Advanced Petrochemicals Co

Petrochemicals – Industrial
APPC AB: Saudi Arabia
11 January 2021

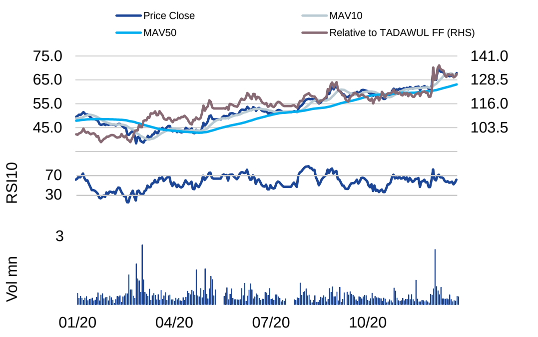
US$3.91291bn	9%	US$5.56mn
Market cap	Free float	Avg. daily volume

Target price	75.00	+11% over current
Current price	67.80	as at 10/1/2021

Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

(SARmn)	2019	2020	2021E
Revenue	2,595	2,231	2,872
Y-o-Y	-5.6%	-14.0%	28.7%
Gross profit	899	729	1,061
Gross margin	34.7%	32.7%	36.9%
Net profit	759	596	949
Y-o-Y	5.9%	-21.5%	57.9%
Net margin	29.3%	26.7%	33.0%
EPS (SAR)	3.5	2.8	4.4
DPS (SAR)	2.6	2.6	3.0
Payout ratio	73.3%	94.4%	69.2%
P/E (Curr)	19.3x	24.6x	15.5x
P/E (Target)	21.4x	27.2x	17.1x

Source: Company data, Al Rajhi Capital

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Maintain OW at SAR75/share

APPC announced its Q4 2020 results. While revenues came in line with our estimate, costs were slightly higher, resulting in a 5% miss at the gross profit level and an 8% miss at the operating level. However, key metrics are broadly in-line with our expectations. PP prices rose ~12% q-o-q and 7% y-o-y in Q4 2020 with the current spot price reaching US$1,240/t, nearing its 2018 levels, indicating recovery post pandemic impact. While Propane price jumped to US$550/t (+31% over Q4 2020 average price) for Jan 2021 on seasonality factors, it is still below the Jan 2020 levels, indicating better product spreads for the company this year. Accordingly, we expect a healthy earnings growth in 2021, despite around 25 days' shutdown in Q1 2021e. Overall, the expansion story is intact for the company and we continue to have an OW rating on the company with an upside of ~11%. We value the company using a mix of dividend yield (existing plant) and DCF (for the expansion) - all unchanged.

Figure 1 APPC Q4 2020 results

(SAR mn)	Q4 2020	Q4 2019	Y-o-Y	Q3 2020	Q-o-Q	ARC est	vs ARC
Revenue	**632**	**618**	**2.3%**	**545**	**16.1%**	**618**	**2.3%**
Gross profit	217	214	1.4%	172	26.1%	227	-4.5%
Gross margin	34.3%	34.6%		31.5%		36.7%	
Operating profit	174	171	1.7%	140	24.1%	188	-7.6%
Operating margin	27.5%	27.7%		25.7%		30.5%	
Net profit	**180**	**192**	-6.1%	**156**	15.2%	**207**	-13.0%
Net margin	28.5%	31.0%		28.7%		33.5%	

Source: Company data, Al Rajhi Capital.

Q4 results: Overall, sales volumes were down 2.1% y-o-y in 2020 as expected. Higher-than-expected COGS and SG&A costs due to seasonality factors are likely to have pushed gross and operating profits slightly below our estimates. Further, equity income from SK Advanced at SAR23.7mn vs. our expectation of SAR25.9mn led to a net income of SAR180mn (+15% q-o-q), missing our (SAR207mn) as well as consensus (SAR197mn) estimates.

Likely shutdown in Q1 2021. On Q3 2020 earnings call, the management reconfirmed that, as per the business plan, there will be a scheduled shutdown of around 25 days at the Saudi plant in March 2021 for replacing catalysts. The planned capex would be SAR130mn. The last maintenance activity at the Saudi plant was for around 22 days in Q1 2018.

APPC's subsidiary inks off-take agreements for the sale of polypropylene products. APPC last month announced the signing of long-term off-take agreements by its 100% owned subsidiary AGIC for the sale of Polypropylene with three different companies, namely Vinmar International LLC of USA (250ktpa), Tricon Dry Chemicals LLC of USA (250ktpa), and Mitsubishi Corporation of Japan (120ktpa). With these agreements, the company has now secured around ~77% of PP production before its new PDH-PP plant starts commercial operation, which is likely in H2 2024. This agreement is valid till Dec 2028 (from the date of the commercial production). We believe that these agreements will provide strong revenue visibility for the company once the plant comes on stream.

APPC to add the IPA plant in the earlier announced PDH-PP project in Jubail. In Oct 2020, APPC announced the addition of the Isopropanol (IPA) plant with a production capacity of 70ktpa and an estimated cost of SAR300mn, in addition to already announced (in March 2020) the 843ktpa Propylene plant and 800ktpa PP plant (combined PDH-PP plants' investment: SAR6.75bn). Post the IPA plant addition, the project cost is now estimated at SAR7.05bn (SAR6.75bn expected earlier), which is likely to be financed by equity (25%) and borrowing (75%). Advanced JV will own an 85% equity stake while the remaining 15% will be owned by SK Gas. The project is estimated to start this year and likely to be completed in H2 2024. APPC has also signed 5.5 years of Murabaha facility worth SAR1.5bn with banks, which will be utilized to fund most of its growth capex including this project. We see the IPA plant addition as a positive development, given its range of usages (including hand sanitizers, medical applications, electronics industry, etc.). There could be an additional SAR2/sh incremental value from the IPA plant (not priced in), in our view.

Valuation and risks: We continue to remain positive on the company's medium to long-term growth prospects, due to i) strong utilization rates, ii) consistent operating performance, iii) FCF generation ability, iv) healthy balance sheet, and v) excellent management quality. The stock is currently trading at a P/E of 15.5x on our 2021E EPS, slightly above its 3-year historical average of 14.5x. We value the existing plants using a 5% historical dividend yield on DPS of SAR3 for 2021. To this, we add our estimated value of the new plant SAR15/sh (based on our NPV analysis) to arrive with a TP of SAR75/sh. We believe that the dividend yield based valuation approach is ideal to value the fundamentally strong dividend-paying companies like APPC amid the current market dynamics. The key upside trigger might be attributed to sustained improvement in spreads while further weakness in product spreads, a dividend cut, and/or any unplanned shutdown may act as the downside triggers.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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