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Low season hurts 4Q14 spread

- **Slow demand in 4Q14 could squeeze margin**
- **More production cuts for PET/PTA to continue**
- **Concerns about PTTGC's cost eased, BUY maintained on cheap valuation**

2Q14 recap: strong IVL profit lifted sector's. Core profit improved strongly by 55.4% QoQ and 36.7% YoY in 2Q14, driven mainly by IVL's much lower inventory loss vs. 1Q14 and 2Q13. The company also booked a Bt1.7bn gain on a bargain purchase, though this was for the most part eaten up by Bt1.3bn impairment on its business in Europe. Profit for PTTGC was also weaker as it had to book impairment loss from business restructuring of its JV in France.

3Q14F: inventory losses could bite into profit. We expect a lower profit for the sector QoQ and YoY due to inventory losses for PTTGC and IVL, although this will be offset by higher utilization rate for PTTGC and profit contribution from newly acquired assets for IVL plus more gains from its bargain purchase.

Ethylene at record high but demand could slow further. QTD average product prices for olefins chain stayed good in 3Q14, rising 0.2-2.6% QoQ, especially ethylene, which increased to a record high of US\$1,495/t. Weaker naphtha price sent product spread up 4.3-10.2% QoQ. Unfortunately, non-integrated producers such as TPIPL continued to suffer from higher ethylene price, which pushed LDPE-ethylene spread down 17.5% QoQ. Of note is the bearish climate for the regional market overall, possibly worsening in the seasonally low fourth quarter. The cooling economy in China will continue to play the leading role in reducing regional demand for petrochemical products – bringing the specter of a narrowed margin in 4Q14.

More PX capacity to come on stream in 2015. YTD average PX price for 2014 has been better than expected after recovering 8.4% QoQ in 3Q14 (QTD) from the weak 2Q14. The additions to supply in the region expected in 2H14 have already entered the market but ~6.1mtpa more will come in 2015. The resultant excess capacity plus lower demand from PTA producers is likely to prolong the PX down-cycle to at least 2015-16. Lower oil prices will also keep buyers from building inventory on fears of inventory losses at quarter's end.

Weakening PET/polyester demand to force more production cuts. Demand for the PET/polyester chain will continue to weaken upon slower demand in Europe and China and aggravated by the five-year low for cotton price. QTD average integrated PET/PTA spread slid 2.2% QoQ in 3Q14 (QTD) to US\$264/t on higher PX and MEG costs. This led PTA producers, mainly in China, to cut back on utilization in an effort to improve margin. Note that PTA utilization in key market China fell to only 53% recently from 80% in Jan, according to ICIS. Another industry expert, PCI, expects PTA overcapacity to dominate market dynamics for the next three years.

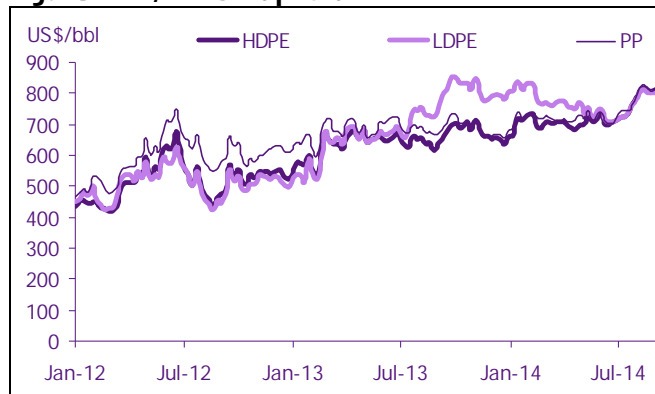
Concerns about PTTGC's feedstock cost largely priced in, still the top pick. The petrochemical sector underperformed the overall market in 3Q14 (QTD), mainly due to continuing concerns about the effect of energy price reform on the price of LPG feedstock for PTTGC. Again, we believe the market is too pessimistic about the impact on PTTGC's profitability. Hence, the damage that could be done by a higher LPG price is largely priced in, in our view. IVL's valuation looks stretched although a new acquisition cycle could still be a near term share price catalyst.

Valuation summary

	Rating	Price (Bt/Sh)	Target (Bt/Sh)	ETR (%)	P/E (x)			EPS growth (%)			P/BV (x)			ROE (%)			Div. Yield (%)			EV/EBITDA (x)		
					13A	14F	15F	13A	14F	15F	13A	14F	15F	13A	14F	15F	13A	14F	15F	13A	14F	15F
IVL	Neutral	25.50	27.00	7.0	n.m.	31.7	25.8	(1,897)	n.m.	23.1	2.0	1.9	1.8	(1.1)	6.2	7.3	0.4	1.1	1.4	16.8	11.1	9.7
PTTGC	Buy	61.50	85.00	43.7	8.2	9.0	7.3	7.0	(8.8)	23.7	1.2	1.1	1.0	13.9	12.1	13.8	5.5	5.5	5.5	6.0	6.5	5.2
Average					8.2	20.4	16.5	(945)	(8.8)	23.4	1.6	1.5	1.4	6.4	9.2	10.6	3.0	3.3	3.5	11.4	8.8	7.4

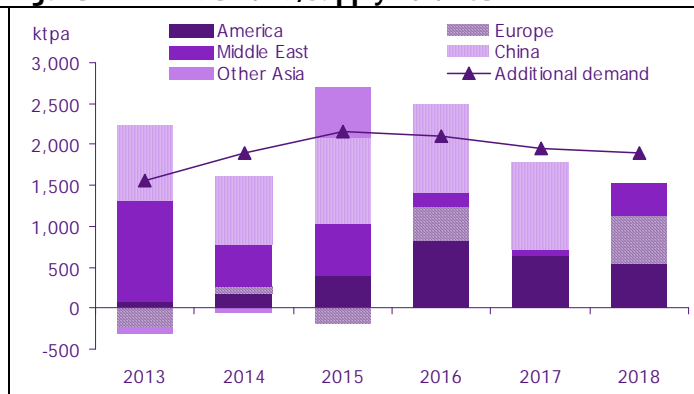
Source: SCBS Investment Research

Figure 1: PE/PP vs. naphtha



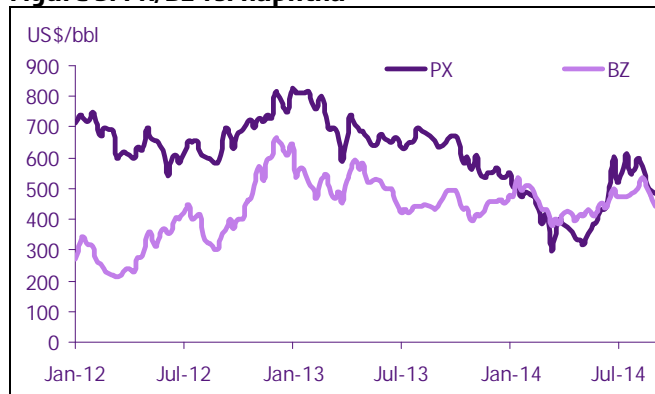
Source: Datastream, SCBS Investment Research

Figure 2: HDPE demand/supply balance



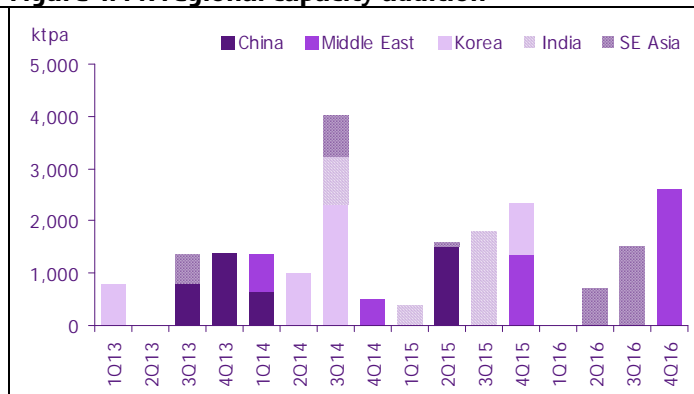
Source: CMAI (October 2013), PTTGC, SCBS Investment Research

Figure 3: PX/BZ vs. naphtha



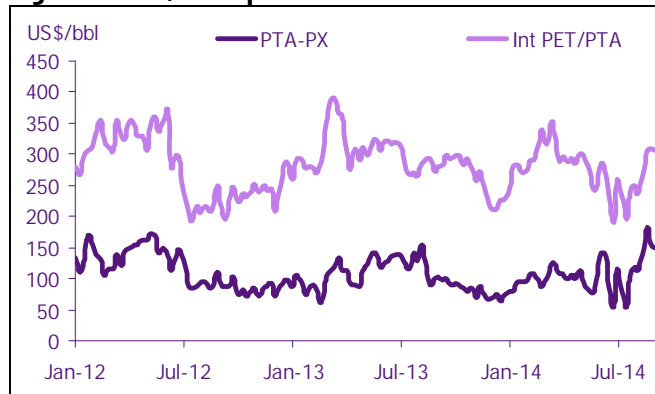
Source: Datastream, SCBS Investment Research

Figure 4: PX regional capacity addition



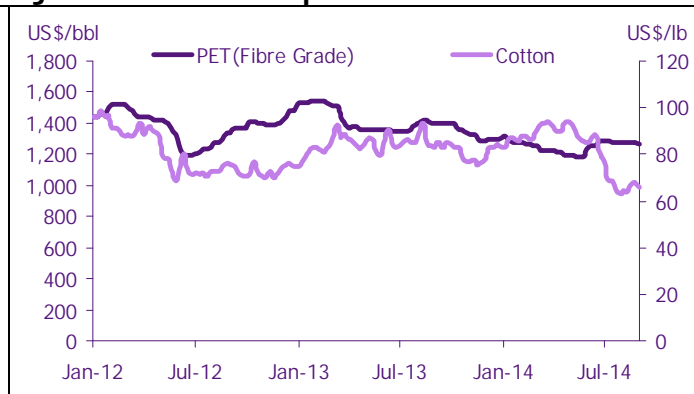
Source: ICIS, SCBS Investment Research

Figure 5: PET/PTA spread



Source: Datastream, SCBS Investment Research

Figure 6: PET vs. cotton prices



Source: Bloomberg Finance LP, SCBS Investment Research

Figure 7: Regional peer comparison

Company	P/E (x)			EPS Growth (%)			P/BV (x)			ROE (%)			Div. Yield (%)			EV/EBITDA (x)		
	14F	15F	16F	14F	15F	16F	14F	15F	16F	14F	15F	16F	14F	15F	16F	14F	15F	16F
Sinopec Shanghai Petrochem	29.5	21.7	21.3	(31.6)	36.2	1.7	2.3	2.1	2.0	5.7	8.6	9.6	0.1	0.9	1.4	21.2	10.1	9.9
China Petroleum & Chemical	8.6	7.9	7.9	8.6	8.4	(0.1)	1.0	0.9	0.9	11.8	11.5	11.6	4.6	4.9	4.8	5.0	4.5	4.2
PetroChina Co Ltd	10.3	9.8	9.4	9.0	5.8	3.7	1.2	1.1	1.0	11.5	11.6	10.9	4.2	4.5	4.6	5.2	4.8	4.6
Reliance Industries Ltd	11.8	10.5	8.8	10.7	12.6	19.5	1.4	1.2	1.1	12.1	12.2	13.3	1.1	1.2	1.4	9.5	8.2	6.6
Far Eastern New Century Corp	16.1	14.9	16.1	28.0	8.0	(7.5)	1.0	1.0	0.8	5.5	5.9	5.0	4.4	4.8	5.8	10.1	9.9	9.5
Formosa Chemicals & Fibre Corp	19.1	18.3	16.1	(13.8)	4.4	13.7	1.5	1.5	1.4	7.2	7.6	7.9	3.3	3.4	3.8	15.7	15.9	13.7
Formosa Plastics Corp	18.5	16.9	15.4	19.9	9.0	10.0	1.7	1.6	1.5	9.7	10.1	10.6	3.4	3.8	4.1	29.3	25.5	24.1
Nan Ya Plastics Corp	16.4	16.6	14.7	29.1	(1.0)	12.9	1.8	1.8	1.7	11.3	10.7	11.1	3.9	4.0	4.3	18.4	17.5	15.9
Formosa Petrochemical Corp	23.6	22.6	21.1	9.6	4.5	6.9	2.8	2.8	2.7	12.2	12.6	12.3	3.6	3.8	3.8	16.0	15.0	16.0
Petronas Chemicals Group Bhd	14.7	13.4	12.3	9.0	9.2	9.7	2.1	1.9	1.8	14.8	15.1	14.8	3.4	3.8	4.0	7.5	7.0	6.6
Indorama Ventures PCL	28.3	19.6	16.5	221.8	44.4	19.0	1.9	1.8	1.7	6.9	8.9	10.7	1.2	1.7	2.1	12.0	10.4	9.5
IRPC PCL	48.7	21.6	14.2	77.5	125.4	52.5	0.9	0.9	0.9	2.1	4.5	6.3	2.3	2.5	3.0	14.7	11.3	8.8
PTT Global Chemical PCL	9.0	8.1	7.7	(7.1)	10.4	5.6	1.1	1.0	0.9	12.7	13.1	12.7	5.0	5.4	5.7	6.6	6.1	5.9
Vinythai PCL	32.3	24.0	27.6	105.9	34.3	(12.8)	0.9	n.a	n.a	2.5	3.3	3.3	2.7	1.1	1.8	12.0	14.8	12.1
Thai Plastic & Chemical PCL	9.1	9.3	n.m.	9.1	(2.5)	n.m.	1.4	n.a	n.a	15.7	13.9	n.m.	n.a	7.0	n.a	6.1	6.5	n.a.
Average	19.7	15.7	14.9	32.4	20.6	9.6	1.5	1.5	1.4	9.4	10.0	10.0	3.1	3.5	3.6	12.6	11.2	10.5

Note: The numbers are based on consensus forecast

Source: Bloomberg Finance LP, SCBS Investment Research

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