

PETROCHEM: 2Q2017 earnings came above estimates due to higher than expected sales that resulted from inventory usage and better production efficiency. Revenue came 21.8% higher than our estimates due to lower than expected impact of plant shutdown for 14 days during May 2017. However, Polymers plant' operating rate is expected to rise to an average rate of 85% in 2H2017. Weak margins due to shutdown, however higher benefit expected from improved spreads across main products during 2H2017 due to improved production efficiency after maintenance. "Overweight" recommendation reiterated with TP of SAR 23.0/share.

- National Petrochemical company (Petrochem) 2Q2017 earnings came above expectation, exceeding AJC and market censuses profits estimates of SAR 101.3mn and SAR 107.3mn, respectively. Petrochem posted net income of SAR 132.3mn; (EPS; SAR 0.28); as compared to net profit of SAR 208.0mn in 2Q2016 and SAR 167.9mn in 1Q2017. The deviation of 2Q2017 earnings with our estimates is mainly ascribed to i) higher than expected sales due to the inventory usage. ii) higher than expected other income of SAR 28mn, as compared to AJC estimate of SAR 21mn. iii) lower than expected finance cost of SAR 55mn, as compared to AJC estimate of SAR 61mn. The YoY weak result was mainly associated with i) unplanned shutdown at Petrochem project (Saudi Polymers Company) for 14 days during May 2017, due to a sudden outage of nitrogen supply to Al-Jubail area. ii) lower gross margin due to higher production cost iii) higher finance cost. Despite of weak 1H-2017 earnings, due to non recurring impact of plant shutdown, we believe going forward the maintenance will have a positive impact, due to expected improvement in operating rate.
- The company's sales revenue stood at SAR 1,754mn, well above AJC estimates of SAR 1,439mn due to inventory draw down and lower than expected impact of plant shutdown (14days in May 2017). We expect that the plant was running at a utilization rate of around 83.50%, as compared to 79.1% in 2Q2016 and 76.8% in 1Q2017; however, the company's operating rate is likely to improve toward an average operating rate of 85% in the coming two quarters. Despite the shutdown in 2Q2017, we ascribe the higher than expected sales revenue to a possible increase in operating rate, as the company completed the main scheduled maintenance of polymers unit during 4Q2016. During the quarter, average selling prices of PP declined by 4.9%QoQ, but increased by 2.8%YoY. Polystyrene increased by 2.6%YoY, but declined 12.5%QoQ. Average ethylene derivatives increased by 0.9%YoY, but declined 4.9%QoQ.
- Gross profit stood at SAR 420.8mn; depicting a fall of 26.3%YoY, well above AJC estimate of SAR 376.8mn due to higher sales. Gross margin stood at 24.0% in 2Q2017 vs. our estimates of 26.2% and 29.8% in 1Q2017. This is we believe is due to high impact of plant shutdown, despite the higher QoQ product spreads. In 2Q2017, Naphtha average prices (Benchmark for feedstock cost) declined by 11.0%QoQ to USD 442/ton, in line with the decline in crude oil prices, whereas most of polymer and other Petchem product prices declined less than the feedstock prices. Thus, higher decline in feedstock price than the final product prices has resulted in PP-Naphtha spreads to expand in QoQ basis. PP-Naphtha spread expanded 0.6%QoQ to USD 560/ton from USD 556/ton in 1Q2017. Therefore, we believe that higher margins of Propane derivatives were partly offset by shutdown impacts and weak margin of ethane downstream products that represents almost 40% of the company's feedstock. Operating profit stood at SAR 263.7mn, depicting a fall of 37.7%YoY, where the company witnessed slight increase in OPEX (SG & A) to record SAR 157.0mn as compare to SAR 148.8mn in 1Q2017 and SAR 149.8 in 2Q2016.

AJC View: Despite the weak performance in 1H2017 due to non-recurring impacts, we believe that the shutdown in 2Q2017 would have a positive impact on the overall performance and would further improve the operating rate in 2H-2017 and onwards. Polymers plant's operating rate is expected to rise to 85% in the coming quarters, as compared to 76.8% in 1Q2017. The company is expected to benefit more from the higher spreads across main products and higher margins during 2H2017 due to production efficiency after maintenance. On the other hand, new feedstock prices will be gradually applied by 3Q2018. Grace period on Methane will end in Nov 2018, whereas Ethane and Propane in Aug/Sep 2019. National Petrochemical Co. (Petrochem) is expected to post SAR 733.0mn in net income (1.53 EPS) for FY2017, indicating an increase of 84.5%YoY for the year. We remain 'Overweight' on the stock with a target price of SAR 23.0/share; indicating a potential upside of 36.9% over current market price of SAR 16.80/share (as of 9th August 2017). The company is trading at a forward PE and P/B of 11.0x and 0.94x respectively based on our FY2017 earnings forecast. We expect the company to maintain its low dividend payment at SAR 0.5 DPS (2.6% D/Y) in 2017, owing to its SAR 10.3bn long term debt.

Results Summary

SARmn (unless specified)	Q2-2016	Q1-2017	Q2-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	1,642	1,685	1,754	6.8%	4.1%	21.8%
Gross Profit	573.5	502.4	420.8	-26.3%	-16.2%	11.7%
Gross Margin	34.9%	29.8%	24.0%	-	-	-
EBIT	423.7	353.6	263.7	-37.7%	-25.4%	15.9%
Net Profit	208	167.9	132.3	-36.4%	-21.2%	30.6%
EPS	0.43	0.34	0.28	-	-	-

Source: Company reports, Aljazira Capital

Recommendation	'Overweight'
Current Price* (SAR)	16.80
Target Price (SAR)	23.00
Upside / (Downside)	36.9%

Source: Tadawul *prices as of 9th of August 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	7,304	6,067	7,151
Growth %	-7.1%	-16.9%	17.9%
Net Income	906	397	733
Growth %	17.0%	-56.2%	84.5%
EPS	1.89	0.83	1.53

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	34.0%	26.5%	29.5%
Net Margin	12.4%	6.6%	10.3%
P/E	8.85x	25.21x	11.00x
P/B	1.48x	1.53x	1.29x
EV/EBITDA (x)	6.09x	8.98x	5.71x
Dividend Yield	0.0%	2.4%	3.0%

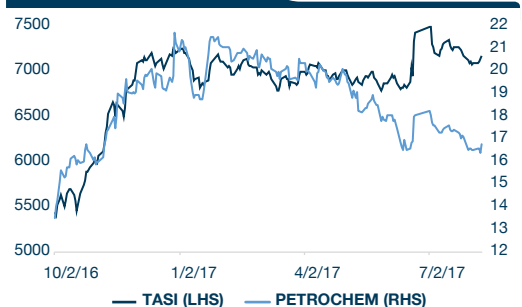
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	8.19
YTD %	-22.0%
52 Week (High)	22.80
52 Week (Low)	13.40
Shares Outstanding (mn)	480.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

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1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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