National Petrochemical Co. (Petrochem)

Result Flash Note 3Q-2017 | **November 2017**

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PETROCHEM: 3Q2017 earnings came slightly above our estimates due to lower than expected non-controlling interest and zakat & income tax. However, revenues were below expectation due to lower than expected operating rate after the impact of plant shutdown for 14 days during 2Q2017. Polymers plant' operating rate declined to an average of 80.3% in 3Q2017 from 83.7% in 2Q2017. Weak margins as a result of lower benefit expected from spreads across main products during 3Q2017. "Overweight" recommendation reiterated with lower TP of SAR 21.80/share.

- National Petrochemical company (Petrochem) 3Q2017 earnings came slightly above our expectation of SAR 189.5mn, and exceeding market consensus profits estimates of SAR 172.70mn. Petrochem posted net income of SAR 196.9mn; (EPS; SAR 0.41); indicating an increase of 2.8%YoY and 48.8%QoQ. The YoY growth was mainly associated with i) an increase in volumetric sales ii) higher average sales prices iii) lower selling and distribution costs and financing costs, despite other income being lower, and higher production costs. Whereas the strong QoQ earnings was ascribed to the unplanned shutdown at Petrochem project (Saudi Polymers Company) for two weeks during May 2017, due to a sudden outage of nitrogen supply to the Jubail area. The deviation of 3Q2017 earnings with our estimates is mainly ascribed to i) lower than expected non-controlling interest of SAR 104.1mn, as compared to AJC estimate of SAR 115.7mn. ii) lower than expected zakat & income tax of SAR 59.5mn, as compared to AJC estimate of SAR 63.4mn. Despite weaker than expected operating rate and sales, we believe that plant shutdown would have a positive impact going forward, due to the usual slowdown in production ramping up after maintenance.
- The company's sales revenue stood at SAR 1,755mn, below AJC estimates of SAR 1,790mn due to higher than expected impact of plant shutdown during 2Q2017. We expect that the plant was running at a utilization rate of around 80.3%, as compared to 83.7% in 2Q2017 and 76.9% in 3Q2016; however, the company's operating rate is likely to improve toward an average operating rate of 85% in the coming quarters. In addition to the shutdown in 2Q2017, the company completed the main scheduled maintenance for polymers unit during 4Q2016 (60 days), which would have a positive impact on the overall performance and would further improve the operating rate in FY2018 and onwards. During the quarter, average selling prices of PP increased by 6.7%QoQ and 6.9%YoY. Polystyrene increased by 8.4%QoQ and 16.1%YoY. Average ethylene derivatives increased by 0.2%QoQ, but declined 1.5%YoY.
- Gross profit stood at SAR 552mn; depicting a fall of 1.1%YoY, below AJC estimate of SAR 573.5mn due to lower than expected sales. Gross margin stood at 31.46% in 3Q2017 vs. our estimates of 32.0% and 34.9% in 3Q2016. This, we believe is due to lower YoY product spreads. In 3Q2017, Naphtha average prices (Benchmark for feedstock cost) increased by 19.4%YoY to USD 464.1/ton, in line with the increase in crude oil prices, whereas most of polymer and other Petchem product prices increased less than the feedstock prices. Thus, higher increase in feedstock price compared to the final product prices has resulted in PP-Naphtha spreads to shrink in YoY basis. PP-Naphtha spread contracted by 16.0%YoY to USD 605/ton from USD 720/ton in 3Q2016. Therefore, we believe that lower margins of Propane derivatives were partly offset by higher margin of ethane downstream products that represents almost 40% of the company's feedstock. Operating profit stood at SAR 403.8mn, depicting an increase of 0.3%YoY and 53.1%QoQ, where the company witnessed slight decline in OPEX (SG & A) to record SAR 148.2mn as compared to SAR 157.1mn in 2Q2017 and SAR 155.7 in 3Q2016.

AJC View: Despite the weaker than expected sales performance in 9M-2017 due to non-recurring impacts, we believe that the shutdown in FY2017 would have a positive impact on the overall performance and would further improve the operating rate in FY2018 and onwards. Polymers plant's operating rate is expected to rise to 85% in the coming quarter, as compared to 80.3% in 3Q2017. On the other hand, new feedstock prices will be gradually applied by 3Q2018. Grace period on Methane will end in Nov 2018, whereas Ethane and Propane will end in Aug/Sep 2019. National Petrochemical Co. (Petrochem) is expected to post SAR 706.0mn in net income (1.47 EPS) for FY2017, indicating an increase of 77.6%YoY for the year. We remain '**Overweight**' on the stock with a revised TP of SAR 21.80/share; indicating a potential upside of 20.5% over current market price of SAR 18.08/share. The company is trading at a forward PE and P/B of 12.3x and 1.3x respectively based on our FY2017 earnings forecast. We expect the company to maintain its low dividend payment at SAR 0.5 DPS (2.7% D/Y) in 2017, owing to its SAR 10.3bn long term debt.

Results Summary

SARmn (unless specified)	Q3-2016	Q2-2017	Q3-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	1,601	1,754	1,755	9.6%	0.1%	-1.9%
Gross Profit	558.3	420.8	552	-1.1%	31.2%	-3.8%
Gross Margin	*34.88%*	*24.0%*	*31.46%*	-	-	-
EBIT	402.6	263.7	403.8	0.3%	53.1%	-3.4%
Net Profit	191.6	132.3	196.9	2.8%	48.8%	3.9%
EPS	**0.40**	**0.28**	**0.41**	-	-	-

Source: Company reports, Aljazira Capital

Recommendation	**'Overweight'**
Current Price* (SAR)	18.08
Target Price (SAR)	**21.80**
Upside / (Downside)	**20.5%**

Source: Tadawul *prices as of 31st of October 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	7,304	6,067	7,047
Growth %	-7.1%	-16.9%	16.2%
Net Income	906	397	706
Growth %	17.0%	-56.2%	77.6%
EPS	1.89	0.83	1.47

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	34.0%	26.5%	29.4%
Net Margin	12.4%	6.6%	10.0%
P/E	8.85x	25.21x	12.3X
P/B	1.48x	1.53x	1.30x
EV/EBITDA (x)	6.09x	8.98x	6.86x
Dividend Yield	0.0%	2.4%	2.7%

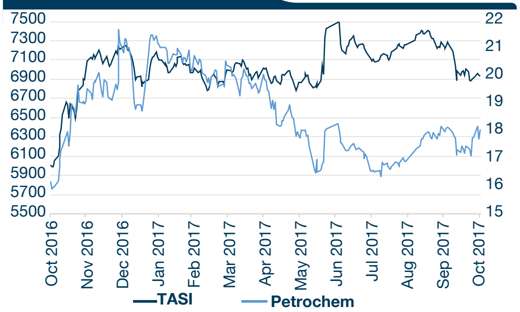
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	8.67
YTD %	- 14.88%
52 Week (High)	22.80
52 Week (Low)	15.80
Shares Outstanding (mn)	480.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

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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