Advanced Petrochemicals Co

Petrochemicals – Industrial
APPC AB: Saudi Arabia
11 October 2021

الراجحي المالية
Al Rajhi Capital

US$4.185bn	9%	US$11.24mn
Market cap	Free float	Avg. daily volume

Target price	90.00	+24.1% over current
Current price	72.50	as at 10/10/2021

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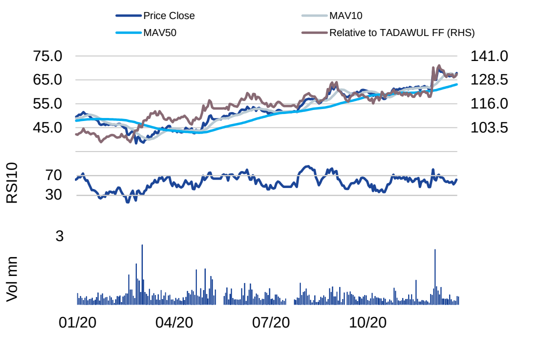
Existing rating

Underweight | Neutral | **Overweight**

Performance



Earnings

(SARmn)	2020	2021E	2022E
Revenue	2,231	2,983	3,103
Y-o-Y	-14.0%	33.7%	4.0%
Gross profit	729	1,028	1,034
Gross margin	32.7%	34.5%	33.3%
Net profit	596	834	918
Y-o-Y	-21.6%	40.0%	10.1%
Net margin	26.7%	27.9%	29.6%
EPS (SAR)	2.8	3.9	4.2
DPS (SAR)	2.6	2.6	3.0
Payout ratio	94.5%	67.5%	70.0%
P/E (Curr)	26.4x	18.8x	17.1x
P/E (Target)	32.7x	23.4x	21.2x

Source: Company data, Al Rajhi Capital

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Q3: Earnings beat

APPC announced a strong set of Q3 results beating our estimates, mainly driven by likely record high sales volumes, offsetting equity losses from SK Advanced. As the plant was already running at almost peak operating rates in Q2 (per our analysis), we had expected the company to sell similar volumes (flat q-o-q) in Q3 as well. However, Q3 results indicate that volumes could have come in 14% higher (q-o-q), beating our expectation.

Going forward, we expect the company's near-term performance to be weighed down by multi-year record highs in Propane Prices, which recently reached $800/t (+20% m-o-m; recording the highest level since 20 July 2014) in Oct 2021. On the other hand, though PP prices broadly remain firm, they are still lagging behind increase in feedstock prices, indicating lower product spreads in Q4. Nevertheless, the long-term outlook remains positive, aided by i) healthy sales volume, ii) better-operating efficiencies, iii) the absence of any planned shutdowns, iv) healthy project pipeline and v) consistent dividend track-record and more importantly vi) planned expansions. Considering the current market dynamics, we maintain our TP at SAR90/sh based on SAR65/share for the existing plants (4% dividend yield on DPS2.6/share), SAR15/share for the PDH-PP Jubail plant (NPV basis), and SAR10/share for the Jubail 2 project. We remain Overweight on the stock.

Figure 1 APPC Q3 2021 results

(SAR mn)	Q3 2021	Q3 2020	Y-o-Y	Q2 2021	Q-o-Q	ARC est	vs ARC
Revenue	**805**	**545**	**47.7%**	**769**	**4.7%**	**728**	**10.5%**
Gross profit	270	172	57.0%	330	-18.2%	234	15.3%
Gross margin	33.5%	31.6%		42.9%		32.2%	
Operating profit	231	140	65.0%	284	-18.7%	189	22.2%
Operating margin	28.7%	25.7%		36.9%		26.0%	
Net profit	**218**	**156**	39.7%	**265**	-17.7%	**200**	9.2%
Net margin	27.1%	28.6%		34.5%		27.4%	

Source: Company data, Al Rajhi Capital.

Q3 results: APPC reported Q3 revenues at SAR805mn (up by 4.7% q-o-q), beating our estimate of SAR728mn, primarily driven by higher-than-expected PP sales volume (+14% q-o-q vs. flat volume growth expected). A better-than-expected gross margin (33.5% vs 32.2% expected) along with a reduction in G&A expenses (-22% q-o-q) further led to a beat at the operating level. Its Korean JV, SK Advanced posted a loss of SAR5mn vs SAR26mn equity income last quarter, capping the net profit beat. Overall, net profit came in at SAR218mn, above our estimate of SAR200mn.

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 vi) expansion plans. The stock is currently trading at a P/E of 17.1x on our 2022E EPS despite the massive expansion (3Y historical avg. of 16.9x).

We value the existing plants using a 4% historical dividend yield on DPS of SAR2.6 for 2021. Q3 2021 results assure management commitment that dividends will remain untouched despite the projects. To this, we add our estimated value of the new PDH-PP KSA plant (SAR15/sh based on our NPV analysis) and the Jubail 2 project (SAR10/sh) to arrive with a TP of SAR90/sh. We believe that the stock deserves to trade at a premium to its peers, given the superior performance. Currently, the market is only partially pricing in the two massive projects which are in pipeline but we are expected to start commercial production only after 3 years. We believe that only as we move closer to commercial production, the stock will reach SAR90/share which is our target price. However, in the medium term, the stock may track the PP-propane spreads or price the stock at ~3 .5 to 4% dividend yield. 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.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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