

Saudi Petrochemical Sector: Saudi Petrochemical sector to show improved performance, on back of healthy global demand and improved product prices, while margins are expected to expand QoQ, due to drop in feedstock prices. NGL feedstock is priced at the lowest level since Oct-2017; Petchem players with liquid gas feedstock to face margin expansion on olefins derivatives. Saudi petrochemical performance could improve in the medium term, due to expected price stability and positive demand outlook. AJC crude price (OPEC Basket) assumption for 2018 rose to USD 67.5/bbl from USD 62.8/bbl; Target prices of our universe were revised accordingly. We maintain our **Overweight recommendation on KAYAN and YANSAB, while upgrading APPC from **Neutral** to **Overweight** at SAR 52.50/share. We also updated our recommendations from **Overweight** to **Neutral** on Petrochem, Tasnee, Sahara and Sipchem with higher TP.**

Saudi Petrochemical sector is likely to witness improved performance in 1Q2018 earnings, due to healthy global demand and improved products prices; while margins are expected to expand QoQ due to drop in feedstock prices: Crude price (Brent) reached USD 70.53 per barrel in January, its highest level since December 2014, increasing 10.6%QoQ to average at USD 67.2/bbl. Crude Prices gained momentum after a surprise drawdown in crude oil stocks and no substantial rise in US oil production at the beginning of 1Q2018. However, the bullish sentiment was capped by increasing US production to 10.3 mbpd in February up by 230 kbpd from the January average, as per EIA estimates. Global consumption of petroleum is expected to rise 1.7mn b/d in 2018. The EIA indicated oil prices may rebound to USD 76 per bbl in 2018. The forecasts mentioned above indicate that the crude prices would continue to stabilize at the current prices level in 2018. Therefore, we raised our average crude price (OPEC Basket) assumption for 2018 to USD 67.5/bbl from the previous USD 62.8/bbl and revising the target prices of our universe accordingly.

The rebound in oil price was the key driver for the increases in the Petchem product prices. Prices of Petchem intermediates and final products witnessed a modest increase during the quarter while prices of NGL feedstock (Propane, Butane) declined to the lowest level since Oct-2017. Naphtha average prices rose 17.0%YoY, in tandem with crude prices, to average at USD 581/ton. Whereas average prices of Saudi Propane and butane declined more than 9%QoQ. Prices of basic petrochemicals such as Ethylene rose lower than its derivatives during the quarter by 2.3%QoQ in line with an average increase in Asian PE prices of 2.9% amid healthy downstream ethylene demand. PP average prices rose 6.8% QoQ to USD 1,219/ton, led by a strong increase in propylene prices (up 12.4%QoQ). Benzene prices rose by 7.0%QoQ to USD 893/ton, while its derivatives Polystyrene prices increased by 8.2%QoQ to average at USD 1,515/ton.

1Q2018 overall earnings are expected to show a significant QoQ increase due to better products prices, margins and multiple non-recurring impacts during 4Q2017: SABIC's earnings are expected to improve by 54.1%QoQ to SAR 5.65bn on improved product spreads and non-reoccurring loss in Q4-2017. Metak business is expected to remain under pressure due to low prices level and sales volumes. For **Kayan**, our outlook remains optimistic in FY2018 as compared to FY2017; gross margin is expected to improve in the coming quarters due to improve efficiency after 4Q2017 plants maintenance and better margins. **APPC**, scheduled shutdown of PP and PDH plants for 22 days and 24 days respectively could weigh on the operating rate and volumetric sales; however earnings are expected to improve by 18.8%QoQ on lower feedstock prices. **Sipchem**, the company is expected to show strong performance, driven by expected up tick in production efficiency and better margins for most products, as Methanol price jumped by 11.2%YoY. **Yansab**, net profit is expected to surge 19.0%YoY (-6.9% QoQ) to SAR 723.8mn largely owing to higher operating rate. **YANSAB** declared dividend of SAR 3.25/share for 2017 and we expect dividend payment to increase to at least SAR 3.75/share during 2018. **SAFCO**, is expected to witness robust Performance (up 482%QoQ), supported by higher sales volume after its major plants shutdowns in 2H2017. **Petrochem**, we expect operating rates to improve YoY, driven by the positive impact of plant shutdown during 2Q2017. However, **Tasnee's** net profit is expected to decline in 1Q18 to SAR 285.5mn from SAR 328mn in the previous quarter, mainly due to positive impact of reverse zakat provisos (SAR 88mn) in the previous quarter. Accordingly, better margins, higher sales prices and improved operating rates are the key catalyst for overall QoQ increase in 1Q-2018 earnings. A significant QoQ increase in overall 1Q2018 earnings.

Petrochemical average price performance in 1Q-2018

	1Q-2018	QoQ	YoY
Naphtha	581	1.8%	17.0%
Propane-Saudi	532	-8.3%	12.8%
Butane-Saudi	513	-11.0%	-8.3%
Ethylene	1295	2.3%	10.4%
Propylene	1031	12.4%	14.6%
MTBE	719	5.4%	9.4%
Benzene	893	7.0%	-2.2%
Styrene	1358	9.5%	1.3%
Methanol-China	386	5.7%	11.2%
HDPE-Asia	1330	6.8%	14.2%
LDPE-Asia	1229	-0.2%	-4.2%
LLDPE-Asia	1198	2.2%	4.0%
PP-Asia	1219	6.8%	15.8%
PP - Gulf	1180	7.5%	15.9%
MEG (SABIC)	1144	8.7%	3.5%
MEG (Asia)	981	8.1%	12.4%
PTA-Asia	758	11.0%	14.6%
Ammonia-Gulf	320	7.0%	10.2%
Urea-Gulf	255	-2.6%	1.1%
DAP-Fertilizer	412	7.9%	15.9%
Acetic Acid-AA	720	26.5%	73.2%
Vinyl Acetate Monomer-VAM	1215	5.9%	57.2%
TiO2*	3383	5.4%	32.9%
Polystyrene-Asia	1515	8.2%	6.7%

Source: ICIS, Argaam, AlJazira Capital Research, *Weighted average

Figure 1: Brent Crude (USD per Barrel)



Source: Bloomberg, AlJazira Capital Research

Propane-PP	Q4-2017		Q1-2018	
	Propane *	\$464	Propane	\$426
	polypropylene	\$1,141	polypropylene	\$1,219
	Cost Margin	40.70%	Cost Margin	34.90%
	spread	\$677	spread	\$793

*based on Export Saudi propane price with 20% discount

Butane-PP	Q4-2017		Q1-2018	
	Butane*	\$461	Butane	\$410
	LDPE-Asia	\$1,232	LDPE-Asia	\$1,229
	Cost Margin	37.70%	Cost Margin	33.40%
	spread	\$771	spread	\$819

*based on export Saudi Butane price with 20% discount

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NGL feedstock is priced at the lowest level since Oct-2017; Petchem players with liquid gas feedstock to face margin expansion on olefins derivatives:

During 1Q2018, Propane average prices (Saudi propane feedstock is calculated on 20% discount compared to export prices from the port) declined by 8.3%QoQ and averaged at USD 426 as against USD 464 in 4Q2017. Due to healthy global demand with the recent pick-up in oil prices, the Polypropylene (PP-Asia) and (HDDA-Asia) both prices rose by 6.8% QoQ. Margin for players with liquid gas feedstock is expected to improve in 1Q2018; as average prices in final products increased compared to the decline in liquid feedstock prices. On the other hand, Petchem players using mostly Ethane (Fixed cost at USD1.75/MMBtu) as feedstock are also expected to report better margin in 1Q2018; thus leading to higher profitability. In the current scenario, liquid gas margins are well positioned for Polypropylene producers, as the final products' prices have over performed the feedstock prices. Therefore, we believe that in 1Q2018, PP players using liquid gas as most of their feedstock would witness better margins improvement compared to players using a diversified feedstock portfolio.

Ammonia average price stands at the highest since 1Q2016, while Urea price have declined: Ammonia rose by 7.0%QoQ to average USD 320/ton in 1Q2018 recording the highest price level since 1Q2016. Urea prices declined -2.6%QoQ to average USD 255/ton from USD 261/ton in 4Q2017. We believe that the increase in Ammonia price was due to an increase in prices of natural gas in China since last December on the back of tightened domestic supply. On the other hand, although the Urea price have shown weakness in 1Q2018; the slow capacity buildup in China and higher china coal cost are considered key catalyst for Urea price recovery during 2018. China's Urea exports have declined 66% over the last two years, from 13.75m tons in 2015 to 8.9m tons in 2016 and 4.66m tons in 2017 according to ICIS news. Although the long-term outlook on fertilizers market is not certain, we expect the urea prices to continue rising for the next month as improvement in demand is expected from Europe and US and lower urea export from China as it concentrates on domestic demand, would lead to higher benefit for fertilizers producers such as SAFCO Co.

Methanol-china hits the highest average quarterly price since 1Q2014 standing at USD 386/ton in 1Q2018; however methanol price is expected to gradually decline in 2019: Methanol-china average prices in 1Q2018 rose 5.7%QoQ to USD 386/ton backed by strong demand in Chinese market and tight supplies. The global demand remains strong, as MTO (methanol to olefins) production in china has rebounded significantly since 2H2017. Thus, we expect improved performance for Sipchem Co. in the coming quarters due to expected higher operating rate and our short-term optimistic outlook of methanol price, which is the key catalyst to support the company's downstream prices. However, mid-term outlook on methanol price still under pressure due to expected additional methanol supply from china; so we expect the price to gradually decline by the beginning of 2019.

Titanium dioxide reaches highest price in more than three years: The weighted average price of Titanium Dioxide (TiO2) rose by 32.9%YoY to USD 3,383/ton in 1Q2018, mainly due to a slowdown in Chinese TiO2 exports. There are signs that the rising price momentum is continuing in 2Q2018, driven by expected demand growth and basic supply constraints. Furthermore, demand in 1Q2018 are still proceeding well, despite some low seasonal factors, sustained by favorable economic conditions, and TiO2 demand is expected to strengthen further in FY2018. Consequently, TASNEE Co. is expected to show improvement in performance for the next quarters due to continued improvement in average sales prices and improved global demand for TiO2 product.

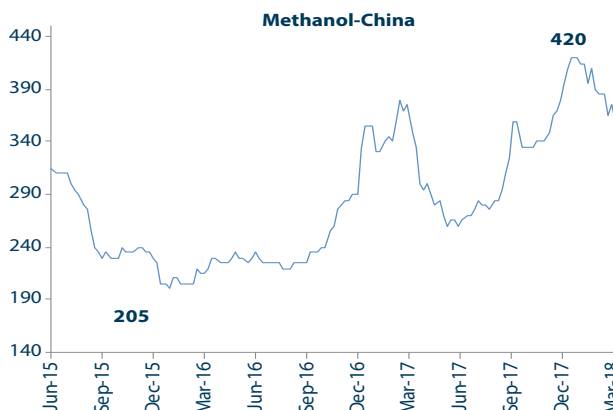
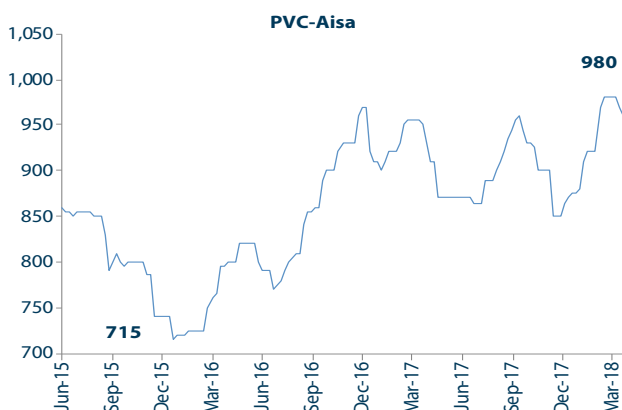
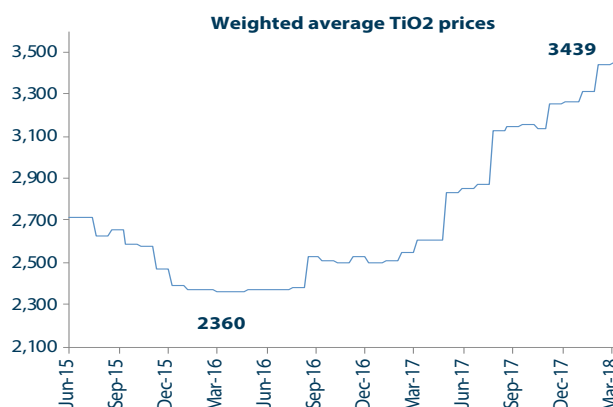
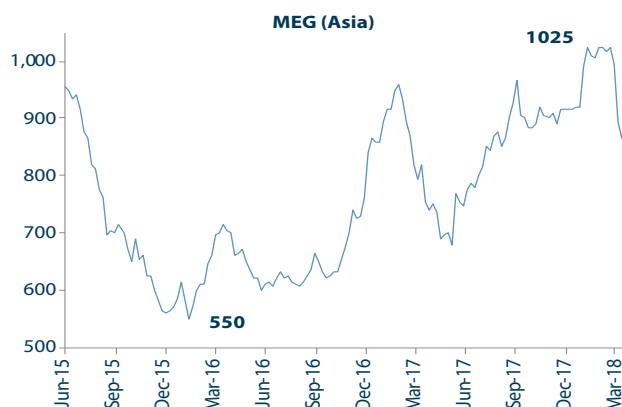
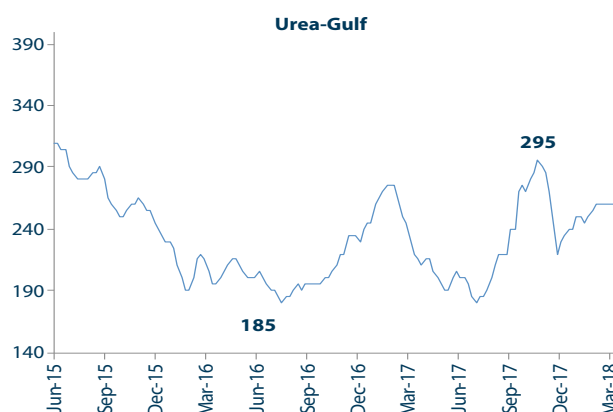
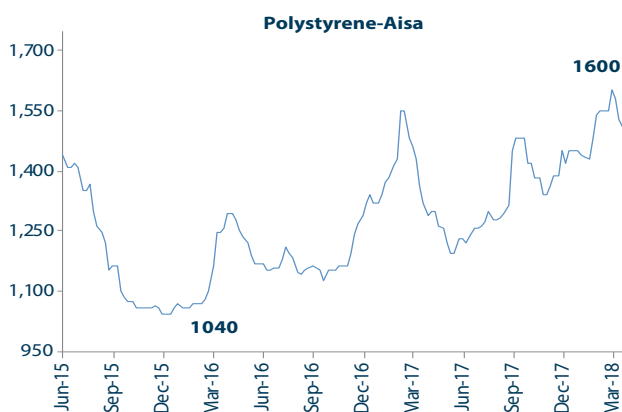
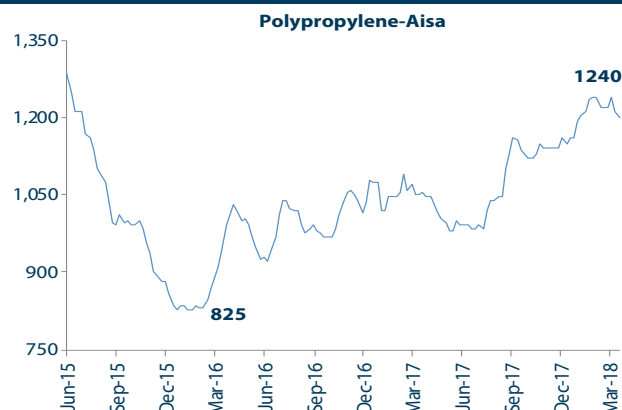
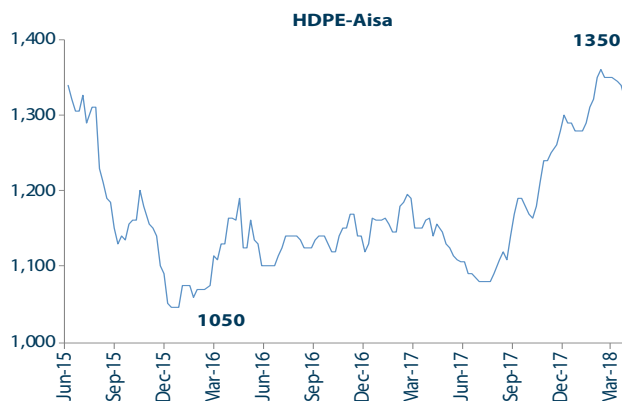
Valuation update on Saudi Petrochemical stocks under AJC coverage: Rating and PT of companies under coverage are adjusted with amended valuation inputs and assumptions. Downward revision in KSA total expected market return that is taken at 10.2% from 11.05%; whereas the company's risk free rate stood at 3.29%. We raised our average crude price (OPEC Basket) assumption for 2018 to USD 67.5/bbl from the previous USD 62.8/bbl and revised the target prices of our universe accordingly. Recent commitment of OPEC and Non-OPEC producers to cut oil output, may give some room, for the oil prices to increase. Therefore, Saudi petrochemical sector could improve in the medium term, due to expected price stability and positive demand outlook. We keep our recommendations for SABIC at Neutral with a target price of SAR 107.0/share. Moreover, we maintain our Overweight recommendation on KAYAN and YANSAB, while upgrading APPC from Neutral to Overweight at SAR 52.50/share. We also updated our recommendations from Overweight to Neutral on Petrochem, Tasnee, Sahara and Sipchem with higher TP. Finally, we remain Neutral on SAFCO with a target price of SAR 65/share. For 2018, we expect a remarkable performance for YANSAB, Kayan and Petrochem due to the positive impact after plant maintenance during the previous year and higher products spread.

Q1-2018 earnings estimates - Petrochemical Sector

code	Company name	Forecasted Net profits 1Q-2018(mn)	Forecasted EPS 1Q-2018	Forecasted QoQ growth	Forecasted YoY growth	Forecasted EPS -2018	Prospective PE -2018	12-month TP	Rating*
2010	SABIC	5,655.7	1.89	54.1%	8.0%	7.42	15.4x	107.00	Neutral
2020	YANSAB	723.8	1.29	-6.9%	19.0%	5.40	13.1x	73.50	Overweight
2290	SAFCO	392.9	0.94	48.2%	-6.3%	3.23	21.1x	65.00	Neutral
2310	Sipchem	182.6	0.50	11.0%	99.3%	2.07	10.3x	22.30	Neutral
2330	APPC	123.3	0.63	18.8%	-0.8%	4.09	11.9x	52.50	Overweight
2060	TASNEE	285.5	0.43	-12.9	176.2%	1.67	11.9x	19.50	Neutral
2350	KAYAN	394.4	0.26	NM**	48.6%	1.18	11.7x	14.50	Overweight
2260	SAHARA	137.0	0.31	44.5%	42.8%	1.24	14.2x	17.20	Neutral
2002	Petrochem	288.7	0.60	-26.2%	71.9%	2.49	9.95x	25.50	Neutral

Source: Aljazira Capital * Our ratings are based on the closing prices of 04/04/2018. **Not Meaningful

Petrochemical price trends



Source: ICIS, Argaam, AlJazira Capital Research

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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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