Sitara Peroxide Limited (SPL) - Price & Expansion to Increase Profitability Going Forward

ABBASI SECURITIES

REP-091
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Sitara Peroxide Limited (SPL)

• Sitara Per Oxide Limited (SPL) is a part of Sitara group that is in the business of manufacturing and marketing hydrogen per oxide (H2O2) from 1981.

• H2O2 market size is around 65k-70k tons. Local manufacturers Descon Oxychem Limited (DOL) and Sitara Peroxide Limited (SPL) sold around 33,000 tons and 22,000 tons in FY18 respectively, rest of the demand was met through imports

• SPL has a name plate capacity of 30,000 tons; plant has historically operated comfortably at 80% capacity, however in precedent financial year SPL has operated at ~70% capacity due to technical complications at its plant that resulted in efficiency loss of Palladium catalyst and working solution/chemicals

• SPL has successfully rescheduled its Rental and Buy-Out Payments of the Sukuk Certificates. As per the Third Supplemental Trust Deed effective April 19, 2018 repayments will be utilized to settle accumulated accrued interest first and then for principal repayment and deferred rental/interest payments in proportion of 67:33.

Capacity enhancement to provide stimulus:

- Company overcame its technical issues and has imported fresh batch of Palladium catalyst in February 2018 and plant has been consistently operating at 80% capacity since the
- Company has recently announced its expansion, which will increase its production capacity from 80tpd to 120tpd. Expansion is scheduled to come online in September 2019 before DOL announced expansion of 7,000 tons in IQCY20

Price increase to bring company into profit:

- Price of H2O2 like any other chemical commodity is largely determined by international prices. Currently international demand for H2O2 is more than supply largely due to China`s resolve to reduce environment pollution. This demand supply mismatch along with increase in gas prices internationally has caused surge in international price of the chemical and consequently price in Pakistan has also been increased
- Currently locally produced H2O2 is being sold around 105/kg (50% concentration), whereas imported H2O2 is priced around 125/kg (50% concentration). Local industry enjoys protection of ~18% (13% custom duty and 5% regulatory duty). Plus there is antidumping duty imposed on dumped import from Bangladesh in the range of 10.67% to 12.14%.
- We foresee further devaluation of Pak rupee, as Pakistan approaches IMF for a bail out program to address its dwindling foreign reserves and upcoming foreign currency loan repayment. In the light of aforementioned reasons, we expect spread between locally produced and imported H202 to persist in the near term

KATS Symbol	**SPL**
Reuters Symbol	**SPL.KA**
Target Price	Rs46
LDCP	Rs31.90
Outstanding Shares (mn)	55.10
Free Float (mn)	33.06
Market Cap (mn Rs)	1758

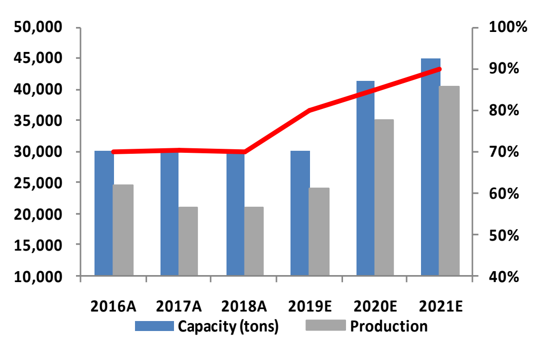
Price Performance Against KSE100 Index

Source: PSX

	FY18A	FY19E	FY20E
EPS (Rs)	-1.7	7.74	11.08
P/E (x)		4.12	2.88

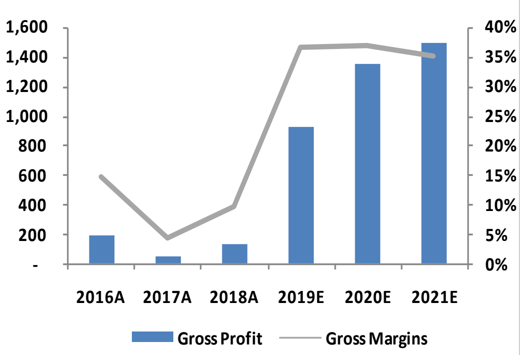
Source: Co Financials, AS Research

Fig1 Capacity & Production



Source: Co Financials, ASL Research

Fig2 Gross Profit vs Gross Margins



Source: Co Financials, ASL Research

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Industry growth to accommodate expansion:

- Around 80% of H_2O_2 in Pakistan is being consumed by textile sector, 19% by mining sector and 1% by food sector
- Industry expects demand to grow by 5% to 6% annually given current government`s stance to lend support to textile sector given persistent trade deficit over the course of years due to dwindling exports and surging import bill.
- We see margins to remain strong in the near term, as domestic demand is expected to surpass supply till FY20 (see fig 3). We believe domestic industry will look to export surplus production from FY21.

Fig3 Domestic Demand vs. Production

Capcity - tons	FY18	FY19E	FY20E	FY21E
Domestic demand	67,000	71,020	75,281	79,798
SPL	30,000	30,000	41,250	43,800
DOL	28,000	28,000	31,360	35,000
EPCL	-	-	-	25,000
Deficit/Surplus	**(9,000)**	**(13,020)**	**(2,671)**	**24,002**

Source: ASL Reaserch, Company Financials

Valuation

- Increase in average selling price to Rs76/kg and capacity utilization to 80% in 4QFY18 helped company post profit of Rs138mn vs. loss in first three quarters of FY18
- We see a turnaround in company as it is selling the bleaching agent at ~Rs105/kg and plant is comfortably operating at 80% capacity utilization
- Our earnings projection for FY19 and FY20 at current selling prices and after incorporating expansion in FY20 comes around to Rs7.74/share and 11.08/share respectively. SPL is currently trading at a forward FY19E/FY20E multiple of 4.12x/2.88x. We have a buy call on the scrip with a June-19 base target price of Rs46/share

Key Risks:

- Entry of new entrants (EPCL 25k tons per annum) eyeing increased profitability and margins in the sector
- Removal or reduction in regulatory and/or custom duty
- Lower than expected devaluation of Pak rupee
- Higher than expected increase in cost of gas
- Delay in COD of announced expansion

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Valuation Methodology

To arrive at period end target price, Abbasi Securities uses different valuation methodologies:

· Comparable Method (P/E, P/B etc.)

· Discounted Cash flow Method

·Equity and Asset based valuation

Rating

BUY	Total return more than 20% from last closing of market price
HOLD	Total return is in between 10% and 20% from last closing of market price
REDUCE	Total return is less than 10% from last closing market price

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