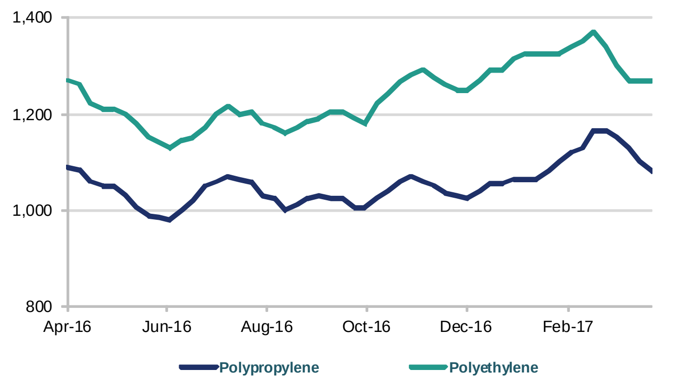
April 4, 2017

SAUDI ARABIAN PETROCHEMICALS
1Q2017 Preview

Spreads Soften As Feedstocks Rally

A stable quarter for oil markets after oil prices witnessed a +5% Q/Q growth in 1Q2017 and the S&P global petrochemical index mimicking with a Q/Q growth of +8%. An uptrend in oil prices continued after it surged by +10% in 4Q while a rally in natural gas was unexpected with prices up by +22% Q/Q to USD 3.14/mmbtu. This was followed by a sharp increase in feedstock prices, primarily increase in propane prices (average) on a Q/Q basis by +27% and butane by +36%, though naphtha was up only by +11%. We note that 1Q2017 is predominantly a double-digit feedstock based rally, while key product prices such as polypropylene and polyethylene barely improved; with low single digit growth. Alongside increase in feedstock prices, Q/Q increase in prices (average) of ethylene (+14%) and propylene (+11%) could affect spreads and in turn reduce margins for producers in this quarter. During 1Q2017, the rally was limited to few intermediates especially MEG and EDC. Ammonia remained the stalwart with +68% Q/Q increase over the quarter while VCM remained the worst, which declined by -11% Q/Q. Overall, petrochemicals in 1Q2017 witnessed a decent movement in output prices, though margins could contract versus last quarter; affecting profitability of few producers.

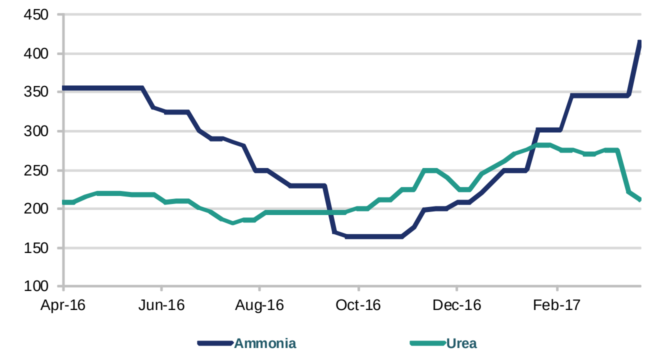
Exhibit 1: Petrochemicals Prices (USD/ton)



Source: Bloomberg

A reasonable move in oil markets is not reflected in TASI well, but reflected partially in petrochemical stocks (combined market cap of petrochemical stocks), the same have grown by +3% versus TASI's -4%. A close look at product prices starting with fertilizers suggest, average urea prices (middle east) improved this quarter with an increase of +23% in 1Q2017 versus +11% in 4Q2016. Ammonia prices, after declining by -24% Q/Q in 4Q2016 and -28% in 3Q2016 had the best rally ever with +68% Q/Q increase in 1Q2017; averaged USD 292/ton. The improved demand from agricultural economies in Asia has lifted the demand for urea and ammonia.

Exhibit 2: Urea and Ammonia Prices (USD/ton)



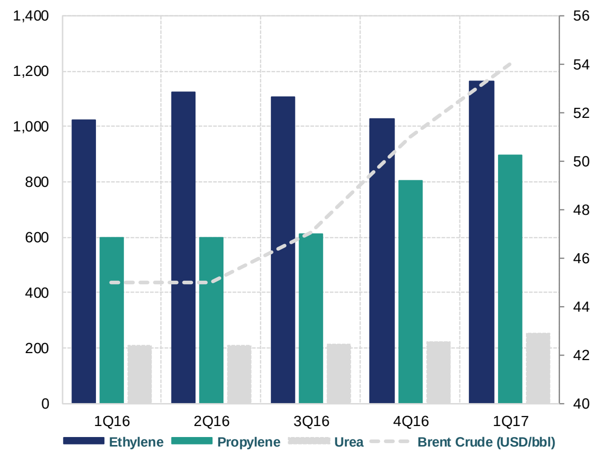
Source: Bloomberg

Santhosh balakrishnan
santhosh.balakrishnan@riyadcapital.com
+966-11-203-6809

Abdullah A. Alrayes
abdullah.alrayes@riyadcapital.com
+966-11-203-6814

In 1Q2017, margins are expected to be lower as feedstock prices have risen more in proportion to rise in product prices with propane up by +27% vs polypropylene, which went up by +2%. We saw similar trends in ethylene, which stayed up by +14% versus polyethylene's +2%. This clearly signifies the impact of lowering spreads on key producers. However, there are exceptions for few producers with prices on a Q/Q basis increased for MEG by +31% and EDC by +21%, while EVA was up by +7%. Methanol prices went up by +20% Q/Q, while Butanol went up only by +2%. Apart from the derivative products, average prices of benzene increased by +28% Q/Q while polystyrene increased by +16%.

Exhibit 3: Quarterly Average Commodity Prices (USD/ton)



Source: Bloomberg

Growth in 1Q2017 is expected to be better but Y/Y is an impact of lower base

1Q2017 forecasts for petrochemical stocks under our coverage are mentioned in Table 1. Revenues of our coverage universe are expected to increase by +17% Y/Y and +3% Q/Q on the back of mixed growth in prices and higher volumes, despite shutdowns from few producers. We attribute the added pressure on spreads to impact profitability due to sharp rise in propane and butane prices over the last two quarters, which increased by +60% and +80% respectively. 1Q2017 earnings are likely to be a mixed bag as prices of basic petrochemicals rose feebly, while few intermediates have gone up (Ammonia and MEG). We believe with KSA producers being primarily ethane and propane feedstock users, the high prices (feedstock) correspondingly lead to spreads contraction. Advanced is likely to witness the impact of high propane prices adding its partial impact of 8-days shutdown reflected in its margins, while Sahara replicates the impact of 32-day shutdown amid higher propane prices. We expect some IFRS translation adjustment to have slight impact for some producers. Yansab is likely to benefit from high MEG prices, while SIIG and Petrochem could see a Q/Q improvement after its 60-day shutdown in 4Q2016. On a standalone basis, we expect SABIC to record a +13% increase in revenues and rise in net income of +48% Y/Y as subsidiaries continues to post better numbers. Overall earnings are expected to grow by +60% Y/Y and +16% Q/Q.

Table 1: 1Q2017 Estimates (SAR mln, except per share data)

	Revenues			EBIT			Net Income			EPS	
Company	1Q2016	1Q2017E	Y/Y Chg	1Q2016	1Q2017E	Y/Y Chg	1Q2016	1Q2017E	Y/Y Chg	1Q2016	1Q2017E
ADVANCED	488	529	8%	144	154	7%	146	164	12%	0.89	1.00
PETROCHEM	1,660	1,627	NM	288	382	33%	122	171	40%	0.25	0.36
SIIG	1,660	1,627	NM	326	456	40%	88	146	66%	0.20	0.32
SAUDI KAYAN	1,693	2,428	43%	(24)	372	NM	(216)	157	NM	(0.14)	0.10
YANSAB	1,496	1,914	28%	474	708	49%	402	657	63%	0.71	1.17
SABIC	31,153	35,053	13%	4,996	7,478	50%	3,406	5,039	48%	1.14	1.68
SAFCO	691	804	16%	256	319	25%	286	329	15%	0.86	0.79
SAHARA	419	386	NM	59	26	NM	55	71	NM	0.13	0.16
SIPCHEM	892	937	5%	159	165	4%	51	91	78%	0.14	0.25
PETRO RABIGH	4,947	7,263	47%	(14)	113	NM	(33)	84	NM	(0.04)	0.10
Group Total	45,099	52,567	17%	6,664	10,173	53%	4,307	6,909	60%		

Source: Riyad Capital, Company Reports

Margins likely to be stable, but could contract on a Q/Q basis

With better improvement in ammonia and urea prices this quarter, Safco is likely to post a +16% increase in revenues and +15% increase in net income. Yansab and Kayan is likely to see improvement in margins as MEG prices rose significantly, but spreads remains volatile In terms of sector profitability. We forecast 1Q gross margins to improve by 200 bps from 1Q2016, while EBIT margins are expected to witness 400 bps improvement. In 1Q2017, Sahara had impact of shutdown for 32 days, which led to decline of 700 bps in operating margins.

Table 2: 1Q2017 Margin Estimates

	Gross		EBIT		Net	
Company	1Q2016	1Q2017E	1Q2016	1Q2017E	1Q2016	1Q2017E
PETROCHEM	26%	33%	17%	23%	30%	31%
SABIC	27%	31%	16%	21%	11%	14%
SAFCO	39%	42%	37%	40%	41%	41%
SIIG	26%	33%	17%	23%	5%	9%
SAHARA	26%	18%	14%	7%	13%	18%
YANSAB	35%	37%	32%	37%	27%	34%
SIPCHEM	26%	25%	18%	18%	6%	10%
ADVANCED	32%	32%	30%	29%	30%	31%
SAUDI KAYAN	5%	19%	-1%	15%	-13%	6%
PETRO RABIGH	4%	5%	0%	2%	-1%	1%
Group Average	**25%**	**27%**	**18%**	**22%**	**15%**	**20%**

Source: Riyad Capital, Company Reports

Our coverage trades at a median 2017E P/E of 14.9x, which is at par with TASI P/E of 14.5x but warrant a premium. We recommend a Buy for Sahara and Petro Rabigh, while we recommend a Neutral on the remaining stocks under coverage.

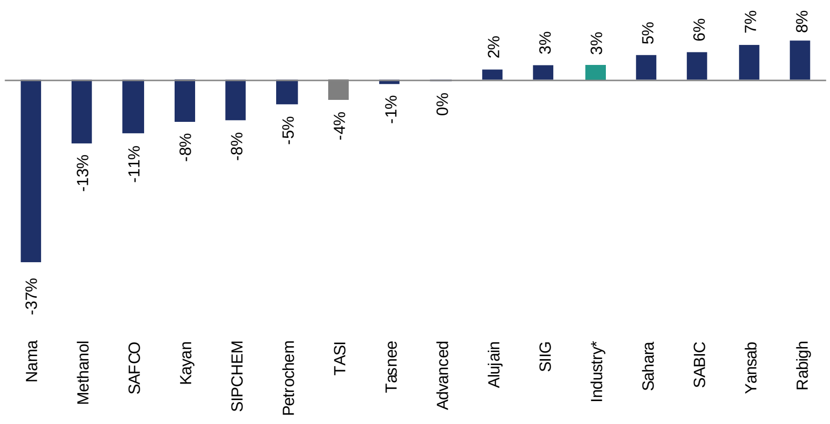
Table 3: Ratings and Valuations (SAR mln)

	TASI	Current	Market	Target		Dividend	P / E		P/B	
Company	Code	Price	Cap	Price	Rating	Yield	2016	2017E	2016	2017E
PETROCHEM	2002	20.35	9,768	19.00	Neutral	-	24.8x	13.5x	1.6x	1.5x
SABIC	2010	96.91	290,730	90.00	Neutral	4.6%	16.2x	14.9x	1.4x	1.3x
SAFCO	2020	67.25	22,417	65.00	Neutral	3.7%	26.7x	23.4x	3.4x	3.2x
SIIG	2250	19.85	8,933	18.00	Neutral	2.5%	18.4x	9.8x	1.6x	1.5x
SAHARA	2260	15.60	6,845	16.00	Buy	3.2%	94.2x	21.3x	0.4x	0.4x
YANSAB	2290	57.71	32,462	55.00	Neutral	3.5%	14.1x	14.4x	2.0x	2.0x
SIPCHEM	2310	17.39	6,376	16.00	Neutral	2.9%	91.5x	17.4x	1.2x	1.1x
ADVANCED	2330	45.88	7,524	48.00	Neutral	6.0%	12.4x	11.9x	3.0x	2.8x
SAUDI KAYAN	2350	8.20	12,300	7.50	Neutral	-	91.1x	17.4x	0.9x	0.8x
PETRO RABIGH	2380	12.89	11,292	16.00	Buy	-	na	na	1.4x	1.4x
Group Average							**24.8x**	**14.9x**	**1.5x**	**1.4x**

Source: Riyad Capital

The petrochemical stock's combined market cap growth has slightly outperformed the TASI by +7%, Nama was the worst with -37% and Rabigh is best performer with +8%.

Exhibit 4: YTD Petrochemical sector vs. TASI performance



Source: Bloomberg
*Industry data is combined growth rate in marketcap for all stocks on a YTD basis

Stock Rating

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

** The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors*

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