

Advanced Petrochemical posted net income of SAR 104mn; indicating a decline of 50.5%YoY and 50.1%QoQ. 4Q2017 sales were in-line with our estimates; but net profit came below AJC and the market consensus estimates of SAR 192.40 and SAR 185.50mn respectively. The weaker than expected net profit was due to i) losses from SK Advanced Co, as compared to AJC estimate of SAR 23.7mn. ii) Operating inefficiency as the company prepares for maintenance in 1Q2018. iii) Higher OPEX at SAR 37.6mn in 3Q2017 vs. AJC estimates of SAR 26.9mn. iv) Lower spreads of Propane derivatives, pressured margins in 4Q2017, reducing gross margin from 34.3% in 4Q2016 to 24.0% in 4Q2017. "Neutral" recommendation reiterated with PT of SAR 45.3/share.

- 4Q2017 net profit came below expectation, significantly below AJC and the market consensus estimates of SAR 192.4mn and SAR 185.50mn. Advanced Petrochemical posted net income of SAR 104mn; (EPS; SAR 0.52); indicating a fall of 50.5%YoY and 50.1%QoQ. We believe that the weaker than expected net profit was mainly associated with i) Higher production cost due to lower operating efficiency as the company prepares for plant maintenance in 1Q2018. ii) Losses contribution from its share in SK Advanced Co. (associated company), as compared to our profit estimate of SAR 23.7mn and SAR 25.0mn in 4Q2016. iii) Higher OPEX for 4Q2017 standing at SAR 37.6mn vs. our estimate of SAR 26.9mn. iv) Lower spreads of Propane derivatives, pressured margins in 4Q2017. Despite the sales volume and operating rate stability, we believe that the higher than expected production cost is partly ascribe to lower production efficiency, that is expected to improve after plant shut down for maintenance in 1Q-2018. Furthermore, lower spreads of Propane derivatives is not sustainable and expected to expand in the coming quarters driven by an increase in product prices and improved production efficiency.
- The company's sales revenue stood at SAR 637.5mn, in-line with AJC estimates of SAR 640.2mn, but higher than SAR 616.4mn in 3Q2017, this is mainly due to operating rate stability of the company's plant and the 6.7%QoQ growth in Polypropylene prices. We expect that the plant was running at a utilization rate of around 121%, as compared to 123% in 3Q2017 and an average of 119% in FY2016.
- The company's plant shutdown is likely to weight on operating rate and sales volume in 1Q2018, however, operating rate is expected to continue at higher level in the 2Q2018 and onwards due to ramping up of production and higher global demand. During 4Q2017, average selling prices of PP-Asia increased by 6.7%QoQ, and 10.5%YoY. Average Propylene prices increased by 4.1%QoQ, and 13.9%YoY.
- Gross profit stood at SAR 152.8mn depicting a fall of 22.7%YoY, missing AJC expectation of SAR 202.3mn due to contraction in product spreads. Gross margin stood at 24.0% in 4Q2017 vs. 34.3% in 4Q2016 and 36.0% in 3Q2017. Accordingly, the level of movement in Propane price compare to Polypropylene prices is a logical reason for margin contraction. In 4Q2017, Propane (feedstock) average prices increased 39.8%YoY to USD 580/MT from USD 415/MT in 3Q2017, while polypropylene prices improved only by 6.7%QoQ to USD 1,141/MT. This led to a 14.0% decline in the Polypropylene-Propane spread.
- Operating profit stood at SAR 115.2mn depicting a decline of 37.8%YoY, where the company witnessed an increase in OPEX (SG & A) by 41.4%QoQ to record SAR 37.6mn as compare to SAR 26.6mn during 3Q2017.

Recommendation	'Neutral'
Current Price* (SAR)	43.40
Target Price (SAR)	45.30
Upside / (Downside)	4.3%

Source: Tadawul *prices as of 15th of January 2018

Key Financials

SARmn (unless specified)	FY15	FY16	FY17
Revenue	2,377	2,139.4	2,384.5
Growth %	-21.7%	-10.0%	11.5%
Net Income	713	731.8	631.1
Growth %	-5.1%	2.2%	-13.7%
EPS	3.62	3.72	3.21

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17
Gross Margin	33.0%	37.5%	30.91%
Net Margin	30.0%	34.2%	26.5%
P/E	8.69x	12.56x	13.5x
P/B	2.96x	3.02x	2.8x
EV/EBITDA (x)	11.46x	8.98x	8.03x
Dividend Yield	6.5%	5.4%	6.5%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	8.53
YTD %	-5.4%
52 Week (High)	48.40
52 Week (Low)	41.90
Shares Outstanding (mn)	196.70

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

Analyst

Jassim Al-Jubran

+966 11 2256248

j.aljabran@aljaziracapital.com.sa

AJC View: In addition to the current weak gross margin, we believe that the company's margin in 1Q2018 would witness pressure due to plant shutdown, whereas Propane-PP spread is expected to improve gradually starting from 2H2018. We believe that companies with mixed feedstock would benefit more in 4Q2017 due to higher QoQ product spread for Ethane-based product; however, companies that mostly used Propane as a feedstock are likely to be affected more than others. Weak contribution from SK Advanced Petrochemical (hold 30% stake in the project) is expected to improve noticeably by 2Q2018 driven by expected margin expansion; as it is well positioned to cater to growing global demand for propylene. The company is trading at PE and P/B of 13.5x and 2.8x respectively based on FY2017 earnings. We expect the company's dividend payments to be impacted in 2H2018 due to the development of Pygas and Pyoil Downstream Project (ownership of 30% to 40% through its subsidiary Advanced Global Investment Company (AGIC) which is owned 95% by ADVANCED). We remain '**Neutral**' on the stock with TP at **SAR 45.30**/share.

Results Summary

SARmn (unless specified)	4Q-2016	Q3-2017	Q4-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	576.4	616.41	637.5	10.6%	3.4%	-0.4%
Gross Profit	197.8	222	152.8	-22.7%	-31.2%	-24.5%
<i>Gross Margin</i>	34.3%	36.02%	23.96%	-	-	-
EBIT	185.2	195	115.2	-37.8%	-40.9%	-34.4%
Net Profit	210	208	104	-50.5%	-50.1%	-45.9%
EPS	1.07	1.06	0.52	-	-	-

Source: Company reports, Aljazira Capital

RESEARCH DIVISION

Head of Research
Talha Nazar
+966 11 2256250
t.nazar@aljaziracapital.com.sa

Analyst
Waleed Al-jubayr
+966 11 2256146
W.aljubayr@aljaziracapital.com.sa

Analyst
Sultan Al Kadi, CAIA
+966 11 2256374
s.alkadi@aljaziracapital.com.sa

Analyst
Muhanad Al-Odan
+966 11 2256115
M.alodan@aljaziracapital.com.sa

Analyst
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales
Alaa Al-Yousef
+966 11 2256060
a.yousef@aljaziracapital.com.sa

AGM-Head of Sales And Investment Centers
Central Region
Sultan Ibrahim AL-Mutawa
+966 11 2256364
s.almutawa@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage
Luay Jawad Al-Motawa
+966 11 2256277
lalmutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province
Abdullah Al-Rahit
+966 16 3617547
aalrahit@aljaziracapital.com.sa

AGM- Head of Western and Southern Region Investment Centers
Mansour Hamad Al-shuaibi
+966 12 6618443
m.alshuaibi@aljaziracapital.com.sa

RESEARCH DIVISION

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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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Head Office: King Fahad Road, P.O. Box: 20438, Riyadh 11455, Saudi Arabia, Tel: 011 2256000 - Fax: 011 2256068