-o-Q Performance

	Q2 - 09	Q3-09	Q-o-Q Change (bps)
Profitability			
Gross Margin	17.70%	11.35%	(635)
Operating Margin	13.68%	8.91%	(477)
EBITDA Margin	27.77%	22.16%	(561)
Net Margin	10.06%	5.78%	(428)
Capital Structure			
Debt-to-Equity	0.92	0.93	157
Debt-to-Capital	0.48	0.48	40
Liquidity			
Cash Ratio	0.73	0.92	1930
Current Ratio	1.80	1.80	39

Source: APC

SWOT ANALYSIS

STRENGTHS

- Faces fewer risks as a green-field project.
- Access to favorably-priced feedstock.
- Based in a hub of petrochemical activity.
- Geographically positioned in the center of a global logistics hub, close to key markets.
- Enjoys leading-edge technology and modern world-scale assets.
- Operates amid an optimal vertically-integrated business structure.
- Production line comprised of only one product, which exhibits strong potential of price appreciation relative to other petrochemical products.
- Long-term agreements with three international off-takers specialized in trading chemicals, plastic and raw materials.

WEAKNESSES

- A small player, relative to regional and global competitors, at a time of significant increases in oversupplies.
- Key market Asia is losing its gleam, on the road to becoming a key rival to Saudi Arabia's petrochemical industry.
- No expansion plans revealed by company's management.
- Operations concentrated in one product line, which entails exposure to market risk.
- Has suffered two unscheduled stoppages in production during a period of only 9 months of operations.
- Propane feedstock price formula applicable only up to 2011.
- Required volume of propane feedstock might not always be delivered.
- Possible imposition of ADD's from APC's prime markets, specifically China.
- A weak cash ratio indicating a poor cushion for meeting its short-term obligations.
- A weak payable turnover and in turn little flexibility with its suppliers.

SWOT ANALYSIS (CONTINUED)

OPPORTUNITIES

- Rising crude oil prices, and in turn petrochemical prices, boost further the competitive cost advantage of Middle Eastern producers.
- A recovery in key economies to renew demand for petrochemicals.
- China, the engine driving recovery, expected to witness an economic growth rate of 8.5%, 9.0% and 9.7% for 2009, 2010 and 2011, respectively.
- China's stimulus package to provide significant support to the petrochemical industry.
- Possible delays and cancellations of petrochemical projects to reduce the projected oversupply.
- Expanding population and a rising middle class in countries such as India, with an increasing disposable income, to boost demand for petrochemicals.
- Encouragement of Saudi Arabia's energy strategy for diversifying into downstream products and for investments in export-oriented plastic conversion industries.

THREATS

- Industries served by the polypropylene industry are still troubled by the effects of the latest global financial crisis.
- A rocky recovery in overall petrochemical demand.
- Excess oversupply of petrochemicals, whose negative impact is further deepened with the economic slowdown.
- Key markets, India and China, continue to invest in domestic capacity, curbing the growth in its import needs.
- Falling crude oil prices dilute the competitive cost advantage of the region's petrochemical producers and compress their margins.
- Intense competition from new projects coming onstream in the region[48].
- Ambitious petrochemical plans, of Iran, aim at surpassing Saudi Arabia as the region's leading petrochemical player[49].
- Consolidation of the Saudi petrochemical industry, resulting from limited cheap feedstock and cheap company valuations, to pose a threat to the Kingdom's small players.
- Saudi Arabia's short supply of unallocated ethane feedstock.
- Removal of the LPG feedstock subsidy in 2012.

FOOTNOTES

[48] Specifically from close neighbor Abu Dhabi, whereby an estimated USD 100 billion worth of petrochemical investments will be undertaken in the emirate up until the year 2030 (MEED, 2009)
[49] MEED, 2008

VALUATION

FCFE METHODOLOGY

We view the Free Cash Flow to Equity (FCFE) valuation method as the optimal model for valuing APC, as the company has only lately reached a stage where it is beginning to generate healthy operational cash flows. Our model is based on a five-year forecast period and draws heavily on the fundamentals of the polypropylene industry, as this polymer's performance will be a key driver behind the company's performance. With the high correlation between oil and propylene prices, and the optimistic outlook for the oil industry, polypropylene prices are projected to remain firm in the long-run despite the pressure that will arise from market oversupply. Furthermore, we expect the company's operating rates to improve in the coming years, boosting production. And with the company's competitive marketing and selling strategies, we project a healthy increase in the selling volumes.

As propylene prices are largely driven by crude oil prices and as the company's performance is largely a function of polypropylene prices, and assuming no expansion in production capacities, we have based our FCFE valuation on scenarios linked primarily to expectations surrounding crude oil prices. The scenarios are as follows:

Base-Case Scenario

We assumed that oil prices will softly rise to USD 90/bbl by 2013, pushing up polypropylene prices to a level of around USD 1,362/mt. Furthermore, we assumed that the stronger competitive environment will somewhat hinder the pace of improvement in the company's sales and operating margins. Our assumptions have resulted in the following polypropylene prices:

	2009 E	2010 E	2011 E	2012 E	2013 E
Crude Oil Prices USD/bbl	60.35	78.04	82.33	87.67	90.13
International Polypropylene Prices USD/mt	1,012.1	1,233.0	1,278.7	1,335.3	1,361.5

Source: Bloomberg contributors and Audi Capital estimates

Best-Case Scenario

We assumed that oil prices will rise gradually, nearing the USD 100/bbl mark by 2013. This will result in polypropylene prices close to the USD 1,450/mt level. Moreover, we assumed that the company's sales efficiency and profit margins will improve sharply, despite the new supplies that will enter the market. Our assumptions have resulted in the following polypropylene prices:

	2009 E	2010 E	2011 E	2012 E	2013 E
Crude Oil Prices USD/bbl	60.35	85.00	90.00	93.00	97.00
International Polypropylene Prices USD/mt	1,012.1	1,307.0	1,360.1	1,392.0	1,434.5

Source: Bloomberg contributors and Audi Capital estimates

Worst-Case Scenario

We assumed a weak improvement of oil prices over our forecast horizon owing to a weak macro-economic recovery. In addition, we assumed a very bleak operating and marketing landscape for APC in light of the massive polypropylene supplies to hit the market, regionally and globally. This outlook is further worsened by APC's status as a minor player in the domestic and global arena as its weak market power poses as a threat to its performance. Our assumptions have resulted in the following polypropylene prices:

	2009 E	2010 E	2011 E	2012 E	2013 E
Crude Oil Prices USD/bbl	60.35	72.50	75.00	81.25	83.75
International Polypropylene Prices USD/mt	1,012.1	1,174.2	1,200.8	1,267.2	1,293.7

Source: Bloomberg contributors and Audi Capital estimates

The assumed terminal growth rate is strongly linked to the economic prospects of the company's key markets: China, Europe and Saudi Arabia. However, the terminal growth rate also accounted for the lack of visibility in the petrochemical industry due to uncertain macroeconomic conditions and an oversupply in the petrochemical market. In turn, a terminal growth rate of 2.5% was used in the model.

For the base-case scenario, a fair value of SAR 32.95/share was derived (as detailed below).

	2008	2009E	2010E	2011E	2012E	2013E
Free Cash Flow to the Equity (SAR 000)	(474,352)	267,882	292,567	333,652	338,997	367,668
PV of Free Cash Flow to the Equity (SAR 000)		248,614	251,994	266,712	251,493	253,145
Present Value of Terminal Value (SAR 000)						4,942,351
Enterprise Value (SAR 000)						6,214,309
Discount Rate						7.75%
Terminal Growth Rate						2.50%
Shares Outstanding (000)						141,375
Fair Value/Share (SAR)						32.95

With the weights detailed below attributed to each scenario, a fair value of SAR 31.76 was derived for APC's share using the FCFE approach. Thus, with a current price of SAR 25.0/share, APC's stock offers an upside potential of 27.04%.

	Weight	Enterprise Value (SAR 000)	Fair Value/Share (SAR)	Weighted Fair Value/Share (SAR)	APC's Final Fair Value/ Share (SAR)
Best-case Scenario	20%	6,970,615	38.30	7.66	
Base-Case Scenario	60%	6,215,060	32.95	19.77	31.76
Worst-Case Scenario	20%	4,615,571	21.64	4.33	

Sensitivity Analysis

The data table below presents a sensitivity analysis to our price target valuation, for the base-case scenario, assuming various growth and discount rates. Our calculated fair value of SAR 32.95/share, for the base case scenario, was based on a discount rate of 7.75% and a growth rate of 2.5%.

		Discount Rate				
		7.25%	7.50%	7.75%	8.00%	8.25%
Growth Rate	2.00%	33.72	31.65	29.75	28.02	26.42
	2.25%	35.60	33.33	31.28	29.40	27.68
	2.50%	37.66	35.19	32.95	30.91	29.05
	2.75%	39.96	37.24	34.79	32.57	30.55
	3.00%	42.53	39.52	36.82	34.39	32.19

COMPARATIVE METHODOLOGY

Owing to the absence of companies with a similar profile to that of APC in terms of stage of growth and status of production, we have decided to exclude the relative valuation analysis from our final valuation as this disparity makes the relative valuation approach unreliable.

	Country	Market Cap (USD mn)	PE 09 (E)	PE 10 (E)	PB	12 Month Yield %
PetroChina Co. Ltd	China	315,648	20.73	16.76	2.96	2.16%
Sinopec Shanghai Petrochemical Co Ltd	China	959	9.90	9.59	1.39	2.86%
Total SA	France	146,215	11.94	9.38	1.83	5.46%
BASF	Germany	51,294	18.41	14.76	2.02	3.85%
Reliance Industries Ltd.	India	68,478	16.89	12.32	2.34	0.75%
Industries Qatar	Qatar	16,887	12.13	9.33	3.14	4.08%
Tasnee	Saudi Arabia	3,354	23.26	19.34	1.73	NA
Saudi Kayan	Saudi Arabia	7,580	NA	NA	1.83	NA
PetroRabigh	Saudi Arabia	8,830	43.45	NA	3.57	NA
Petrochem	Saudi Arabia	2,086	NA	NA	NA	NA
Sabic	Saudi Arabia	65,598	26.94	16.40	2.37	NA
Yansab	Saudi Arabia	4,710	NA	20.84	3.11	NA
Dow Chemical Co.	USA	28,876	53.27	19.70	1.67	3.81%
ExxonMobil Co.	USA	355,436	18.82	12.71	3.33	2.25%
	Industry Average		**23.25**	**14.65**	**2.41**	**3.15%**
APC		**942**	**27.32**	**22.49**	**2.15**	**3.00%**

Source: Bloomberg as of October 30, 2009

APPENDIX A: PROJECTED INCOME STATEMENT

(SAR 000)	2008	2009E	2010E	2011E	2012E	2013E
Sales	1,459,176	1,318,063	1,411,219	1,435,362	1,481,533	1,510,508
Cost of sales	(1,179,655)	(1,088,278)	(1,149,872)	(1,157,730)	(1,194,971)	(1,205,909)
Gross Profit	279,521	229,785	261,347	277,632	286,562	304,598
Selling and distribution expenses	(16,536)	(28,487)	(30,501)	(31,022)	(32,020)	(32,647)
General and administrative expenses	(8,891)	(14,122)	(15,120)	(15,379)	(15,873)	(16,184)
Operating income	254,094	187,176	215,726	231,230	238,668	255,768
Financing charges	(48,344)	(50,796)	(50,009)	(44,504)	(37,805)	(31,106)
Other income	4,399	3,079	3,739	3,409	3,574	3,492
Net Income before Zakat	210,149	139,459	169,457	190,136	204,437	228,154
Zakat	-	(10,104)	(12,300)	(13,876)	(15,589)	(17,501)
Net Income	210,149	129,355	157,157	176,260	188,849	210,653
EPS	1.49	0.91	1.11	1.25	1.34	1.49

APPENDIX B: PROJECTED BALANCE SHEET

(SAR 000)	2008	2009E	2010E	2011E	2012E	2013E
Cash and cash equivalents	216,367	111,085	202,438	289,875	344,303	413,027
Trade receivables	344,619	311,292	333,293	338,995	349,899	356,742
Inventories	194,652	179,574	189,738	191,035	197,180	198,984
Other receivables, advances and prepayments	20,201	18,636	19,691	19,825	20,463	20,650
Total current assets	775,839	620,587	745,159	839,729	911,844	989,404
Intangible assets	88,181	75,584	62,986	50,389	37,792	25,195
Property, plants and equipment	2,642,972	2,463,591	2,284,210	2,104,828	1,925,447	1,746,066
Total non-current assets	2,731,153	2,539,175	2,347,196	2,155,218	1,963,239	1,771,260
Total Assets	3,506,993	3,159,761	3,092,355	2,994,947	2,875,083	2,760,665
Accounts payable and other liabilities	171,679	105,328	111,289	112,049	115,654	116,712
Short-term loan	187,500	-	-	-	-	-
Current portion of long-term loan	125,000	111,111	141,880	172,650	172,650	172,650
Total current liabilities	484,179	216,439	253,169	284,699	288,303	289,362
Long-term loans	1,400,000	1,288,889	1,147,009	974,359	801,709	629,060
End-of-service indemnities	5,368	7,504	9,479	11,974	15,125	19,106
Total non-current liabilities	1,405,368	1,296,393	1,156,488	986,333	816,835	648,166
Share capital	1,413,750	1,413,750	1,413,750	1,413,750	1,413,750	1,413,750
Statutory reserve	21,406	27,566	34,997	44,432	56,411	71,620
Retained earnings	182,290	205,614	233,951	265,732	299,784	337,766
Total stockholders' equity	1,617,446	1,646,930	1,682,698	1,723,915	1,769,945	1,823,136
Total Liabilities and Stockholders' Equity	3,506,993	3,159,761	3,092,355	2,994,947	2,875,083	2,760,665

APPENDIX C: TABLE OF KEY FINANCIAL MEASURES

	2008	2009E	2010E	2011E	2012E	2013E
Business Assessment & Profitability Measures:						
Gross Margin	19.16%	17.43%	18.52%	19.34%	19.34%	20.17%
Operating Margin	17.41%	14.20%	15.29%	16.11%	16.11%	16.93%
EBITDA Margin	25.36%	28.04%	28.26%	28.84%	28.46%	29.04%
Net Margin	14.40%	9.81%	11.14%	12.28%	12.75%	13.95%
ROE	13.85%	7.93%	9.44%	10.35%	10.81%	11.73%
ROA	6.94%	3.88%	5.03%	5.79%	6.43%	7.48%
Liquidity Measures:						
Cash Ratio	0.45	0.51	0.80	1.02	1.19	1.43
Current Ratio	1.60	2.87	2.94	2.95	3.16	3.42
Utilization Measures:						
Asset Turnover	0.48	0.40	0.45	0.47	0.50	0.54
Receivable Turnover	4.23	4.02	4.38	4.27	4.30	4.28
Receivable Days	86	91	83	85	85	85
Inventory Turnover	6.06	5.82	6.23	6.08	6.16	6.09
Inventory Days	60	63	59	60	59	60
Payable Turnover	10.33	7.86	10.62	10.37	10.50	10.38
Payable Days	35	46	34	35	35	35
Conversion Period	111	107	108	110	109	110
Leverage Measures:						
Debt-to-equity	1.06	0.85	0.77	0.67	0.55	0.44
Debt-to-capital	0.51	0.46	0.43	0.40	0.36	0.31
Financial Coverage Measures:						
Short Term Debt Coverage	-	2.56	2.18	2.03	2.06	2.22
Operating Cash Flow to Total Debt	-	0.20	0.24	0.31	0.36	0.48
Free Cash Flow to Total Debt	-	0.19	0.23	0.29	0.35	0.46

APPENDIX D: QUARTERLY FINANCIAL STATEMENTS

INCOME STATEMENT

(SAR 000)	Q1 - 08	Q2 - 08	Q3 - 08	Q4 - 08	Q1 - 09	Q2 - 09	Q3-09
Sales Revenues	-	319,830	682,501	456,845	369,516	344,264	361,498
Cost of sales	-	(230,721)	(452,215)	(496,719)	(306,000)	(283,342)	(320,475)
Gross Profit	-	89,109	230,286	(39,874)	63,515	60,922	41,023
Selling & distribution expenses	-	(2,943)	(4,576)	(9,017)	(6,522)	(8,905)	(5,146)
General & administrative expenses	(46)	(1,978)	(3,199)	(3,666)	(2,714)	(4,934)	(3,671)
Operating income	(46)	84,188	222,510	(52,558)	54,279	47,083	32,206
Financing charges	-	(9,384)	(13,818)	(25,140)	(11,924)	(13,474)	(11,470)
Other income	(2)	1,093	1,725	1,581	515	1,025	145
Net Income	(49)	75,897	210,417	(76,117)	42,870	34,634	20,882

BALANCE SHEET

(SAR 000)	Q1 - 08	Q2 - 08	Q3 - 08	Q4 - 08	Q1 - 09	Q2 - 09	Q3-09
Cash and Cash equivalents	345,555	105,866	140,922	216,367	320,021	334,576	378,055
Commercial accounts receivable	-	263,931	393,684	344,619	350,744	290,506	190,001
Inventories	130,024	371,495	422,507	194,652	134,364	178,400	134,146
Prepayments and other current assets	20,350	20,144	34,276	20,201	27,461	23,719	37,899
Total current assets	495,929	761,436	991,389	775,839	832,590	827,202	740,102
Intangible assets	96,383	91,825	91,856	88,181	105,692	97,085	88,478
Property, plant and equipment	47,263	2,543,928	2,601,944	2,642,972	2,608,818	2,573,623	2,535,943
Projects under construction	2,483,084	-	-	-	-	-	-
Total non-current assets	2,626,730	2,635,753	2,693,800	2,731,153	2,714,510	2,670,707	2,624,421
Total Assets	3,122,659	3,397,190	3,685,188	3,506,993	3,547,101	3,497,909	3,364,523
Accounts payable and other liabilities	258,609	365,993	367,891	171,679	169,681	241,697	175,349
Short-term loan	-	93,750	93,750	187,500	187,500	93,750	93,750
Short-term bank facilities	-	-	-	-	-	-	-
Current portion of long-term loan	-	62,500	62,500	125,000	125,000	125,000	140,000
Dividends Payable	-	-	-	-	-	-	1,979
Total current liabilities	258,609	522,243	524,141	484,179	482,181	460,447	411,078
Long-term debt	1,445,000	1,382,500	1,462,500	1,400,000	1,400,000	1,337,500	1,302,500
Employees' service benefits payable	2,657	3,369	3,990	5,368	6,198	6,606	7,395
Total non-current liabilities	1,447,657	1,385,869	1,466,490	1,405,368	1,406,198	1,344,106	1,309,895
Share capital	1,413,750	1,413,750	1,413,750	1,413,750	1,413,750	1,413,750	1,413,750
Statutory reserve	391	7,976	29,017	21,406	25,693	29,156	31,244
Retained earnings	2,252	67,352	251,790	182,290	219,279	250,449	198,556
Total stockholders' equity	1,416,393	1,489,078	1,694,557	1,617,446	1,658,721	1,693,355	1,643,550
Total Liabilities and Stockholders' Equity	3,122,659	3,397,190	3,685,188	3,506,993	3,547,101	3,497,909	3,364,523

APPENDIX E:

2009- THE YEAR OF INDIA'S ANTI-DUMPING PETROCHEMICAL PROBES

In February 2009, New Delhi launched an anti-dumping investigation into the polypropylene imports for the nine-month period between April 1st till December 31st 2008. The application was filed by Reliance Industries with the support of Haldia Petrochemicals. The two companies, currently the only domestic polypropylene producers in India with a combined annual production capacity of 3 million tons of polypropylene, alleged that suppliers from Oman, Saudi Arabia and Singapore were dumping[50] polypropylene into the Indian market. Middle Eastern polypropylene producers view the allegations as unfounded and unjustified, with some stating that as the domestic polypropylene prices in the region during that period were consistently below the prices in India, their exports cannot be considered as dumping. Furthermore, some Middle Eastern exporters viewed the allegations as simply a protectionist tactic to curb current and future imports from their countries, especially in light of the planned polypropylene capacity additions by Indian producers . These allegations are interpreted as a move to safeguard the interests of the domestic producers[51]. Moreover, according to a statement by the chairman of the executive council of Saudi Export Development Center, the amount of polypropylene imports from Saudi Arabia is of an insignificant size[52].

This move by the Indian government would largely support the domestic polypropylene producers, but not the polypropylene converters, as prices of polypropylene will be increased randomly affecting the converters' margins. The trade associations and bodies representing the Indian plastics processing industry have even appealed to government not to exercise the anti-dumping duties on polypropylene imports.

The main exporters of interest during the anti-dumping probe were: Advanced Petrochemical Company, formerly known as Advanced Polypropylene Company (Saudi Arabia), Sabic (Saudi Arabia), Tasnee (Saudi Arabia), ExxonMobil Chemical Co. (Singapore) and Oman Polypropylene LLC (Oman). According to the preliminary findings (dated June 15th, 2009) by India's Department of Commerce, specifically the Directorate General of Anti-dumping & Allied Duties, the following dumping margins were determined.

Figure 39: Dumping Margins

Name	Country	Dumping Margin
Oman Polypropylene LLC	Oman	29.31%
Non-cooperative producers and exporters	Oman	243.70%
Sumitomo Corporation Asia Pte. Ltd.	Singapore	12.26%
Toyota Tsusho (Singapore) Pte. Ltd.	Singapore	27.61%
Marubeni Chemical Asia Pacific Pte. Ltd.	Singapore	5.08%
Itochu Plastics Pte. Ltd.	Singapore	53.59%
Exxon Mobil Chemical Asia Pacific, Singapore	Singapore	12.42%
Mitsubishi Chemical Thailand (Co.) Ltd.	Singapore	12.02%
Non-cooperative producers and exporters	Singapore	235.35%
Advanced Polypropylene Co.	Saudi Arabia	53.59%
Saudi Polyolefins Co.	Saudi Arabia	1.89%
Non-cooperative producers and exporters*	Saudi Arabia	185.68%

Source: India's Department of Commerce
**The non-cooperative producers and exporters, in Saudi Arabia, refer to Sabic and ExxonMobil Chemical Asia Pacific*

FOOTNOTES

[50] WTO's glossary definition for dumping is as follows: Dumping "occurs when goods are exported at a price less than their normal value, generally meaning they are exported for less than they are sold in the domestic market or third-country markets, or at less than production cost"
[51] ICIS, 2009
[52] Argaam, 2009

According to the preliminary findings of India's Department of Commerce, Saudi Polyolefins Co. was the only subject supplier with a dumping margin of below 2%, i.e. its dumping margin was de minimis[53]. The overall assessment by the authority was that polypropylene was being dumped into India from all the other subject countries. In turn, ADD's ranging from nil to USD 1,033.65/mt were recommended by India's Anti-Dumping Authority (ADA). For Saudi Arabia producers, ADD's of USD 440.48/mt and USD 820.55/mt were recommended to be imposed on the polypropylene products of Advanced Petrochemical Co. and Sabic, respectively. For producers in Singapore, ADD's of as much as USD 1,033.65 were recommended. Sabic and Advanced Petrochemical Co. are planning to appeal against these anti-dumping rulings.

In August 2009, India's Finance Ministry levied provisional ADD's on the polypropylene imports from Oman, Saudi Arabia and Singapore. The ADD's have been imposed on all shipments directed to the Indian market for the six month period of July 31h 2009 till January 29th 2010.

Figure 40: ADD's Levied on Polypropylene Imports

Name	Country	ADD Levied per mt
Non-cooperative producers and exporters	Oman	$977.67
Sumitomo Corporation Asia Pte. Ltd.	Singapore	$81.20
Toyota Tsusho (Singapore) Pte. Ltd.	Singapore	$119.32
Exxon Mobil Chemical Asia Pacific, Singapore	Singapore	$44.43
Non-cooperative producers and exporters	Singapore	$1,033.65
Advanced Polypropylene Co.	Saudi Arabia	$440.48
Non-cooperative producers and exporters	Saudi Arabia	$820.55

Source: The Hindu Business Line, Zawya

The preliminary findings described above are subject to a comprehensive review. The process will allow the companies, subject to the ADD's, to give evidence supporting their respective positions and thus give them a way to appeal against the anti-dumping ruling issued against them. "Both of the Saudi companies have rejected the allegations, but they have also thought – not wholly convincingly- to reassure shareholders that the dispute will not seriously damage their total earnings", according to the Economist Intelligence Unit[54]. It is noteworthy to mention here that the final stage and decision in this process could involve an extension of the provisional ADD's, which are supposed to end on January 29th, 2010, to a period of up to five years.

FOOTNOTES

[53] According to WTO's legal text, "the margin of dumping shall be considered to be de minimis if this margin is less than 2 per cent, expressed as a percentage of the export price". When the margin of dumping is de minimis, it means that "the volume of dumped imports, actual or potential, or the injury, is negligible".
[54] Cited by Zawya, 2009

FAIR VALUE DEFINITION

It is an unbiased estimate of the 12-month potential market price of the stock

RECOMMENDATION GUIDE

BUY: Upside potential in share price is more than 30%

ACCUMULATE: Upside potential in share price is between 10 and 30%

HOLD: Upside or downside potential in share price less than 10%

REDUCE: Downside potential in share price is between 10 and 30%

SELL: Downside potential in share price is more than 30%

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