Advanced Petrochemical Co.

Advanced Petrochemical posted net income of SAR 98.0mn; indicating a decline of 21.2%YoY and 5.6%QoQ. 1Q2018 earnings came below AJC and the market consensus estimates of SAR 123.2mn and SAR 127.6mn respectively. Weaker than expected net profit was due to i) lower than expected sales volume after the scheduled maintenance of PP and PHD production facilities that weighed on the operating rate. ii) lower contribution from SK Advanced Co, stood at SAR 10mn compared to AJC estimate of SAR 18.7mn. iii) Increase in outsourced Propylene prices, pressured margins in 1Q2018, reducing gross margin from 27.2% in 1Q2017 to 23.6% in 1Q2018. However, we believe that the company's sales volume and margins to improve gradually starting from 2Q2018. Thus, we maintain our "Overweight" recommendation with PT of SAR 52.50/share.

Recommendation	**Overweight**
Current Price* (SAR)	48.57
Target Price (SAR)	**52.50**
Upside / (Downside)	**8.0%**

Source: Tadawul *prices as of 12th of April 2018

- 1Q2018 net profit came, significantly below AJC and the market consensus estimates of SAR 123.3mn and SAR 127.60mn. Advanced Petrochemical posted net income of SAR 98.0mn; (EPS; SAR 0.50); indicating a fall of 21.2%YoY and 5.6%QoQ. We believe that the weaker than expected net profit was mainly associated with i) lower than expected volumetric sales after scheduled shutdown of PP and PDH plants for 22 days and 24 days respectively. ii) higher production cost due to increase in outsourced Propylene prices. iii) lower than expected contribution from its share in SK Advanced Co. (associated company) standing at SAR 10mn, as compared to our profit estimate of SAR 18.7mn and the actual of SAR 15.3mn in 1Q2017. Despite the impact on sales volume, COGS and operating rate due to plant maintenance in 1Q2018, we believe that the company's weak operating rate and margins are not sustainable and expected to improve in the coming quarters driven by an increase in average product prices and improved production efficiency.
- The company's sales revenue stood at SAR 504mn, below AJC estimates of SAR 531.1mn and SAR 526.2mn in 1Q2017, this is mainly due to lower than expected operating rate of the company's plant and despite the 15.8%YoY growth in Polypropylene prices. We expect that the plant was running at a utilization rate of around 86.7%, as compared to 107% in 1Q2017 and an average of 121% in FY2017. Although the company's plant shutdown is likely to still weight on operating rate and sales volume in 2Q2018, operating rate is expected to continue at higher level in 3Q2018 and onwards due to ramping up of production and higher global demand. During 1Q2018, average selling prices of PP-Asia increased by 6.8%QoQ, and 15.8%YoY. Average Propylene prices increased higher than PP by 12.4%QoQ, and 14.6%YoY.
- Gross profit stood at SAR 119.0mn depicting a fall of 16.9%YoY, missing AJC expectation of SAR 139.6mn due to higher than expected contraction in product spreads. Gross margin stood at 23.6% in 1Q2018 vs. 27.2% in 1Q2017 and 24% in 4Q2017. Accordingly, the YoY level of movement in Propane price compares to Polypropylene prices is a reason for margin expansion; however the impact of plant maintenance and low operating efficiency played a negative role in pushing margins down. In 1Q2018, Propane (feedstock) average prices increased 12.8%YoY to USD 532/MT from USD 471/MT in 1Q2017, while polypropylene prices improved by 15.8%YoY to USD 1,219/MT. Operating profit stood at SAR 95.0mn depicting a decline of 18.8%YoY, however the company witnessed a decline in OPEX (SG & A) by 8.2%QoQ to record SAR 24.0mn as compare to SAR 26.2mn during 1Q2017.

AJC View: We believe that the company's margins and sales volume are likely to improve gradually starting from 2Q2018, whereas the current Propane–PP spread is expected to contribute positively on the company's overall performance for the coming quarters. Weak contribution from SK Advanced Petrochemical (hold 30% stake in the project) is expected to improve by 2Q2018 driven by expected margin expansion; as it is well positioned to cater to growing global demand for propylene. In addition, the amended agreement between APPC and SATORP to increase propylene supplied to Advanced Co. by 20KT/MT annually is expected to play a key positive support based on market prices of propylene and polypropylene. Advanced Petro Co. is expected to post SAR 779.2mn in net income (3.96 EPS) for FY2018, indicating an increase of 23.5%YoY for the year supported by higher margins and average product price. The development of Pygas and Pyoil downstream Project with GDI Company (ownership of 30% to 40% through its subsidiary AGIC) is expected to play an important role in the company's future performance .The company is trading at PE and P/B of 12.2x and 3.07x respectively based on FY2018 earnings. We expect the company's dividend payments to increase during coming quarters to SAR 0.75 DPS from the current SAR 0.70 DPS. We remain '**Overweight**' on the stock with TP at **SAR 52.50/share**.

Key Financials

SARmn (unless specified)	FY2016	FY2017	FY2018
Revenue	2,139.4	2,384.5	2,625
Growth %	-10.0%	11.5%	10.1%
Net Income	731.8	631.1	779.2
Growth %	2.2%	-13.7%	23.5%
EPS	3.72	3.21	3.96

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY2016	FY2017	FY2018
Gross Margin	37.5%	30.91%	33.4%
Net Margin	34.2%	26.5%	29.7%
P/E	12.56x	13.5x	12.2x
P/B	3.02x	2.8x	3.0x
EV/EBITDA (x)	8.98x	8.03x	8.66x
Dividend Yield	5.4%	6.5%	5.7%

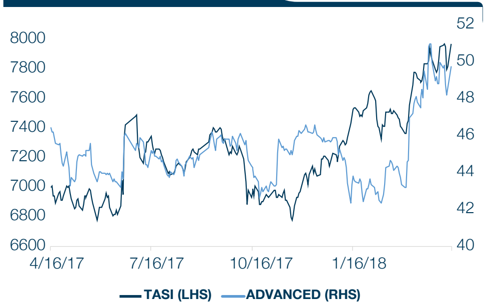
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	9.78
YTD %	8.30%
52 Week (High)	51.90
52 Week (Low)	41.90
Shares Outstanding (mn)	196.70

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

Results Summary

SARmn (unless specified)	1Q-2017	Q4-2017	Q1-2018	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	526.2	637.5	504	-4.2%	-20.9%	-5.1%
Gross Profit	143.2	152.8	119	-16.9%	-22.1%	-14.7%
Gross Margin	*27.2%*	*23.96%*	*23.6%*	-	-	-
EBIT	117.0	115.2	95	-18.8%	-17.5%	-15.4
Net Profit	124.4	103.8	98	-21.2%	-5.6%	-20.4
EPS	**0.63**	**0.52**	**0.50**	-	-	-

Source: Company reports, Aljazira Capital

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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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