High operating rates supports strong results

Advanced reported a better than expected set of Q3 19 results with a net income of SAR213mn, higher than the NCBC estimates of SAR172mn. This reflects a growth of 5.3% yoy and 10.8% qoq. We believe the higher than expected results are due to strong operating rates and better than expected margins. We estimate that Advanced operating rates stood at 121% vs our estimate of 116% which we believe confirmed that feedstock supply disturbance had no impact on Saudi petrochemical companies.

1. Revenues stood at SAR647mn in Q3 19, 10.8% higher than our estimates of SAR584mn. This is a decline of 13.1% yoy and 5.0% qoq. Based on our calculations, Advanced facilities operated at 121% in Q3 19, higher than our estimates of 116% and compared to 120% in Q2 19. We were conservative on our operating rates assumptions due to the curtailment of feedstock supply, however, the company’s strong performance proves the resilience of the Saudi producers and provides a strong positive read-across signal.

2. Gross profit stood at SAR245mn (+12.3% yoy, flat qoq), higher than our estimates of SAR206mn. The growth was driven by a strong gross margin expansion at 37.9% vs our estimates of 35.3% and 29.3% in Q3 19. This is the highest gross margin since Q4 16. We believe margin expansion is due to higher revenues and expanding spreads.

3. The deviation increased at the net income level driven by strong performance at SK Advanced. Advanced’s share in the profits of SK Advanced came-in at SAR25.8mn vs our estimates of SAR20.4mn and SAR25.4mn in Q3 18. We believe the strong performance is attributed to operational efficiency.

4. In Q3 19, average PP prices declined 16.4% yoy and 6.3% qoq to US$1,036. Propylene prices declined 15.3% yoy but increased 5.3% qoq to US$906. PP-propane spread declined 4.5% yoy but increased 8.2% qoq to US$645.

5. Saudi Petrochemical companies announced curtailment of supplies of feedstock ranging from 30%-50% due to attack on Saudi Aramco facilities in September 2019. However, Supplies have been resumed 10-14 days after the incident and it seems that Saudi producers had no material financial impact has been reported.

6. We are Neutral on Advanced, with a PT of SAR58.8. Operational efficiency, a sustainable dividend yield of 5.9% are the key strengths of the stock. Advanced is trading at 2019f PE of 12.1x, lower than peers average of 14.2x.

Q3 19 Results Summary

<table>
<thead>
<tr>
<th>SARmn</th>
<th>Q3 19</th>
<th>Q3 18</th>
<th>% yoy</th>
<th>Q3 19f</th>
<th>%Var*</th>
<th>%qoq</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>547</td>
<td>745</td>
<td>(13.1)%</td>
<td>584</td>
<td>10.8%</td>
<td>(5.0)%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>245</td>
<td>218</td>
<td>12.3%</td>
<td>206</td>
<td>18.7%</td>
<td>(0.6)%</td>
</tr>
<tr>
<td>Gross margin (%)</td>
<td>37.9%</td>
<td>29.3%</td>
<td>859bps</td>
<td>35.3%</td>
<td>253bps</td>
<td>169bps</td>
</tr>
<tr>
<td>Operating Income</td>
<td>202</td>
<td>191</td>
<td>6.0%</td>
<td>169</td>
<td>19.8%</td>
<td>(2.6)%</td>
</tr>
<tr>
<td>Operating margin (%)</td>
<td>31.2%</td>
<td>25.6%</td>
<td>564bps</td>
<td>28.9%</td>
<td>235bps</td>
<td>77bps</td>
</tr>
<tr>
<td>Net income</td>
<td>213</td>
<td>202</td>
<td>5.3%</td>
<td>172</td>
<td>23.9%</td>
<td>10.8%</td>
</tr>
<tr>
<td>Net margin (%)</td>
<td>32.9%</td>
<td>27.1%</td>
<td>578bps</td>
<td>29.4%</td>
<td>350bps</td>
<td>468bps</td>
</tr>
<tr>
<td>EPS (SAR)</td>
<td>0.98</td>
<td>0.93</td>
<td>5.3%</td>
<td>0.79</td>
<td>23.9%</td>
<td>10.8%</td>
</tr>
</tbody>
</table>

Source: Company, NCBC Research. ^ % Var indicates variance from NCBC forecasts

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