

Advanced Petrochemical posted a disappointing set of result with net income of SAR 202.2mn; indicating a fall of 2.9%Y/Y and 20.2%Q/Q. Q3-18 earnings came below AJC and the market consensus estimates of SAR 230.4mn and SAR 222.1mn respectively. Weak net profit was due to higher than expected production cost, as tight PP-Propane spreads reduced gross margins to 29.3% from 36.8% in Q2-18. We expect the company's margin to remain weak during Q4-18 due to continued hike in feedstock prices. However, the company's sales continue to perform well, above our estimate due to higher operating rate and production efficiency. We maintain our "Neutral" recommendation on the stock with TP of SAR 57.0/share.

- Q3-18 net profit came below AJC and the market consensus estimates of SAR 230.4mn and SAR 222.1mn. Advanced Petrochemical posted net income of SAR 202.2mn; (EPS; SAR 1.03); indicating a decline of 2.9%Y/Y and 20.2%Q/Q. We believe that the weaker than expected net profit was mainly associated with higher than expected production cost due to i) higher feedstock cost, ii) higher propylene prices that is outsourced from SATORP company.
- The company's sales revenue stood at SAR 744.9mn, above AJC estimates of SAR 733.4mn and SAR 616.4mn in Q3-17, this is mainly due to higher than expected operating rate after scheduled shutdown of PP and PDH plants in Q1-18. We expect that the plant was running at a utilization rate of around 129.5% in Q3-18, as compared to AJC estimate of 127% and 123% in Q3-17. During Q3-18, average selling prices of PP-Asia slightly declined by 0.5%Q/Q, but jumped 16.0%Y/Y. SK Advanced Co. (associated company) recorded the highest contribution since inception to advanced petrochemical at SAR 25.4mn, as compared to our estimate of SAR 24.8mn and the actual of SAR 23.6mn in Q2-18; this is mainly due to jump in Propylene prices.
- Gross profit stood at SAR 218.1mn; depicting a decline of 21.3%Q/Q, below AJC expectation of SAR 249.2mn due to lower than expected PP-Propane spreads. Accordingly, the higher outsourced Propylene prices also pushed the overall gross margins lower. Thus, gross margin declined to 29.3% in Q3-18 vs. 36.8% in Q2-18 and 35.99% in Q3-17. In Q3-18, Propane (feedstock) average prices increased 13.0%Q/Q to USD 578/MT from USD 512/MT in Q2-18, while polypropylene prices declined by 0.5%Q/Q to USD 1,240/MT. Average Propylene prices increased to the highest level in four years at USD 1084/ton, indicating an increase of 23.3%Y/Y and 2.7%Q/Q.
- Operating profit stood at SAR 190.6mn, depicting a fall of 2.4%Y/Y and 22.7%Q/Q, where the company witnessed a decline in OPEX (SG & A) to record SAR 27.5mn as compared to our estimates of SAR 30.2mn and SAR 30.5mn in Q2-18.

AJC View: We believe that the company's gross margin will further decline in Q4-18 driven by an additional increase in average feedstock prices. Furthermore, Propylene prices (outsourced product) continue to stabilize high due to tighter supply in the market, which is expected to further weigh on gross margin for at least two quarters. However, production efficiency, operating rate and stable PP prices are the key support and expected to remain high, where the company's operating rate is likely to stabilize between 126%-130% in the next few quarters. In addition, Strong contribution from SK Advanced Petrochemical is expected to continue, given the better operating rate, propylene prices; and growing global demand. The company's net income was revised down to SAR 746.9mn (-4.7%) for FY18, indicating an increase of 18.3%Y/Y for the year supported by higher operating rate and average product price. The company is trading at PE and P/B of 14.4x and 3.50x respectively based on FY18 earnings. Dividend payment is expected to maintain at SAR 2.80/share in FY18. We remain 'Neutral' on the stock with TP at SAR 57.0/share.

Results Summary

SARmn (unless specified)	Q3-2017	Q2-2018	Q3-2018	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	616.41	749.7	744.9	20.9%	-0.6%	1.6%
Gross Profit	221.9	277.1	218.1	-1.7%	-21.3%	-12.5%
Gross Margin	35.99%	36.8%	29.3%	-	-	-
EBIT	195.4	246.6	190.6	-2.4%	-22.7%	-12.9%
Net Profit	208.4	253.3	202.2	-2.9%	-20.2%	-12.1%
EPS	1.06	1.29	1.03	-	-	-

Source: Company reports, Aljazira Capital

Neutral

Target Price (SAR) **57.00**

Upside / (Downside)* **4.4%**

Source: Tadawul *prices as of 4th of October 2018

Key Financials

SARmn (unless specified)	FY16	FY17	FY18E
Revenue	2,139.4	2,384.5	2,725.5
Growth %	-10.0%	11.5%	14.3%
Net Income	731.8	631.1	746.9
Growth %	2.2%	-13.7%	18.3%
EPS	3.72	3.21	3.80

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY16	FY17	FY18E
Gross Margin	37.5%	30.91%	30.6%
Net Margin	34.2%	26.5%	27.4%
P/E	12.56x	13.5x	14.4x
P/B	3.02x	2.8x	3.5x
EV/EBITDA (x)	8.98x	8.03x	8.86x
Dividend Yield	5.4%	6.5%	5.1%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	10.74
YTD %	18.98%
52 Week (High)/(Low)	57.20/41.90
Shares Outstanding (mn)	196.70

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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- 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.
- 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.
- 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.
- 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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