National Petrochemical Co. (Petrochem)

Result Flash Note 1Q-2017 **May 2017**

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

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PETROCHEM: 1Q2017 strong performance with higher gross margin. Revenue came below our estimates as ramping up capacity back to normal took longer then expected, after maintenance in prior quarter; however, high operating rate is expected for the coming quarters. Weak margins from Propane and Styrene derivatives were partly offset by higher margin of ethane downstream products. Better production efficiency and an increase in some product prices led to gross margin of 29.8% in 1Q2017 from 25.6% in 1Q2016. "Overweight" recommendation reiterated with TP of SAR 23/share.

- National Petrochemical company (Petrochem) 1Q2017 earnings came above expectation, showing a deviation of 16.1% from AJC estimates of SAR 144.7m. Petrochem posted net income of SAR 167.9mn; (EPS; SAR 0.34); as compared to net profit of SAR 121.4mn in 1Q2016 and losses of SAR 123.6mn in 4Q2016. We believe the YoY strong result was mainly associated with i) sales increase due to higher average sales prices of all products, whereas volumetric sales declined due to the impact after plant maintenance in 4Q2016 ii) higher gross margin of Ethane downstream, despite the higher cost of other feedstock cost iii) higher other income. Whereas, the strong improvement on QoQ result is attributed to the scheduled maintenance for polymers unit for 60 days during 4Q2016. On the other hand, the deviation of 1Q2017 earnings from our estimates is attributed mainly to high products spreads; however, we ascribe the lower than expected sales revenue to a possible decline in operating rate, as the company finished the scheduled maintenance in 4Q2016.
- The company's sales revenue stood at SAR 1,685mn, below AJC estimates of SAR 1,810mn due to slow ramping up in capacity after maintenance in the prior quarter. We expect that the plant was running at a utilization rate of around 76.8%, as compared to 84.6% in 1Q2016; however, the company's operating rate is likely to improve toward operating rate of 85% in the coming quarters. During the quarter, average selling prices of PP increased by 2.4%QoQ, and 22.5%YoY. Polystyrene increased by 15.5%QoQ and 26.4%YoY. Average ethylene derivatives increased by 1.0%QoQ and 8.9%YoY.
- Gross profit stood at SAR 502.4mn; depicting an increase of 18.2%YoY and above AJC estimate of SAR 420mn due to higher than expected products spreads. Gross margin stood at 29.8% in 1Q2017 vs. our estimates of 24.7% and 25.6% in 1Q2016. In 1Q2017, Naphtha average prices (Benchmark for feedstock cost) increased by 11.1%QoQ to USD 496/ton, in line with the increase in crude oil prices, whereas most of polymer and other Petchem product prices increased less than the feedstock prices. Thus, higher increase in feedstock price than the final product prices has resulted in PP-Naphtha spreads to shrink in QoQ basis. PP-Naphtha spread contracted 4.9%QoQ to USD 557/ton from USD 585/ton in 4Q2016. Therefore, we believe that weak margins of Propane derivatives were partly offset by higher margin of ethane downstream products that represents almost 40% of the company's feedstock. Accordingly, new feedstock prices will be gradually applied by 3Q-2018. Methane grace period will end on Nov 2018, whereas Ethane and Propane in Aug/Sep 2019. Operating profit stood at SAR 353.6mn depicting an increase of 26.4%YoY, where the company witnessed slight increase in OPEX (SG & A) to record SAR 149mn as compare to SAR 145mn in 1Q2016.

AJC View: The company benefitted from the high spreads across some products based on Ethane, despite margin contraction in products based on LPG (almost 60% of Petrochem feedstock). On the other hand, Polymers plant' operating rate is expected to rise to 85% in the coming quarter, as compared to 76.8% in 1Q2017. National Petrochemical Co. (Petrochem) is expected to post SAR 747mn in net income (1.56 EPS) for FY2017, indicating an increase of 83.6%YoY for the year. We remain '**Overweight**' on the stock with a target price of SAR 23.0/share; indicating a potential upside of 20.4% over current market price of SAR 19.10/share (as of 10th May 2017). The company is trading at a forward PE and P/B of 12.3x 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)	Q1-2016	Q4-2016	Q1-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	1,659	1,163	1,685	1.6%	44.9%	-6.9%
Gross Profit	425.1	51.9	502.4	18.2%	8.6x	8.6%
Gross Margin	*25.6%*	*4.5%*	*29.8%*	-	-	-
EBIT	279.8	(98.8)	353.6	26.4%	NM	9.1%
Net Profit	121.4	(123.6)	167.9	38.3%	NM	16.1%
EPS	**0.25**	**(0.26)**	**0.34**	-	-	-

Source: Company reports, Aljazira Capital

Recommendation	'Overweight'
Current Price* (SAR)	19.10
Target Price (SAR)	**23.00**
Upside / (Downside)	**20.4%**

*prices as of 10th of May 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E*
Revenue	7,304	6,067	7,209
Growth %	-7.1%	-16.9%	18.8%
Net Income	906	407	747
Growth %	17.0%	-55.1%	83.6%
EPS	1.89	0.85	1.56

Source: Company reports, Aljazira Capital *Based on IFRS accounting policy

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E*
Gross Margin	34.0%	26.3%	30.1%
Net Margin	12.4%	6.7%	10.4%
P/E	8.85x	24.62x	12.27x
P/B	0.97x	1.11x	0.94x
EV/EBITDA (x)	6.09x	9.01x	6.12x
Dividend Yield	0.0%	2.4%	2.6%

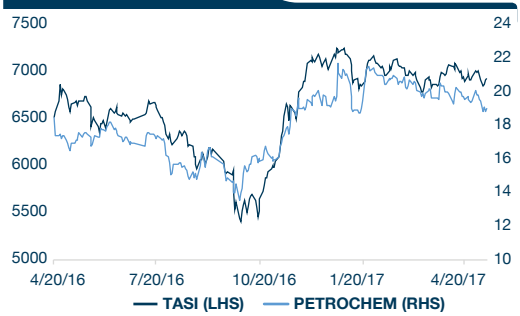
Source: Company reports, Aljazira Capital *Based on IFRS accounting policy

Key Market Data

Market Cap (bn)	9.12
YTD %	- 11.5%
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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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.

Disclaimer