National Petrochemical Co.(Petrochem)

Result Flash Note 4Q-2018

Petrochem reported net income of SAR 236mn, below our estimates of SAR 250.8mn due to multiple non-recurring impacts; however, the normalized earnings of SAR 285mn are far better than market consensus of SAR 251mn. The result was supported by higher than expected revenues; where Polymers plant' operating rate increased to the highest record since inception. Q/Q Gross margin declined to 20.5% from 32.0% in Q3-18; as a result of accelerated depreciation of SAR 236mn for Polystyrene unit. The company's ability to increase its production efficiency and rates are a key potential growth for FY19 and onwards. We reiterate our TP at SAR 30.0/share with "**Neutral**" recommendation on the stock.

- National Petrochemical Company (Petrochem) posted net income of SAR 236mn; indicating a decline of 39.6%Y/Y and 23.1%Q/Q. The Y/Y decline was mainly associated with i) additional cost of SAR 236mn as accelerated depreciation for Polystyrene unit ii) higher non-operating profit during Q4-17 as a result of SAR 65mn for reversing zakat provision and SAR 38mn gain on currency exchange. Thus, the company's normalized net income stood at SAR 285mn; above our estimates of SAR 250.8mn. The deviation of normalized Q4-18 earnings with our estimates is mainly ascribed to higher than expected volumetric sales; driven by the improved operating rate.
- The company's sales revenue stood at SAR 2,183mn, above our estimates of SAR 2,008mn. We expect that the plant was running at a utilization rate of around 101%, as compared to 94.5% in Q3-18. During the quarter, average selling prices of PP declined by 3.4%Q/Q and increased by 3.4%Y/Y. Polystyrene plunged by 10.4%Q/Q and 4.5%Y/Y. Average selling price of HDPE declined by 9.7%Q/Q and 5.6%Y/Y.
- Gross profit stood at SAR 447mn; depicting a decline of 43.3%Y/Y, below AJC estimate of SAR 671mn due to SAR 236 accelerated depreciation for Polystyrene unit (normalized gross profit stood at SAR 683mn vs. our estimate of SAR 671mn). Normalized gross margin stood at 31.3% in Q4-18 vs. our estimates of 33.4%, and 32.0% in Q3-18. This, we believe is due to sourcing the basic materials from local market, which indicates lower spreads across products. However, in Q4-18, the change in feedstock price compared to the final product prices has resulted in PP-Naphtha spreads to increase by 1.0%Q/Q to USD 771/tonne from USD 762/tonne in Q3-18.
- Normalized operating profit stood at SAR 497mn, depicting a decline of 12.7%Q/Q, where the company witnessed a remarkable increase in OPEX (SG & A) to record SAR 186mn as compared to SAR 166.6mn in Q3-18 due to increase in selling and administrative expenses.

AJC View: Despite the weaker than expected gross margin and one-off impact, we believe that the production efficiency and operating rate has been positively reflected on the top line. Polymers plant's average operating rate is expected to rise at around 97% in FY19, as compared to an average of 93.8% during FY18. We expect the sudden upsurge in production capacity could be due to either outsourcing basic materials from the local market or obtaining additional feedstock from Aramco (additional clarification is required). On the other hand, new feedstock prices was gradually applied during Q3-18, where the grace period on Ethane and Propane will end in Aug/Sep FY19 (Propane represents almost 60% of the company's feedstock). National Petrochemical Co. (Petrochem) is expected to post SAR 1,109mn in net income (2.31 EPS) for FY19. Indicating a decline of 4.9%Y/Y. The company is trading at a forward TTM PE of 11.1x based on our FY19 earnings forecast, lower than the current sector average PE of 12.2x. We remain our '**Neutral**' recommendation on the stock with TP at SAR 30.0/share, awaiting for full financials details for more clarity.

Results Summary

SARmn (unless specified)	Q4-17	Q3-18	Q4-18	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	**2,169**	**2,297**	**2,183**	0.7%	-4.9%	8.7%
Gross Profit	788	736	447	-43.3%	-39.3%	-33.4%
Gross Margin	*36.33%*	*32.04%*	*20.47%*	-	-	-
EBIT	605	569	261	-56.9%	-54.1%	-45.6%
Net Profit	**391**	**307**	**236**	-39.6%	-23.1%	-5.9%
EPS	0.81	0.64	0.49	-	-	-

Source: Company Reports, AlJazira Capital *NM: Not meaningful

Neutral

Target Price (SAR)	**30.0**
Upside / (Downside)*	**15.2%**

Source: Tadawul *prices as of 23rd of January 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenue	7,367	8,930	8,755
Growth %	21.4%	21.3%	-2.0%
Net Income	888	1,165	1,109
Growth %	123.5%	31.2%	-4.9%
EPS	1.85	2.43	2.31

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY17	FY18	FY19E
Gross Margin	30.7%	30.1%	31.5%
Net Margin	12.1%	13.1%	12.7%
P/E	10.0x	10.60	11.10
P/B	1.31x	1.65	1.57
EV/EBITDA (x)	5.50x	5.14	5.22
Dividend Yield	2.7%	2.9%*	2.9%

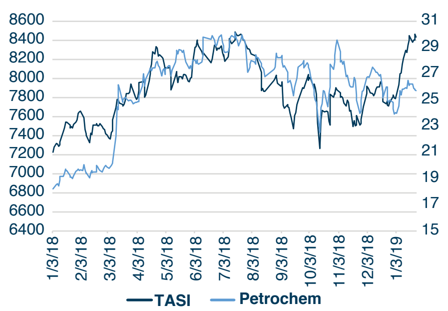
Source: Company reports, Aljazira Capital, *expected

Key Market Data

Market Cap (bn)	12.36
YTD %	6.2%
52 Week (High)/(Low)	30.80/18.80
Shares Outstanding (mn)	480.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, 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