Petronas Chemicals Group Berhad

***Maintain* BUY**

(5183 | PCHEM MK) Industrial Products & Services | Chemicals

Higher product prices continue to support earnings

***Unchanged* Target Price: RM11.93**

KEY INVESTMENT HIGHLIGHTS

- **Petronas Chemicals Group's 2QFY22 earnings increased marginally +1%yoy to RM1.9b; within expectations**
- **Lower sales offset by higher forex flattens earnings**
- **Revenue climbed +17%yoy to RM6.6b due to high oil prices and tight supply**
- **Balance sheet remain strong on higher profitability**
- **No changes to earnings forecast**
- **Maintain BUY with TP of RM11.93 per share**

Earnings grew +1%yoy. Petronas Chemicals Group Bhd (PCG) 2QFY22 earnings was nearly flat by +0.9%yoy but slipped -9.7%qoq to RM1.87b. For the cumulative first half, earnings gained by +18.8%yoy to RM3.94b – which came in within our expectation at 93%. The nearly flat profit was due to lower sales, mitigated largely by higher foreign exchange gain on revaluation of shareholder loan to a joint operation company.

Revenue increased +17%yoy. PCG reported a rise in revenue by +17.4%yoy but slipped marginally by -0.8%qoq to RM6.58b. Cumulatively for 1HFY22, revenue increased by +28.5%yoy to RM13.22b. Revenue was up mainly due to higher product prices in tandem with the improved crude oil price amidst tight supply, partially offset by lower sales volumes.

Lower plant utilisation. PCG recorded lower plant utilisation rate of 72% in 2QFY22, compared to 97% in 1QFY22, and 79% utilisation in 1HFY22, compared to 94% in 1HFY21. This is mainly due to plant shutdowns for heavy turnarounds and maintenance activities resulting in lower production and sales volumes.

Robust balance sheet. PCG's total assets grew by +8.3% at RM50.3m, attributable to: (i) higher cash and cash equivalents due to profit generated in 1HFY22, and (ii) higher PPE by project costs incurred at Pengerang Petrochemical Co (PPC) and PC Isononanol (PC INA). Total equity also improved by +8.5% to RM38.4b, offset by higher liability of RM11.9b due to higher borrowings.

Olefins & Derivatives. O&D recorded a rise in revenue by +7%yoy and +19.4%qoq to RM3.28b, while earnings slipped marginally by -0.4%yoy but was up by +30.2%qoq to RM954m. Cumulatively for the first half, revenue was up +1.7%yoy to RM6.02b, while earnings lost -7.6%yoy to RM1.69b. This segment recorded lower plant utilisation rate of 89% as compared to 98% in 1QFY22, due to higher maintenance activities resulting in lower production and sales volumes.

RETURN STATISTICS	
Price @ 22nd August 2022 (RM)	8.70
Expected share price return (%)	+37.1
Expected dividend yield (%)	+3.4
Expected total return (%)	**+40.5**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	1.2	-0.3
3 months	-3.3	-9.3
12 months	10.9	13.2

KEY STATISTICS	
FBM KLCI	1,487.37
Syariah compliant	Yes
FSGBM Index	Yes
ESG Grading Band	☆☆☆☆
Issues shares (m)	8000.00
Estimated free float (%)	17.63
Market Capitalisation (RM'm)	69,600.00
52-wk price range	RM7.75 - RM11.0
Beta vs FBM KLCI (x)	1.13
Monthly velocity (%)	0.26
Monthly volatility (%)	13.71
3-mth average daily volume (m)	7.14
3-mth average daily value (RM'm)	65.24
Top Shareholders (%)	
Petroliam Nasional Bhd	64.35
Employees Provident Fund Board	8.39
Amanah Saham Nasional Bhd	5.21

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Fertiliser & Methanol. The F&M segment reported a climb in revenue by +26.3%yoy but dropped down by -14.5%qoq to RM2.83b, while earnings slipped by -13.2%yoy and -32.4%qoq to RM792m. However, for the cumulative 1HFY22, revenue increased by +61.2%yoy to RM6.13b, while profit gained +36.4%yoy to RM1.96b. The segment recorded lower plant utilisation rate of 62% as compared to 96% in the previous quarter due to higher plant statutory turnaround and maintenance activities resulting in lower production and sales volumes.

Table 1: PCG's Outlook for 3QFY22 for O&D and F&M

Olefins & Derivatives – Downstream demand expected to slowdown from Covid-19 lockdowns in China		
Products	**2Q22 Results**	**3Q22 Outlook**
Ethylene	• Higher feedstock costs with limited supply in NE Asia • Demand stagnant from extended lockdown in China • Depreciation of Chinese yuan	• Cracker outages and lower operating rate • Sluggish downstream demand
Polymers	• Firm feedstock prices supported by bullish market • Price uptick limited by China zero-Covid-19 policies and recession fears	• Ample supply die to additional volume from LDPE swing plants • Bearish demand amid inflation and Covid-19 fears
MEG	• Weak downstream demand due to China lockdowns • High port inventories in China due to poor offtake	• Reduced operating rates from negative margins • Sluggish demand amid high China stockpiles
Paraxylene	• Strong gasoline market amid supply shortage • Stable downstream from rising production cost	• Short supply due to plant TA • Sluggish demand from PTA and polyester market
Fertilisers & Methanol – Demand slowdown on off-planting season, correction with stabilising crude oil		
Products	**2Q22 Results**	**3Q22 Prospects**
Urea	• Tight supply over China's prolonged strict restriction • Healthy demand from India for Rabi season	• Stable supply due to no plant TA and planned shutdown • Weak demand over off-planting season and lower India tender
Ammonia	• Limited supply amid Russian sanctions • Stable downstream demand	• New plant in ME to start • Steady demand limited by tight margins for products
Methanol	• Ample supply in SE Asia due to better netback and Russia volumes flooding NE Asia • Subdued demand from China lockdowns	• Higher supply from Russia and Iran to China • Stagnant demand in China

Source: Company, MIDFR

Corporate developments in 2QFY22. PCG's plan to build a melamine plant in Gurun Kedah will extend its urea value chain for higher valued products and will make PCG the sole melamine producer in SE Asia. The group also signed an agreement with its joint venture company, BASF-Petronas Chemical Sdn Bhd to acquire its maleic anhydride plant located in Gebeng, Kuantan. PCG aimed to repurpose and upgrade the plant and its facilities to produce higher quality maleic anhydride which are better suited for the food and pharmaceutical industries. PCG also announced their landmark acquisition of Perstorp Holdings (Perstorp) – a global leader in sustainable specialty chemicals based in Sweden. This development is a major milestone for the group for its diversification strategy to venture into specialty chemicals and derivatives. We opine that these development plans will enable PCG to run strongly on its businesses against the volatility of the market in the near term.

Net-Zero Roadmap completed. Under its ESG and sustainability initiatives, PCG reported that its Net Zero Carbon Emissions (NZCE) roadmap, which sets its carbon reduction goals and pathways, had been completed. Under its New Plastic Economy Initiative, the group is looking into reducing 20% of carbon by 2030, gradually towards becoming net-zero by 2050. The group is also actively working with various companies to source and secure plastic waste to be used as feedstock to its circular economy drive. The plant will convert plastic waste to crude naphtha, and onward into circular plastic resin. PCG will also continue to monitor its key sustainability metrics (see Table 2).

Table 2: PCG's Sustainability Metrics (as of 1HFY22)

Metrics	Indicators	Progress
Economic	Plant Utilisation (%)	• 72% in 2QFY22 (-26%yoy, -17%qoq) • 79.2% in 1HFY22 (-15%yoy)
	Sales Volume (MMtpa)	• 1.6 MMtpa in 2QFY22 (-24%yoy, -16%qoq) • 3.5 MMtpa in 1HFY22 (-15%yoy)
Environmental	Energy Intensity (GJ/tonne)	• 19.14 GJ/tonne in 2QFY22 (+21%yoy, +12%qoq) • 18.11 GJ/tonne in 1HFY22 (+14%yoy)
	GHG Intensity (tCO2e/t)	• 0.87 tCO2e/t in 2QFY22 (+34%yoy, +21%qoq) • 0.79 tCO2e/t in 1HFY22 (+18%yoy)
	GHG Emissions (tCO2e)	• 1.73 tCO2e in 2QFY22 (-0.1%yoy) • 3.47 tCO2e in 1HFY22 (+0.0%yoy)
	Waste Recycling (%)	• 75% in 2QFY22 (+9%yoy, +3%qoq) • 74% in 1HFY22 (+3%yoy)
Social	Environment	• Be Green • ecoCare
	Community Development & Well-Being	• Safe Handling of Chemicals for School (SHOC4School) • PCG Covid-19 Relief • Sentuhan Kasih
	Education	Plastic, Sustainability & You Education (PSYE)
	Social & Governance	Focus on closing gaps identified from previous social risk assessment

Source: Company, MIDFR

Risks and challenges. PCG's near-term performance is expected to be influenced by: (i) global economic conditions, (ii) petrochemical products prices in correlation to crude oil price, (iii) utilisation rate of production facilities, and (iv) foreign exchange rate movements. Utilisation of production facilities is dependent on plant maintenance activities, as well as sufficient feedstock and utilities supply. Another challenge to look out for is the market volatility influenced by the ongoing Covid-19 pandemic that continues to affect the global supply chain and consumer demand for petrochemical products. Coming into 2HFY22, PCG is expecting O&D product prices to remain stable amidst a balanced supply-demand, while F&M product prices to be moderately supported by the elevated crude oil prices.

No changes to FY23-FY24 earnings estimate. Given that PCG's 2QFY22 financial performance is within the trajectory of our expectations, we make no changes to our earnings forecast as of now. Hence, we also maintain our target price at RM11.93 for PCG, based on pegging PER of 11.3x on a revised EPS22 of 106sen. The PER is based on the group's best 5-year average.

Maintain BUY. All in, we maintain our **BUY** call on PCG with the **target price of RM11.93 per share**.

We reiterate our positive stance with PCG's financial performance in FY22, as product prices will continue to be driven by the elevated energy prices and tight energy supply. In addition to the ongoing start-up integration at Pengerang Integrated Complex, its butyllithium and specialty ethoxylates is also progressing ahead of the timeline. Meanwhile, mergers filing for the proposed acquisition of Perstorp is still ongoing, subsequently further the prospects of more investments in derivates and special chemicals. Nevertheless, the impact of: (i) the volatility of the crude oil prices, (ii) economic slowdown and recession fears, and (iii) China's near-term demand against its zero-Covid policy, will continue to weigh in our optimistic view. We like PCG for its: (i) resiliency and strict financial discipline, (ii) pursuit to improve operational and commercial capabilities through digitalisation, (iii) strong petrochemical industry footprint locally and regionally, and (iv) continuous upholding of HSE practices and implementation of NZCE Roadmap 2050.

INVESTMENT STATISTICS

Financial year ending 31st December (in RM'm unless otherwise stated)	2020A	2021A	2022E	2023F	2024F
Revenue	14,362	23,025	26,418	27,188	28,558
EBIT	2,200	7,010	8,031	8,483	8,453
Pretax Profit	1,857	7,710	8,837	9,308	9,308
Net Profit	1,586	7,319	8,479	9,064	9,285
EPS (sen)	20.0	92.0	106.0	113.3	116.1
EPS growth (%)	-43.2%	360.0%	15.2%	6.9%	2.4%
PER (x)	53.4	11.6	11.3	10.5	10.3
Dividend per share (sen)	12.0	33.0	39.0	40.0	41.0
Dividend yield (%)	1.1%	3.1%	3.3%	3.4%	3.4%

Source: Company, MIDFR

Table 3: Petronas Chemicals's quarterly earnings review

Financial year ending 31st Dec (in RM'm unless stated otherwise)	Quarterly results					Cumulative results		
	2QFY21	1QFY22	2QFY22	QoQ (%)	YoY (%)	1HFY21	1HFY22	YoY (%)
Revenue	**5,608.0**	**6,634.0**	**6,583.0**	**-0.8**	**17.4**	**10,283.0**	**13,217.0**	**28.5**
Cost of revenue	(3,349.0)	(4,157.0)	(4,471.0)	7.6	33.5	(6,325.0)	(8,628.0)	36.4
Gross Profit	**2,259.0**	**2,477.0**	**2,112.0**	**-14.7**	**-6.5**	**3,958.0**	**4,589.0**	**15.9**
Selling & Dist Expenses	(270.0)	(279.0)	(278.0)	-0.4	3.0	(499.0)	(557.0)	11.6
Admin Expenses	(231.0)	(183.0)	(262.0)	43.2	13.4	(416.0)	(445.0)	7.0
Other Expenses	(11.0)	-	(11.0)	nm	0.0	(22.0)	(11.0)	-50.0
Other Income	69.0	82.0	315.0	284.1	356.5	238.0	397.0	66.8
Operating Profit	**1,816.0**	**2,097.0**	**1,876.0**	**-10.5**	**3.3**	**3,259.0**	**3,973.0**	**21.9**
Net Financing Costs	(6.0)	(7.0)	(8.0)	14.3	33.3	(13.0)	(15.0)	15.4
Associates	167.0	123.0	70.0	-43.1	-58.1	300.0	193.0	-35.7
Profit Before Tax	**1,977.0**	**2,213.0**	**1,938.0**	**-12.4**	**-2.0**	**3,546.0**	**4,151.0**	**17.1**
Tax expense	(122.0)	(141.0)	(66.0)	-53.2	-45.9	(225.0)	(207.0)	-8.0
Profit After Tax	**1,855.0**	**2,072.0**	**1,872.0**	**-9.7**	**0.9**	**3,321.0**	**3,944.0**	**18.8**
Minority Interests	(4.0)	(4.0)	2.0	-150.0	-150.0	1.0	(2.0)	-300.0
PATAMI	**1,859.0**	**2,068.0**	**1,874.0**	**-9.4**	**0.8**	**3,320.0**	**3,942.0**	**18.7**
				+/(-) ppts				*+/(-) ppts*
Gross margin (%)	40.3	37.3	32.1	-5.3	-8.2	38.5	34.7	-3.8
Operating profit margin (%)	32.4	31.6	28.5	-3.1	-3.9	31.7	30.1	-1.6
PBT margin (%)	35.3	33.4	29.4	-3.9	-5.8	34.5	31.4	-3.1
PATAMI margin (%)	33.1	31.2	28.5	-2.7	-4.7	32.3	29.8	-2.5
Tax rate (%)	6.2	6.4	3.4	-3.0	-2.8	6.3	5.0	-1.4
Segmental:								
Revenue								
- Olefins & Derivatives	3,063.0	2,743.0	3,276.0	19.4	7.0	5,916.0	6,019.0	1.7
- Fertilisers & Methanol	2,237.0	3,304.0	2,826.0	-14.5	26.3	3,802.0	6,130.0	61.2
Profit After Tax								
- Olefins & Derivatives	958.0	733.0	954.0	30.2	-0.4	1,825.0	1,687.0	-7.6
- Fertilisers & Methanol	912.0	1,172.0	792.0	-32.4	-13.2	1,440.0	1,964.0	36.4

Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK: GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology