

Advanced Petrochemicals Co

Petrochemicals – Industrial

APPC AB: Saudi Arabia

10 January 2022

الراجحي المالية
Al Rajhi Capital



US\$4.037bn

Market cap

9%

Free float

US\$8.76mn

Avg. daily volume

Target price

90.00

+28.6% over current

Current price

70.00

as at 9/1/2022

Research Department

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Existing rating

Underweight

Neutral

Overweight

Performance



Earnings

(SARmn)	2020	2021	2022E
Revenue	2,231	3,111	3,272
Y-o-Y	-14.0%	39.4%	5.2%
Gross profit	729	1,059	1,084
Gross margin	32.7%	34.0%	33.1%
Net profit	596	815	928
Y-o-Y	-21.6%	36.8%	12.5%
Net margin	26.7%	26.2%	28.4%
EPS (SAR)	2.8	3.8	4.3
DPS (SAR)	2.6	2.6	2.6
Payout ratio	94.5%	69.0%	60.7%
P/E (Curr)	25.4x	18.6x	16.3x
P/E (Target)	32.7x	23.9x	21.0x

Source: Company data, Al Rajhi Capital

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Maintain Overweight; TP SAR90/sh

APPC announced slightly weaker-than-expected Q4 earnings, primarily due to lower product spreads and logistics costs, coupled with higher-than-expected equity losses from SK Advanced, offsetting the top-line beat. In Q3 2021 earnings call, the management indicated a possible temporary shutdown at its Korean plant for a very short period in Dec 2021, which, along with lower product spreads, could have led to higher equity losses during the quarter. If we were to adjust the equity losses, then our Q4 earnings would have been largely in-line with the reported numbers.

Going forward, we expect PP prices to remain at stable levels, while Propane prices are expected to decline (already declined 10% in Jan 2022 over Q4 average prices) due to seasonality factors, indicating a possible improvement in product spreads in Q1. Additionally, logistics costs could decline helping margins further. Overall, 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. 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 latest project. We remain Overweight on the stock.

Figure 1 APPC Q4 2021 results

(SAR mn)	Q4 2021	Q4 2020	Y-o-Y	Q3 2021	Q-o-Q	ARC est	vs ARC
Revenue	905	632	43.1%	805	12.4%	840	7.8%
Gross profit	251	217	15.6%	270	-7.0%	240	4.6%
Gross margin	27.7%	34.4%		33.5%		28.6%	
Operating profit	189	174	8.3%	231	-18.2%	198	-4.6%
Operating margin	20.9%	27.6%		28.7%		23.6%	
Net profit	161	180	-10.4%	218	-26.1%	179	-9.9%
Net margin	17.8%	28.4%		27.1%		21.3%	
EPS	0.75	0.83	-10.1%	1.01	-25.7%	0.83	-9.5%

Source: Company data, Al Rajhi Capital.

Q4 results: APPC reported Q4 revenues at SAR905mn (up by 12.4% q-o-q), slightly higher than our estimate of SAR840mn, primarily driven by better-than-expected PP sales volume and sales mix. However, increased Propane prices and higher other COGS (mainly due to the incremental SAR48mn costs related to supply chain issues) lowered the gross margin by 5.8pps to 27.7% (vs. our expectation of 28.6%). This, along with higher-than-expected SG&A costs, pushed the operating profit ~5% below our estimate. The company's Korean JV, SK Advanced posted a loss of ~SAR26mn vs ~SAR5mn equity loss recorded last quarter, leading to a further miss at the net profit level. Overall, net profit came in at SAR161, missing our estimate of SAR179mn.

APPC inks a deal with SATORP to extend annual propylene supply to 120,000 MT until 2025:

APPC signed an amendment with Saudi Aramco Total Refining and Petrochemical Co. (SATORP) for the extension of annual propylene supply to 120kmt (with a range of +/- 10%; earlier agreed supply: 100kmt) and contract duration from 1 Dec 2021 to 31 Dec 2025.

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We view this announcement as positive as the increased availability of outsourced propylene will help the company boost its sales volume. As per our initial calculations, we expect the increased supply of outsourced propylene from SATORP may improve APPC's top-line and bottom-line by ~3% and ~2%, respectively for 2022.

Figure 2 APPC's historical supply agreements with SATORP

Date	Annual supply agreement (mtpa)
Jun-12	50,000
Aug-13	80,000
Dec-17	100,000
Dec-21	120,000

Source: Company data, Al Rajhi Capital.

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 16.3x on our 2022E EPS despite the massive expansion (3Y historical avg. of 17.5x).

We value the existing plants using a 4% historical dividend yield on DPS of SAR2.6 for 2022. 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 recently announced 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 ~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.

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