

SP Chemicals

14 Feb 2008

Volatility lies ahead

Snapshot		P&L				Key ratios (FY08F)	
Recommendation	Trading Buy	(Y/E Dec)	07	08F	09F	PER	5.5x
Current Price	S\$0.675	Sales (RMB'm)	1636	2454	2945	P/BV	1.1x
Target Price	S\$0.735	Gross profit	385	491	589	Div yield	3.62%
No of Shares	365.69m	Earnings	263	223	264	ROE	20.34%
Market Cap	S\$246.84m	EPS (RMB cts)	72.1	61.1	72.1	Net gearing	154.3%
Year Hi/Lo	S\$1.39/0.665	EPS growth (%)	(0.08)	(15.2)	17.97	Current ratio	0.52x

Source: SIAS Research, Bloomberg

Event summary – Full Year Result

RMB'm	FY06	FY07	%
Sales	1,501	1,636	8.98
Gross profit	392	385	(1.98)
Gross margins %	26.1	23.5	-
Earnings	263.7	263.5	(0.08)
Net margins %	17.6	16.1	-

RMB'm	4Q06	4Q07	%
Sales	437	372	(15.0)
Gross profit	146	72	(50.6)
Gross margins %	33.3	19.4	-
Earnings	79.4	38.2	(51.9)
Net margins %	18.2	10.3	-

- **Revenue:** Full year sales increased 9% to RMB 1636m due to phase 4 capacity expansion. However, sales for 4Q07 declined 15% YoY to RMB 371.67m, mainly due to lower average selling price (ASP) and lower sales volume for aniline.
- **Margins:** Full year net profit remained flat at RMB 263.5m in FY07. However, 4Q07 net profit saw a sharp drop of 52% to RMB 38.2m, due to losses for aniline and the one time start-up cost of VCM plant.
- **Expenses:** Distribution expenses rose by 43% during FY07 while administrative expenses increased by 10% during the year. The rise in distribution expenses was due to rising freight rates while the

higher administrative expenses was attributed to a one time increase of RMB 6.5m for property taxes related to land-use rights.

- **Balance Sheet:** Inventory increased 133% as inventory turnover rose from 37 to 77 days. The increase was mainly due to the shipment of benzene, coal and salt received towards the end of the year.
- **Cash Flow:** Full year's operating cash flow decreased by 14.2% to RMB 336.8m while 4Q07's operating cash flow was cut by 81.8% to RMB 20.3m.

Industry Outlook

- **Snow Storm in China:** The current snowstorm in China has disrupted transportation system which will result in lower production volume due to lack of supplies.

In addition, some of SP Chemicals' regular customers in the Taixing Chemical Park had stopped operations, resulting in a temporary reduction in the sales of chlorine.

Furthermore, power shortages are expected to delay the trial operations of phase 5 production in 1Q08.

- **Weak Aniline Prices:** The weak aniline's ASP in 4Q07 was due to an oversupply situation in China (resulting from an aggressive industry wide capacity expansion during 1H07) as well as weak

demand from MDI producers (due to routine maintenance shutdowns in Sep-Oct07).

Significant capacity expansion for MDI, a major source of demand for aniline, is only expected to occur in FY09. A slowdown in aniline exports, following an 8% reduction in Chinese export rebates in July 07, could result in further domestic oversupply as some producers decide to forego the less lucrative export market in favour of the domestic market.

- **High Ethylene Prices:** Management has indicated that they will produce VCM from their VCM plant as long as free cash flow contribution remains positive. However, the current high price of ethylene (a key raw material for VCM) will most likely negatively impact VCM production.
- **Medium Term Strategic Business Plan II:** Assuming more favourable conditions in the longer term, management intends to further expand its chlor-alkali and aniline production capacities as well as produce a new product, styrene monomer. A total investment of RMB1.1bn is projected, of which, a third will be funded through internal cash flow and the remainder through bank borrowings. Construction is expected to commence in 3Q08 and trial production is expected to begin in 1Q10.

Key Risks

- **Volatile Pricing:** As with most producers in the chemical industry, SP Chemicals is a price taker and is susceptible to global market trend in terms of pricing. The price of key input benzene generally tracks international crude oil prices and has been on an uptrend.

Going forward, management expects the high price of ethylene to moderate when smaller producers utilizing ethylene are forced to shut down, resulting in a fall in demand.

Meanwhile, management is conducting a feasibility study regarding the construction of a petrochemical complex and a naphtha cracking plant in Hoa Tam, Vietnam. This will create an internal supply of key input material such as ethylene.

Valuation/Recommendation

- **Attractive valuation in the midst of volatility:** Given the current market volatility, we have factored in the rise in market risk premium by pricing SP Chemicals at a conservative PER of 6.0x based upon FY08F earnings. This gives us a target price of 73.5 cents. We are calling a **"Trading Buy"**. (Alan Lok)

About the Company

SP Chemicals, a Singapore-based company listed on the Main Board of SGX-ST, is one of the largest ion-membrane Chlor-alkali producer and aniline producer in the PRC. Backed by a 11-year track record in the PRC, SP Chemicals manufactures and sells Chlor-alkali products and related downstream products to PRC-based and export customers. Their customers include established multinational corporations and state-owned enterprises in various industry segments in the PRC – such as petrochemicals, textiles, paper, consumer goods, plastic polymers, rubber, dye, pharmaceuticals and metallurgy

Price Chart



Source: Bloomberg

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