FALCOM فالكم

Advanced Petrochemical Company

Materials| Advanced| 2330

INTELLIGENT INVESTMENT IDEAS

1Q 2018 Results Update

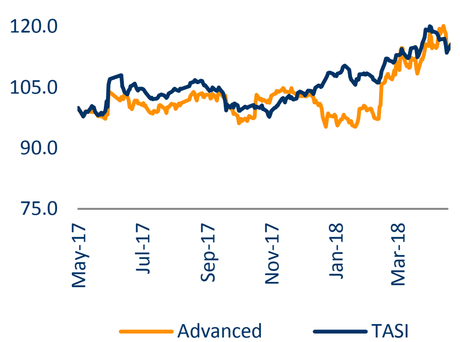
May 25, 2018

Recommendation	**Overweight**
Previous Recommendation	Overweight
Current Price (SAR)	51.3
Target Price (SAR)	56.9
Upside/Downside (%)	11.0%

As of May 24th 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	10.1
52 Wk High (SAR)	54.0
52 Wk Low (SAR)	41.9
Total Outstanding shares (in mn)	197
Free Float (%)	93.2%

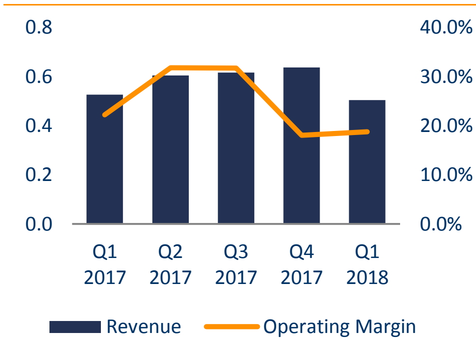
Advanced vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	-2.4%	1.1%
6m	12.0%	(4.9%)
12m	15.4%	(0.5%)

Major Shareholders (%)	
Poly Propylene National Company	7.95%
General Organization for Social Insurance	6.37%

Quarterly Sales (SAR bn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 24th May 2018

Weak Sales Volume and Higher Feedstock Costs Affected 1Q18 Earnings

The Q1 2018 net profit of Advanced Petrochemical (Advanced) declined 21.6% YoY to SAR 97.6mn (below consensus estimates) due to a reduction in sales volume resulting from the scheduled maintenance of production facilities in March 2018. Higher feedstock prices and weaker earnings equity investment in SK Advanced Co. Ltd. further affected margins, which declined 4.3% YoY to 19.4% in Q1 2018. Although polypropylene (PP) prices rose 13.7% YoY, they failed to offset the significant increase in propane (+16.4% YoY) and outsourced propylene prices (+21.5% YoY), thus narrowing the spread.

However, we are still optimistic about the company's valuation, given its strong fundamentals and operational expertise. We expect the demand to increase as specified by the Chemical Economics Handbook (HIS), which states that demand for PP will increase 25% by 2022 from current levels, driven by economic growth in China and India. Advanced, which produces PP as its single end product, will benefit from this trend. Advanced's high utilization rate (> 100%) historically indicates the company will be able to meet the increased demand once it resumes operation. In addition, a high dividend yield and strong free cash flows make the company a good bet, thus reiterating our positive view on the stock.

- Advanced's top line decreased (-4.3% YoY, -21.0% QoQ) led by a reduction in sales quantities (-15.8% YoY, -26.1% QoQ) resulting from a scheduled maintenance of production facilities in March 2018, despite the increase in Polypropylene prices (+13.7% YoY, +7.0% QoQ).
- Gross profit fell 16.8% YoY and 22.0% QoQ to SAR 119.1mn due to higher feedstock prices. Prices of propane and propylene rose 16.4% YoY and 21.5% YoY, respectively. Consequently, operating margins fell to 23.6% in Q1 2018 (Q4 2017: 24.0%) from 27.2% in Q1 2017.
- Operating profit declined to SAR 94.7mn (-19.1% YoY, -17.8% QoQ) primarily due to a decline in sales, in addition to higher feedstock costs, even as SG&A costs during the quarter reduced on quarterly and annual basis. The operating margin, thus, fell to 18.8% in Q1 2018 from 22.2% in Q1 2017.
- Net profit for the period dropped 21.6% YoY and 6.0% QoQ to SAR 97.6mn, steered by weak sales volume. Furthermore, the share of profit from associates declined 33.4% YoY to SAR 10.2mn, fuelling the descent. Net profit margin declined 430bps YoY to 19.4% in Q1 2018 (Q4 2017: 16.3%)
- Despite depressed earnings, Advanced's cash flow from operating activities improved 12.8% YoY and 22.8% QoQ to SAR 245.7mn in Q1 2018 (Q1 2017: SAR 217.9mn) primarily due to decline in accounts receivables.
- After the shutdown in Q1 2018, which largely impacted earnings, we expect production rates to improve in the coming quarters. Moreover, given the northward direction of oil prices, we expect petrochemical prices to follow suit, while polypropylene and propylene spread to remain stable.

Valuation: We have revised our target price upward with a fair value of SAR 56.9 per share, considering expectations of improved earnings going forward. We have maintained our 'Overweight' rating on the stock.

	1Q'18	1Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	503.8	526.2	(4.3%)	2508.7	2384.5	5.2%
Gross Profit (SAR mn)	119.1	143.2	(16.8%)	802.8	738.1	8.8%
EBITDA (SAR mn)	46.0	69.3	(33.6%)	887.5	811.7	9.3%
Net Profit (SAR mn)	97.6	124.4	(21.6%)	700.9	631.1	11.1%
EPS basic (SAR)	0.5	0.6	(21.6%)	3.6	3.2	11.1%
Gross Margin (%)	23.6%	27.2%	(3.6%)	32.0%	31.0%	1.0%
EBITDA Margin (%)	9.1%	13.2%	(4.0%)	35.4%	34.0%	1.3%
Net Profit Margin (%)	19.4%	23.6%	(4.3%)	27.9%	26.5%	1.5%

Source: Company Financials, FALCOM Research

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by ≥ 10%.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by ≥ 10%.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company`s performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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