

Advanced Petrochemical Co (APPC AB)

Target Price: SAR 50.9
Upside: 10.2%

Recommendation

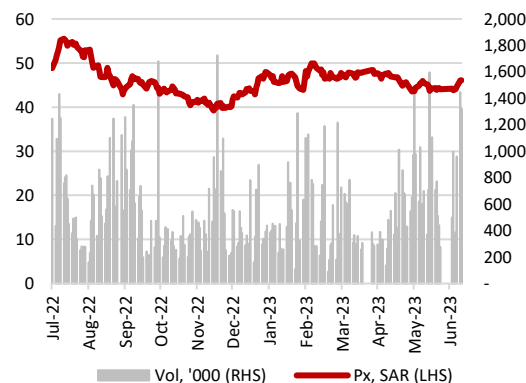
	Accumulate
Bloomberg Ticker	APPC AB
Current Market Price (SAR)	46.15
52wk High / Low (SAR)	56.200/38.450
12m Average Vol. ('000)	550.2
Mkt. Cap. (USD/SAR mn)	3,267/11,999
Shares Outstanding (mn)	260.00
Free Float (%)	88%
3m Avg Daily Turnover (SAR'000)	26,406.1
6m Avg Daily Turnover (SAR'000)	24,962.9
P/E'23e (x)	31.9 x
EV/EBITDA'23e (x)	19.1 x
Dividend Yield '23e (%)	4.6%

Price Performance:

1 month (%)	1.3%
3 month (%)	-2.2%
12 month (%)	-3.0%

Source: Bloomberg, values as of 10 July 2023

Price-Volume Performance



Source: Bloomberg

- **Polypropylene price surge drives revenue growth by 1Q-24.**
- **Propane-Polypropylene spreads to improve from 1Q-24 will bolster company's profitability.**
- **Robust cash flows generation with impressive cash conversion cycle and attractive dividends.**

We review our coverage of Advanced Petrochemical CO (APPC AB: Saudi Arabia) and update the stock to **Accumulate rating** with our **target price to SAR 50.9**. This upgrade is based on the expected improvement in polypropylene prices 1Q-24 which leaves an **upside of 10.2%** from the current levels. The stock is currently trading at a P/E of 30.6x based on our 2023 estimates, compared to its historical average 1-year forward P/E of 22.78x. The stock's resilient performance amid market volatility, projected revenue growth with improved spread, and robust cash flow generation.

Investment Thesis

APPC presents promising investment prospects due to its strong financial performance, improving margins and return ratios with healthy cash conversion and efficient debt management.

- Polypropylene prices are expected to rise steadily once the China market opens, leading to increased revenues for APPC and supporting the company's growth starting from 1Q-24.
- APPC is poised to experience a rebound in margins and return ratios, driven by improved spreads and effective cost management, which will bolster the company's profitability.
- Therefore, cash flow from operations will revive beyond 2023, supported by stable capex and an enhanced cash conversion cycle.
- Projected steady increase in dividend yield and a constant dividend payout ratio demonstrates its commitment to rewarding its shareholders. The company's effective debt management, evidenced by decreasing Debt/Equity and Net Debt/EBITDA ratios, further strengthens its financial stability.

Valuation and risks: Our valuation is based on a mix of DCF (80% weight), EV/EBITDA and P/E (10% weight each) based multiples. Key downside risks: Sudden fall in the prices of Polypropylene, economic slowdown, and unplanned shutdowns.

SAR mn	FY21	FY22	FY23e	FY24e	FY25e
Revenues	3,111	2,948	2,580	3,030	3,181
Gross profit margin	34.0%	18.2%	23.4%	28.1%	29.2%
Net income margin	26.1%	9.9%	14.3%	17.9%	19.1%
EBITDA margin	34.9%	20.8%	27.5%	29.3%	30.6%
ROE	22.8%	8.4%	12.0%	18.1%	19.7%
ROA	16.5%	4.1%	4.3%	6.0%	6.7%
P/E	15.6x	37.5x	31.9x	21.6x	19.4x
EV/EBITDA	18.4x	23.2x	19.1x	15.2x	13.9x
EV/Sales	6.4x	4.8x	5.2x	4.5x	4.3x
Dividend yield	4.4%	5.2%	4.6%	4.3%	4.1%

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Investment rationale

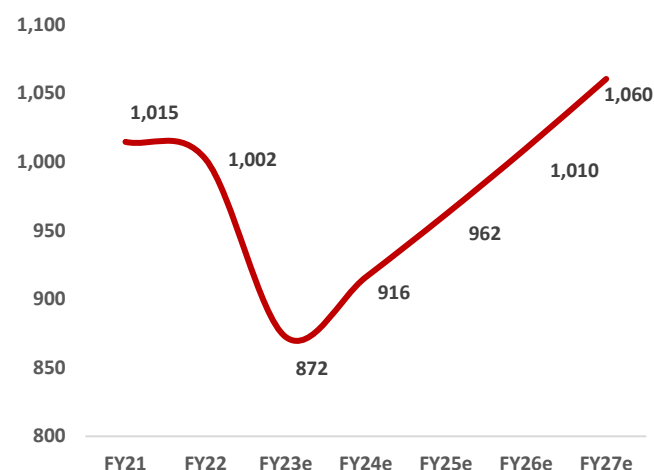
Revenue to grow as polypropylene prices stabilize and utilization improves

Advanced Petrochemical Co, a producer and distributor of propylene and polypropylene products, has been a strong performer in the polypropylene segment. The company maintained an impressive utilization rate of 130% until 2022, which we anticipate will improve to 140% from 2025 onwards. The company experienced a standout year in 2021 when polypropylene prices increased by around 28% to reach USD 1015 per MT, leading to a revenue growth of 39.4%.

However, with the gradual improvement in supply chains, prices began to decline in the second half of 2022, and we expect this trend to continue into 2023. As a result of this price reduction, revenue dipped by 5.2% in 2022 and we anticipate a further decline of 19% for 2023, as prices are expected to drop to USD 872 per MT, which is 14% less than the prices observed in 2021.

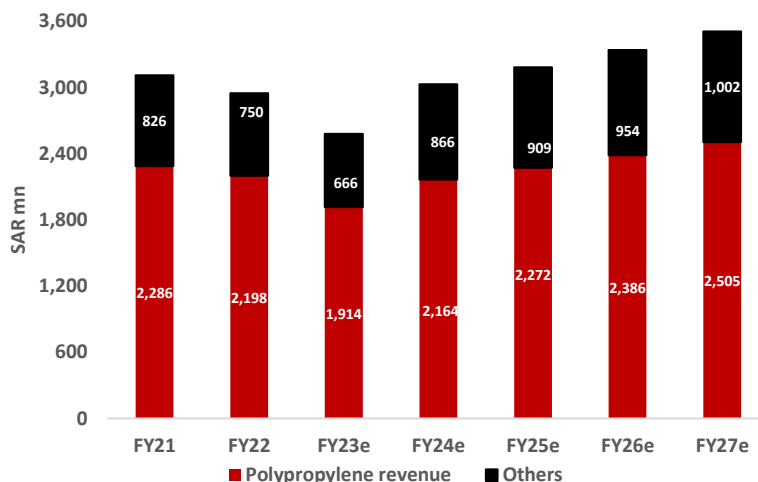
Looking ahead to 2024 and beyond, we expect polypropylene prices to stabilize, leading to an increase in the group's revenue. We also anticipate an improvement in the company's utilization rate, rising from 130% in 2022 to 135% in 2023, and further to 140% in 2025, remaining constant thereafter. Given the anticipated price stability and improvement in utilization, we expect polypropylene revenues to grow at a CAGR of 6.4% from 2023 to 2027.

Polypropylene Prices (\$/MT)



Source: Company Reports, U Capital Research

Revenue by segment



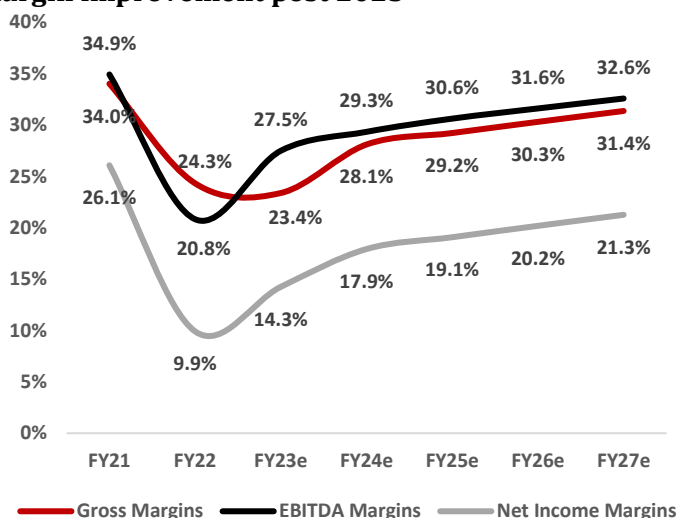
Source: Company Reports, U Capital Research

APPC should exhibit resilience with improvement in spread and return ratios

Margins: The group witnessed fluctuations in profit margins due to a significant price decrease in 2022, resulting in a 22% spread reduction for the company, reaching USD 404 per metric ton that year. The margins experienced a sharp decline, with the gross margin falling to 24.3%, followed by the EBITDA margin decreasing to 20.8%, and the net income margin reducing to 9.9% in 2022. Despite this substantial fall, it is anticipated that conditions will improve starting from 2023, with margins gradually recovering and displaying strong resilience thereafter. By 2027, gross margins are projected to reach 31.4%, with the EBITDA margin showing the most improvement and expected to reach 32.6%. Net income margins are forecasted to increase to 21.3% in 2027.

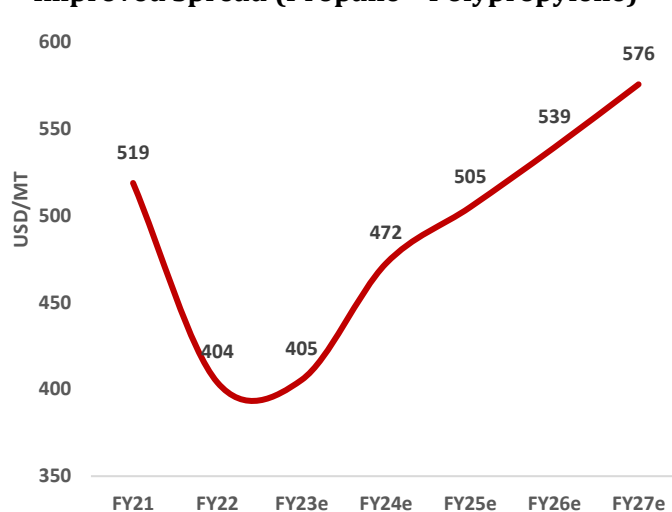
ROE and ROA: In 2021, APPC ROE and ROA reached 22.8% and 16.5% respectively, driven largely by increase in polypropylene prices. Post this peak, both ratios witnessed a sharp decline in 2022 due to correction in product prices. However, starting in 2023, both ROE and ROA are projected to rebound. The company's ROE is expected to increase steadily from 8.4% in 2023 to 21.2% by 2027, while the ROA is also set to rise from 4.1% to 7.9% over the same period. This anticipated upward trend reflects the company's improved operational efficiency and effective utilization of assets and equity, underlining its potential for steady future growth.

Margin improvement post 2023



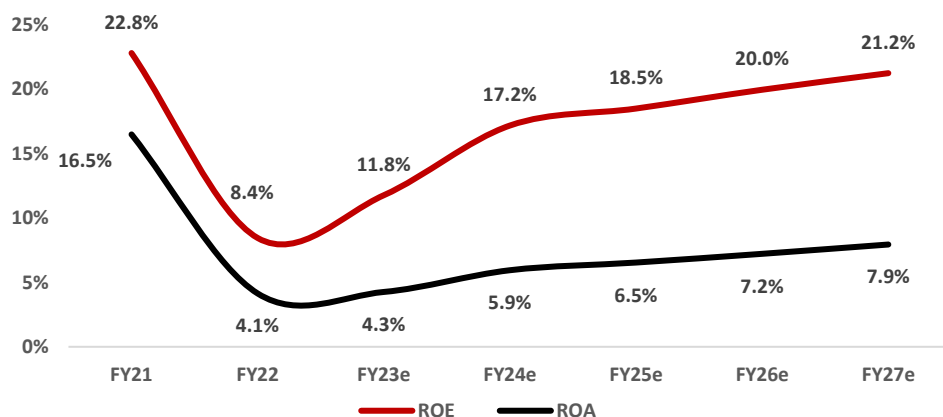
Source: Company Reports, U Capital Research

Improved Spread (Propane – Polypropylene)



Source: Bloomberg, U Capital Research

ROE & ROA: Enhanced profitability



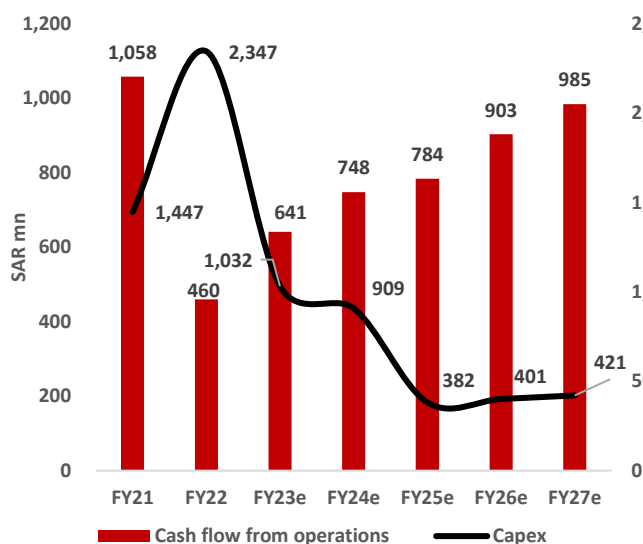
Source: Company Reports, U Capital Research

Robust cash generation and optimal capex drive company's financial health

Cash Flow & Capex: The cash flow from operations shows a steady growth from SAR 460mn in 2022 to SAR 985mn in 2027, representing an increase of 114% over the period. This substantial growth in cash flow suggests an enhanced operational efficiency and profitability for the company. In contrast, the company's capital expenditure peaked at SAR 2,347mn in 2022, reflecting a considerable 62% rise from the previous year. This is primarily due to the company's strategic decision to invest in new Propane Dehydrogenation (PDH) and Polypropylene (PP) projects. Post 2022, the Capex shows a marked decline, dropping to SAR 421mn by 2027 and with a steady rise in operational cash flow, the company is poised to generate higher free cash flows upon project completion.

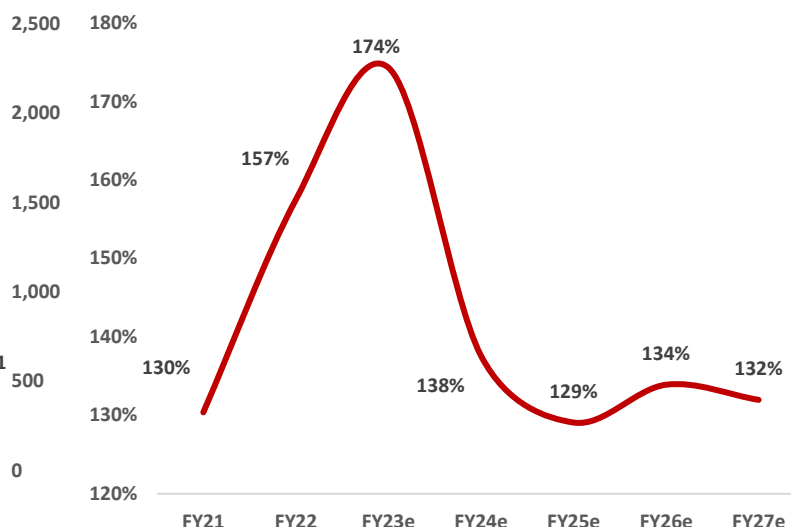
Cash conversion ratio: The Cash conversion ratio shows an impressive performance from 2021 to 2027, ranging from 129% to a high of 174% in 2023. This sustained high ratio suggests robust cash generation, reflecting the company's solid financial health and operational efficiency. These elements together enable the company to support investments, manage debt effectively, and maintain dividend payouts.

Cash generation and capex



Source: Company Reports, U Capital Research

Cash conversion ratio



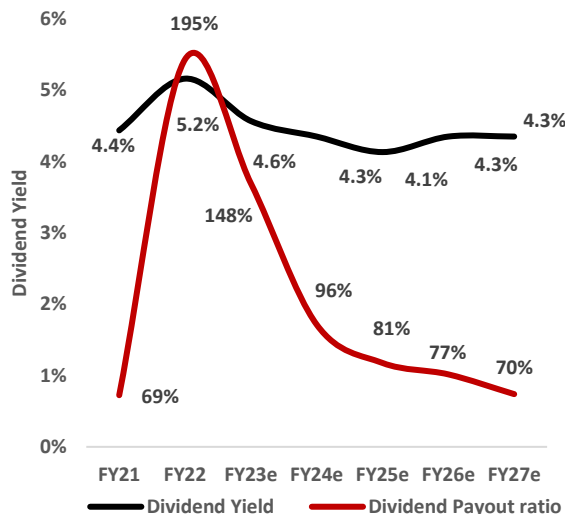
Source: Company Reports, U Capital Research

Ambitious expansion underpinned by stable dividends and well-managed leverage

Dividend: The Advance Petrochemical Company, showcasing a steady dividend yield fluctuating between 4.1% and 5.2% from 2021 to 2027, signifies robust shareholder returns. Despite the dividend payout ratio peaking at an unusually high 195% in 2022, it gradually stabilizes to about 70% by 2027, indicating an increased focus on business reinvestment. This is reinforced by the company's ambitious expansion plans, notably the construction of new Propane Dehydrogenation (PDH) and Polypropylene (PP) projects.

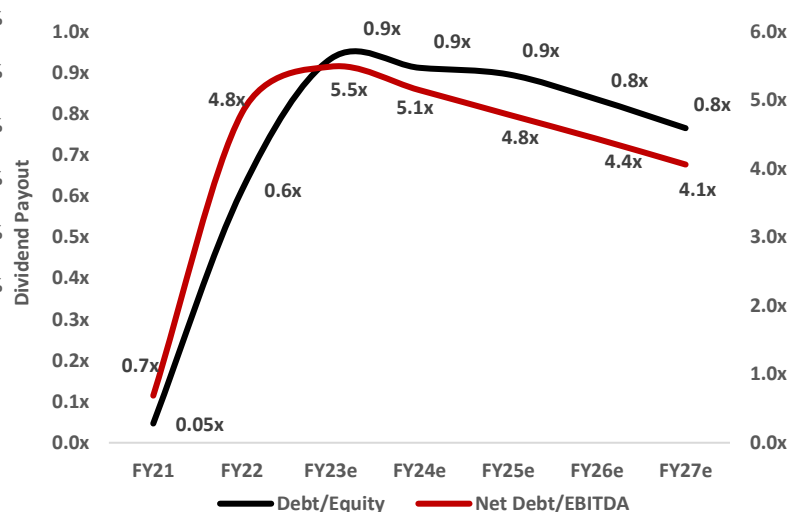
Leverage ratio: The Debt/Equity ratio sees a significant increase from 2021 to 2022, eventually peaking at 0.9x by 2023. This can be attributed to the new debt acquired from Marubeni and SIDF for the construction of PDH and PP projects, leading to a shift in the company's capital composition. Correspondingly, the Net Debt/EBITDA ratio also escalates, reaching a high of 5.5x in 2023 before gradually decreasing to 4.1x by 2027. This rise illustrates heightened financial risk, but the subsequent decrease signifies the company's potential to manage this increased debt, demonstrating a trajectory of improving financial health.

Dividend payout ratio and Dividend yield



Source: Company reports, U Capital research

Debt/Equity and Net Debt/EBITDA



Source: Company reports, U Capital research

Sensitivity Analysis

Our TP for Advanced Petrochemical Co (APPC AB) is sensitive to valuation inputs such as Cost of Equity (CoE) (+/- 1%) and terminal growth rate (+/- 0.25%). Between them, the higher sensitivity is towards Cost of Equity. Our TP is also sensitive (although relatively much lower) to the PP and Propane prices.

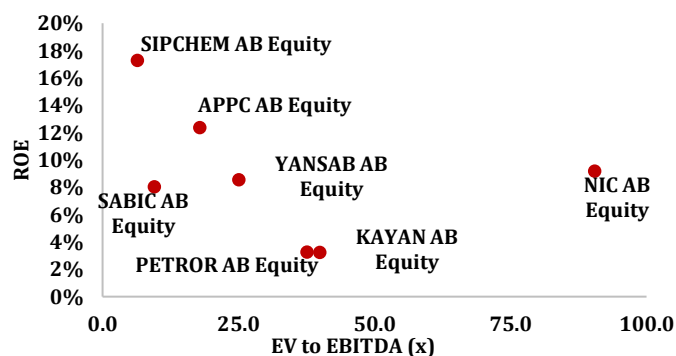
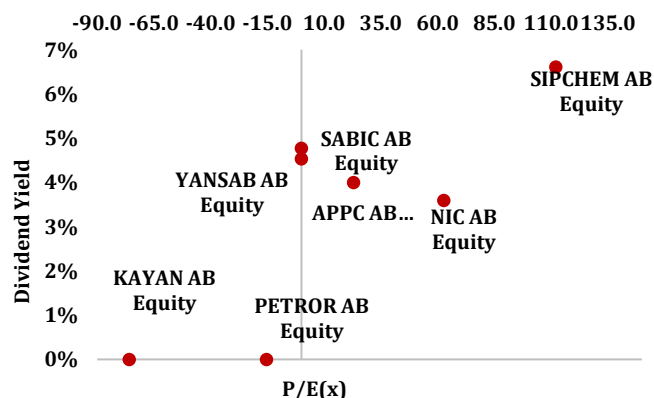
APPC

Terminal Growth rate	Cost of Equity					Propane price (USD/t, 2023e)	PP price (USD/t, 2023e)						
		7.9%	8.9%	9.9%	10.9%		11.9%		985	1085	1185	1285	1385
	0.50%	60.5	56.6	52.7	48.3		44.2	545	51.2	50.7	50.2	49.7	49.2
	0.75%	59.8	55.8	51.8	47.6		43.4	595	51.4	50.9	50.4	49.9	49.4
	1.00%	59.1	55.0	50.9	46.8		42.7	645	51.9	51.4	50.9	50.4	49.9
	1.25%	59.8	55.8	51.8	47.6		43.4	695	52.4	51.9	51.4	50.9	50.4
	1.50%	60.5	56.6	52.7	48.4		44.1	745	52.6	52.1	51.6	51.1	50.6

Peer Group Valuation

Name	Mkt Cap (SAR mn)	Last Px (AED)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITD A'23e, (x)	P/E'23e, (x)	ROE'23e, (%)	Div Yield' 23e, (%)	FCF Yield'23e (%)
ADVANCED PETROCHEMICALS CO	11,999.0	46.15	1.3%	-2.2%	8.6%	17.9	23.0	12.4%	4.0%	-15.7%
SAUDI BASIC INDUSTRIES CORP	2,66,400.0	88.80	-0.2%	-4.0%	-0.7%	9.6	NA	8.0%	4.5%	10.1%
SAUDI KAYAN PETROCHEMICAL CO	19,800.0	13.20	-1.5%	4.3%	-3.4%	40.0	-75.9	3.2%	0.0%	14.3%
NATIONAL INDUSTRIALIZATION C	10,060.5	15.04	0.8%	17.3%	21.7%	90.5	62.7	9.2%	3.6%	21.8%
YANBU NATIONAL PETROCHEMICAL	27,084.4	48.15	2.8%	11.2%	15.7%	25.1	NA	8.6%	4.8%	5.3%
SAHARA INTERNATIONAL PETROCH	26,876.7	36.65	-0.1%	-6.0%	8.0%	6.4	112.1	17.3%	6.6%	18.4%
RABIGH REFINING AND PETROCHE	18,815.5	11.26	0.0%	3.5%	5.4%	37.6	-15.4	-5.0%	0.0%	19.5%
Average						32.4	21.3	7.7%	3.4%	10.5%
Median						25.1	23.0	8.6%	4.0%	14.3%

Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 09 July 2023 Market-cap weighted average multiples – EV/ EBITDA, and P/E



Valuation

To value Advanced Petrochemical Company, we employed two valuation methods: the Discounted Cash Flow (DCF, 80% weight) and Relative Valuation. In our DCF analysis, we use a WACC of 4.4%, a cost of equity of 9.9%, a risk-free rate of 3.75%, a beta of 1.0, and a risk premium of 6.2%. This yields a fair value of SAR 50.8 per share.

For Relative Valuation we consider EV/EBITDA and P/E with a 10% weight each. We derive this multiple based on industry median values, resulting in an EV/EBITDA multiple of 18.5x and P/E multiple of 33.8x. We then apply this multiple to EBITDA of SAR 710mn and EPS of 1.4 per share, yielding fair values of SAR 53.6 and 48.8 per share respectively. Taking a weighted average of these valuations, we arrived at an overall fair value of **SAR 50.9/ share**.

Valuation

APPC

DCF (80% weight)

PV of Free Cash Flow (SAR mn)

2023e	-294
2024e	-60
2025e	448
2026e	515
2027e	543
Terminal value	14,615
Total PV of Future Cashflows (Enterprise Value, SAR mn)	15,767

Assumptions

Risk Free Rate (%)	3.7%
Adjusted Beta	1.00
Risk Premium (%)	6.2%
Cost of Equity (COE) (%)	9.9%
WACC (%)	4.8%
Equity value (SAR mn)	13,188
Outstanding Shares (mn)	260
Target Price (SAR)	50.8

P/E based Relative Valuation (10% weight)

Target P/E multiple for 2023e	33.8x
EPS 2023e (SAR)	1.4
Target Price (SAR)	48.8

EV/EBITDA based Relative Valuation (10% weight)

Target EV/EBITDA multiple for 2023e	18.5x
EBITDA 2023e (SAR)	710
Net Debt (SAR)	1209
Target Price (SAR)	53.6

Weighted Average Target Price (SAR)	50.9
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Current Market Price (SAR)	46.2
Upside/(Downside), %	10.2%

Recommendation

Accumulate

Source: Company Financials, Bloomberg, U Capital Research

Financial tables

(SAR mn)	FY21	FY22	Previous FY23e	FY23e	Previous FY24e	FY24e	FY25e
Income Statement							
Sales	3,111	2,948	2,878	2,580	3,022	3,030	3,181
COGS	-2,052	-2,412	-2,246	-1,976	-2,135	-2,178	-2,251
Gross profit	1,059	536	632	603	886	852	930
Selling & distribution expenses	-25	-32	-31	-30	-33	-61	-64
G&A expenses	-169	-105	-130	-124	-136	-182	-191
Operating profit	865	399	471	449	718	609	675
Finance charges	-16	-1	-10	-74	-10	-74	-74
Other income/expenses	11	7	8	1	8	1	1
Share in loss of an associate	11	-109	-86	17	6	47	49
Income before zakat	871	296	384	393	722	583	651
Zakat and income tax	-59	-3	-10	-25	-18	-39	-44
Net income	812	292	374	368	704	543	607
Balance Sheet							
Bank balances and cash	243	1,007	1,091	1,027	1,360	346	254
Trade receivables	435	354	347	311	364	365	383
Inventories	202	181	168	148	160	163	169
Property, Plant & Equipment	2,985	5,185	5,006	5,956	4,829	6,585	6,668
Investment in an associate	637	484	398	501	404	548	597
Total assets	5,891	8,238	8,028	8,923	8,152	9,046	9,129
Accounts payable	190	144	134	118	128	130	135
Accruals and other current liabilities	340	242	225	198	214	219	226
End-of-service indemnities	145	167	181	176	190	184	194
Loan	0	2,042	2,042	3,000	2,042	3,000	3,000
Share capital	2,165	2,600	2,600	2,600	2,600	2,600	2,600
Statutory reserve	697	465	465	425	465	479	427
Other components of equity	299	-27	-27	-27	-27	-27	-27
Retained earnings	492	252	57	81	195	116	242
Total stockholders' equity	3,956	3,240	3,045	3,029	3,182	3,119	3,192
Total liabilities & stockholders' equity	5,891	8,238	8,028	8,923	8,152	9,046	9,129
Cash Flow Statement							
Cash from operations	1058	460	713	641	901	748	784
Cash from investing activities	(1181)	(1971)	(58)	(1032)	(60)	(909)	(382)
Cash from financing	303	2274	(571)	412	(571)	(520)	(494)
Net changes in cash	181	764	85	21	269	(681)	(92)
Cash at the end of period	243	1007	1091	1027	1360	346	254
Key Ratios							
Current ratio	0.7	0.8	0.8	0.8	1.0	0.5	0.5
Inventory turnover ratio	10.9	12.6	-13.2	-11.8	-13.0	-14.0	-13.6
Debtors turnover ratio	8.2	7.5	8.2	7.8	8.5	9.0	8.5
Creditors turnover ratio	12.3	-14.4	-16.5	-14.4	-2.0	-1.6	-1.6
Gross profit margin	34.0%	18.2%	22.0%	23.4%	29.3%	28.1%	29.2%
Operating margin	27.8%	13.5%	16.4%	17.4%	23.7%	20.1%	21.2%
Net profit margin	26.1%	9.9%	13.0%	14.3%	23.3%	17.9%	19.1%
EBITDA margin	34.9%	20.8%	24.6%	27.5%	31.7%	29.3%	30.6%
Return on equity	22.8%	8.4%	12.0%	12.0%	22.8%	18.1%	19.7%
Return on assets	16.5%	4.1%	4.6%	4.3%	8.7%	6.0%	6.7%
Debt/Equity (x)	0.0x	0.6x	0.6x	0.9x	0.6x	0.9x	0.9x
Interest coverage ratio (x)	68.1x	441.1x	34.0x	9.6x	55.2x	12.0x	13.2x
P/E	15.6x	37.5x	32.9x	31.9x	17.5x	21.6x	19.4x
EV/Sales	6.4x	4.8x	20.1x	5.2x	18.8x	4.5x	4.3x
EV/EBITDA	18.4x	23.2x	19.6x	19.1x	14.2x	15.2x	13.9x
EPS (SR)	3.77	1.13	1.5	1.4	2.7	2.1	2.4
Dividend yield (%)	4.4%	5.2%	4.6%	4.6%	4.6%	4.3%	4.1%
Net debt (SR 'mn)	748	2,958	1,133	3,894	864	4,575	4,667
Net debt/ EBITDA	0.7	4.8	1.6	5.5	0.9	5.1	4.8
ROCE	20.2%	6.6%	8.0%	6.6%	11.9%	8.8%	9.7%

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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