# Forecasts Report

## Petrochemical Sector I 2Q2018 forecasts



**Saudi Petrochemical Sector: 2Q2018 overall earnings are expected to show a significant YoY increase due to better products prices, margins and multiple non-recurring impacts during 2Q2017. Oil prices extend gains after EIA reports biggest weekly drop in U.S. crude inventory during 2018, whereas the oil market supply is under pressure due to the US sanction on Iran. Saudi petrochemical performance is expected to remain solid in the med-term, due to expected price stability and positive demand outlook. AJC crude price (OPEC Basket) assumption for 2018 rose to USD 69.5/bbl from the previous USD 67.4/bbl; Target prices of our universe were revised accordingly.**

**Oil prices extend gains after EIA reports biggest weekly drop in U.S. crude inventory during 2018, whereas the oil market supply is under pressure due to the US sanction on Iran:** Crude price (Brent) reached USD 80.5/bbl in May, its highest level since November 2014, depicting an increase of 12.8%QoQ to average at USD 74.90/bbl in 2Q2018 and USD 71.2/bbl since the beginning of 2018. After testing the level of USD 72/bbl two weeks ago, benchmark Brent crude returns back to USD 79/bbl on the back of supply distribution in Venzuela (declined by 1.0mn bpd), Libya (declined by 0.5mn bpd) and temporary production shutdown at Canada's Sycrude Co. of 350 Kbpd. The latest initiative by OPEC to increase oil production by 700Kbpd-1mbpd is expected to fail in meeting with rising demand with the coming US sanction on Iran. During last week, the US is pushing foreign countries to completely cut their oil imports from Iran by November, which could reduce the Iranian's supply by 1.0-1.5mn bpd (2.4mn bpd Iran's total export) if the sanctions successfully implemented. Thus, the crude price seems to remain strong for the rest of 2018. The U.S. EIA reported a crude inventory decline by 9.9mn/bbl for the week ended June 22, which is the largest weekly decline YTD, compared to analysts' forecasts of 2.3mn/bbl drop. US weekly oil inventories stood at 416.7mn/bbl, as U.S. crude oil inventories are about 4% below the five year average. According to EIA latest report, global consumption of petroleum and other liquid fuels is expected to increase by 1.76 mbpd in 2018 and 1.73 mbpd in 2019. Therefore, the latest updates on oil fundamental indicate that the crude prices would continue to stabilize high in 2018. Therefore, we raised our average crude price (OPEC Basket) assumption for 2018 to USD 69.5/bbl from the previous USD 67.4/bbl and revising the target prices of our universe accordingly.

**Saudi Petrochemical sector is likely to witness better QoQ performance in 2Q2018 earnings, due to improved most products prices and higher margins; while fertilizers prices continue its downtrend due to higher Chinese Urea exports:** The rebound in oil price was the key driver for the increases in the most Petchem product prices. Prices of Petchem intermediates and final products witnessed a modest increase during the quarter while average prices of NGL feedstock (Propane, Butane) declined by 3.8%YoY and 0.3%YoY respectively. Naphtha average prices rose 10.8QoQ, in tandem with crude prices, to average at USD 643/ton. Prices of basic petrochemicals such as Propylene increased higher than its derivatives during the quarter by 2.3%QoQ in line with an average increase in Asian PP prices of 1.8% amid healthy demand. Styrene prices slightly rose by 0.4%QoQ to USD 1,364/ton, while its derivatives Polystyrene prices increased by 0.9%QoQ to average at USD 1,529/ton. MEG-Asia prices plunged 2.9%QoQ to USD 953 per ton. Ethylene prices slightly declined by 0.6%QoQ to USD 1,1288 per ton, while methanol prices jumped by 2.9% to average price of USD 398 per ton. The weighted average price of titanium dioxide continues its uptrend to USD 3,427/ton in 2Q2018 from USD 3,383/ton in the previous quarter as demand is still proceeding well. Ammonia prices declined 17.2%QoQ to USD 265/ton, while urea average prices fell 4.2% to USD 244/ton as Chinese exports of Urea fertilizer has picked up again according to ICIS news.

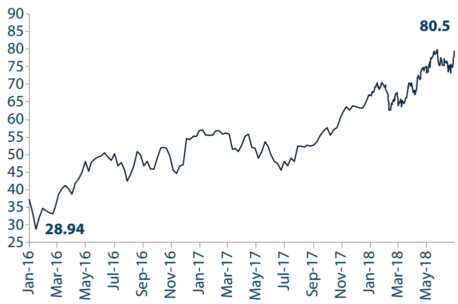
**2Q2018 overall earnings are expected to show a significant YoY increase due to better products prices, margins and multiple non-recurring impacts during 2Q2017:** **SABIC's** earnings are expected to improve by 5.8%QoQ to SAR 5.82bn on improved product spreads and after the impact of non-recurring impact during previous quarter and 2Q2017, whereas metal business performance is expected to witness better YoY performance due to higher prices level and sales volumes. **Kayan,** our outlook remains optimistic in 2Q2018 to post SAR 503.7mn as compared to SAR 462.5mn in the previous quarter; gross margin and operating rate are both expected to improve due to more efficiency after 4Q2017 plants maintenance. **APPC,** earnings are expected to improve by 114.6% QoQ on the back of scheduled shutdown of PP and PDH plants during 1Q2018; whereas the 23.9%YoY improved selling price of Polypropylene is the key support for the current quarter. **Sipchem,** the company is expected to show strong performance, driven by expected better production efficiency and better margins for most products, as Methanol price jumped by 45.2%YoY. **Yansab,** net profit is expected to surge 127.3%YoY due to the impact of plant maintainace in 2Q2017; where we expect the company to post SAR 785.7mn largely owing to higher operating rate. **SAFCO,** net income is expected to decline to SAR 231.1mn from SAR 237.2mn in 1Q2018 (down 2.6%QoQ), impacted by lower sales volume due to its plants shutdowns in 2Q2018 (SAFCO2 & SAFCO3). **Petrochem,** we expect the company to show a robust performance; indicating 162.7%YoY due to the impact of non-scheduled plant shutdown for 15 days during 2Q2017. **Tasnee's** net profit is expected to grow in 2Q18 to SAR 395.0mn from SAR 93.6mn in the same quarter last year, mainly due to 24.1% growth in Tio2 prices and improved operating rate of petrochemical segment. **SAHARA,** earnings are expected to improve by 60.6YoY due to i) The impact of AlWaha plant shutdown for 28 days in 2Q2017 ii) higher income from associates (TSO & SAMACO), while lower losses from SAAC Company iii)improved PP prices. Accordingly, better margins, the higher sales prices and improved operating rates are the key points to show a significant YoY increase in overall 2Q2018 sector earnings.

**Petrochemical average price performance in 2Q-2018**

| | 2Q-2018 | QoQ | YoY |
|---|---|---|---|
| Naphtha | 643 | 10.8% | 45.6% |
| Propane-Saudi | 512 | -3.8% | 28.9% |
| Butane-Saudi | 512 | -0.3% | 22.8% |
| Ethylene | 1288 | -0.6% | 23.5% |
| Propylene | 1055 | 2.3% | 28.5% |
| MTBE | 802 | 11.4% | 28.8% |
| Benzene | 843 | -5.6% | 10.2% |
| Styrene | 1364 | 0.4% | 24.8% |
| Methanol-China | 398 | 2.9% | 45.2% |
| HDPE-Aisa | 1352 | 1.6% | 20.9% |
| LDPE-Asia | 1205 | -1.9% | 0.7% |
| LLDPE-Aisa | 1176 | -1.9% | 6.2% |
| PP-Asia | 1241 | 1.8% | 23.9% |
| PP - Gulf | 1199 | 1.6% | 23.9% |
| MEG (SABIC) | 1147 | 0.2% | 20.5% |
| MEG (Asia) | 953 | -2.9% | 28.7% |
| PTA-Asia | 810 | 6.9% | 30.4% |
| PTA-Asia | 1327 | 15.2% | 42.2% |
| Ammonia-Gulf | 265 | -17.2% | -15.4% |
| Urea-Gulf | 244 | -4.2% | 21.5% |
| DAP-Fertilizer | 421 | 2.1% | 15.4% |
| Acetic Acid-AA | 793 | 10.2% | 83.8% |
| Vinyl Acetate Monomer-VAM | 1334 | 9.8% | 39.1% |
| TiO2* | 3427 | 1.3% | 24.1% |
| Polystyrene-Asia | 1529 | 0.9% | 23.1% |

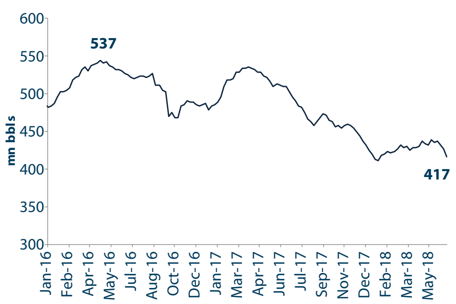
Source: ICIS, Argaam, AlJazira Capital Research,*Weighted average

**Brent Crude (USD per Barrel)**




Source: Bloomberg, AlJazira Capital

**US Weekly Oil Inventories**




Source: US EIA, AlJazira Capital Research

# Forecasts Report

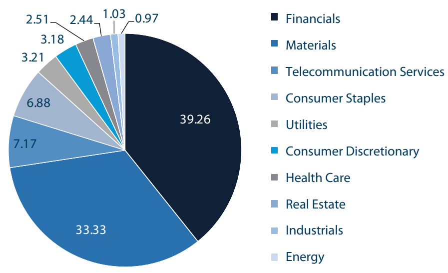
## Petrochemical Sector I 2Q2018 forecasts

**The Basic Materials sector is the second most influential sector in MSCI Saudi index after the financial sector, weighing 33.3%, whereas SABIC Co. has the biggest weight on the MSCI Saudi index with total weight of 15.9%:** MSCI stated on 20-06-2018 the re-classification of Saudi Arabia's stock index from Standalone Market to Emerging Market after putting Saudi market on a watch list last year. MSCI Saudi Arabia index included 32 stocks with a weighing of 2.6% in the MSCI EM index, following a two steps inclusion process. The first inclusion step will coincide with the May 2019 Semi-Annual Index Review; while the second step will take place as part of the August 2019. Saudi Arabia's Tadawul index is the Middle East's largest stock exchange with a market capitalization of about USD 522bn. The Basic Materials sector is the second most influential sector in MSCI Saudi index after the financial sector, weighing 33.3%, whereas SABIC Co. has the biggest weight on the MSCI Saudi index with total weight of 15.9%. (Subject to quarterly changes)

| | Float Adj Mkt Cap ( USD bn) | Index Wt. (%) | Sector |
|---|---|---|---|
| SAUDI BASIC IND CORP | 25.61 | 15.87 | Materials |
| AL RAJHI BANKING & INV | 17.72 | 10.98 | Financials |
| NATIONAL COMM BANK | 14.59 | 9.04 | Financials |
| SAUDI TELECOM CO | 9.00 | 5.58 | Telecom |
| SAMBA FINANCIAL GROUP | 7.47 | 4.63 | Financials |
| SAUDI ARABIAN MINING CO | 6.48 | 4.02 | Materials |
| ALMARAI CO | 6.39 | 3.96 | Cons Staples |
| SAUDI ELECTRICITY CO | 4.86 | 3.01 | Utilities |
| RIYAD BANK | 4.84 | 3.00 | Financials |
| ALINMA BANK | 4.23 | 2.62 | Financials |
| **Total** | **101.2** | **62.71** | |

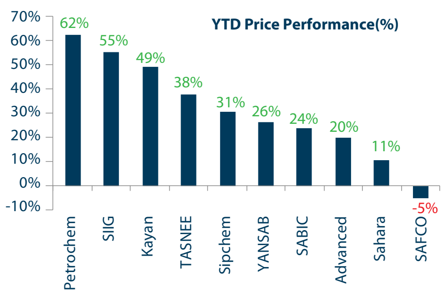
Source : MSCI on 31 May 2018

**MSCI Saudi Arabia index: SECTOR WEIGHTS**




Source: MSCI

**Petrochemical stocks : Price Performance**




Source: Bloomberg, AlJazira Capital

The MSCI Emerging Markets Index is tracked by more than USD 1.9tn in assets; which could bring at least USD 14.5bn foreign inflows into the market from the passive funds which track the index (assumed 30% of the total funds); in addition to the expected cash inflows by active funds. The additional cash flow by foreign fund is expected to result in passive fund flow of about USD 4.5-5bn into Basic materials. Furthermore, we believe that the expected higher liquidity is one of the factors that boosted the stock valuation and price movement. As high liquidity in the stock usually positively impacts risk and the cost of equity; resulting in a positive impact on stock price and valuation. Therefore, the companies that are heavy weights in MSCI Saudi index such as SABIC and AlRajhi are expected to have higher PE multiples compared to the previous year averages and higher valuation compared to less liquid counterparts.

**Valuation update on Saudi Petrochemical stocks under AJC coverage:** Rating and PT of companies under coverage are adjusted with amended valuation inputs and assumptions. We raised our average crude price (OPEC Basket) assumption for 2018 to USD 69.5/bbl from the previous USD 67.4/bbl and revised the target prices of our universe accordingly. The latest updates on oil fundamental indicate that the crude prices would continue to stabilize high due to the pressure on oil market supply. Therefore, Saudi petrochemical sector could remain solid in the med-term, due to expected price stability and positive demand outlook. We keep our recommendations for **SABIC** at **Neutral** with a higher target price of **SAR 120.0/share**. Moreover, we maintain our **Overweight** recommendation on **Sipchem** with a higher TP of **SAR 25.50**, while downgrading **APPC**, **Petrochem** from **Overweight** to **Neutral**. We also remain **Neutral** on **YANSAB, Kayan** and **SAHARA** with higher TP. Finally, we maintain our **Neutral** recommendation on **SAFCO** with a lower target price of **SAR 62.50/share**. For FY2018, 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.

**Q2-2018 earnings estimates - Petrochemical Sector**

| code | Company name | Forecasted Net profits 2Q-2018(mn) | Forecasted EPS 2Q-2018 | Forecasted QoQ growth | Forecasted YoY growth | Forecasted EPS -2018 | Prospective PE -2018 | 12-month TP | Rating* |
|---|---|---|---|---|---|---|---|---|---|
| 2010 | SABIC | 5,825.3 | 1.94 | 5.8% | 57.2% | 7.78 | 16.02x | 120.00 | **Neutral** |
| 2020 | YANSAB | 785.7 | 1.40 | 24.6% | 127.3% | 5.23 | 14.47x | 78.00 | **Neutral** |
| 2290 | SAFCO | 231.1 | 0.55 | -2.6% | 13.1% | 2.58 | 23.77x | 62.50 | **Neutral** |
| 2310 | Sipchem | 187.9 | 0.51 | 24.2% | 214.4% | 1.88 | 12.18x | 25.50 | **Overweight** |
| 2330 | APPC | 209.3 | 1.06 | 114.6% | 7.6% | 3.74 | 14.77x | 57.00 | **Neutral** |
| 2060 | TASNEE | 395.0 | 0.59 | 9.3% | 322.2% | 2.25 | 10.03x | 23.40 | **Neutral** |
| 2350 | KAYAN | 503.7 | 0.34 | 8.9% | 108.1% | 1.22 | 13.11x | 17.10 | **Neutral** |
| 2260 | SAHARA | 142.2 | 0.32 | 1.4% | 60.6% | 1.23 | 15.04x | 17.80 | **Neutral** |
| 2002 | Petrochem | 347.4 | 0.72 | 4.0% | 162.7% | 2.81 | 10.71x | 31.50 | **Neutral** |

Source: Aljazira Capital * Our ratings are based on the closing prices of 01/07/2018.

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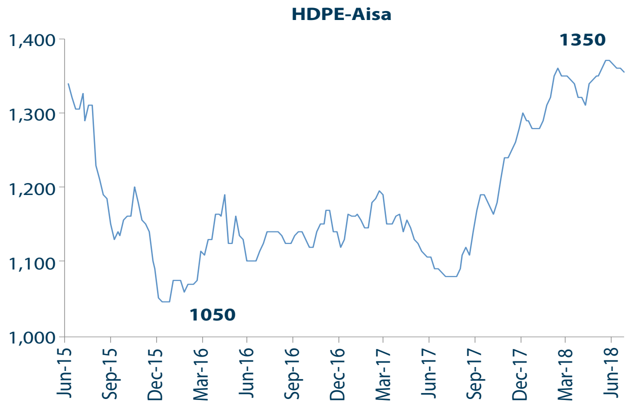
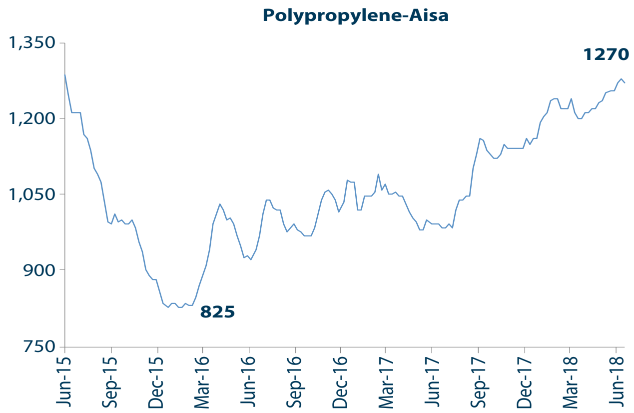
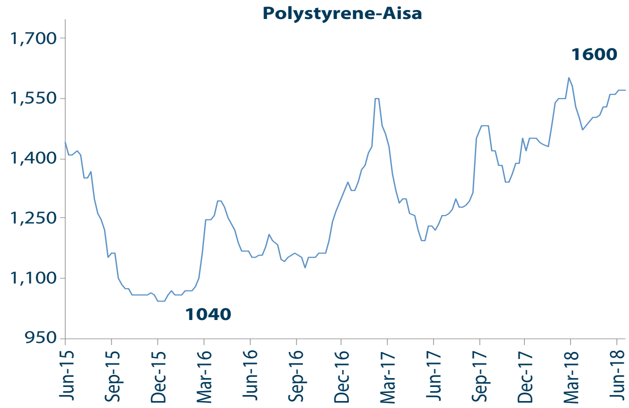
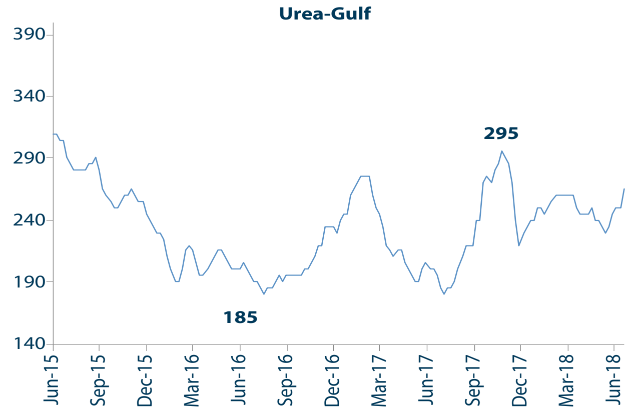
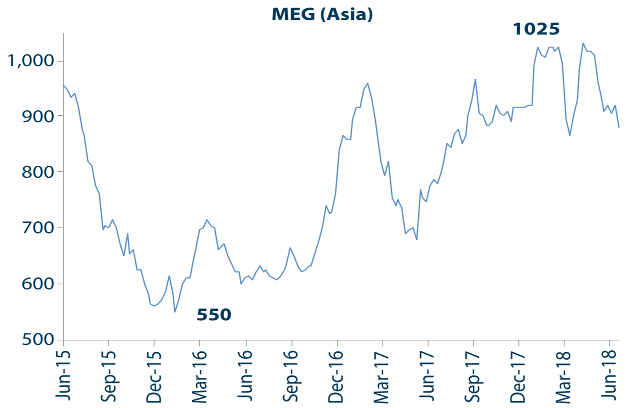
### Petrochemical price trends

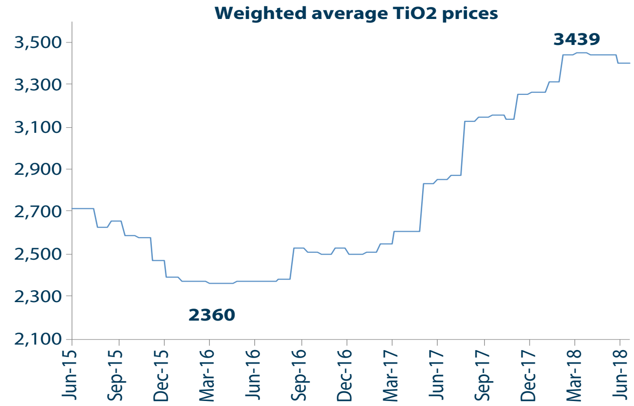


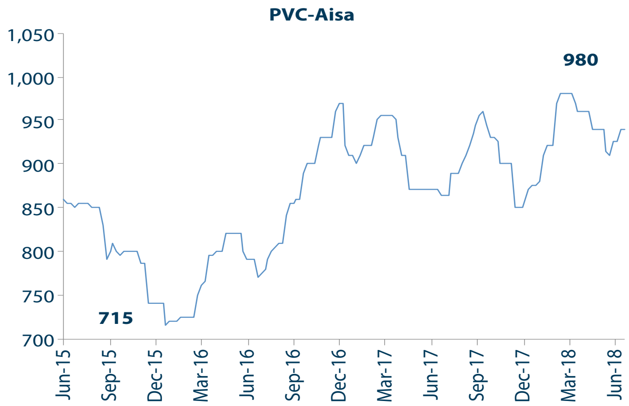



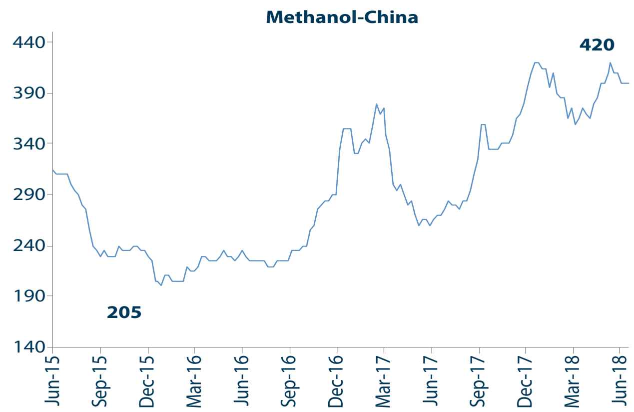




Source: ICIS, Argaam, AlJazira Capital Research

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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