

# Advanced Petrochemical Co.

# Initiation of Coverage

## Recommendation **Overweight**

Fair Value (SAR) **52.75**

Price as of May 10, 2016 47.94

Expected Return 10.0%

### Company Data

Tadawul Symbol 2330.SE

52 Week High (SAR) 61.00

52 Week Low (SAR) 31.90

YTD Change 27.8%

3-Month Average Volume (Thousand Shares) 696

Market Cap. (SAR Million) 7,862

Market Cap. (USD Million) 2,097

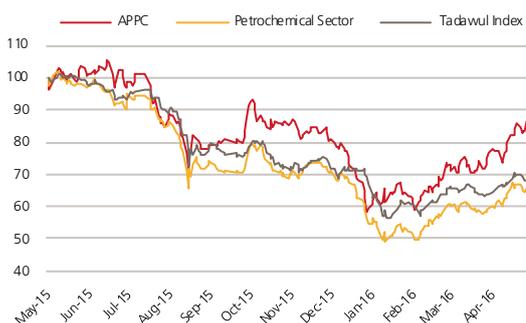
Outstanding Shares (Million Shares) 164

### Major Shareholders (> 5%)

National Polypropylene Limited 7.95%

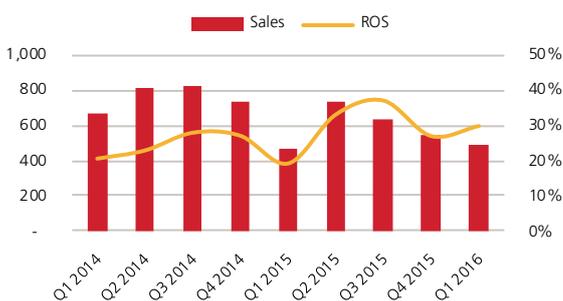
General Organization for Social Insurance 6.37%

52-week Stock Price Movement



Source: Tadawul

Quarterly Sales (SAR mn) and ROS



Source: Company Filings, Albilad Capital Research Estimates

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Advanced Petrochemical Company was founded as a closed joint stock company in Saudi Arabia on October 1, 2005. The company produce polypropylene with a capacity of 450 thousand metric tons per year. In 2015 Advanced produced 579 thousand metric tons rose 3.2% compared to 2014.

Advanced reported sales of SAR 488.04 million in the first quarter of 2016 surging 4.3% YoY driven by significant increase in sales volume resulting from periodic scheduled maintenance carried out in the comparable period of last year. Gross profit rose 41.6% culminating at SAR 157.33 million. Operating profit hiked 43.8% to SAR 144.29 million. Bottom line hit SAR 145.55 million growing by 62.4% YoY. Margins improved dramatically with gross margin of 32% compared to 24% in the same quarter of last year posting 30% operating profit compared to 21%, and profit margin of 30% compared to 19%. The improvement resulted from lower feedstock prices as the average price of propane in Q1 2016 reached USD 306 per ton compared to USD 458 per ton in Q1 2015.

Petrochemical sector witnessed major changes in the current period as petrochemical products prices tumbled in 2015 compared to 2014 in line with oil prices and global demand shrinkage for some petrochemical products. Recently, at the beginning of 2016 most of petrochemical product prices began to rebounded as a result of increases in oil price and demand improvement in some petrochemical products.

Polypropylene prices declines coincide with declines in oil prices and reached very low levels at the end of 2015. However, forecasts are indicating an improvement in polypropylene prices which rose by 25% from the beginning of 2016. Demand for polypropylene is expected to increase by 5.7% in the next coming years.

China and Asia pacific are the main company's customers which accounted for about 53% of company's total sales. Company seeks to promote sales through the long and short – term marketing agreements In addition to diversifying its investments through its investment in the joint project in the Republic of South Korea to produce 600 thousand metric tons per year of propylene which will have a positive impact in the coming years.

We estimate that sales, operating profit and net income will slump by 10.5% ,13.4% and 16.3% respectively in 2016 compared to 2015.

We initiate our coverage for the share with a fair value of SAR 52.75 per share using a discounted cash flow model, thus we assign an "overweight" recommendation.

FY - Ending December	2014A	2015A	2016E	2017F
EV/EBITDA	8.41	8.46	9.03	8.92
EV/Sales	2.62	3.39	3.68	3.48
P/E	8.78	11.03	13.17	11.97
Dividend Yield	6.3%	7.9%	6.3%	6.3%
P/BV	2.77	3.13	2.96	2.80
Current Ratio	3.77	1.60	2.56	3.35
Revenue Growth	9.0%	-21.7%	-10.5%	3.6%

Source: Company Filings, Albilad Capital Research Estimates

## Overview of petrochemical sector

The petrochemical sector has witnessed major changes in the recent period with prices of petrochemical products tumbling in 2015 compared to 2014 due to the decline in oil price and slowdown in global demand for some petrochemical products. At the beginning of 2016 most of petrochemical product prices began to rebounded as a result of increases in oil price and demand improvement for some petrochemical products such as polypropylene, polyethylene, and polyethylene styrene.

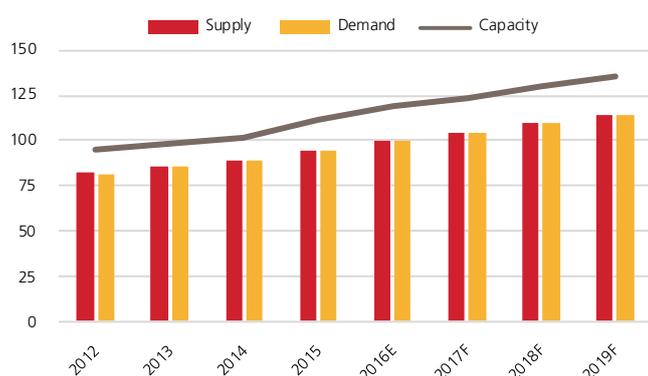
The following table shows changes in some of the prices of petrochemical products:

Commodity Prices (US\$/Ton)	Q1 2016	Q1 2015	YoY	Q4 2015	QoQ	YTD
Polypropylene (SE Asia)	902	1,115	(%19)	959	(%6)	%25
Polyethylene - High Density (SE Asia)	1,111	1,202	(%8)	1,145	(%3)	%12
Polyethylene - Low Density (SE Asia)	1,129	1,218	(%7)	1,146	(%1)	%14
Polystyrene (SE Asia)	1,114	1,173	(%5)	1,063	%5	%17

## Global supply and demand for propylene

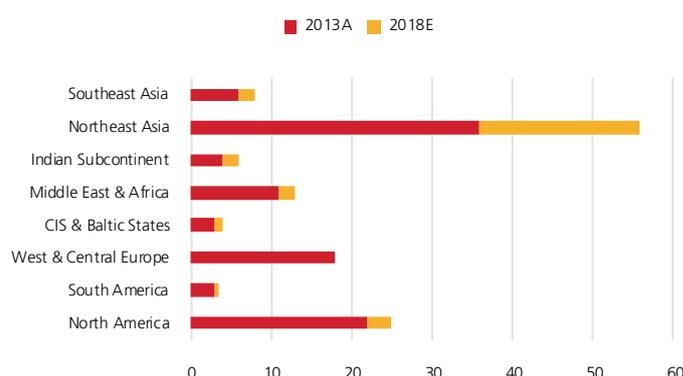
Propylene is the second important raw material for the production of other organic chemicals. In 2014 about 64% of total propylene produced for chemical uses worldwide went into the manufacture of polypropylene resins. Around 7% of propylene is consumed in the production of propylene oxide and about 6% in acrylonitrile. China, the United States and Western Europe are the major propylene market, which together accounted for around 55% of global consumption in 2014. By reason of new propylene capacity scheduled to be brought on stream during 2014 – 2019 driven primarily by developments in the polypropylene industry, the United States and the Chinese market will show significant growth and account for about 76% of the total increase in propylene demand. The market size is projected to increase 28% in 2019 compared to 2014 to 114 million metric tons about 67% of total propylene produced for chemical use worldwide will be in the manufacture of polypropylene. The supply of polypropylene is expected to grow by 4.8% from 2014-2019. Global consumption of propylene is projected to increase at an average rate of 4.6% annually over the next five years.

World Propylene Supply and Demand (Million Metric ton)



Source: Bloomberg

Propylene Capacity Additions (Million Metric Ton)

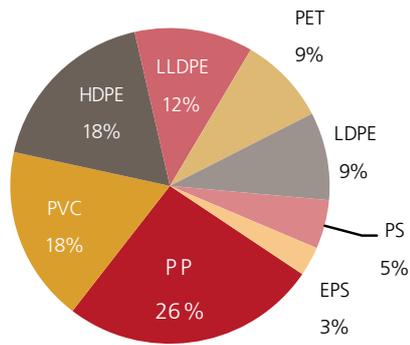


Source: HIS

## Global demand for Polypropylene

Polypropylene is used widely in the packaging industry because of its flexibility, light weight and high resistance to pressure and cracks and operating temperature, high resistance to most acids and alkalis In addition to availability at competitive prices. Accordingly polypropylene has become a substitute of a lot of minerals in the packaging industry, Polypropylene captured 26% of global demand of and 29% in Asia and the Pacific.

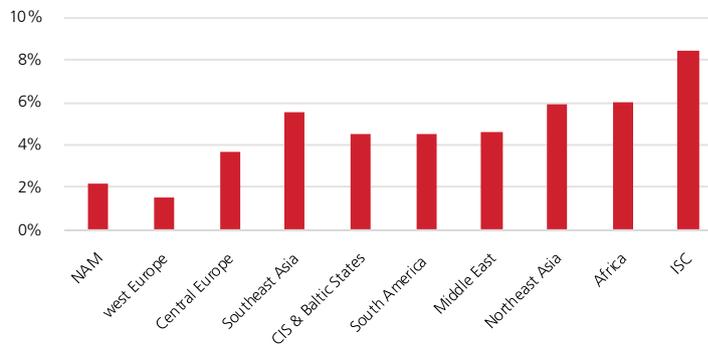
Polymers Demand by Product 2014



Source: IHS

Demand increases from end-use industries such as packaging, automotive and consumer products alongside technology improvement are pushing the polypropylene market to grow. Demand for polypropylene is expected to increase by 5.7% in the next five years.

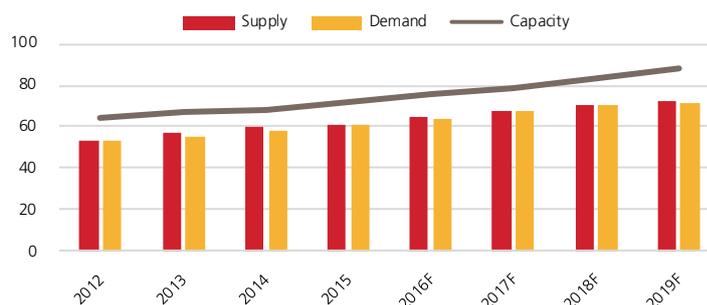
Polypropylene Domestic Demand Average Annual Growth Rate



Source: IHS

In 2014 Asia Pacific constituted a share of more than 50% in the global market for polypropylene. The demand for polypropylene is predicted to rise in China, Brazil, India and the Association of Southeast Asian Nations as a result of rising demand for food containers in addition to the increasing number of supermarkets. The market size is projected to increase 21% in 2019 compared to 2014 to 88 million metric tons.

World Polypropylene Production and Consumption (Million Metric Ton)



Source: Bloomberg

## About the company

Advanced Petrochemical Company was founded as a closed joint stock company in Saudi Arabia on October 1, 2005. polypropylene is the main company's product and propane is the main feedstock supplied by Aramco at 20% discount from Japan price. The company produce propylene with a capacity of 455 thousand metric tons per year to produce polypropylene with a capacity of 450 thousand metric tons per year. In 2015 Advanced produced 579 thousand metric tons rose 3.2% compared to 2014.

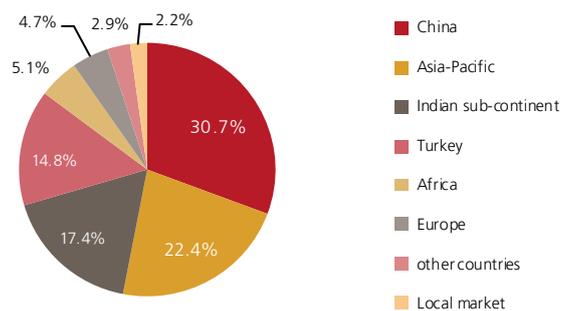
## Subsidiaries

**Advanced Renewable Energy Company** is a mixed limited liability company registered in Jubail, Kingdom of Saudi Arabia and was founded February 2012. It produces polysilicon and its derivatives, which include photovoltaic cells and photovoltaic panels.

**Advanced Global Investment Company** is a mixed limited liability company registered in Jubail, Kingdom of Saudi Arabia and was founded on August 2012. the company invests in industrial projects, including projects related to petrochemical and chemical industries inside and outside Saudi Arabia.

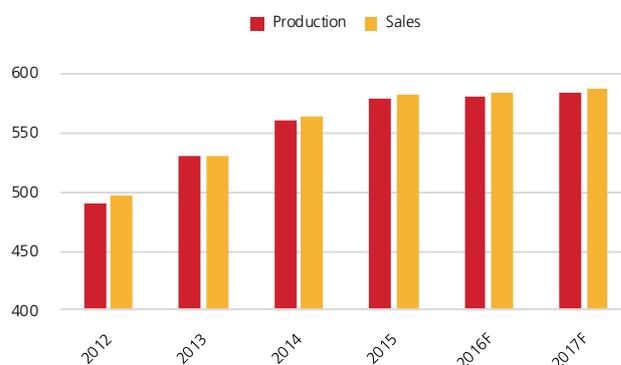
In 2014 Advanced Global Investment Company made a 100% investment in Advanced Global Holding Limited, a limited liability company incorporated in Luxembourg. In September 2014 Advanced Global Investment Company made a 35% stake in SK advanced Co which is a limited liability company registered in the Republic of South Korea in September 2014 as a joint venture with SK Gas Co., Ltd to set up a factory for the production of propylene.

Sales by geographic region



Source: Company Filings

Production and Sales (in Thousand Ton)



Source: Company Filings, Albilad Capital Estimates

## China and Asia Pacific are the main customers

The company seeks to be in better markets that has better returns. Therefore the company reduces its share in China to 30.68% in 2015 compared to 33% in 2014 due to the dramatic decline in polypropylene prices and raise its share in Europe and Turkey from 2.11% and 14.04% to 4.65 and 14.80% respectively, in addition, company increased its share in the Indian Sub- continent in 2014 from 14.46% to 17.41% in 2015.

## Polypropylene prices are improving

Polypropylene prices have witnessed declines coinciding with declines in oil prices and reached very low levels at the end of 2015. However, our forecasts are indicating an improvement in polypropylene prices which rose by 25% from the beginning of 2016 which in turn will help in earnings growth the future. The production of Polypropylene rose by 3.2% at 579 thousand metric tons compared to 561 thousand metric tons in 2014 despite the downtime of the scheduled maintenance for 22 days which shows the improvement in the operational efficiency and the company's ability to reduce expenses and costs despite the decline in product prices.

## A joint venture to produce propylene in Korea

A joint venture between Advanced Petrochemical Co. and SK Korean Gas Company and the Kuwaiti Petrochemical Industries by 30% and 45% and 25%, respectively in order to set up a factory to produce propylene in Republic of South Korea. Experimental operation of the factory production of propylene began in the first quarter of 2016. The production capacity of factory is 600 thousand metric tons per year and factory will be subject to the performance test to verify the reliability and sustainability of commercial operation of the factory which may take from one to three months. It is expected that financial impact of this investment will be in the second quarter after the commercial operation of the factory start.

## Marketing agreements

In 2015 Advanced Petrochemical Company signed a long-term marketing agreements with Mitsubishi Corporation of Japan (150 thousand metric tons per year) and Domo Investment Group of Belgium (100 thousand metric tons per year) to sell the company's products for 10 years start from 2019. The company also signed a short-term marketing agreements for four years with Mitsubishi Corporation of Japan and Domo Investment Group of Belgium to sell additional polypropylene by 50 thousand metric tons per annum each. Additional quantities of polypropylene will be produced from propylene that will be purchased from a local source and the financial impact will be positive in the coming years.

Polypropylene Price (USD/Ton)



Source: Bloomberg

Propane price (USD/Ton)



Source: Bloomberg

Brent Price (USD/Barrel)



Source: Bloomberg

## A look at the expected performance in the coming years

### Sales

We anticipate an decline in sales in 2016 by 10.5% compared to 2015 due to the decreases in polypropylene prices. Sales are expected to grow by 2.6% from 2016 to 2018 in light of polypropylene price improvement and a great demand for company's products in addition to short and long term marketing agreements which support sales and presence in better markets such as European and Turkish markets.

### Operating profit

Operating profit is expected to decrease by 13.4% in 2016 compared to 2015 as result of lower sales, higher general and administrative expenses and despite the reduced production cost.

Operating profit is expected to grow by 1.2% from 2016 to 2018 as result of the improvement in polypropylene prices and lower feedstock prices as well as the improvement in operational efficiency and the company's ability to control expenses and operational costs, which in turn will support the growth in operating profit.

### Net Income

Our estimates show a decline in net income in 2016 by 16.3% compared to 2015 due to decline in polypropylene prices and the increases in operating expenses despite the lower feedstock price.

Net income expected to grow by 8.2% from 2016 to 2018 as result of recovery of polypropylene prices and improved demand for company's products in addition to the expected profit from the investment in the joint venture in Republic of South Korea.

Our forecasts indicate that the company is able to pay a dividend regularly over the coming years due to its strong financial position and solid cash flows.

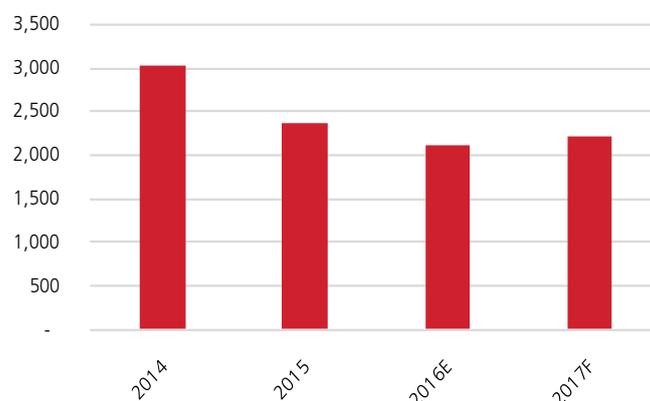
### Risk

- Fluctuations and changes in the prices of raw materials and energy prices.
- company sells one product in competitive markets, which makes them vulnerable to competitive risks.
- slowing demand growth in the main markets.

### Valuation and recommendation.

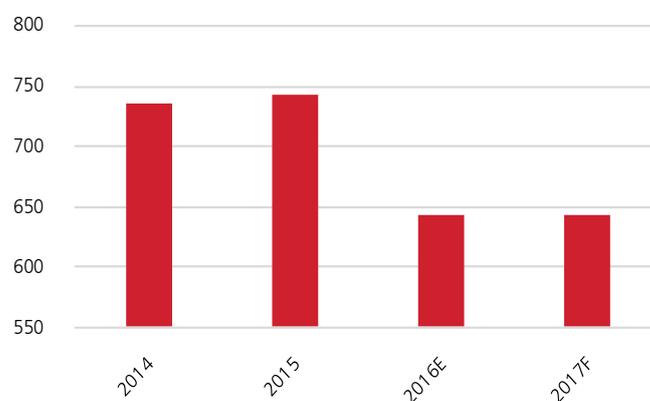
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Sales (Million SAR)



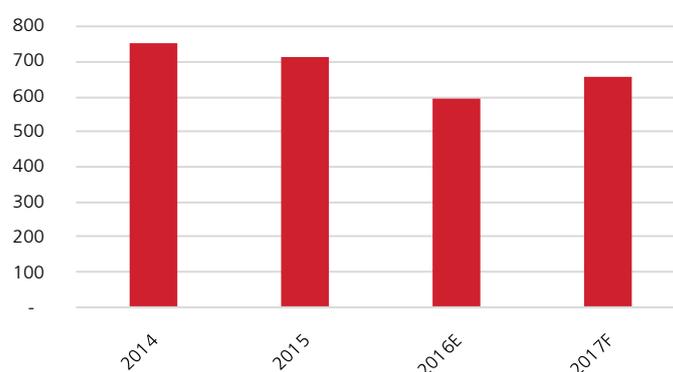
Source: Company Filings, Albilad Capital Research Estimates

Operating Income (Million SAR)



Source: Company Filings, Albilad Capital Research Estimates

Net Income (Million SAR)



Source: Company Filings, Albilad Capital Research Estimates

Income Statement (SAR mn)	2013A	2014A	2015A	2016E	2017F
<b>Total Revenues</b>	2,786	3,036	2,377	2,127	2,204
COGS	1,967	2,047	1,383	1,206	1,288
SG&A	45	45	41	54	57
<b>EBITDA</b>	<b>774</b>	<b>945</b>	<b>954</b>	<b>867</b>	<b>859</b>
EBITDA Margin	28%	31%	40%	41%	39%
Depreciation and amortization	209	209	211	224	217
<b>EBIT</b>	<b>566</b>	<b>735</b>	<b>743</b>	<b>643</b>	<b>642</b>
Net interest income	15	13	18	20	20
Others (Net)	6	2	(5)	2	2
<b>Net Income</b>	<b>557</b>	<b>751</b>	<b>713</b>	<b>597</b>	<b>657</b>
ROS	20%	25%	30%	28%	30%
<b>EPS</b>	<b>3.40</b>	<b>4.58</b>	<b>4.35</b>	<b>3.64</b>	<b>4.00</b>
<b>Balance Sheet (SAR mn)</b>					
	<b>2013A</b>	<b>2014A</b>	<b>2015A</b>	<b>2016E</b>	<b>2017F</b>
Cash and Marketable securities	544	884	85	279	406
Accounts Receivables	266	198	222	234	242
Inventory	145	123	124	121	129
Others	17	29	22	20	21
<b>Total ST Assets</b>	<b>972</b>	<b>1,234</b>	<b>453</b>	<b>653</b>	<b>798</b>
Net Fixed Assets	2,163	2,170	2,179	2,105	2,045
Intangible assets	57	18	5	5	5
Others	29	28	26	26	26
<b>Total LT Assets</b>	<b>2,251</b>	<b>2,594</b>	<b>3,433</b>	<b>3,328</b>	<b>3,321</b>
<b>Total Assets</b>	<b>3,223</b>	<b>3,828</b>	<b>3,886</b>	<b>3,981</b>	<b>4,119</b>
Accounts Payable	357	271	218	190	203
Others	129	56	65	65	35
<b>Total ST Liabilities</b>	<b>485</b>	<b>327</b>	<b>283</b>	<b>255</b>	<b>238</b>
Total Long Term Debt	455	1,088	1,048	1,008	998
Other Noncurrent Liabilities	28	36	46	58	73
<b>Equity</b>	<b>2,254</b>	<b>2,377</b>	<b>2,509</b>	<b>2,660</b>	<b>2,810</b>
<b>Total Liabilities and Equity</b>	<b>3,223</b>	<b>3,828</b>	<b>3,886</b>	<b>3,981</b>	<b>4,119</b>

Source: Company Filings, Albilad Capital Research Estimates

## Albilad Capital Rating Methodology

Al-Bilad Capital 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  $\geq 10\%$ .

**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  $\geq 10\%$ .

**To be Revised:** No target price had been set for one or more of the following reasons: waiting for more analysis, waiting for detailed financials, waiting for more data to be updated, major change in company's performance, change in market conditions or any other reason from Albilad Capital Research.

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