Saudi Kayan Petrochemical Co.

Result Flash Note 2Q-2017 **July 2017**

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

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Saudi KAYAN: 2Q-2017 earnings came above our estimates; net income was supported by lower than expected finance cost and other expenses. Lower than expected sales revenue due to the company's preparation for plants maintenance in 2H2017. Gross margin increased on YoY basis to 26.8% Vs. 23.6% due to the improvement after plant maintenance in 2016. Weak margins of Ethane derivatives were partly offset by higher margin of Butane downstream products leading to margin stability. Revenue to be under pressure in 2H2017 due to plants maintainace. Recommendation remains "Overweight" on the stock with PT of 10.4/share.

- 2Q2017 net profit came above our estimates of SAR 210.1mn, and the market consensus of SAR 192.0mn. Saudi Kayan (KAYAN) reported a net profit of SAR 242.0mn; (EPS; SAR 0.16); indicating an increase of 148.7%YoY and a fall of 8.8%QoQ. The YoY strong performance is mainly attributed to i) higher volumetric sales due to improved operating rate, despite the higher feedstock cost ii) higher average sales prices iii) the impact of scheduled maintenance during 2Q2016 iv) lower OPEX by 8.1%, despite the higher finance expenses and zakat provision. On the other hand, although the top line performance in 2Q2017 was slightly in-line with AJC estimates, the company's net income showed a positive deviation from our estimates, which is mainly attributed to the lower than expected finance cost and other expenses. In 2Q2017, the Company is expected to register a decline in finance cost by 14.5%QoQ stood at SAR 200mn from SAR 234.8mn in 1Q2017, whereas other expenses are expected to decline by 93.5% stood at SAR 3.5mn from SAR 55mn in 1Q2017.
- Kayan's sales in 2Q2016 stood at SAR 2,308.7mn, below our estimates of SAR 2,417mn, which is ascribed to lower than expected operating rate due to the company's preparation for plants maintenance in 2H2017. The plant was running with operating rate of 97.6%, lower than our estimates of 99.5% and 101.3% in 1Q2017. Despite the slowdown in operating rate, we believe that the maintenance in March/April-2016 had positively impacted the overall performance. We expect further improvement in performance in FY2017 and onward. However, the plants shutdown in 2H2017 is expected to weigh on kayan's top line, as the company plans to halt operations at some of its production facilities for debottlenecking and regular maintenance. During the quarter, Asian average prices of Kayan key products such as, HDPE, PP and MEG declined by 4.0%QoQ, 4.9%QoQ and 15.3%QoQ in 2Q2017 respectively; however, the company's 60-70% feedstock cost (Butane) declined by 25.6%QoQ, but increased 14.1%YoY.
- Gross profit stood at SAR 619.4mn, below our estimate of SAR 661mn that can be attributed to lower than expected operating rate and gross margin contraction. Gross margin stood at 26.8% in 2Q2017 vs. 27.2% in 1Q2017, we believe the stability in margin is due to higher production efficiency, despite the lower margin in Ethane based products. In 2Q2017, Naphtha average prices fell by 11.0%QoQ to USD 442/ton, in line with the decline in crude oil prices, where 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 slightly expand on QoQ basis. PP-Naphtha spread expanded 0.4%QoQ to USD 559/ton from USD 557/ton in 1Q2017. Therefore, we believe that margins stability of butane derivatives were partly offset by lower margin of ethane downstream products. On the other hand, the Company was granted a grace period for ethane, butane and methane feedstock until 1Q2017, as new feedstock prices will be gradually applied by 2Q2017.

AJC view: We believe that in addition to the lower than expected sales volume, the impact of higher production cost in some particular feedstock prices (Ethane-base) has been partly offset by Butane margin expansion in 2Q2017. Our outlook will remain optimistic in the year FY2017 as compared to FY2016; however, gross margin is expected to slightly decline in the coming quarters due to the new feedstock prices that would be implemented gradually during 2Q2017. Furthermore, We believe that the company's sales volume in 2H2017 to show more weakness due to the maintenance of ethylene glycol plant and olefins plant. We remain "**Overweight**" on KAYAN with a PT of SAR 10.40/share indicating a potential upside of 13.9%: Saudi Kayan Co. is expected to post SAR 443.4mn in net income (0.30 EPS) for FY2017, as compared to SAR 152.0mn in FY2016. The company is trading at a forward PE and P/B of 30.8x and 1.02x respectively based on our FY2017 earnings forecast.

Results Summary

SARmn (unless specified)	Q2-2016	Q1-2017	Q2-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	2,154.6	2,667.2	2,308.7	7.15%	-13.5%	-4.5%
Gross Profit	508.2	726.7	619.4	21.9%	-20.5%	-6.3%
Gross Margin	*23.6%*	*27.2%*	*26.8%*	-	-	-
EBIT	311.4	554.9	438.5	40.8%	-21.1%	-10.4%
Net Profit	97.3	265.5	242.0	148.7%	-8.8%	15.1%
EPS	**0.06**	**0.18**	**0.16**	-	-	-

Source: Company reports, Aljazira Capital

Recommendation	'Overweight'
Current Price* (SAR)	9.13
Target Price (SAR)	**10.40**
Upside / (Downside)	**13.9%**

*prices as of 17th of July 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	8,155	8,609	9,092
Growth %	-29.9%	7.9%	5.6%
Net Income	(1,243.4)	152.0	443.4
Growth %	NM	NM	191.7%
EPS	(0.83)	0.10	0.30

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	-2.6%	17.5%	22.9%
Net Margin	-15.2%	1.8%	4.9%
P/E	-	85.10x	30.89x
P/B	0.79x	1.02x	1.02x
EV/EBITDA (x)	17.4x	10.5x	9.3x
Dividend Yield	-	-	-

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	13.69
YTD %	3.3%
52 Week (High)	9.85
52 Week (Low)	5.05
Shares Outstanding (mn)	1500.0

Source: Company reports, Aljazira Capital

Price Performance

Source: Bloomberg, Aljazira Capital

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RATING TERMINOLOGY

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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