Petronas Chemicals Group

Early Signs of Bottoming

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PCHEM does not expect a meaningful recovery in its overall plant utilisation in 3QFY23 vs. three months ago. On a brighter note, spot urea prices have firmed up in recent months, prompting us to raise our FY24F price assumption. We cut our FY23F net profit by 7% but raise our FY24F number by 8%. We lift our TP by 16% to RM7.20 (from RM6.20) and upgrade our call to MARKET PERFORM from UNDERPERFORM.

We came away from a conference call with PCHEM feeling neutral of its near-term outlook. The key takeaways are as follows:

1. **No meaningful recovery in utilisation in 3QFY23.** PCHEM guided for flattish QoQ plant utilisation in 3QFY23 on the back of the shutdown of its methanol plant in Labuan. Recall, in 2QFY23, its overall utilisation fell to 82% (from 96% in 1QFY23) due to the shutdown of its Sipitang and Bintulu urea plants for a month. In the absence of a significant recovery in its plant utilisation in 3QFY23, our FY23F full-year assumption of 95% now appears lofty. As such we are cutting it to 89%.
2. **PIC's full start-up date still uncertain.** Pengerang Integrated Complex (PIC) is still under pilot operations while waiting full commencement date from its supporting facilities (cracker owned by Petronas, its parent). Pre-operating costs were at RM170m in 1HCY23 and might be slightly higher in 2HCY23 as capacity ramps up further. Hence, we are not expecting PIC to contribute positively for whole of FY23.
3. **Specialty chemicals still in the doldrums.** Being largely driven by the construction industry in Europe, a slowdown since late FY22 has crimped its speciality division margins in 1HCY23 because of slower top line growth and less favourable terms from clients. Chinese capacities have been flooding the market given its faltering domestic economy. We expect this to persist throughout 2HFY23 and recovery would gradually resume in FY24.
4. **Ethane supply contract still under negotiation.** PCHEM is still undergoing talks with its parent, Petronas, on its ethane supply contract for its cracker, and we maintain our assumption that the contract would be renewed for another two years without significant change in contract terms. Hence, our base case assumes that the majority of its O&D cost structure would be maintained as per before.

On a separate note, spot urea prices have recovered to a range of between USD350/MT and USD400/MT since Jul 2023, from a low of USD280/MT in Jun 2023, driven by export restrictions in China since Jul 2023 to secure domestic supplies. YTD, urea prices have averaged at c. USD350/MT, which is consistent with our assumption of USD350 for FY23. We expect the uptrend in urea prices to sustain into FY24 driven by the recovery in the global economy. As such we raise our assumption to USD400/MT (from USD350/MT) in FY24F.

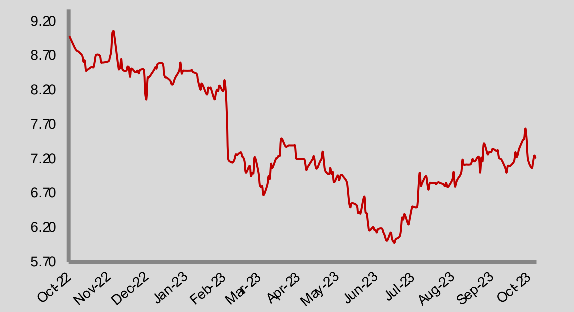
Forecasts. We cut our FY23F earnings forecast by 7% as we lower our plant utilisation assumption to 89% (from 95%) but raise our FY24F earnings by 8% to reflect a higher urea price assumption as mentioned.

MARKET PERFORM ↑

Price: RM7.13

Target Price: RM7.20 ↑

Share Price Performance



KLCI	1,440.60
YTD KLCI chg	-3.7%
YTD stock price chg	-16.0%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	PCHEM MK Equity
Market Cap (RM m)	57,760.0
Shares Outstanding	8,000.0
52-week range (H)	9.18
52-week range (L)	5.84
3-MTh avg daily vol:	3,762,573
Free Float	16%
Beta	1.2

Major Shareholders

Petroliam Nasional Bhd	64.4%
Employees Provident Fund	10.1%
Amanah Saham Nasional	5.2%

Summary Earnings Table

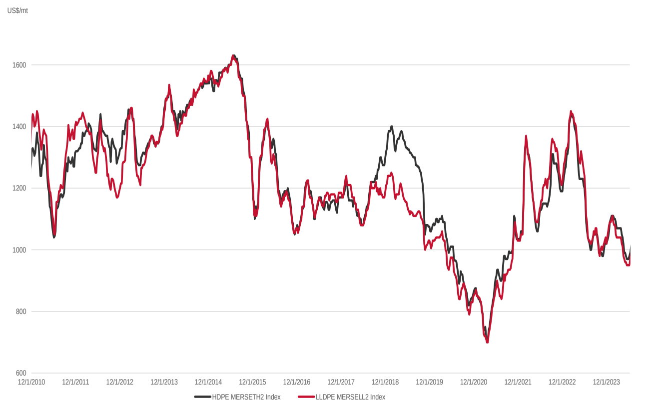
FYE Dec (RM m)	2022A	2023F	2024F
Revenue	28,953	24,832	28,414
EBIT	7,087	2,158	4,531
PBT	6,733	2,204	4,577
Net Profit (NP)	**6,322**	**1,854**	**3,838**
Core NP (CNP)	**6,333**	**1,854**	**3,838**
Consensus (CNP)	-	2,697	3,651
Earning Revision (%)	-	-7.1	+8.4
EPS (sen)	79.0	23.2	48.0
EPS growth (%)	-13.9	-70.7	107.0
DPS (sen)	41.0	21.6	44.8
BV/share (RM)	4.9	5.0	5.1
PER (x)	9.2	31.3	15.1
PBV (x)	1.5	1.5	1.4
Net Gearing (x)	NC	NC	NC
Div. Yield (%)	5.6	2.2	3.3

Coupled with a recent re-rating of sector forward PER (comprising LCTITAN, Evonik, PTTGC and Formosa Chemicals), we lift our TP by 16% to RM7.20 (from RM6.20) based on 15x FY24F PER (from 14.3x previously). There is no change to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

We like the company due to: (i) signs of bottoming of polyolefin prices supported by crude prices, (ii) specialty chemicals division potentially seeing trough earnings in FY23 with FY24 poised to be a year of gradual recovery, and (iii) its superior margins vs. its peers due to a favourable cost structure. However, the upside to its earnings and hence share price is capped by the limited upside to its product prices amidst a tepid global economic outlook.

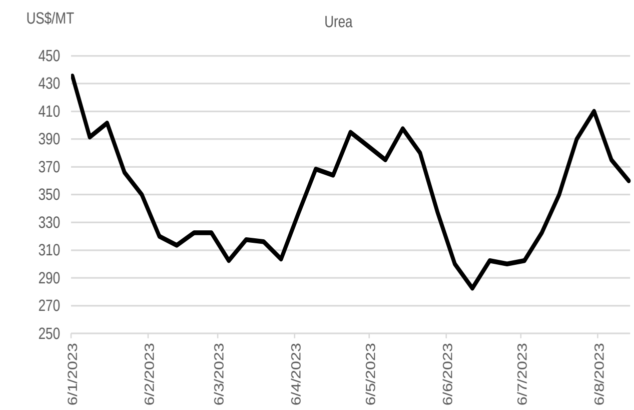
Risks to our call include: (i) worse than expected economic growth globally leading to weaker petrochemical prices, (ii) PIC costs exceeding estimates due to operational issues, and (iii) worse-than-expected oversupply in specialty chemicals particularly in European region.

PE prices stabilisng at USD1000/MT levels



Source: EIA, Kenanga Research

Urea prices still higher than average



Source: EIA, Kenanga Research

Income Statement

FY Dec (RM m)	2020A	2021A	2022A	2023F	2024F
Revenue	14,362.0	23,025.0	28,953.0	24,832.1	28,413.8
Operating Profit	1,976.0	6,928.0	7,087.0	2,158.1	4,530.5
Interest Exp	197.0	88.0	15.0	- 54.1	- 53.3
Associate & JV	- 316.0	729.0	165.0	100.0	100.0
PBT	1,857.0	7,710.0	6,733.0	2,204.0	4,577.3
Taxation	- 271.0	- 391.0	- 406.0	- 252.5	- 537.3
Non-controlling interest	42.0	26.0	5.0	- 97.6	- 202.0
Net Profit	1,628.0	7,345.0	6,322.0	1,854.0	3,838.0
Core Net Profit	**5,103.0**	**7,226.0**	**6,333.0**	**1,854.0**	**3,838.0**

Balance Sheet

FY Dec (RM m)	2020A	2021A	2022A	2023F	2024F
Fixed Assets	20987.0	22195.0	27213.0	27536.0	27833.1
Intangible Assets	744.0	684.0	9364.0	9364.0	9364.0
Other long term assets	1601.0	2303.0	2835.0	2935.0	3035.0
Inventories	1806.0	2214.0	3465.0	2971.8	3400.5
Receivables	1938.0	2737.0	3619.0	3103.9	3551.6
Other CA	46.0	85.0	46.0	46.0	46.0
Cash	12707.0	16390.0	8888.0	9285.3	10864.5
Total Assets	39829.0	46608.0	55430.0	55242.0	58094.6
Payables	2893.0	4378.0	5914.0	5072.3	5803.9
ST Borrowings	198.0	232.0	229.0	229.0	229.0
Other ST Liability	153.0	343.0	359.0	359.0	359.0
LT Borrowings	1994.0	2156.0	2489.0	2489.0	2489.0
Other LT Liability	3582.0	3959.0	6706.0	6706.0	6706.0
Minorities Int.	563.0	535.0	655.0	752.6	954.6
Perpetual securities	0.0	0.0	0.0	0.0	0.0
Net Assets	**30446.0**	**35005.0**	**39078.0**	**39634.2**	**41553.2**
Share Capital	8871.0	8871.0	8871.0	8871.0	8871.0
Reserves	21575.0	26134.0	30207.0	30763.2	32682.2
Equity	**30446.0**	**35005.0**	**39078.0**	**39634.2**	**41553.2**

Cashflow Statement

FY Dec (RM m)	2020A	2021A	2022A	2023F	2024F
Operating CF	3015.0	8185.0	8049.0	4331.0	6134.0
Investing CF	-1444.0	-1556.0	-12951.0	-2500.0	-2500.0
Financing CF	-792.0	-3173.0	-3806.0	-1433.7	-2054.9

Financial Data & Ratios

FY Dec	2020A	2021A	2022A	2023F	2024F
Growth					
Revenue (%)	-12.27	60.32	25.75	-14.23	14.42
Operating Profit (%)	-31.71	250.61	2.30	-69.55	109.93
PBT (%)	-41.14	315.19	-12.67	-67.27	107.68
Net Profit (%)	-36.91	319.71	-12.36	-70.73	107.02
Profitability (%)					
Operating Margin	13.76	30.09	24.48	8.69	15.94
PBT Margin	12.93	33.49	23.25	8.88	16.11
Net Margin	35.53	31.38	21.87	7.47	13.51
Effective Tax Rate	14.59	5.07	6.03	11.46	11.74
ROA	12.81	15.50	11.43	3.36	6.61
ROE	16.76	20.64	16.21	4.68	9.24
DuPont Analysis					
Net Margin (%)	35.53	31.38	21.87	7.47	13.51
Assets Turnover (x)	0.36	0.49	0.52	0.45	0.49
Leverage Factor (x)	1.31	1.33	1.42	1.39	1.40
ROE (%)	16.76	20.64	16.21	4.68	9.24
Leverage					
Debt/Asset (x)	0.06	0.05	0.05	0.05	0.05
Debt/Equity (x)	0.07	0.07	0.07	0.07	0.07
N. Debt/(Cash	-10515	-14002	-6170	-6567	-8146
Net Debt/Equity (x)	-0.35	-0.40	-0.16	-0.17	-0.20
Valuations					
EPS (sen)	20.35	91.81	79.03	23.17	47.97
DPS (sen)	14.58	56.00	41.00	16.22	23.99
BVPS (RM)	3.81	4.38	4.88	4.95	5.19
PER (x)	35.68	7.91	9.19	31.33	15.13
Div. Yield (%)	2.01	7.71	5.65	2.23	3.30
P/BV (x)	1.91	1.66	1.49	1.47	1.40

Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net. Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
Stocks Under Coverage																	
BUMI ARMADA BHD	OP	0.550	0.600	9.1%	3,257.5	N	12/2023	11.0	13.6	-15.4%	23.6%	5.0	4.0	0.6	11.8%	0.0	0.0%
DIALOG GROUP BHD	OP	2.08	3.10	49.0%	11,736.6	Y	06/2024	9.9	10.3	11.6%	3.9%	21.0	20.2	1.8	8.9%	3.0	1.4%
MISC BHD	MP	7.21	7.62	5.7%	32,183.6	Y	12/2023	57.5	54.9	32.4%	-4.5%	12.5	13.1	0.8	6.7%	30.0	4.2%
PETRONAS CHEMICALS GROUP BHD	MP	7.13	7.20	1.0%	57,040.0	Y	12/2023	23.2	48.0	-71.2%	107.0%	30.8	14.9	1.4	4.7%	16.2	2.3%
PETRONAS DAGANGAN BHD	MP	22.80	24.90	9.2%	22,650.8	Y	12/2023	106.0	92.6	41.3%	-12.6%	21.5	24.6	3.9	18.3%	106.0	4.6%
PETRON MALAYSIA REFINING	MP	4.51	4.65	3.1%	1,217.7	Y	12/2023	103.0	97.8	-7.6%	-5.0%	4.4	4.6	0.5	11.9%	21.0	4.7%
UZMA BHD	OP	0.745	1.05	40.9%	288.5	Y	06/2024	10.2	10.5	1.3%	2.5%	7.3	7.1	0.5	7.6%	0.0	0.0%
VELESTO ENERGY BHD	UP	0.260	0.190	-26.9%	2,136.1	Y	12/2023	0.6	1.3	-45.8%	104.6%	41.2	20.2	0.9	2.2%	0.0	0.0%
WAH SEONG CORP BHD	OP	0.980	0.890	-9.2%	758.8	Y	12/2023	6.9	9.9	-31.6%	43.4%	14.1	9.9	1.2	8.8%	0.0	0.0%
YINSON HOLDINGS BHD	OP	2.44	3.79	55.3%	7,092.5	N	01/2024	29.0	29.9	13.7%	3.0%	8.4	8.2	1.4	18.4%	2.0	0.8%
Sector Aggregate					**140,538.6**					**-30.2%**	**25.0%**	**17.4**	**13.9**	**1.3**	**9.8%**		**1.8%**

Source: Kenanga Research

Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★	★		
	Community Investment	★	★	★	★	
	Workers Safety & Wellbeing	★	★	★		
	Corporate Governance	★	★	★		
	Anti-Corruption Policy	★	★	★	★	
	Emissions Management	★	★	★	★	
SPECIFIC	Transition to Low-Carbon Future	★	★	★		
	Conservation & Biodiversity	★	★	★	★	
	Effluent/Waste Management	★	★	★	★	
	Water Management	★	★	★		
	Supply Chain Management	★	★	★		
	Energy Efficiency	★	★	★		
	OVERALL	★	★	★		

☆ denotes half-star
★ -10% discount to TP
★★ -5% discount to TP
★★★ TP unchanged
★★★★ +5% premium to TP
★★★★★ +10% premium to TP

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT : A particular sector's Expected Total Return is MORE than 10%
NEUTRAL : A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT : A particular sector's Expected Total Return is LESS than -5%

Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.

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