Advanced Petrochemicals Co

Petrochemicals – Industrial
APPC AB: Saudi Arabia
14 January 2018

الراجحي المالية
Al Rajhi Capital

US$2.279bn	9%	US$2.952mn
Market cap	Free float	Avg. daily volume

Target price	47.00	10.8% over current
Current price	42.40	as at 14/1/2018

Existing rating

Underweight | Neutral | **Overweight**

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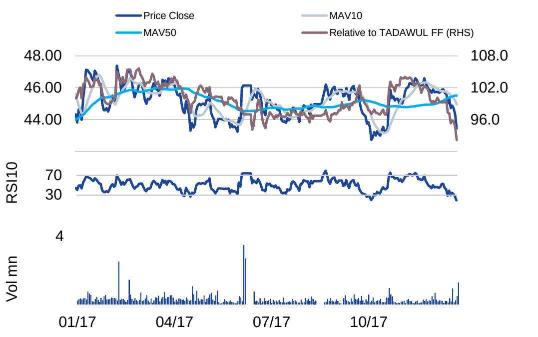
Performance



Source: Bloomberg

Forecasted earnings

(SARmn)	2017	2018e	2019e
Revenue	2,385	2,385	2,455
Y-o-Y	11.5%	0.0%	2.9%
Gross profit	738	697	747
Gross margin	31.0%	29.2%	30.4%
Net profit	631	616	653
Y-o-Y	-13.8%	-2.4%	5.9%
Net margin	26.5%	25.8%	26.6%
EPS (SAR)	3.21	3.13	3.32
DPS (SAR)	2.80	2.80	2.80
Payout ratio	87.3%	89.4%	84.4%
P/E (Curr)	13.1x	13.4x	12.7x
P/E (Target)	14.7x	15.0x	14.2x

Source: Company data, Al Rajhi Capital

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Q4: Lower equity income and higher feedstock cost led to weaker than expected profit

While 2017 full year revenue increased 11.5% y-o-y (mostly in-line with our estimates), operating income was down 15% as cost of propane surged 38%. 2017 net profit at SAR631mn was down 14%, coming below our estimate of SAR687mn due to higher costs and losses (Q4) reported at its Korean associate, SK Advanced. With a DPS of SAR2.8, the dividend pay-out for 2017 stood at 87% in 2017. There could be challenges as feedstock price remains elevated as oil prices continue to be steadily increasing while the product prices would only gradually (given its defensiveness) catch up. Capex for maintenance and investment for Py-gas project would imply flat dividends for 2018. However, given no major fundamental concerns and the stock at 52 week-low, with production rates expected to improve, we still believe APPC is a fundamentally healthy stock to own and maintain our Overweight rating and revised target price of SAR47/sh.

Results: Q4 revenue came 5% below our estimate. We expected productivity in Q4 to continue to increase, as it had in the last three quarters. However, based on our calculations, operating rate came in slightly lower than Q3 due to the end of life of the PDH catalyst which is expected to be replaced in H1 2018. As a result of the same, the production costs were higher than usual. Due to a 38% increase in propane costs and a 70% increase in outsourced propylene costs (higher than our expectations), gross margin in Q4 came at 24% (vs our exp. of 28% and 36% in the last quarter). We also believe there might have been a slight increase in general operating costs due to year end. Overall Q4 operating profit came at SAR115mn as compared to our SAR162mn estimate. Net profit came further lower in Q4 (Figure 1) owing to losses at SK Advanced (based on our calculations), which was reported to have a month long maintenance shutdown (source: polymerupdate.com).

Figure 1 Q4 results

(In SARmn)	4Q16	3Q17	4Q17	y/y	q/q	ARCe
Revenue	576	616	637	11%	3%	668
Gross Profit	198	222	153	-23%	-31%	189
Op. profit	185	195	115	-38%	-41%	162
Net profit	210	208	104	-51%	-50%	160

Source: Company data, Al Rajhi Capital

Outlook and Valuation: Though Q4 results have come in lower than expected, we do not see any red flags for either the production or the dividends despite its higher capex needs in 2018. We expect to see operating rates go up after the replacement of PDH catalyst. As for its dividends, we do not expect an increase in 2018 as we see higher investment/capex needs in the form of a) maintenance shutdown in H1 2018 b) Py-gas project (around SAR200mn equity infusion) apart from its general capex needs. The company also signed an agreement with SATORP to extend propylene supply till 2023 (100,000 mt instead of 80,000) from Jan 1, 2018. Our revised TP is SAR47/share based on equal mix of relative (SAR43/sh. based on 12.5x forward PE) and DCF valuation (SAR51/sh. based on FCF, cost of equity 10.6%). At our DPS estimate of SAR2.8/share, the dividend yield is healthy at 6.7%.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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