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• **Prices Rebound on Higher Feedstock Costs and Strong Demand from China:** Petrochemical prices have rallied, following the recent surge in oil prices, combined with strong demand from China. The rise in naphtha prices, in particular, has increased costs for Western European and Asian producers, further strengthening the cost competitiveness of the Middle East's fixed-cost producers.

• **But will China not Continue to Absorb Global Excess Capacity?** Although YTD PE imports to China have surged 58% Y-o-Y, there is a broad consensus within the industry that this high demand will not be sustained into 4Q2009. In our opinion, this is supported by i) higher inventory levels in 3Q2009, following strong restocking activities in China, and ii) slowing demand for agricultural film after the start of the peak demand season in September. The risk to this view is an extended restocking cycle, or a positive surprise in Western demand that replace the end of the Asia restocking cycle

• **Downside Risks to Global Utilisation Rates:** We continue to see downside risks in the global ethylene value chain, to which GCC petrochemical producers are highly leveraged. In particular, we expect the global ethylene supply / demand gap to widen as supply increases by c22 million tons during 2009-12e while demand grows at a slower pace. We believe global ethylene utilisation rates could fall to 83% in 2010e (from 91% in 2008) unless a swift wave of marginal capacity closures start taking place (at least c8-10 million tons).

• **..But Not for The GCC Low-Cost Producers:** We estimate that, YTD, the export-oriented producers in the Middle East have maintained utilisation rates above 95%. While Asian import demand is likely to slow in the medium term, we expect Middle Eastern producers to maintain their market share at the expense of European and Asian marginal exporters, given their strong price competitiveness. We believe SABIC, Yansab and IQ can sell polymers in Asia at a significant discount to the minimum price afforded by a local producer.

• **Oil Price Remains the Main Earnings Driver:** The margins of SABIC, Yansab, IQ and SAFCO are naturally correlated to oil prices, which set the floor prices for their key petrochemical commodities. Typically, higher oil prices shift the global cost curve upwards leading to higher prices for commodities, with the difference feeding directly through to their margins. We therefore believe the core investment thesis remains the prevailing ultra easy monetary policy environment, which will continue to drive oil prices upwards. We have revised our oil price assumptions upwards to USD70 p/b in 2010e (from USD65 p/b) and a long-term oil price of USD80 p/b (from USD65 p/b).

• **Our Top Picks:** We upgrade our forecasts and LTFV estimates for SABIC, IQ and Yansab to account for the higher oil price scenario, together with a lower discount rate following aggressive interest rate cuts and improvement in investors' risk appetite. SABIC and Yansab are highly leveraged to oil-based commodities and we therefore believe both will be major beneficiaries of the recent oil price rally. While IQ is also exposed to petrochemicals, it is highly leveraged to nitrogen fertilisers. We believe nitrogen fertiliser prices will continue to lag changes in oil prices into next year and we are therefore less bullish on IQ in the short term. This is even more the case for SAFCO, which is a pure nitrogen fertiliser producer. We have a ST/LT Buy recommendation for SABIC, Yansab and IQ, and a ST/LT Neutral for SAFCO.

SECTOR NOTE

Companies Analysed in this Report

Company	Price*	Rec.		LTFV	P/E			EV/EBITDA			Div. Yield 09e
		ST	LT		09e	10e	11e	09e	10e	11e	
SABIC (SAR)	83.5	Buy	Buy	105.0	26.9	13.1	8.6	16.0	10.5	8.0	1.2%
IQ(QAR)	116.8	Buy	Buy	140.0	16.0	14.2	10.4	16.1	13.5	9.6	2.6%
YANSAB (SAR)	32.6	Buy	Buy	42.0	48.5	14.2	8.3	42.1	11.5	8.7	0.0%
SAFCO (SAR)	117.8	Neu.	Neu.	123.0	15.1	13.7	11.6	13.4	11.6	9.9	6.8%

*Prices as at 21 October 2009

I. INVESTMENT THESIS

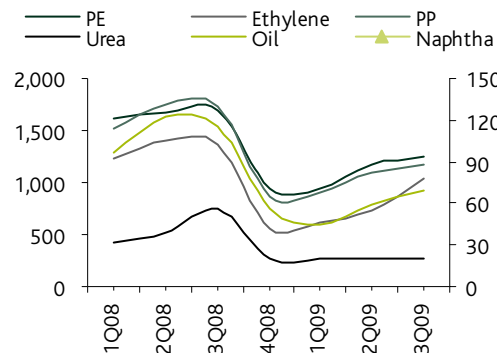
WHAT HAS CHANGED?

Oil prices have recently surged to cUSD80 p/b, well above our previous assumption of USD65 p/b over our forecast horizon. Petrochemical prices have consequently rallied, driven by higher oil-based feedstock costs (mainly naphtha), combined with strong demand from China, which has continued to absorb global excess capacity and thus allowed for relatively high global utilisation rates (except in Western Europe).

Were we too pessimistic? We still believe it is too early to call for a recovery and continue to see downside risks in the global ethylene value chain, to which GCC petrochemical producers are highly leveraged. In particular, we expect the global ethylene supply / demand gap to widen as supply increases by c22 million tons during 2009-12e (mostly from the Middle East and China) while demand is unlikely to grow at the same rate. We believe global ethylene utilisation rates could fall to 83% in 2010e (from 91% in 2008) unless a swift wave of marginal capacity closures start taking place (at least c8-10 million tons). In addition, we believe that Chinese demand, which has been a key driver of high utilisation rates YTD, could slowdown after strong restocking during 9M2009.

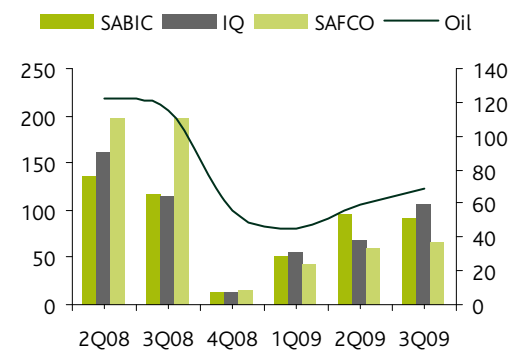
However, we did underestimate the speed and magnitude of change in both the market's sentiment towards high-risk cyclical stocks during the downward leg of the cycle, even though we agreed that prices bottomed out in 1Q2009, as well as investors' risk appetite for commodities. Oil prices continued to benefit from a weak USD exchange, aggressive monetary measures taken globally and a strong recovery "mood" across the globe. Essentially, higher oil prices provide strong upside risks to our forecasts and valuations for the low-cost GCC producers who enjoy access to fixed feedstock costs (at varying degrees) that are significantly cheaper elsewhere.

Figure 1: Prices of Oil vs. Key products
USD/barrel (RHS), USD/Ton (LHS)



Source: CMAI

Figure 2: Oil Price vs. Rebased* EBITDA
EBITDA Rebased (LHS), Oil price in USD pb (RHS)



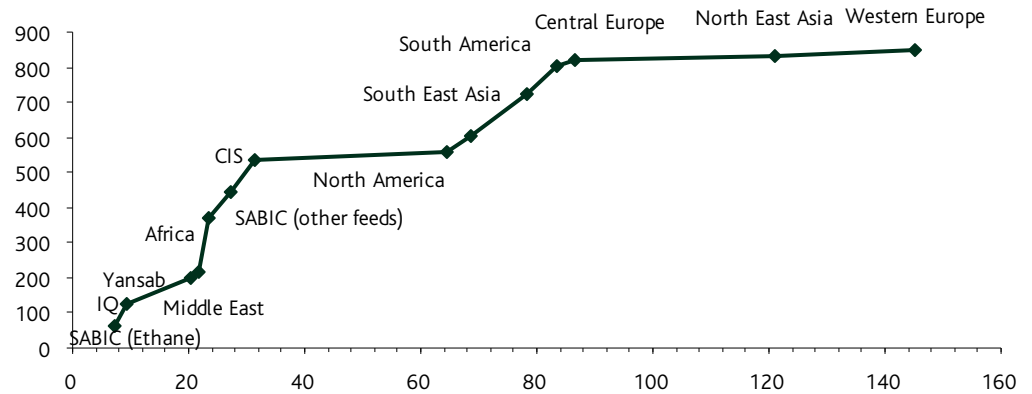
*Rebased Oil Prices

Source: CMAI, company disclosures

HIGHER OIL PRICES NATURALLY IMPROVE MARGINS AND CASH GENERATION

The margins of SABIC, IQ and SAFCO are naturally correlated to oil prices, which set the floor prices for their key petrochemical commodities. Typically, higher oil prices shift the global cost curve upwards leading to higher prices for commodities, with the difference feeding directly through to their margins. We have revised our oil price assumptions upwards to USD70 p/b in 2010e (from USD65 p/b) and a long term oil price of USD80 p/b (from USD65 p/b). Our 2010e oil price assumption is lower than the current spot as we would expect price corrections to if fundamentals continued to lag strong price gains. We however believe the core investment thesis remains the prevailing ultra easy monetary policy environment, which will continue to drive oil prices upwards. We estimate that the oil price would have to fall to around USD20-25 p/b for a global naphtha-based producer to match the cost advantage of either SABIC, Yansab or IQ.

Figure 3: 2010e Ethylene Global Cost Curve (Based on an Oil Price of USD70 pb)
USD/ton (Y-Axis), Cumulative Capacity (X-axis)



Source: CMAI, EFG-Hermes estimates

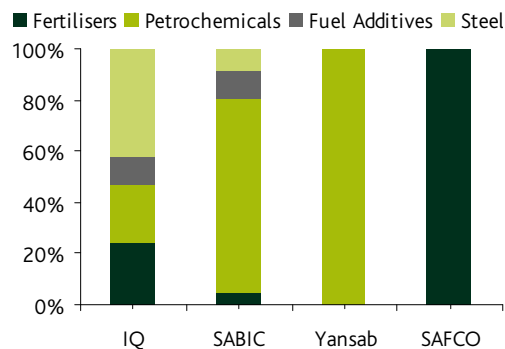
WE ARE BULLISH ON SABIC, YANSAB, AND, TO A LESSER DEGREE, IQ

Increased oil prices positively impact SABIC, Yansab and, to a lesser degree, IQ....

We upgrade our forecasts and LTFV estimates for SABIC, IQ and Yansab to account for the higher oil price scenario, together with a lower discount rate following aggressive interest rate cuts and improvement in investors' risk appetite (please see figure 6). SABIC and Yansab are highly leveraged to oil-based commodities and we therefore believe both will be major beneficiaries of the recent oil price rally. While IQ is also exposed to petrochemicals (38% of 2009e EBITDA), it is highly leveraged to nitrogen fertilisers (c38% of 2009e EBITDA). We believe nitrogen fertiliser prices will continue to lag changes in oil prices into next year and we are therefore less bullish on IQ. This is even more the case for SAFCO, which is a pure nitrogen fertiliser producer. We have a ST/LT Buy recommendation for SABIC, Yansab and IQ. Any upward/downward movements in oil prices, however, provide a significant upside/downside potential to our forecasts and valuations.

Figure 4: 2009e Revenue Breakdown

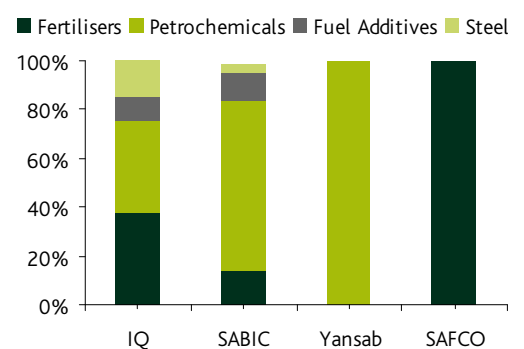
%, unless otherwise stated



Source: EFG-Hermes estimates

Figure 5: 2009e EBITDA Breakdown

%, unless otherwise stated



Source: EFG-Hermes estimates

WE ARE NEUTRAL ON SAFCO

...While expected improvements in urea prices are already priced into SAFCO

We slightly reduce our forecasts for SAFCO to account for lower than estimated urea prices, but maintain our LTFV estimate. Natural gas prices recently decoupled from oil, which has led to negative sentiment over nitrogen fertiliser stocks. The spot gas to oil ratio has fallen to c20x from its historical range (8-10x). As a result, both SAFCO and IQ failed to benefit from the recent rally in regional petrochemical stocks. We note that urea prices always lag changes in the oil price, as most of the gas supplied to marginal

producers in Europe is based on 6-month oil-linked contract prices. We therefore expect urea prices to pick up next year as the effective gas prices for European producers (particularly in Ukraine) start to reflect higher crude prices. This is especially true as most marginal producers lack access to spot gas prices. We however believe the upside risks on urea prices are already priced in by the market and therefore maintain our ST/LT Neutral recommendation for SAFCO.

WHAT DO CURRENT MARKET VALUATIONS IMPLY?

We examine the market's estimated returns over companies' invested capitals (as measured by current enterprise values over invested capital, EV/IC) vs. market's expected value creation (measured by expected returns in excess of cost of capital, ROICL/WACC). The limitation of this analysis is that it does not take into account different growth rates expected from companies. We therefore used normalised cash returns in estimating their economic value added. Except for SAFCO, we believe the current market valuations are factoring in lower than estimated normalised cash flow generations.

Figure 6: Analysis of Economic Value Added (EVA)

In SAR million, except for IQ (QAR million), unless otherwise stated

	SABIC	Yansab	SAFCO	IQ
Share Price	83.5	32.6	117.8	116.8
DCF-Based LTFV	105	42.0	123	140
Upside / Downside	26%	29%	4%	20%
No of shares	3,000	563	250	550
Market Cap	250,500	18,338	29,438	64,240
Adjusted Market Cap (Total Equity)*	404,030	N/A	N/A	N/A
Net Debt	51,076	12,428	(2,069)	281
EV	455,106	30,765	27,368	64,521
AIC	162,332	21,125	4,666	25,638
EV/IC	2.8	1.5	5.9	2.5
ROIC (2004-08 Average)	40%	NA	59%	51%
2010e ROIC	19.9%	10.7%	38.0%	20.4%
Normalized ROIC (based on LT Oil Price of USD80 / bbl)	32.8%	16.3%	57.7%	31.3%
WACC	9.4%	9.1%	10.4%	10.6%
ROIC / WACC	3.5	1.8	5.6	3.0
EV/IC / ROIC / WACC**	0.80	0.8	1.05	0.85

*Adjusted to account for minority interest

**Represents Implied Market's Discount to EFG-Hermes's estimates of mid-cycle valuation

Source: EFG-Hermes estimates

Upside potential for SABIC, Yansab and IQ, SAFCO fairly priced

We believe the market is discounting mid-cycle valuations for SABIC and Yansab lower than historical trends. We also see room for a further value creation in IQ, but believe SAFCO is fairly priced at current levels. On a normalised basis, (based on discounted 2012e EPS), SABIC trades at 10.7x PE, Yansab at 9.5x PE, IQ at 10.2x and SAFCO at 14.7x.

Figure 7: Analysis of Mid-Cycle Valuations

SAR except for IQ (QAR), unless otherwise stated

Analysis of Mid Cycle Valuation	SABIC	IQ	SAFCO	Yansab
Market Price	83.5	116.8	117.8	32.6
2010e EPS	6.37	8.2	8.6	2.3
2010e PE	13.1	14.2	13.7	14.2
Normalised EPS (explicit period)	10.2	15.4	10.8	4.4
Normalised EPS (discounted)	7.8	11.4	8.0	3.4
Market Implied Mid-cycle PE	10.7	10.2	14.7	9.5
LTFV Estimate	105.0	140.0	123.0	42.0
LTFV Implied Mid-cycle PE	13.5	12.3	15.4	12.3
Upside / Downside	26%	20%	4%	29%

Source: EFG-Hermes estimates

Based on our revised numbers, SABIC trades at a 30.8x 2009e PE, which falls to 13.1x in 2010e. We believe SABIC's main earnings drivers will be i) new volumes (Sharq and Yansab), ii) stronger margins resulting from higher oil prices and a change in product mix after its new capacities come on stream, and iii) better performance at the level of SIP following the aggressive restructuring program currently underway. Yansab trades at 14.2x 2010e PE (vs peer average of 15.7x). IQ looks fairly valued at 14.2x 2010e PE (based on a recurring EPS), compared to global peers with high exposure to nitrogen fertilisers. However, we believe its new capacity (Ras Laffan/Qatofin project in 2009-10e and QAFECO V in 2011e) will contribute positively to its long term earnings growth. SAFCO trades at 13.7x 2010e PE, a 12% premium to global and regional peers.

Figure 8: Comparable Multiples

(x), unless otherwise stated

Company	EV/EBITDA			P/E			P/BV		
	2009e	2010e	2011e	2009e	2010e	2011e	2009e	2010e	2011e
Petrochemicals									
Reliance	10.5	8.3	7.5	17.3	13.1	11.1	2.8	2.4	2.0
Formosa Plastic	22.6	20.9	18.8	17.7	17.0	15.1	2.1	2.0	1.9
Nan Ya Plastics	28.5	23.0	21.7	37.7	19.8	14.9	1.9	1.8	1.7
Petkim Petrokimya Holding	8.5	7.4	6.5	23.1	18.3	13.3	1.1	1.0	0.9
Solvay SA	6.8	6.0	5.4	14.3	11.8	10.2	1.3	1.2	1.1
Croda	9.6	8.8	8.2	16.8	14.6	12.9	3.7	3.3	2.9
Clariant AG	8.5	6.7	5.7	N/A	22.4	11.5	1.4	1.3	1.2
Wacker Chemie AG	8.1	5.6	4.6	45.9	14.8	10.9	2.7	2.3	2.0
Linde	8.6	7.9	7.4	15.9	14.5	12.8	1.5	1.5	1.3
BASF	7.8	6.9	6.3	18.4	15.2	13.0	2.2	2.1	2.0
Dow Chemical Co	11.1	8.7	7.4	83.2	11.2	11.8	1.4	1.5	1.4
Average	11.9	10.0	9.0	29.0	15.7	12.5	2.0	1.8	1.7
Fertilisers									
Yara	13.4	8.4	8.1	28.1	12.8	10.6	2.0	1.9	1.7
Agrium	8.6	6.4	6.3	15.6	10.3	8.3	1.9	1.6	1.3
Israel Chem	13.0	8.4	8.7	22.1	13.1	11.6	5.8	4.6	3.8
K+S	13.7	7.6	6.0	39.4	14.0	10.4	4.4	3.5	2.9
Monsato	10.4	13.0	10.3	22.0	16.9	13.6	3.7	3.4	3.0
Potash Corp	20.6	9.5	8.3	29.6	13.8	11.1	4.5	3.3	2.5
Uralkaliy OAO	14.5	9.1	5.7	20.6	8.6	7.8	6.5	4.7	3.1
Arab Potash	11.8	6.5	5.5	12.9	8.2	7.0	3.5	2.7	2.2
Average	13.2	8.6	7.4	23.8	12.2	10.0	4.0	3.2	2.6
SABIC*	16.0	10.5	8.0	30.8	13.1	8.6	2.1	1.9	1.7
Industries Qatar	16.1	13.5	9.6	19.2	14.2	10.4	3.4	3.0	2.5
Yansab	N/A	11.5	8.6	48.5	14.2	8.3	3.0	2.4	1.8
SAFCO	13.4	11.6	9.9	15.1	13.7	11.6	4.8	4.7	4.3

*Uses proportionate EBITDA

Source: Reuters, EFG-Hermes estimates

We expect 2010e prices will be higher for major commodities, but still generally below 2008 peak levels

Figure 9: Summary of New Forecasts

USD/ton, unless otherwise stated

Revised Estimates	2007a	2008a	2009e	2010e	2011e	2012e
Feedstock Prices						
Naphtha	696	825	529	629	669	714
Propane	642	761	503	581	594	622
Butane	656	777	520	602	612	645
Prices of Main Commodities						
Ethylene	1,189	1,141	805	902	1,017	1,083
Propylene	1,155	1,259	845	903	1,017	1,083
HDPE	1,363	1,484	1,115	1,105	1,276	1,351
LDPE	1,444	1,562	1,140	1,194	1,365	1,443
LLDPE	1,336	1,475	1,102	1,104	1,270	1,345
PP	1,362	1,466	1,078	1,125	1,287	1,378
MEG	1,084	1,041	515	577	651	693
Methanol	550	490	238	332	365	390
MTBE	805	855	677	813	837	845
Urea	319	510	273	300	325	350
Ammonia	280	600	242	325	340	400
SABIC (USD mn)						
Revenue	33,655	40,216	27,075	34,046	40,684	44,699
Gross Profit	12,787	12,204	7,273	11,133	15,222	15,887
EBITDA	13,028	12,438	7,562	11,568	15,258	15,608
Net Profit	7,206	5,875	2,170	5,097	7,744	8,161
IQ (USD mn)						
Revenue	2,562	4,050	2,656	2,851	3,617	4,527
Gross Profit	1,355	2,104	1,122	1,328	1,806	2,466
EBITDA	1,352	2,068	1,100	1,310	1,854	2,513
Net Profit	1,369	2,089	1,423	1,246	1,696	2,333
Yansab (USD mn)						
Revenue	N/A	N/A	422	1,699	2,104	2,256
Gross Profit	N/A	N/A	171	547	796	854
EBITDA	N/A	N/A	195	712	949	1,005
Net Profit	N/A	N/A	101	344	593	666
SAFCO (USD mn)						
Revenue	938	1,396	780	878	1,020	1,125
Gross Profit	612	1,176	504	583	694	737
EBITDA	659	1,201	545	628	737	778
Net Profit	589	1,141	519	571	677	718

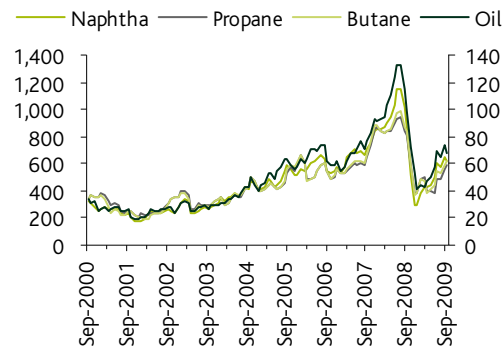
Source: Companies disclosures, EFG-Hermes estimates

II. PETROCHEMICALS OUTLOOK

PRICES REBOUND ON HIGHER FEEDSTOCK COSTS

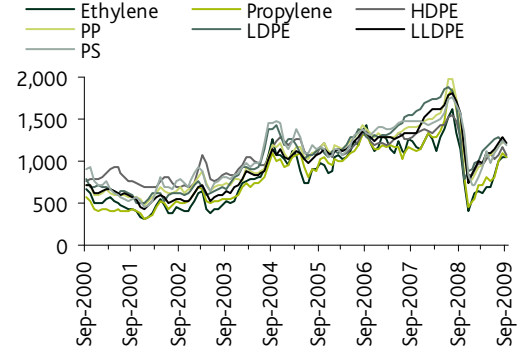
Petrochemical prices maintained their positive momentum in 3Q2009, driven by continuing strong demand from China, supply restrictions in the US (c6% of capacity) and in Western Europe (c10% of capacity), and, most importantly, the surge in oil price and feedstock costs that led to cost pressures for marginal producers. Average Brent prices increased 16% Q-o-Q, to USD69 p/b (vs USD60 p/b in 2Q2009) and further rallied to USD78 p/b last week. Naptha prices (the feedstock for c60% of global ethylene capacity) rose 18% Q-o-Q to USD610/ton (from USD514/ton in 2Q2009), while ethane prices in the US remained soft as natural gas prices continued to be depressed by weak supply and demand fundamentals.

Figure 10: Oil and Key Feedstock Prices
USD/barrel (RHS), USD/ton (LHS)



Source: CMAI

Figure 11: Petrochemicals Prices
USD/ton, unless otherwise stated

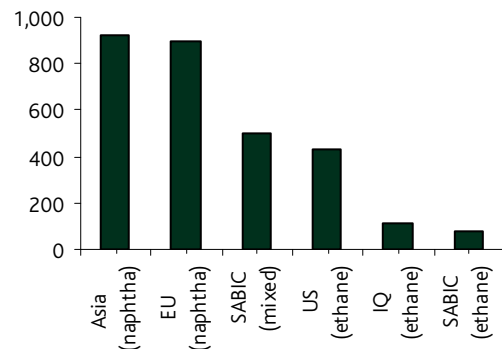


Source: CMAI

ETHANE MAINTAINED STRONG COST ADVANTAGE OVER NAPHTHA

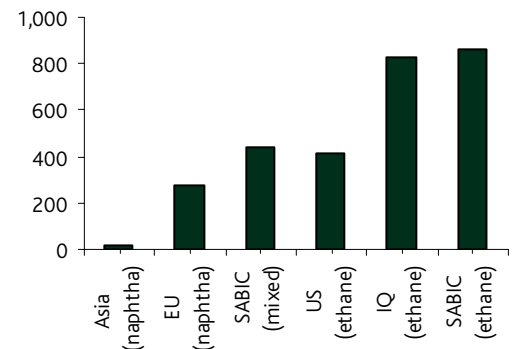
Ethane feedstock (typically in the US and the Middle East) maintained a strong cost advantage over naphtha (mainly in Europe and Asia). The escalation in naphtha prices in 3Q2009 increased production costs of Western European and Asian producers and further strengthened the cost competitiveness of the Middle East's fixed-cost producers and, to a lesser extent, the ethane-based producers in the US. This cost advantage allowed them to withstand relatively weak local demand through higher exports (mainly to China).

Figure 12: 3Q09 Avg. Ethylene Cash Costs
USD/ton, unless otherwise stated



Source: CMAI, EFG-Hermes estimates

Figure 13: 3Q09 Avg. Ethylene Cash Margins
USD/ton, unless otherwise stated

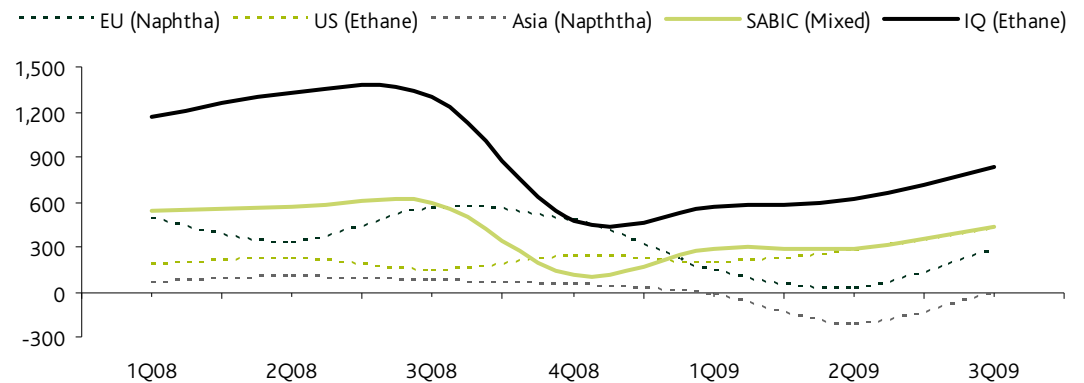


Source: CMAI, EFG-Hermes estimates

Undoubtedly, SABIC, Yansab and IQ were the world's major beneficiaries of the stronger energy price environment due to their access to fixed ethane prices that are significantly cheaper than elsewhere (USD0.75/mmBtu in Saudi and cUSD1.5/mmBtu in Qatar). We believe this has led both of them to enjoy a positively disproportionate impact on their margins. To put things into perspective, we estimate IQ's ethylene production costs in 3Q2009 at USD112/ton, which implies USD828/ton of cost advantage over a naphtha based producer in Asia. We estimate SABIC's ethane-based crackers in Saudi Arabia at USD76/ton, implying a cUSD844/ton cost advantage over producers in Asia. SABIC however uses other feedstocks such as naphtha (in Europe) and propane/butane, which it buys in Saudi Arabia at a discount to the Saudi export price of naphtha. We estimate SABIC's 3Q2009 ethylene cash margin at USD440/ton based on mixed feedstocks (ethane, propane, butane and naphtha), which implies a global cost advantage of cUSD420/ton.

Figure 14: Historical Ethylene Cash Margins (SABIC and IQ vs. World)

USD/Ton, unless otherwise stated



Source: CMAI, EFG-Hermes estimates

STRONG CHINESE DEMAND SUPPORTS GLOBAL UTILISATION RATES

Utilisation rates remained relatively high in 3Q2009 (except in Western Europe) with healthy trading conditions across the globe. This was led by strong domestic demand in Asia, particularly in China where demand for plastics continued to surge owing to the government's economic stimulus plan. While YTD demand in North America and in Europe has declined Y-o-Y by c3.4% and 6%, respectively, demand in North East Asia (including China, Japan, S. Korea, N. Korea and Singapore) has surged 15% Y-o-Y.

Despite the fact that the global economic recession has, YTD, led Chinese plastics exports to fall c7% Y-o-Y, domestic demand has been very strong (particularly for food packaging and agricultural film). This has resulted in local producers operating at c90% capacity in 9M2009. According to the CMAI, domestic polyethylene (PE) and polypropylene (PP) demand in China increased Y-o-Y by an impressive 15% and 7%, respectively. That said, while China's YTD PE production increased c9% Y-o-Y, imports have surged 58% Y-o-Y. The consumption pattern of PP is similar, with local production increasing by 7% Y-o-Y while imports have soared 61% Y-o-Y in 9M2009. This has benefited low-cost exporters in the Middle East and in the USA.

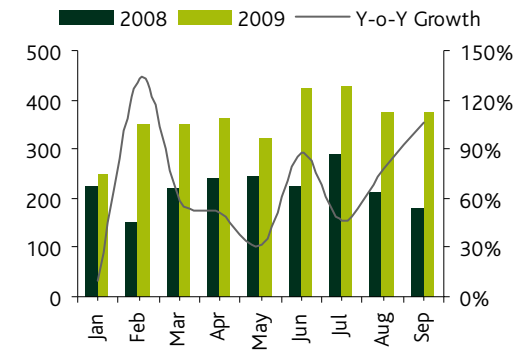
We estimate that the Middle East's producers have maintained utilisation rates at above 95% YTD

We estimate that the export-oriented producers in the Middle East have maintained utilisation rates at above 95% since the beginning of the year. In the US, despite relatively weak domestic demand, utilisation rates have improved to 86% in 3Q2009 (vs 83% in 1H2009) driven by higher Chinese exports resulting from the strong competitiveness of ethane over naphtha (based on the existing large differential between natural gas prices in the US and international crude oil prices) as well as supply restrictions (6% of total capacity). In Western Europe, however, 3Q2009 utilisation rates remained depressed at 72% in 3Q2009 (vs c75% in 1H2009) on weak domestic demand and lack of global cost advantage.

While Chinese PE production increased by 7% Y-o-Y, imports surged 58% on strong domestic demand

Figure 15: China PE Imports

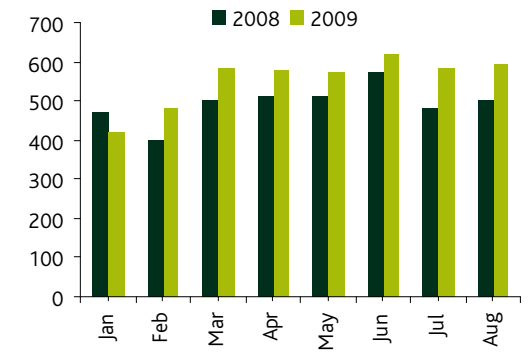
In thousands tons, unless otherwise stated



Source: CMAI

Figure 16: China Plastics Film Production

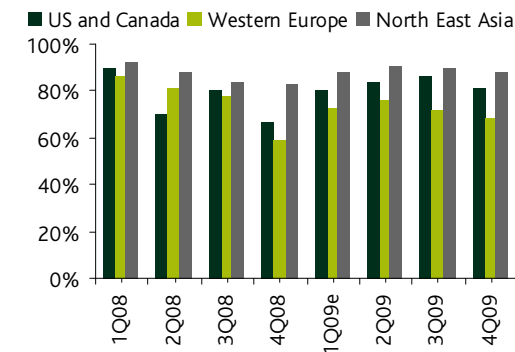
In thousand tons, unless otherwise stated



Source: CMAI

Figure 17: PE Utilisation Rates in Main Regions

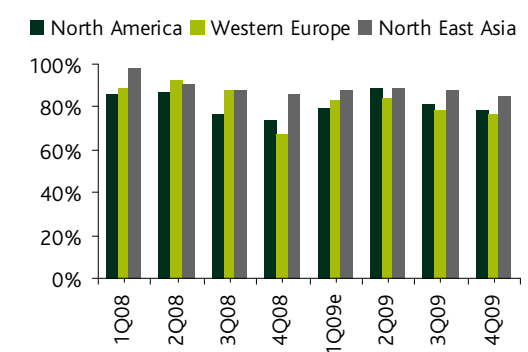
UR in %, unless otherwise stated



Source: CMAI

Figure 18: PP Utilisation Rates in Main Regions

UR in %, unless otherwise stated

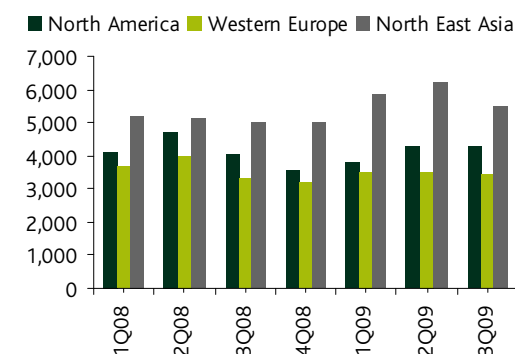


Source: CMAI

While YTD demand has declined by c3.4% Y-o-Y in North America and 6% Y-o-Y in Europe, it surged 15% Y-o-Y in North East Asia led by China

Figure 19: PE Demand in the World's Main Regions

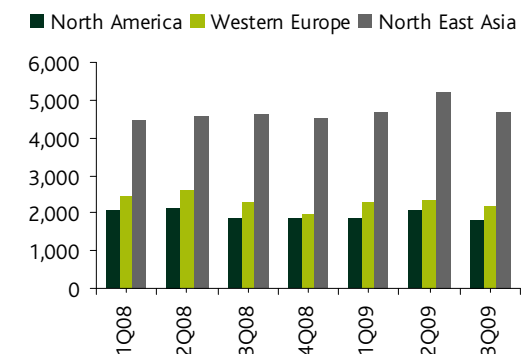
In thousands tons, unless otherwise stated



Source: CMAI

Figure 20: PP Demand in the World's Main Region

In thousands tons, unless otherwise stated

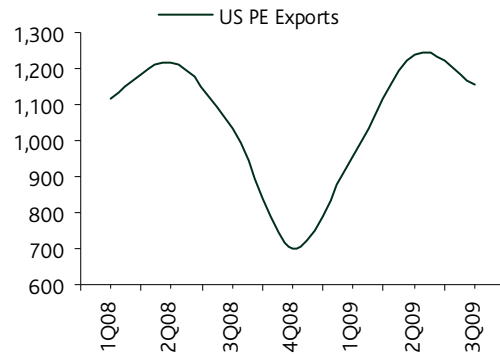


Source: CMAI

US producers weathered weak domestic demand though higher exports to China, supported by a strong cost advantage on ethane

Figure 21: US PE Exports

In thousands tons, unless otherwise stated



Source: CMAI

Figure 22: China's PE Imports

In thousands tons, unless otherwise stated



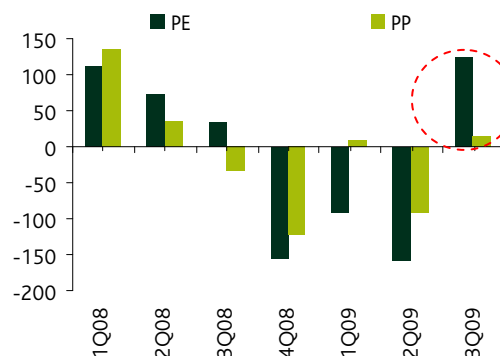
Source: CMAI

WILL CHINA CONTINUE TO ABSORB GLOBAL EXCESS CAPACITY?

In 9M2009, Chinese polymers' supply (including imports) has risen 30% Y-o-Y. However, there is a broad consensus in the industry that actual demand is unlikely to have increased by the same percentage. CMAI believes that some of these imports will be used in 4Q2009, and expects imports to revert to traditional levels in 4Q2009. We believe this assumption is supported by i) higher inventory levels in 3Q2009, following strong restocking activities in China, and ii) slowing demand for agricultural film after the start of the peak demand season in September. We believe this could lead to overall lower utilisation rates and prices in 4Q2009. However, we expect Middle Eastern producers to maintain their market share in China at the expense of other marginal exporters in Europe and Asia, given their strong price competitiveness.

Figure 23: PE and PP Inventory Changes in NEA

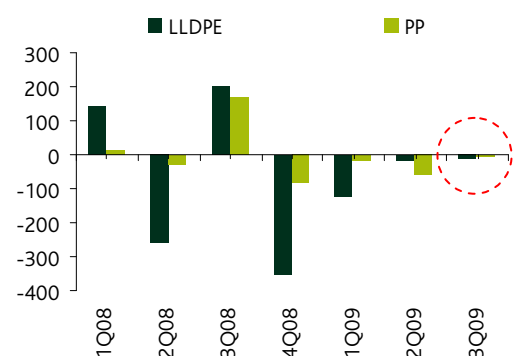
In thousands tons, unless otherwise stated



Source: CMAI

Figure 24: PE and PP Inventory Changes in Western Europe

In thousands tons, unless otherwise stated



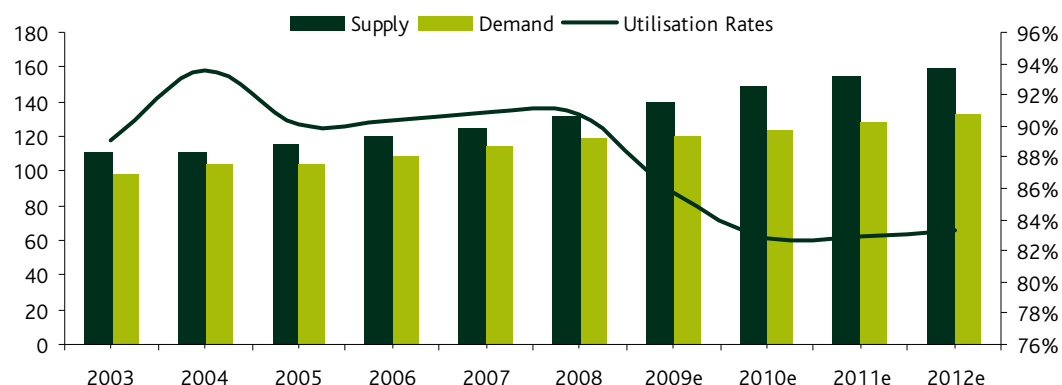
Source: CMAI

Over the longer term, we remain concerned about the substantial growth in global supply of ethylene, with c22 million tons of new ethylene capacity expected during 2009-12e. Of the total new supply, c53% is scheduled in the low-cost Middle East region and c34% in China. Assuming demand will grow at a CAGR of 3.5% during 2009-12e (vs a CAGR of 3.8% during 2003-08), we believe global utilisation rates could fall to 83% during 2009-12e and expect c8-10 million tons of supply will be permanently shutdown (mostly from Western Europe).

Theoretically, lower utilisation rates should place downward pressure on petrochemical prices and squeeze the spread of ethylene to naphtha prices. However, global pricing mechanisms will continue to be set by marginal producers, whose production costs could be further inflated if oil prices continue their surge whether due to monetary-led inflation, improving fundamentals or further weakness in the US dollar. Indeed, any upward shift in the global ethylene cost curve will be to the advantage of IQ, SABIC and Yansab over the next couple of years.

Figure 25: Global Ethylene Utilisation Rates

In million tons, unless otherwise stated



Source: CMAI, Industry

III. NITROGEN FERTILISERS

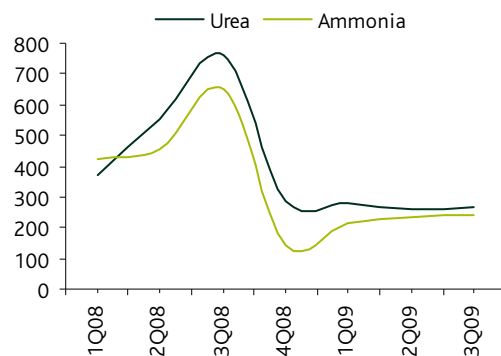
STILL A SUPPLY-DRIVEN MARKET

Urea prices remain soft on weak demand and lower gas price in Europe

The global urea market continues to be supply-driven since the beginning of 2009, with lacklustre demand and limited production cuts as prices remain slightly above the production costs of marginal producers – a typical supply-driven market behaviour. The Middle East's spot urea price averaged USD265/ton in 1H2009 (USD245/ton for Black Sea) but has dropped recently to USD258/ton (USD235/ton for Black Sea) reflecting both weaker global demand and a lower gas price in Europe. Ammonia prices however strengthened to USD300/ton (vs. USD230/ton in 1H2009) following a moderate pick up in demand for industrial activities and phosphate derivatives.

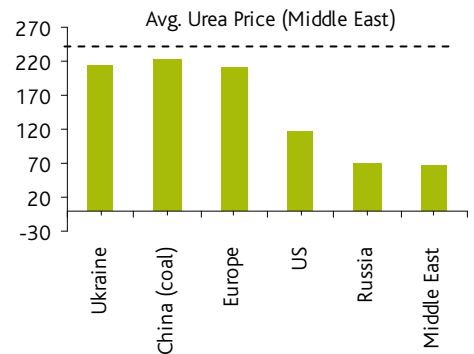
In Europe, oil-linked gas contracts averaged USD6.8/mmBtu in 1H2009 (implying a urea cash cost of USD225/ton), while spot gas prices continued to slump below USD4/mmBtu reflecting weak supply/demand fundamentals. In mid-August, the Ukraine government approved a c17% discount on the gas price supplied to local nitrogen producers. We estimate the effective gas price for Ukraine exporters (c10% of global trade) is now at cUSD6.5/mmBtu (from USD7.6/mmBtu), implying a cash cost of USD215/ton of urea (from USD237/ton previously).

Figure 26: Urea and Ammonia Prices
USD/ton, unless otherwise stated



Source: Fertecon, Bloomberg

Figure 27: 2009e Urea Cash Cost
USD/ton, unless otherwise stated



Source: EFG-Hermes estimates

EXPECT MODERATE PICK UP IN 4Q2009 PRICES ON A SEASONAL DEMAND PUSH

...Prices may firm in 4Q2009 as spring applications season starts

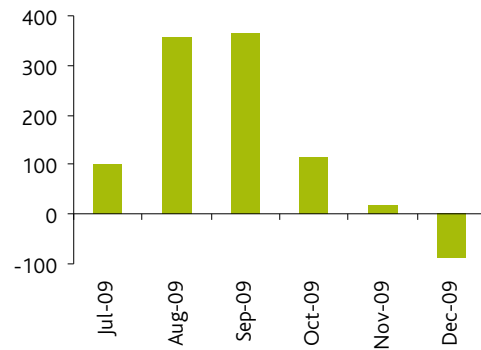
We anticipate a moderate pick up in urea prices during 4Q2009e-1Q2010e due to i) a seasonal increase in demand in major markets ahead of the spring application season in the US and Western Europe, and the Rabi season in India and Pakistan (November 2009 - February 2010), ii) a virtually no exports from China during October (the government is currently imposing 110% export tariffs), and iii) a slight increase in oil-linked gas prices in Europe, which should start reflecting the higher Brent prices of 2Q-3Q2009.

November export from China already booked at USD273/ton

We believe increased demand, coupled with low inventory levels in major markets (India, US, Pakistan and Brazil), could lead to strong restocking in 4Q2009e. This would benefit the pricing power of exporters in the Middle East and the Former Soviet Union countries (FSU). Global consultants, Profercy, reported that a large volume (November delivery) has already been booked from China (to Bangladesh) at a price of USD273/ton of urea.

Figure 28: Urea Market Balance

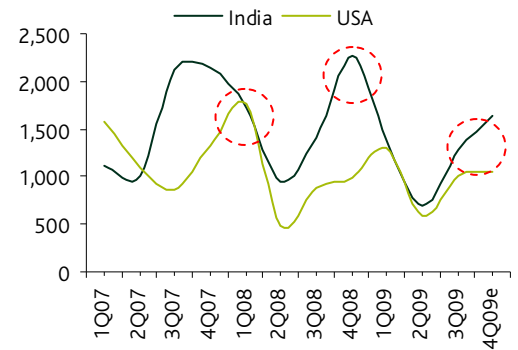
In thousand tons, unless otherwise stated



Source: Profercy

Figure 29: Urea Imports in India and USA

In thousand tons, unless otherwise stated



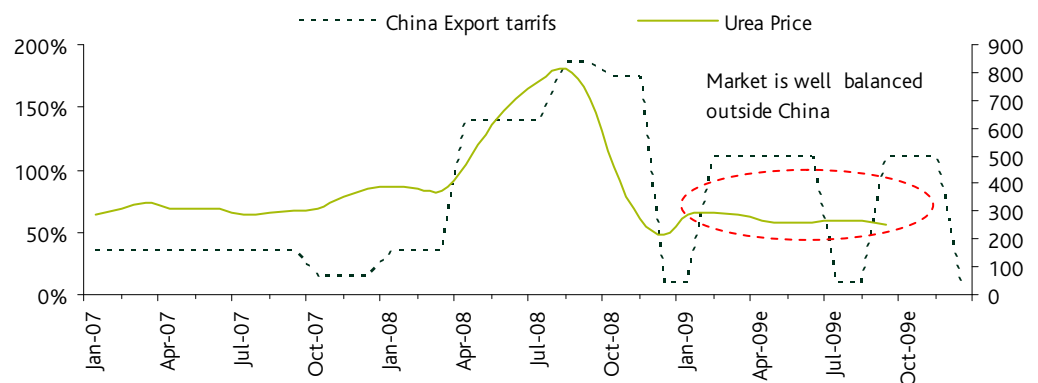
Source: Fertecon, Profercy and EFG-Hermes estimates

2010E OUTLOOK: WILL THE GLOBAL MARKET BE TIGHTER?

We believe the global urea price during 2009-11e will be a function of i) production costs in Europe (price floor), particularly in the Ukraine which accounts for approximately 10% of global urea exports, and ii) the outlook for export tariffs in China (price ceiling), which could influence global prices if, and only if, the demand for imports outside China exceeds supplies from the Middle East and the FSU. 9M2009, unlike 1H2008, saw weak demand for Chinese exports, which meant that global prices did not adjust to reflect the 110% export tariffs during the peak season (February - June and Mid-September to October), which would have translated into a urea price of approximately USD550/ton. Global prices were not competitive for Chinese exporters (mostly coal-based capacities), and China's export volumes therefore declined significantly to c1.8 million tons in 9M2009 (from 4.2 million tons last year).

Figure 30: No Impact of Chinese Tariffs on Global Prices in 2009

Urea Price - USD/Ton (RHS), China's Export Tariffs - % (LHS)



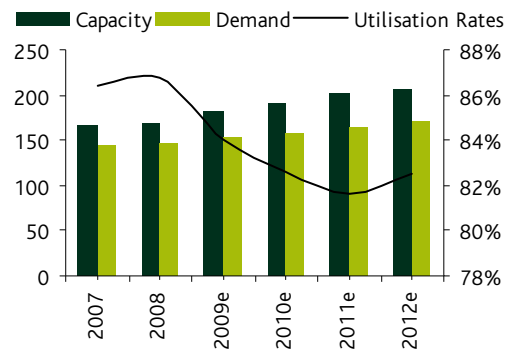
Source: Fertecon, Bloomberg

Going forwards, the International Fertilisers Association (IFA) estimates that demand for urea will grow at a CAGR of 3.7% during 2009-11e. On the supply side, however, global capacity is expected to grow at a CAGR of 5.3% during the same period, with 57% of the world's new capacity coming from China and 22% from the MENA region. Outside China, urea capacity is expected to grow by 3.8% during 2009-11e, of which c72% is planned in the Middle East's low gas cost region. Assuming the IFA's estimated demand growth materialises during 2009-11e, we believe the market outside China could be tighter in 2010e, but not sufficiently tight for China's export tariffs to impact global prices.

Our model expects global utilisation rates to fall to 82% in 2011e, from 87% in 2008. Outside China, however, we estimate global utilisation rates will improve in 2010e to 93% (from 92% in 2009e).

Figure 31: Global Utilisation Rates

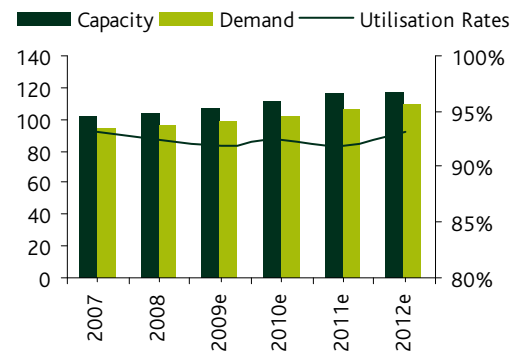
mtpa (LHS), % (RHS)



Source: Fertecon, IFA, and Yara

Figure 32: Utilisation Rates Ex-China

mtpa (LHS), % (RHS)



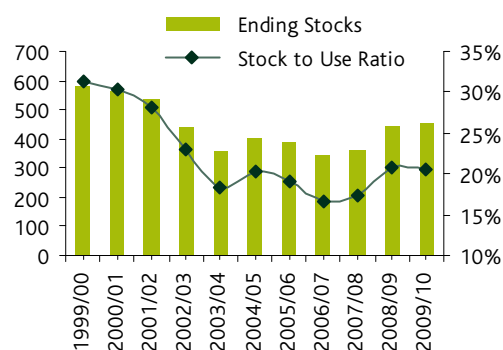
Source: Fertecon, IFA, and Yara

We believe there are growing downside risks to next year's expected recovery, and expect the IFA to revise its estimates downwards (last published on July 2009e). These downside risks include:

i) Falling grain prices (55% of demand for nitrogen globally). In September 2009, the USDA revised its global grains stock-to-use ratio upwards to 20.6% (from 20.3% in June 2009 and 19% in March 2009), due to higher than expected production and slowing demand. The adjusted stock-to-use ratio is at the lower end of the comfort range (20%-25%), well below the 15 year historical average of 25%.

Figure 33: World Grain Stocks and Stock-to-Use Ratio

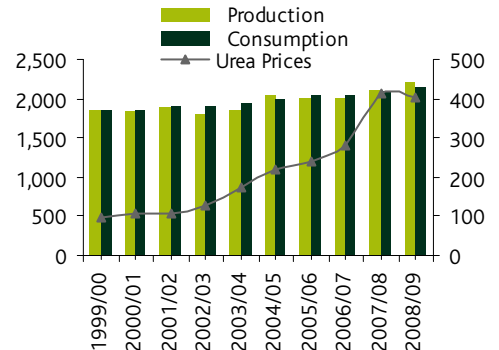
Stock to Use % (RHS), million tons (LHS)



Source: USDA

Figure 34: World Grain Production and Consumption

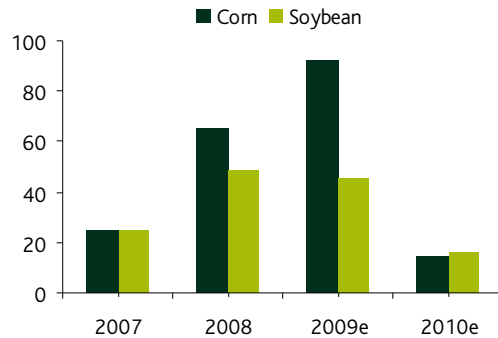
In million tons, unless otherwise stated



Source: USDA

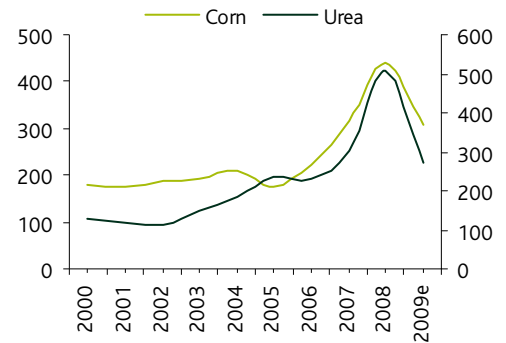
Rising grain stocks and higher yield expectations have caused grain prices to fall, weakening global farmers' economic position. Corn prices have dropped 24% from their level at the beginning of the year, on higher yield expectations. Based on the USDA's 2010e farms costs model, we estimate the breakeven price for corn growers at USD3.5/bu. This is slightly below the current spot price, with the 2010e expected margin being the lowest since 2006. This increases the risk of a large-scale shift from corn to soybean production (corn requires more nitrogen). The 2010e soy to corn ratio is estimated at 2.5x, meaning that soy growers could be more profitable than corn growers next year (a ratio below 2.4x means corn margins are higher than soy, and vice versa).

Figure 35: Corn Cash Margins vs. Soybean
USD/bushel, unless otherwise stated



Source: USDA, EFG-Hermes estimates

Figure 36: Urea Price vs. Corn
USD/ton (RHS), USD/bushel (LHS)



Source: Fertecon, USDA, and EFG-Hermes estimates

ii) El Nino, which is a weather phenomena arising from the Pacific Ocean. El Nino is the warming of surface waters in the equatorial zone off the central and eastern Pacific Ocean, which occurs every 4-5 years and impacts atmospheric circulation. According to the World Metrological Organisation, the risk of El Nino has been growing as the water surface temperature in the equatorial Pacific has increased by 0.5c more than average. Simply put, El Nino could reduce the rainfall level in Southeast Asia, Australia, and North and Latin Americas, negatively impacting agricultural production and thus fertiliser demand.

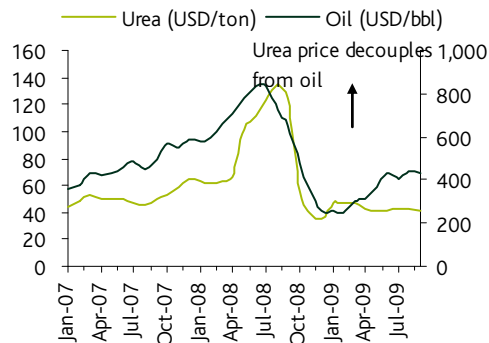
iii) A risk of drought in India: India's monsoon rains (the main source of irrigation in the country) was reported to be c25% below normal as of June 2009. This has reduced fertiliser consumption during the kharif season (April - June), and increased the risk of drought in the country. India is the world's largest importer of urea and ongoing weather uncertainties could continue to negatively affect imports next year.

DECOUPLING OF OIL AND GAS PRICES: NEGATIVE FOR SAFCO AND IQ?

The current oil/gas ratio stands at 20x from its historical average of 8-10x,

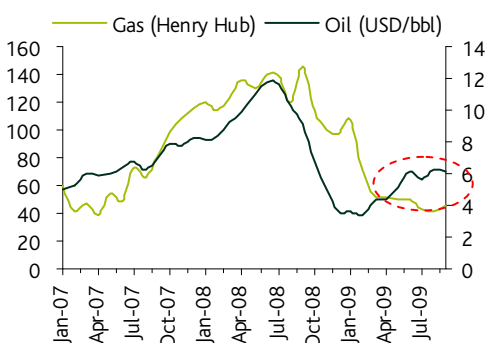
Some of our clients have been concerned about the decoupling of gas prices from oil, and the consequent impact on global urea prices. The historically strong correlation of urea price to oil has weakened recently, as gas prices decoupled from oil. While the fundamentals of both oil and gas remain weak, oil is a globally traded commodity that has benefited from a weak USD, improved risk appetite and a monetary-led inflation. The current oil/gas (Henry hub) ratio stands at 20x from its historical average of 8-10x, and we expect this decoupling will continue in 2010e.

Figure 37: Urea Price vs. Oil
USD p/b (LHS), USD/ton (RHS)



Source: CMAI, Fertecon, and Bloomberg

Figure 38: Gas Price vs. Oil
USD p/b (LHS), USD/ton (RHS)



Source: CMAI, Bloomberg

DOES THIS MEAN THE GLOBAL UREA COST CURVE WILL SHIFT DOWNWARDS?

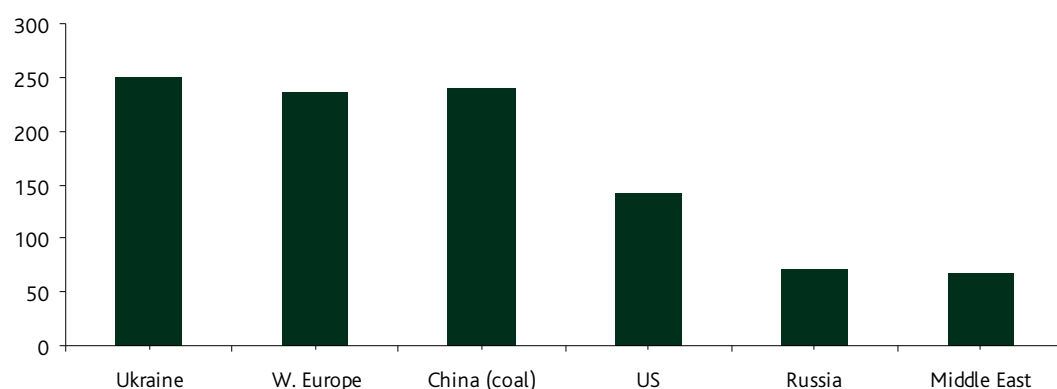
We argue not. While the decoupling of gas and oil prices has eased the cost structure of producers in North America (particularly in the US), these producers are not the world's marginal producers who set floor prices. We believe the urea floor price will continue to be set according to production costs in Western Europe and Ukraine, where producers have limited access to gas at spot prices. That said, we would expect production costs in Europe to increase moderately as oil-linked contracts start reflecting stronger oil prices in 2Q-3Q2009.

Higher gas price in Ukraine suggests a floor price of USD250/ton in 2010e

In Ukraine, the 20% discount on European gas prices that was given on 2009 Russia gas supplies will end on 31 December 2009. The Ukrainian government therefore expects the cost of gas could increase by USD60/kcm (approximately USD2/mmBtu). Assuming an average oil price of USD70 p/b in 2010e, our model suggests European oil-linked gas prices will be increased to USD8/mmBtu (from USD6.8/mmBtu currently). This would raise the urea floor price to approximately USD250/ton (from USD215/ton currently), and we believe it is highly unlikely that we will see 2010e prices below this level. Our model forecasts urea and ammonia prices at USD300/ton and USD310/ton in 2010e. In the long-term, we forecast urea and ammonia prices at USD325/ton and USD360/ton, respectively.

Figure 39: 2010e Global Cash Costs of Urea

USD per ton, unless otherwise stated



Source: EFG-Hermes estimates

Short-Term Rec.: Buy
Long-Term Rec. : Buy

Current Price*: SAR 83.5
LT Fair Value : SAR 105.0

• **3Q2009 Revenue Growth in-line with Forecasts:** SABIC's 3Q2009 results show a significant recovery from 2Q2009 levels. Consolidated revenue was 3% ahead of our forecasts at SAR27.9 billion (up 18% Q-o-Q, down 37% Y-o-Y), vs our estimate of SAR27.2 billion. The main driver of growth was the petrochemical segment, which accounts for c87% of SABIC's 2009e turnover and c81% of EBITDA. SABIC benefited from higher oil prices in 3Q2009 that led to cost pressures for marginal producers and resulted in strong price increases. Fertilisers and steel prices, however, remained relatively stable Q-o-Q.

• **Gross Profit and EBITDA 10% Ahead of Estimates:** SABIC's 3Q2009 cash costs were SAR17 billion, 1% above our forecasts of SAR16.9 billion. However, gross profit was 10% higher, largely due to a lower depreciation expense (9% below our estimate and down 7% Q-o-Q). 3Q2009 EBITDA also came 10% ahead of forecasts, due to a lower SG&A expense which, at SAR2.2 billion was 9% below estimates. We believe this could be attributable to the aggressive restructuring program of its US subsidiary, SIP. 3Q2009 EBITDA grew 31% to SAR8.7 billion (down 42% Y-o-Y).

• **Net Income Surprises Positively:** 3Q2009 net profit grew by an impressive 102% Q-o-Q to SAR3.6 billion (down 50% Y-o-Y), 46% ahead of our estimates. This was led by lower SG&A and depreciation expenses, as well as lower minority interest expense (cSAR2.2 billion, vs our estimate of SAR2.4 billion). Our initial take is that SIP's operating performance was better than expected. SABIC owns 100% of SIP and SABIC Europe, and different stakes in Saudi Arabia (where the bulk of its profits are usually generated). A lower minority interest share of net income therefore suggests a lower-than-expected loss (or no loss) on SABIC Europe.

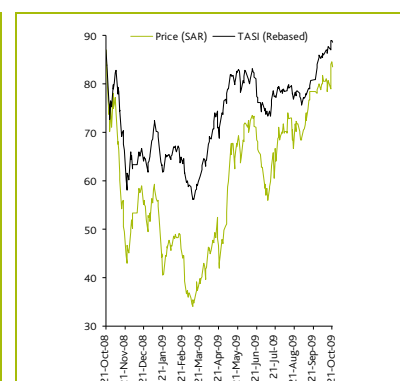
• **Upgrading 2009e EPS by 25%:** We raise our EPS estimates by 25% in 2009e to account for strong operating results in 3Q2009, and increase our 2009-11e EPS marginally by c3% to reflect a less bearish outlook on SIP.

• **...Leading to A Marginal 5% increase in LTFV:** We upgrade our LTFV estimate slightly by 5% to SAR105.0/share, reflecting a relatively improved cost structure. However, our price and margin assumptions remain unchanged. Our LTFV estimate is based on three year detailed forecasts followed by a normalised cash flow, which we believe represents average mid-cycle margins. We assign a WACC of 9.4% and a terminal growth rate of 2%.

• **Reiterating ST/LT Buy Recommendation:** Our LTFV estimate offers 26% upside potential over current levels. We reiterate our ST/LT Buy recommendation for SABIC, which we believe will benefit from a higher oil price environment over the next couple of years. SABIC trades at 30.8x 2009e PE, which falls to 13.1x in 2010e. The main earnings growth drivers are higher oil prices and production volumes from Yansab and Sharq. Assuming a long-term oil price of USD80 p/b, we believe SABIC currently trades at a 10.7x normalised PE (based on 2012e discounted EPS).

December Year End	2008a	2009e	2010e	2011e
Revenue	150.8	101.5	127.7	152.6
EBITDA	46.6	28.4	43.4	57.2
Operating Profit	36.6	18.5	31.8	45.4
Net Attributable Income	22.0	8.1	19.1	29.0
EPS (SAR)	7.3	2.7	6.4	9.7
DPS (SAR)	3.0	1.0	3.0	5.0
Net Debt (Cash)	41.6	37.7	31.9	7.2
P/E (Attrib.) (x)	11.4	30.8	13.1	8.6
P/E (Recurring)	11.4	26.9	13.1	8.6
EV / EBITDA (proportionate) (x)	9.8	16.0	10.5	8.0
P/BV (x)	2.4	2.1	1.9	1.7
P/CF (Proportionate) (x)	8.3	18.8	10.4	6.5
Div. Yield	3.6%	1.2%	3.6%	6.0%
RoAE	22.7%	8.4%	15.3%	21.0%

Figures in SAR billion, unless otherwise stated



Ahmed Shams El Din
+20 2 3332 1143
ashamseldin@efg-hermes.com

KINDLY REFER TO THE
IMPORTANT DISCLOSURES AND
DISCLAIMERS ON BACK PAGE

Estimate Changes					
	2008a	2009e		2010e	
(SAR bn)		Old	New	Old	New
Revenue	150.8	100.3	101.5	127.7	127.7
EBITDA	46.6	27.5	28.4	42.3	43.4
EBITDA Margin	30.9%	27.4%	27.9%	33.1%	34.0%
Net Attrib. Income	22.0	6.4	8.1	18.1	19.1

*Prices as at 21 October 2009

Stock Data	
Last Ex-Div. Date	SAR1.24 on 12 Apr 09
Mkt. Val. / Shares (mn)	SAR250,500 / 3,000
Av. Mthly Liqd. (mn)	SAR14,463
52-Wk. High / Low	SAR87.0 / 34.1
Bloomberg / Reuters	SABIC AB/2010.SE
Est. Free Float	30.00%

FINANCIAL STATEMENTS

Income Statement (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Revenue	150,810	101,532	127,673	152,564	167,622
Cash Costs	(94,994)	(64,373)	(74,378)	(83,706)	(96,387)
Depreciation and Amortisation	(10,052)	(9,886)	(11,547)	(11,776)	(11,658)
Gross Profit	45,763	27,273	41,749	57,082	59,578
S,G&A	(9,172)	(8,801)	(9,916)	(11,639)	(12,704)
EBITDA	46,643	28,359	43,379	57,218	58,532
EBITDA Margin	31%	28%	34%	38%	35%
Net Operating Profit	36,591	18,472	31,832	45,443	46,874
Net Operating Margin	24%	18%	25%	30%	28%
Net Interest Income (Expense)	(3,801)	(1,390)	(422)	169	802
Other Income (Expense)	4,545	(1,181)	703	1,094	1,236
EBT	37,335	15,901	32,114	46,706	48,912
Zakat	(1,400)	(689)	(1,285)	(1,868)	(1,956)
Net Income before Minorities	35,935	15,212	30,829	44,838	46,955
Minority Interest	(13,905)	(7,073)	(11,715)	(15,798)	(16,350)
Net Income	22,030	8,139	19,114	29,039	30,605

Source: SABIC, EFG-Hermes estimates

Balance Sheet (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Cash and Time Deposits	51,028	62,756	62,317	66,782	74,350
Receivables	16,104	20,863	20,987	20,899	22,962
Inventory	24,360	21,623	23,965	26,971	31,057
Other Debit Balances	3,963	8,345	6,996	836	459
Total Current Assets	95,455	113,588	114,265	115,488	128,828
Net Fixed Assets	141,440	154,175	162,629	165,853	164,195
Other LT Assets	34,865	33,638	34,396	35,547	36,840
Total Assets	271,760	301,401	311,290	316,888	329,863
ST Debt	4,289	6,313	17,598	15,012	12,265
Payables	8,261	11,498	14,304	16,097	18,536
Other Current Liabilities	14,030	14,411	9,508	8,426	9,675
Total Current Liabilities	26,580	32,221	41,410	39,536	40,476
LT Debt	88,367	94,187	76,589	58,923	43,840
Other Liabilities	53,881	55,602	62,830	72,476	82,458
Total Liabilities	102,932	119,391	130,461	145,953	163,088
Net Worth	6,284	6,186	6,327	6,867	7,058

Source: SABIC, EFG-Hermes estimates

Cash Flow Statement (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Operating Profit after Tax	5,243	27,669	42,094	55,350	56,575
Change in Working Capital	4,014	(2,787)	(3,214)	3,955	(2,085)
Cash Flow after Change in WC	49,258	24,882	38,880	59,305	54,490
CAPEX	(28,394)	(22,047)	(20,000)	(15,000)	(10,000)
Free Cash Flow	20,864	2,836	18,880	44,305	44,490
Non-Operating Cash Flow	4,205	(530)	(55)	(56)	(57)
Cash Flow before Financing	25,068	2,306	18,826	44,249	44,433
Net Financing	(20,096)	9,422	(19,266)	(39,784)	(36,865)
Change in Cash	4,973	11,728	(440)	4,465	7,569

Source: SABIC, EFG-Hermes estimates

Short-Term Rec.: Buy
Long-Term Rec. : Buy

Current Price*: QAR 116.8
LT Fair Value : QAR 140.0

• **Raising LTFV on Higher Price Forecasts:** We raise our LTFV to QAR140.0 from QAR111.8, reflecting i) higher oil price assumptions and ii) a cut in our discount rate (130bps) on the back of aggressive interest rate cuts and an improvement in investor risk appetite. Based on our revised estimates, IQ trades at 16.0x recurring PE, which falls to 14.2x in 2010e. Our new LTFV offers 20% upside potential over current levels. We therefore upgrade our recommendation to ST/LT Buy from ST/LT Neutral.

• **2Q2009 Net Profits Well Above Forecasts:** IQ's 3Q2009 net income was QAR1.2 billion, up 2% Q-o-Q, down 54% Y-o-Y. However, 2Q2009 included QAR366 million of government compensation for capping steel prices during 1H2008. On a recurring income basis, IQ's bottom-line earnings jumped by an impressive 40% Q-o-Q and was well above our estimates of QAR951 million. This was mainly attributable to higher net back on petrochemicals, stronger margins on steel and higher investment income. IQ's 3Q2009 revenue grew by 11% Q-o-Q to QAR2.58 billion, while operating profit rose by an impressive 63% Q-o-Q to QAR1.1 billion.

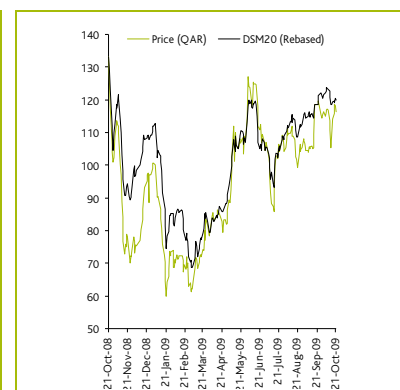
• **Margins to Further Improve:** We revise our oil price assumptions upwards to USD70 p/b in 2010e and USD80 p/b in the long-term. We believe a higher oil price environment should further improve IQ's petrochemical and fertiliser margins, especially as its plants are based on cheap natural gas in Qatar. In addition, we expect steel margins to further improve with new iron ore prices being negotiated at a c35% discount to last year.

• **The Most Diversified Petrochemicals Play in the Region:** We believe IQ's well-diversified cash flow stream, coupled with its absolute cost advantage in petrochemicals and fertilisers, will limit any exposure to a single product or sector. We estimate that QAFCO (ammonia and urea) and QAPCO (ethylene, LDPE and LLDPE) will both contribute 38% to IQ's 2009e EBITDA, while 10% will come from QAFAC (methanol and MTBE) and 14% from Qatar Steel.

• **A Further Value-Added Expansion on the Horizon:** QAPCO (80% owned) is expected to add 0.23 mtpa of LLDPE capacity in 4Q2009, 0.3 mtpa of ethylene in 2H2010, and 0.18 mtpa of LDPE by 1Q2012. Furthermore, QAFCO (75% owned) plans to increase its capacity by 1 mtpa of urea and 1.2 mtpa of ammonia through its QAPCO V project, which will come on stream by 2H2011. Moreover, QAFCO has recently awarded EPC the contract for the construction of its QAFCO VI plant (0.95mtpa of urea), which will utilise QAPCO's excess ammonia production. The project is expected to start in 3Q2012. IQ's proportionate investment costs for these projects amount QAR16.4 billion.

December Year End	2008a	2009e	2010e	2011e
Revenue	14,743	9,669	10,378	13,167
EBITDA	7,528	4,002	4,769	6,750
Operating Profit	7,067	3,421	4,118	5,656
Net Attributable Income	7,605	5,181	4,536	6,173
EPS (QAR)	13.8	9.4	8.2	11.2
DPS (QAR)	8.0	3.0	3.0	3.0
Net Debt (Cash)	(3,408)	(87)	280	(667)
P/E (Attrib.) (x)	8.4	12.4	14.2	10.4
P/E (Recurring) (x)	8.4	16.0	14.2	10.4
EV / EBITDA (x)	8.6	16.1	13.5	9.6
P/BV (x)	3.5	3.4	3.0	2.5
P/CF (x)	10.6	19.1	13.5	10.4
Div. Yield	6.8%	2.6%	2.6%	2.6%
RoAE	44.3%	18.5%	20.5%	23.8%

Figures in QAR million, unless otherwise stated



Ahmed Shams El Din
+20 2 3332 1143
ashamseldin@efg-hermes.com

Rita Guindy
+20 2 3331 8987
rguindy@efg-hermes.com

Estimate Changes	2008a	2009e	2010e	
(QAR mn)		Old	New	Old
Revenue	14,743	8,984	9,669	12,372
EBITDA	7,528	3,614	4,002	5,185
EBITDA Margin	51.1%	40.2%	41.4%	41.9%
Net Attrib. Income	7,605	4,176	5,181	4,902

Stock Data	
Last Ex. Div. Date	QAR8 on 12 Apr 2009
Mkt. Val./Shares (mn)	QAR64,020 / 550
Av. Mthly Liqd. (mn)	QAR1,190
52-Wk. High / Low	QAR133.0 / 59.8
Bloomberg / Reuters	IQCF QD / IQCD QA
Est. Free Float	30.00%

FINANCIAL STATEMENTS

Income Statement (December Year End)

In QAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Revenue	14,743	9,669	10,378	13,167	16,478
Cash Costs	(6,623)	(5,106)	(4,892)	(5,500)	(6,180)
Depreciation and Amortisation	(461)	(498)	(652)	(1,093)	(1,324)
Gross Profit	7,660	4,065	4,834	6,575	8,975
SG&A	(593)	(661)	(716)	(918)	(1,153)
EBITDA	7,528	4,002	4,769	6,750	9,146
EBITDA Margin	51.1%	41.4%	46.0%	51.3%	55.5%
Net Operating Profit	7,067	3,421	4,118	5,656	7,822
Net Operating Margin	47.9%	35.4%	39.7%	43.0%	47.5%
Net Interest Income (Expense)	306	91	238	250	305
Other Income (Expense)	431	1,835	421	498	588
EBT	7,606	5,181	4,536	6,173	8,492
Taxes	-	-	-	-	-
Net Income	7,605	5,181	4,536	6,173	8,492

Source: IQ, EFG-Hermes estimates

Balance Sheet (December Year End)

In QAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Cash and Time Deposits	9,445	5,950	5,950	6,542	8,696
Receivables	1,298	2,227	2,360	2,971	3,713
Inventory	2,521	1,761	1,608	1,755	1,945
Other Debit Balances	812	299	303	318	336
Total Current Assets	14,076	10,236	10,220	11,587	14,691
Net Fixed Assets	11,324	14,269	17,341	20,163	19,742
Other LT Assets	2,050	2,081	2,238	2,411	2,600
Total Assets	27,450	26,586	29,800	34,160	37,033
ST Debt	2,668	142	354	343	598
Payables	2,226	1,354	1,319	1,493	1,695
Other Current Liabilities	343	310	306	325	346
Total Current Liabilities	5,237	1,806	1,979	2,160	2,638
LT Debt	3,369	5,721	5,875	5,533	4,935
Other Liabilities	601	411	411	411	411
Net Worth	18,243	18,649	21,534	26,057	29,049

Source: IQ, EFG-Hermes estimates

Cash Flow Statement (December Year End)

In QAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
NOPAT	7,528	3,920	4,769	6,750	9,146
Change in Working Capital	(1,456)	(561)	(23)	(581)	(727)
Cash Flow after Change in WC	6,072	3,359	4,746	6,168	8,418
CAPEX	(3,145)	(3,443)	(3,724)	(3,915)	(902)
Free Cash Flow	2,927	(84)	1,022	2,253	7,516
Non-Operating Cash Flow	133	1,804	264	326	398
Cash Flow before Financing	3,060	1,720	1,287	2,579	7,914
Net Financing	357	(5,215)	(1,287)	(1,987)	(5,760)
Change in Cash	3,417	(3,496)	0	592	2,154

Source: IQ, EFG-Hermes estimates

Short-Term Rec.:	Buy	Current Price*:	SAR 32.6
Long-Term Rec.:	Buy	LT Fair Value :	SAR 42.0

• **Raising LTFV On Higher Oil Price Outlook:** We upgrade our LTFV for Yansab to SAR42.0/share (from SAR25.4/share) to account for the stronger than expected oil price environment. Oil prices surged recently to USD80 p/b, significantly above our previous explicit period assumption of USD65 p/b. We believe this will have a disproportionately positive impact on Yansab's profitability and margins due to its access to cheap feedstock in Saudi Arabia.

• **Upgrading to ST/LT Buy:** Our new LTFV offers 26.5% upside potential over current levels. We therefore upgrade our recommendation to ST/LT Buy from ST Reduce / LT Neutral. Based on our revised estimates, Yansab trades at 14.2x 2010e PE and 11.5x 2010e EV/EBITDA. Assuming a long-term oil price of USD80 p/b, we believe Yansab currently trades at a 9.5x normalised PE (based on 2012e discounted EPS).

• **Global Cost Advantage Further Strengthens:** We estimate that c38% of Yansab's ethylene capacity is based on fixed cost ethane at USD0.75/mmBtu while c62% is based on propane, which it receives at a discount to the Saudi export prices of naphtha. We estimate Yansab's ethylene production costs at USD215/ton in 2010e, which implies a cost advantage of USD725/ton over an Asian naphtha-based producer. We therefore believe Yansab can sell polymers in Asia at a significant discount to the minimum price afforded by a local producer.

• **Volumes on Track, But HDPE Unit Slightly Delayed:** Yansab started production of linear low density polyethylene (LLDPE - 0.4mtpa), polypropylene (PP - 0.4mtpa), and monoethylene glycol (MEG - 0.7mtpa) late in 3Q2009. Management expects production of high density polyethylene (HDPE - 0.4mtpa) will commence by the end of 2009e. We estimate the company will operate at nearly full capacity in 2010e, supported by an exclusive marketing agreement with its parent company SABIC.

• **Is Yansab Under Capitalised?** One of our main concerns about Yansab is that it looks over-leveraged, especially with our revised net debt/EBITDA estimate of 5.0x. Although Yansab enjoys strong support from SABIC, we believe this higher leverage makes its bottom-line vulnerable to changes in polymer prices. Yansab stated recently that its investment costs have increased by SAR2.4 billion to SAR21.18 billion. The company partially financed this extra cost through a SAR465 million loan from SABIC, but it has not disclosed how it secured the remaining portion. Given the company's high leverage, we think it likely that Yansab will need to increase its capital should further additional investment be required.

December Year End	2008a	2009e	2010e	2011e
Revenue	-	1,584	6,373	7,890
EBITDA	(26)	731	2,670	3,558
Operating Profit	(26)	504	1,752	2,624
Net Attributable Income	(26)	378	1,292	2,222
EPS (SAR)	(0.05)	0.67	2.30	3.95
DPS (SAR)	0	0	0	0
Net Debt (Cash)	10,764	15,338	13,265	10,681
P/E** (x)	N/A	48.5	14.2	8.3
EV / EBITDA (x)	N/A	42.1	11.5	8.7
P/BV (x)	3.3	3.0	2.4	1.8
P/CF (x)	N/A	N/A	6.8	5.9
Div. Yield	0.0%	0.0%	0.0%	0.0%
RoAE	-0.4%	6.4%	18.9%	22.3%

Figures in SAR million, unless otherwise stated

**2009e P/E is based on estimated 4Q09e EPS



Ahmed Shams El Din
+20 2 3332 1143
ashamseldin@efg-hermes.com

Malak Youssef
+20 2 3332 1044
mayoussef@efg-hermes.com

Estimate Changes					
(SAR mn)	2008a	2009e	2010e		
	Old	New	Old	New	
Revenue	-	808	1,584	5,303	6,373
EBITDA	(26)	284	731	2,186	2,670
EBITDA Margin	N/A	35%	46%	41%	42%
Net Attrib. Income	(26)	(105)	378	565	1,292

*Prices as at 21 October 2009

Stock Data

Last Ex. Div. Date	N/A
Mkt. Val. / Shares (mn)	SAR18,338 / 563
Av. Mthly Liqd. (mn)	SAR774.4
52-Wk. High / Low	SAR34.3 / 12.5
Bloomberg / Reuters	YANSAB AB / 2290.SE
Est. Free Float	35.00%

FINANCIAL STATEMENTS

Income Statement (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Revenue	-	1,584	6,373	7,890	8,461
Cash Costs	-	(727)	(3,448)	(4,017)	(4,355)
Depreciation and Amortisation	-	(215)	(872)	(888)	(904)
Gross Profit	-	642	2,052	2,985	3,201
SG&A	(26)	(138)	(300)	(361)	(384)
EBITDA	(26)	731	2,670	3,558	3,767
EBITDA Margin	N/A	46%	42%	45%	45%
Net Operating Profit	(26)	504	1,752	2,624	2,817
Net Operating Margin	N/A	32%	27%	33%	33%
Net Interest Income (Expense)	-	(114)	(420)	(333)	(243)
Other Income (Expense)	-	-	-	-	-
EBT	(26)	390	1,332	2,291	2,575
Taxes	-	(12)	(40)	(69)	(77)
Net Income	(26)	378	1,292	2,222	2,498

Source: Yansab, EFG-Hermes estimates

Balance Sheet (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Cash and Time Deposits	1,033	518	1,502	2,175	3,011
Receivables	-	260	1,048	1,297	1,391
Inventory	8	120	567	660	716
Other Debit Balances	176	43	175	216	232
Total Current Assets	1,217	942	3,291	4,348	5,350
Net Fixed Assets	-	21,279	20,725	20,231	19,728
Other LT Assets	17,460	344	298	253	208
Total Assets	18,677	22,564	24,314	24,833	25,285
ST Debt	669	1,089	1,911	2,175	2,302
Payables	63	242	1,149	1,004	1,089
Other Current Liabilities	1,039	272	783	914	991
Total Current Liabilities	1,771	1,603	3,844	4,093	4,382
LT Debt	11,128	14,767	12,856	10,681	8,379
Other Liabilities	81	81	81	81	81
Net Worth	5,697	6,113	7,534	9,978	12,444

Source: Yansab, EFG-Hermes estimates

Cash Flow Statement (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
NOPAT	(26)	719	2,630	3,489	3,690
Change in Working Capital	(173)	(827)	53	(399)	(4)
Cash Flow after Change in WC	(199)	(109)	2,682	3,090	3,686
CAPEX	(4,118)	(4,388)	(319)	(395)	(401)
Free Cash Flow	(4,317)	(4,497)	2,364	2,695	3,285
Non-Operating Cash Flow	(20)	-	-	-	-
Cash Flow before Financing	(4,336)	(4,497)	2,364	2,695	3,285
Net Financing	3,663	3,982	(1,380)	(2,023)	(2,449)
Change in Cash	(673)	(515)	984	673	836

Source: Yansab, EFG-Hermes estimates

Short-Term Rec.: Neutral
Long-Term Rec. : Neutral

Current Price*: SAR 117.8
LT Fair Value : SAR 123.0

• **Cutting Estimates on Weaker Prices:** We cut our net income estimates by an average of 13% during 2009-11e to account for weaker than estimated urea prices. We lower our urea price estimate slightly to USD272/ton in 2009e (from USD280/ton) and keep it at USD300/ton in 2010e. This mainly reflects a lower than estimated gas price for European producers. We also lower our 2009e ammonia price estimates to USD240/ton in 2009e (from USD275/ton), on the back of lower production costs and weaker demand. In the longer term, we maintain our price assumptions of USD400 per ton of ammonia and USD350 per ton of urea.

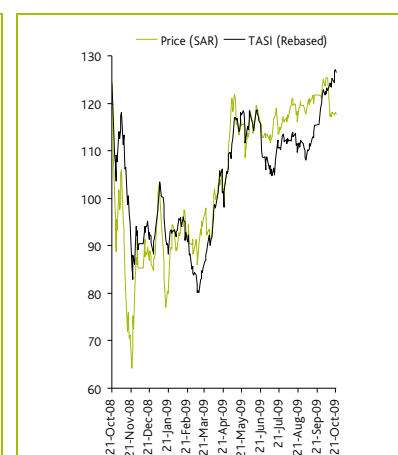
• **Urea Prices Remain Depressed due to Weak Demand and Lower European Gas Prices:** The global urea market was supply-driven in 2009e, with lacklustre demand and limited production cuts as prices remained slightly above the production costs of marginal producers. Urea prices recently dropped to USD260/ton (USD265/ton in 1H2009) reflecting both weaker global demand and a lower gas price in Europe. Ammonia prices however strengthened to USD280/ton recently (vs USD230/ton in 1H2009) following a moderate pick up in demand for industrial activities and phosphate derivatives.

• **...But Prices Should Pickup in 4Q2009 On Stronger Demand:** We expect to see a moderate pick-up in urea prices (85% of SAFCO's 2009e revenues and 78% of EBITDA) starting 4Q2009 due to i) a seasonal increase in demand ahead of the spring application season in Europe and the Rabi season in India and Pakistan, ii) a slight increase in oil-linked gas prices in Europe which should start to reflect the higher oil prices in 2Q2009 and 3Q2009, and iii) relatively low inventory levels in major markets.

• **Fairly Valued at Current Levels:** We maintain our LTFV estimate for SAFCO at SAR123.0 per share based predominantly on a normalised-based DCF methodology. We assign a WACC of 10.4% and a terminal growth rate of 2%, on a par with perpetual growth rates assigned to commodity stocks under coverage. SAFCO trades at 13.7x PE in 2010e and 11.6x PE in 2011e. On an EV/EBITDA basis, it trades at 11.6x in 2010e and 9.9x in 2011e. This is at a c12% premium to global peers. While we believe this premium is justified by SAFCO's significantly higher profitability compared to regional and global players, we also believe its strong fundamentals are already priced in at current market levels. We maintain our ST/LT Neutral recommendation for SAFCO.

December Year End	2008a	2009e	2010e	2011e
Revenue	5,236	2,923	3,292	3,824
EBITDA	4,505	2,045	2,356	2,762
Operating Profit	4,250	1,820	2,053	2,450
Net Attributable Income	4,280	1,948	2,141	2,539
EPS (SAR)	17.1	7.8	8.6	10.2
DPS (SAR)	13.0	8.0	8.0	8.0
Net Debt (Cash)	(1,342)	(1,796)	(1,892)	(2,358)
P/E (x)	10.2	15.1	13.7	11.6
EV / EBITDA (x)	6.1	13.4	11.6	9.9
P/BV (x)	4.7	4.8	4.7	4.3
P/CF (x)	6.9	13.2	13.1	11.1
Div. Yield	11.0%	6.8%	6.8%	6.8%
RoAE	73.3%	30.0%	33.7%	38.1%

Figures in SAR million, unless otherwise stated



Estimate Changes					
	2008a	2009e		2010e	
(SAR mn)		Old	New	Old	New
Revenue	5,236	3,000	2,923	3,279	3,292
EBITDA	4,505	2,341	2,045	2,587	2,356
EBITDA Margin	86.0%	78.0%	70.0%	78.9%	71.6%
Net Attrib. Income	4,280	2,145	1,948	2,390	2,141

Stock Data

Last Ex. Div. Date	SAR5 on 18 Jul 2009
Mkt. Val. / Shares (mn)	SAR29,438 / 250
Av. Mthly Liqd. (mn)	SAR1,781
52-Wk. High / Low	SAR125.5 / 64.3
Bloomberg / Reuters	SAFCO.AB/2020.SE
Est. Free Float	42.50%

Ahmed Shams El Din
+20 2 3332 1143
ashamseldin@efg-hermes.com

Rita Guindy
+20 2 3331 8987
rguindy@efg-hermes.com

*Prices as at 21 October 2009

FINANCIAL STATEMENTS

Income Statement (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Revenue	5,236	2,923	3,292	3,824	4,220
Cash Costs	(572)	(809)	(805)	(908)	(1,134)
Depreciation and Amortisation	(255)	(225)	(303)	(312)	(322)
Gross Profit	4,409	1,889	2,185	2,603	2,763
SG&A	(159)	(69)	(132)	(153)	(169)
EBITDA	4,505	2,045	2,356	2,762	2,916
EBITDA Margin	86%	70%	72%	72%	69%
Net Operating Profit	4,250	1,820	2,053	2,450	2,594
Net Operating Margin	81%	62%	62%	64%	61%
Net Interest Income (Expense)	76	2	13	18	24
Other Income (Expense)	64	123	129	136	142
EBT	4,389	1,996	2,196	2,604	2,760
Taxes	(109)	(48)	(55)	(65)	(69)
Net Income	4,280	1,948	2,141	2,539	2,692

Source: SAFCO, EFG-Hermes estimates

Balance Sheet (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Cash and Time Deposits	2,168	2,468	2,310	2,609	2,577
Receivables	893	368	414	481	531
Inventory	191	687	684	772	964
Other Debit Balances	22	35	39	46	51
Total Current Assets	3,411	3,214	3,106	3,522	3,640
Net Fixed Assets	3,458	3,378	3,240	3,119	3,008
Other LT Assets	1,232	1,221	1,352	1,490	1,634
Total Assets	8,100	7,813	7,698	8,130	8,282
ST Debt	237	254	167	171	80
Payables	321	323	321	363	453
Other Current Liabilities	181	144	143	162	202
Total Current Liabilities	739	721	631	695	735
LT Debt	590	418	251	81	1
Other Liabilities	488	488	488	488	488
Total Liabilities	1,816	1,627	1,370	1,263	1,223
Net Worth	6,284	6,186	6,327	6,867	7,058

Source: SAFCO, EFG-Hermes estimates

Cash Flow Statement (December Year End)

In SAR million, unless otherwise stated

	2008a	2009e	2010e	2011e	2012e
Operating Profit after Tax	4,395	1,997	2,301	2,698	2,848
Change in Working Capital	(149)	230	(51)	(57)	(20)
Cash Flow after Change in WC	4,247	2,227	2,250	2,640	2,828
CAPEX	99	(146)	(165)	(191)	(211)
Free Cash Flow	4,345	2,081	2,085	2,449	2,617
Non-Operating Cash Flow	64	174	129	136	142
Cash Flow before Financing	4,632	2,272	2,083	2,447	2,615
Net Financing	(3,628)	(2,198)	(2,241)	(2,148)	(2,647)
Change in Cash	1,004	74	(158)	299	(32)

Source: SAFCO, EFG-Hermes estimates

EGYPT SALES TEAM

Local call center 16900
 Int'l call center +20 2 33 33 94 00
 cc-hsb@efg-hermes.com

Head of Western Institutional Sales

Mohamed Ebeid
 +20 2 33 32 1054
 mebeid@efg-hermes.com

Local Institutional Sales

Amr El Khamissy
 +20 2 33 32 1045
 amrk@efg-hermes.com

GCC Business Development

Ahmed Salem
 +20 2 33 32 1078
 asalem@efg-hermes.com

UAE SALES TEAM

call center
 +971 4 306 9333
 uaerequests@efg-hermes.com

Western Institutional Sales

Julian Bruce
 +971 4 363 4092
 jbruce@efg-hermes.com

Head of GCC Institutional Sales

Amro Diab
 +971 4 363 4086
 adiab@efg-hermes.com

Gulf HNW Sales

Chahir Hosni
 +971 4 363 4090
 chosni@efg-hermes.com

UAE Retail Sales

Reham Tawfik
 +971 4 306 9418
 rtawfik@efg-hermes.com

KSA SALES TEAM

call center
 +800 123 4566
 RiyadhCallCenter@efg-hermes.com
 RiyadhTraders@efg-hermes.com

Deputy Head of Gulf Sales

Ahmed Sharawy
 +9661 279 8677
 asharawy@efg-hermes.com

RESEARCH MANAGEMENT

Cairo General + 20 2 33 38 8864
 UAE General + 971 4 363 4000
 efgresearch@efg-hermes.com

Head of Research

Wael Ziada
 +20 2 33 32 1154
 wziada@efg-hermes.com

Head of Publ. and Distribution

Rasha Samir
 +20 2 33 32 1142
 rsamir@efg-hermes.com

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CONTACTS AND STATEMENTS

Background research prepared by EFG-Hermes Holding SAE. Report prepared by EFG-Hermes Holding SAE (main office), 58 Tahrir Street, Dokki, Egypt 12311, Tel +20 2 33 32 1140 | Fax +20 2 33 36 1536 which has an issued capital of EGP 1,939,320,000.

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