Thanachart Securities

BUY (From: HOLD)

Change in Recommendation

TP: Bt 16.00 (From: Bt 8.20)

Upside : 31.1%

13 JUNE 2022

Small Cap Research

Esso (Thailand) Pcl (ESSO TB)

Our top refinery pick

We upgrade ESSO to BUY from Hold and it is our top refinery pick based on three key factors. It is highly exposed to strong GRM, it offers a volume growth story, and it trades on a valuation that is yet to reflect new sector fundamentals in our view.



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Upgrading to BUY

This report is a part of *Energy sector – A longer period of high GRM,* dated 13 June 2022. We upgrade ESSO to BUY (from Hold) and it is our top pick among refinery peers. *First*, ESSO's exposure to strong gross refining margin (GRM) has increased after closing its loss-making paraxylene (PX) unit last year. It also doesn't have hedging positions that would dilute high GRM benefits. *Second*, ESSO offers a volume growth story or a higher utilization rate from petrol station expansion. *Lastly*, given our much higher GRM assumptions over the next three years vs. historical levels, we believe ESSO deserves to trade above its current P/BV of 1.3x, which is below its five-year historical average. In this report we lift our GRM assumptions and earnings estimates by 87-831% in 2022-24F and DCF-based 12-month TP, using a 2023F base year, to Bt16.0 (from Bt8.2 previously).

A better product mix

PX is a downstream, petrochemical product that uses output (reformate) from refinery plants as a key feedstock. PX, having been in a structural down cycle for many years, made losses for ESSO and the unit was shut down in April 2021. This has resulted in higher refined product output and ESSO is enjoying the current strong GRM market fully. ESSO also has the second-highest yield among peers with middle distillate and gasoline products at 82% vs. peers' 70-83%. See our GRM assumptions for ESSO in Exhibit 11. As for the benchmark Singapore GRM assumptions, see Exhibit 1 in the main part of the sector report.

Volume growth story

We expect ESSO's utilization rate to rise to 81/85% in 2022-23F vs. 71% in 2021. This is because of its petrol station expansion plan as well as domestic demand recovery. ESSO had 731 stations in 2021 and we expect the number to rise to 800 this year. ESSO also has a deal with Susco Pcl (SUSCO TB, BUY, Bt3.80) to manage more than 80 of SUSCO's stations this year and rebrand them to ESSO stations.

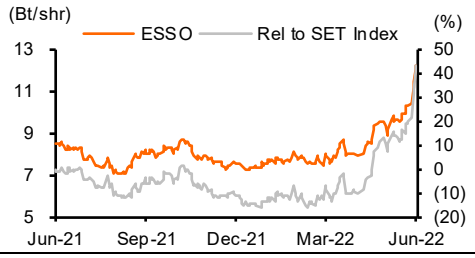
To pay first dividend in three years

As a result of much larger cash flows from the sharp rise in GRM that turned its retained loss to a profit from 1Q22, we expect ESSO to resume dividend payments after not doing so for the past three years. We estimate a Bt1.0 DPS (27% payout), or an 8% yield in 2022F. With our FCF yield projections of 18-22%, ESSO in our view can afford such high dividend payments.

COMPANY VALUATION

Y/E Dec (Bt m)	2021A	2022F	2023F	2024F
Sales	172,878	169,762	169,343	165,990
Net profit	4,443	13,062	4,263	4,437
Consensus NP	—	7,213	4,942	5,241
Diff frm cons (%)	—	*81.1*	*(13.7)*	*(15.3)*
Norm profit	(1,704)	6,291	5,671	5,097
Prev. Norm profit	—	676	2,846	2,719
Chg frm prev (%)	—	*830.2*	*99.3*	*87.4*
Norm EPS (Bt)	(0.5)	1.8	1.6	1.5
Norm EPS grw (%)	na	na	(9.9)	(10.1)
Norm PE (x)	na	6.7	7.4	8.3
EV/EBITDA (x)	31.9	4.6	5.6	5.4
P/BV (x)	2.2	1.4	1.3	1.2
Div yield (%)	0.0	8.2	4.0	4.2
ROE (%)	na	25.3	18.1	15.2
Net D/E (%)	146.7	44.2	31.5	15.8

PRICE PERFORMANCE



COMPANY INFORMATION

Price *as of* 10-Jun-22 (Bt)	12.20
Market Cap (US$ m)	1,214.6
Listed Shares (m shares)	3,460.9
Free Float (%)	34.0
Avg Daily Turnover (US$ m)	5.1
12M Price H/L (Bt)	12.00/7.05
Sector	Energy
Major Shareholder	ExxonMobil Int'l 65.99%

Sources: Bloomberg, Company data, Thanachart estimates

This report is prepared by Thanachart Securities. Please contact our salesperson for authorisation. Please see the important notice on the back page

ESSO is our top refinery pick

We upgrade Esso (Thailand) Pcl (ESSO) to BUY (from Hold) and it also becomes our top refinery stock pick. We like it from the growth angles of both high gross refining margin (GRM) and volume growth stories while we see its valuation as inexpensive. ESSO also doesn't have product price hedging positions that would dilute the benefits of high GRM.

GRM stories

GRM stories are on rising margin and improved product mix

We see two growth angles from rising GRM via the strong market outlook and ESSO's improved product mix. Exhibit 11 shows our new GRM assumptions for ESSO, in tandem with our more bullish outlook for the refinery market which we discuss in our main sector note, *Energy Sector – A longer period of high GRM,* dated 13 June 2022.

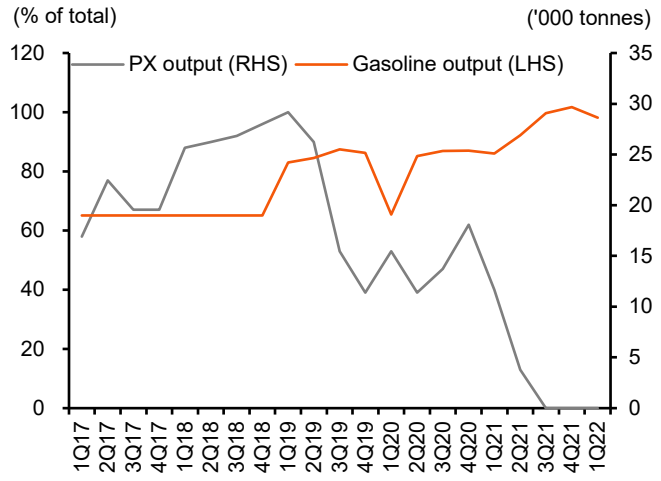
ESSO is also enjoying a higher margin from an improved product mix after the shutdown of its loss-making PX unit in April 2021 that has resulted in higher production output of high-margin gasoline (see Exhibit 2). Gasoline output has increased to 29% of total output currently from 24% before the PX unit's shutdown.

Ex 1: New Singapore Complex GRM Assumptions

(US$/bbl)	Actual			New			Old			Change (US$)		
	2021	1Q22	June	2022F	2023F	2024F	2022F	2023F	2024F	2022F	2023F	2024F
Spread over Dubai												
Gasoline	11.0	17.8	40.0	27.1	20.3	18.3	16.5	13.0	12.0	*10.6*	*7.3*	*6.3*
Diesel	6.7	19.6	32.0	27.0	17.1	15.1	19.1	14.0	14.0	*7.9*	*3.1*	*1.1*
Jet	5.8	16.2	33.4	25.3	20.8	18.8	17.6	13.0	13.0	*7.7*	*7.8*	*5.8*
HSFP	(4.9)	(8.3)	(6.1)	(5.4)	(8.0)	(8.0)	(7.7)	(8.0)	(8.0)	*2.3*	*0.0*	*0.0*
SG GRM	**3.1**	**8.0**	**18.6**	**14.2**	**9.1**	**7.7**	**7.3**	**5.5**	**5.2**	***6.9***	***3.6***	***2.5***

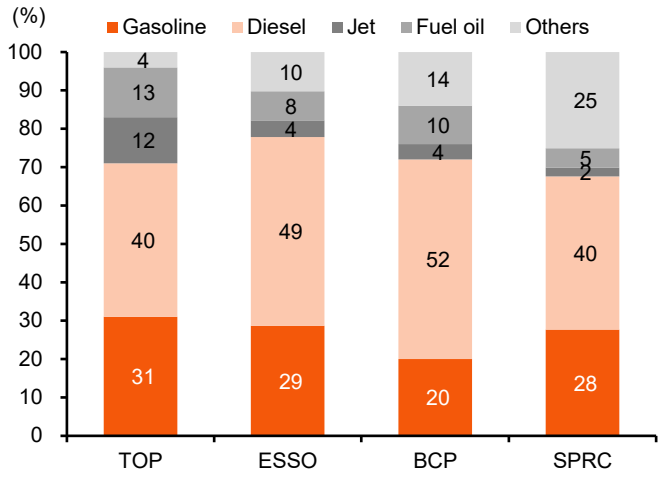
Sources: Bloomberg, Thanachart estimates

Ex 2: Gasoline Output Rises After PX Plant Closure



Source: Company data

Ex 3: High Exposure To High Margin Diesel And Gasoline



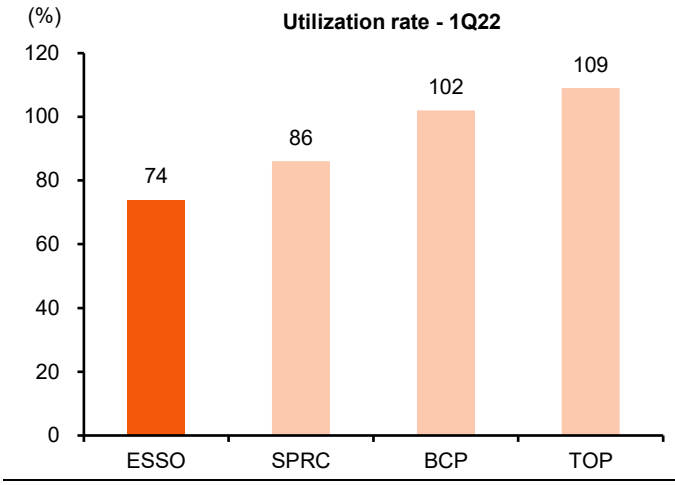
Source: Company data

Volume growth stories

Rising utilization

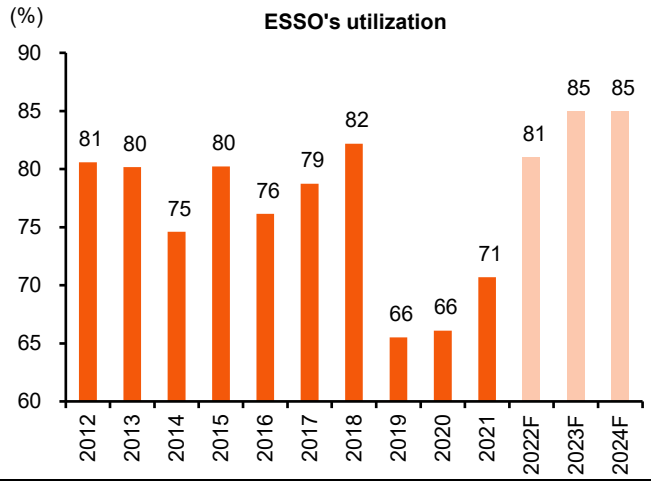
There are two key factors driving ESSO's refinery utilization rate. The first is an oil retail consumption recovery post-COVID and the second is the expansion of petrol stations. We estimate ESSO's utilization to rise to 81/85/85% in 2022-24F from 71% in 2021.

Ex 4: ESSO Has Room To Increase Utilization



Source: Company data

Ex 5: Rising Utilization



Sources: Company data; Thanachart estimates

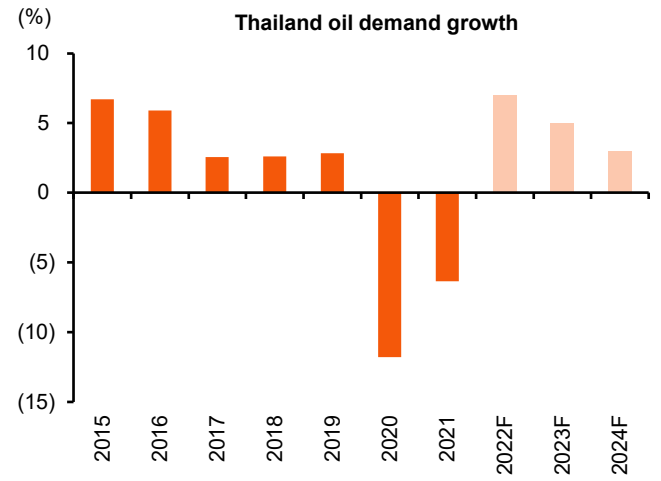
Domestic oil demand recovery

Exhibit 6 shows domestic oil consumption in Thailand which we estimate to grow by 7/5/3% in 2022-24F following the post-COVID economic recovery and country reopening. In 4M21, oil consumption grew by 12% y-y.

ESSO's two-way petrol station expansions

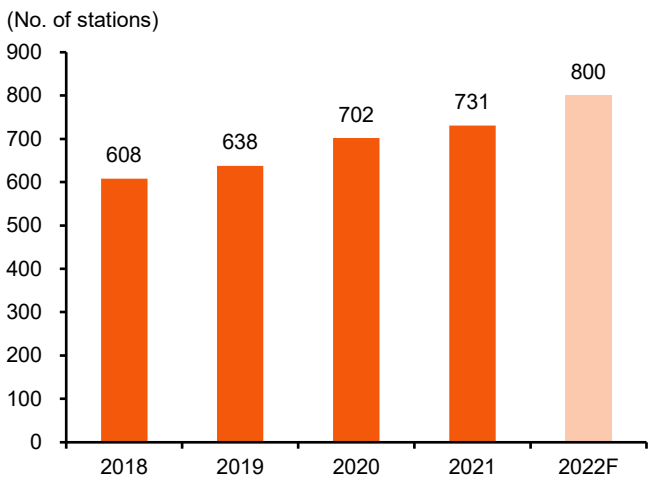
As for petrol station expansions, we expect ESSO's petrol stations to increase from 739 currently to 800 in 2024F. ESSO targets to add 69 new stations this year. On top of that, it has a partnership contract with Susco Pcl (SUSCO, BUY, Bt3.80) to rebrand 81 of SUSCO's petrol stations to become ESSO stations. As for the business model, SUSCO continues to be the owner of these stations. ESSO pays for renovation expenses and in return it sells its refined oil products to the stations and also gets a share of the marketing margin. Some 57 stations have been converted to ESSO stations since 2021. Due to stronger brand recognition after the conversion, sales volumes at those stations have improved by as much as 40%, according to SUSCO's management.

Ex 6: Domestic Oil Demand



Sources: DOEB; Thanachart estimates

Ex 7: ESSO's Petrol Station Expansions



Sources: Company data; Thanachart estimates

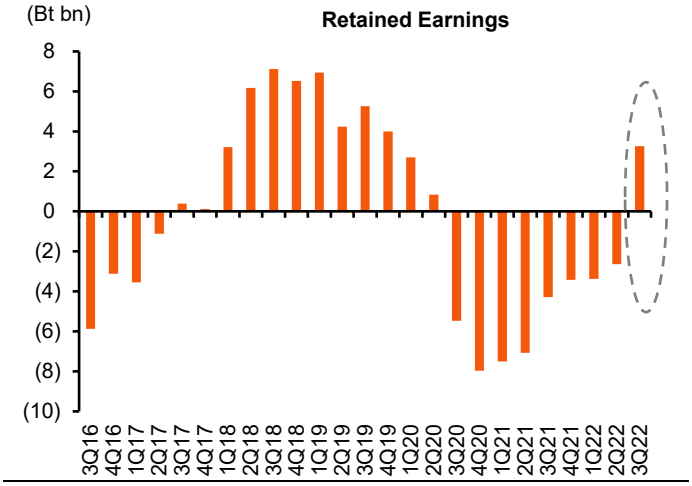
Dividend story

Can now afford to pay a dividend and we estimate an 8% yield in 2022F

We expect ESSO to start paying a dividend this year after three years of no payment. ESSO's retained earnings turned to a loss in 3Q20 due to the COVID impact on its operation. That said, its retained earnings already turned positive in 1Q22 (see Exhibit 8) giving leeway for the company to be able to pay dividends.

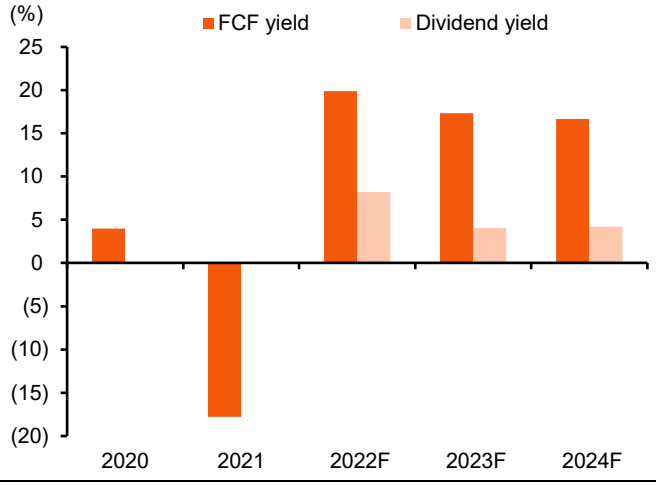
And with our more bullish refinery market outlook and our new GRM assumptions, we expect ESSO to continue to pay dividends for the next three years. We estimate its dividend yields at 8/4.0/4.2% in 2022-24F, supported by high FCF yields of 19.9/17.3/16.7%.

Ex 8: Retained Earnings Have Turned Positive



Source: Company data

Ex 9: FCF Vs. Dividend Yield



Source: Thanachart estimates

Earnings revisions

Note that in this report we revise up our normalized earnings estimates by 87-831% in 2022-24F mainly on the back of our higher GRM assumptions (see Exhibit 1 in our main sector report). We therefore lift our DCF-based 12-month TP, which is rolled over to a 2023F base year, to Bt16.0 (from Bt8.2 previously).

Ex 10: Earnings Revisions

(Bt m)	Normalized profit			TP
	2022F	2023F	2024F	(Bt/shr)
New	6,291	5,671	5,097	16.00
Old	676	2,846	2,719	8.20
Change (%)	*830.7*	*99.3*	*87.4*	*95.10*

Sources: Thanachart estimates

Ex 11: Key Assumption Changes

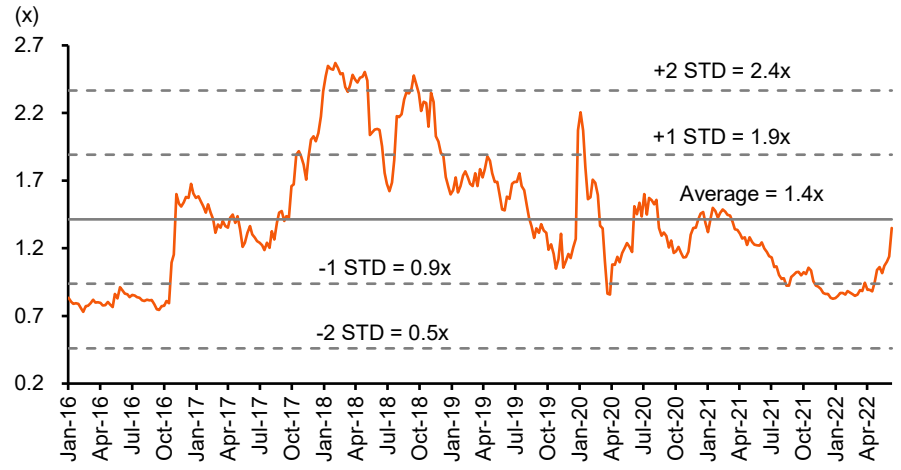
	New			Old			Change (%)		
	2022F	2023F	2024F	2022F	2023F	2024F	2022F	2023F	2024F
Accounting GRM (US$/bbl)	13.44	6.35	6.22	8.74	5.14	5.02	*53.8*	*23.5*	*23.9*
Utilization (%)	81.0	85.0	85.0	75.0	80.0	80.0	*8.0*	*6.3*	*6.3*
Marketing margin (Bt/litre)	1.50	1.70	1.90	1.70	1.70	1.90	*(12)*	*0.0*	*0.0*
Retail volume growth	7.0	5.0	3.0	5.0	4.0	3.0	*40.0*	*25.0*	*0.0*

Sources: Thanachart estimates

Inexpensive valuation in our view

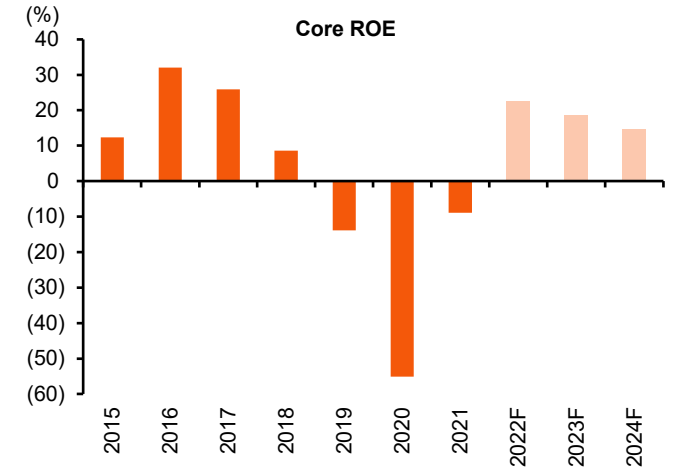
Valuation wise, we see ESSO as inexpensive. On a P/BV basis, it is still trading below its historical mean (see Exhibit 12) despite ROE being at a higher base compared to the past (Exhibit 13). The stock doesn't look expensive to us on a PE multiple basis either, trading at 7.4x 2023F PE (see Exhibit 14).

Ex 12: P/BV Band



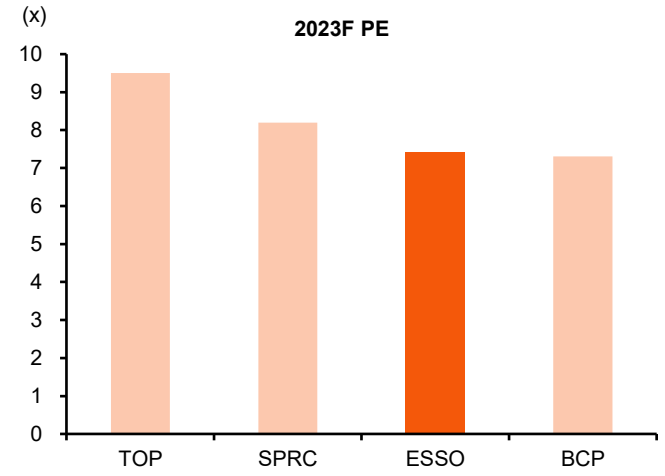
Sources: Bloomberg, Thanachart estimates

Ex 13: ROE At A Higher Base



Sources: Company data; Thanachart estimates

Ex 14: 2023F PE Of ESSO And Refinery Peers



Sources: Bloomberg; Thanachart estimates

Ex 15: 12-month DCF-based TP Calculation, Using A Base Year Of 2023F

(Bt m)		2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F	Terminal Value
EBITDA + dividend		9,349	8,830	7,024	7,834	8,440	8,091	7,434	8,040	8,646	8,297	8,372	
Free cash flow		6,847	6,851	5,022	5,628	6,107	5,761	5,222	5,820	6,316	5,970	4,878	71,854
PV of free cash flow		6,340	5,872	3,935	4,066	4,067	3,537	2,955	3,036	2,925	2,538	1,904	28,044
Risk-free rate (%)	2.5												
Market risk premium (%)	8.0												
Beta	1.1												
WACC (%)	8.0												
Terminal growth (%)	2.0												
Enterprise value - add investments	69,221												
Net debt (2022F)	13,498												
Minority interest	8												
Equity value	55,715												
# of shares (m)	3,461												
Equity value/share (Bt)	**16.0**												

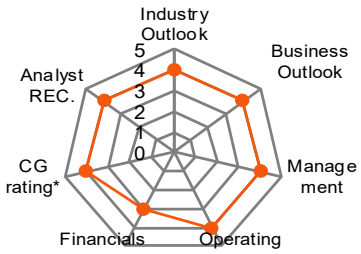
Sources: Company data, Thanachart estimates

COMPANY DESCRIPTION

Esso (Thailand) Pcl (ESSO) is one of the leading refining companies in Thailand. It operates a 177,000bpd complex refinery with a Nelson Complexity of 6.6. It controls 13% of Thailand's refining production capacity and commands around a 15% oil retail market share. ESSO also has a PX capacity of 0.5m tonnes. The company is a 65%-owned subsidiary of ExxonMobil while the Ministry of Finance owns 7%. ESSO has one of the highest sales volumes in the domestic market at over 90%, as its parent, ExxonMobil, has strategically positioned ESSO as a key refinery supplier for Thailand, while ExxonMobil's larger refinery and petrochemical complex in Singapore is used for export markets.

Source: Thanachart

COMPANY RATING



Rating Scale	
Excellent	5
Good	4
Fair	3
Weak	2
Very Weak	1
None	0

Source: Thanachart; *CG Rating

THANACHART'S SWOT ANALYSIS

S — Strength

- Technology transfer and benefits of crude sourcing from Exxon – its parent company.

W — Weakness

- Inactive parent company policy limits growth potential.
- Government intervention in retail refined oil price easier than at the wholesale level via control of marketing margins.
- Being a less complex refinery would cause the company to have a higher cost structure and is thus less competitive.

O — Opportunity

- Only moves along with industry; limited growth opportunities in our view.

T — Threat

- Rivals under PTT group are active in capacity expansion and new areas of growth potential.
- Threat of substitutes such as electric vehicles may lower demand for oil products.

CONSENSUS COMPARISON

	Consensus	Thanachart	Diff
Target price (Bt)	11.12	16.00	44%
Net profit 22F (Bt m)	7,213	13,062	81%
Net profit 23F (Bt m)	4,942	4,263	-14%
Consensus REC	**BUY: 3**	**HOLD: 3**	**SELL: 1**

Sources: Bloomberg consensus, Thanachart estimates

HOW ARE WE DIFFERENT FROM THE STREET?

- Our 2022F EPS estimate is higher than consensus mainly due to our higher GRM assumptions.
- Consequently, our target price is higher than consensus.

RISKS TO OUR INVESTMENT CASE

- Lower-than-expected refining margins would be the key downside risks to our call.
- Lower-than-expected domestic demand growth would negatively impact ESSO's oil retail business and is another downside risk to our call.

Source: Thanachart

INCOME STATEMENT

FY ending Dec (Bt m)	2020A	2021A	2022F	2023F	2024F
Sales	126,672	172,878	169,762	169,343	165,990
Cost of sales	131,408	168,408	155,396	157,926	155,242
Gross profit	**(4,736)**	**4,471**	**14,367**	**11,417**	**10,748**
% gross margin	-3.7%	2.6%	8.5%	6.7%	6.5%
Selling & administration expenses	5,217	5,068	4,976	4,964	4,866
Operating profit	**(9,953)**	**(597)**	**9,390**	**6,453**	**5,882**
% operating margin	-7.9%	-0.3%	5.5%	3.8%	3.5%
Depreciation & amortization	2,568	2,808	2,845	2,896	2,948
EBITDA	**(7,385)**	**2,210**	**12,235**	**9,349**	**8,830**
% EBITDA margin	-5.8%	1.3%	7.2%	5.5%	5.3%
Non-operating income	70	29	69	69	69
Non-operating expenses	0	0	0	0	0
Interest expense	(360)	(311)	(285)	(168)	(128)
Pre-tax profit	**(10,243)**	**(879)**	**9,174**	**6,354**	**5,823**
Income tax	(2,048)	1,051	3,266	1,066	1,109
After-tax profit	**(8,195)**	**(1,930)**	**5,908**	**5,288**	**4,714**
% net margin	-6.5%	-1.1%	3.5%	3.1%	2.8%
Shares in affiliates' Earnings	285	227	384	384	384
Minority interests	(1)	(1)	(1)	(1)	(1)
Extraordinary items	0	6,147	6,771	(1,408)	(660)
NET PROFIT	**(7,911)**	**4,443**	**13,062**	**4,263**	**4,437**
Normalized profit	**(7,911)**	**(1,704)**	**6,291**	**5,671**	**5,097**
EPS (Bt)	(2.3)	1.3	3.8	1.2	1.3
Normalized EPS (Bt)	(2.3)	(0.5)	1.8	1.6	1.5

Core profit to improve in 2022F on higher GRM, absence of loss-making PX unit

BALANCE SHEET

FY ending Dec (Bt m)	2020A	2021A	2022F	2023F	2024F
ASSETS:					
Current assets:	22,921	33,784	32,077	32,325	31,750
Cash & cash equivalent	262	802	802	802	802
Account receivables	5,083	8,171	8,024	8,004	7,846
Inventories	13,144	18,786	17,334	17,617	17,317
Others	4,432	6,025	5,917	5,902	5,785
Investments & loans	5,649	4,455	4,455	4,455	4,455
Net fixed assets	24,750	23,706	22,161	20,565	18,917
Other assets	8,058	8,109	8,041	8,031	7,958
Total assets	**61,378**	**70,055**	**66,734**	**65,376**	**63,080**
LIABILITIES:					
Current liabilities:	35,446	42,008	28,185	25,612	21,309
Account payables	4,452	5,117	4,722	4,799	4,717
Bank overdraft & ST loans	16,703	19,323	9,531	7,310	4,206
Current LT debt	5,167	5,667	2,795	2,144	1,233
Others current liabilities	9,125	11,900	11,137	11,360	11,152
Total LT debt	**6,333**	**3,999**	**1,973**	**1,513**	**870**
Others LT liabilities	5,239	4,839	6,036	6,030	5,982
Total liabilities	**47,019**	**50,846**	**36,193**	**33,155**	**28,162**
Minority interest	7	7	8	9	10
Preferreds shares	0	0	0	0	0
Paid-up capital	17,075	17,075	17,075	17,075	17,075
Share premium	4,032	4,032	4,032	4,032	4,032
Warrants	0	0	0	0	0
Surplus	325	731	731	731	731
Retained earnings	**(7,080)**	**(2,637)**	**8,695**	**10,375**	**13,071**
Shareholders' equity	14,352	19,201	30,532	32,213	34,909
Liabilities & equity	**61,378**	**70,055**	**66,734**	**65,376**	**63,080**

With low capex, higher profit should improve its balance sheet

Sources: Company data, Thanachart estimates

Strong cash-flow generation due to limited capex and lower working capital requirements

CASH FLOW STATEMENT

FY ending Dec (Bt m)	2020A	2021A	2022F	2023F	2024F
Earnings before tax	(10,243)	(879)	9,174	6,354	5,823
Tax paid	2,048	(1,051)	(3,266)	(1,066)	(1,109)
Depreciation & amortization	2,568	2,808	2,845	2,896	2,948
Chg In w orking capital	6,754	(8,064)	1,203	(186)	376
Chg In other CA & CL / minorities	2,269	1,436	(271)	622	293
Cash flow from operations	**3,394**	**(5,751)**	**9,685**	**8,621**	**8,330**
Capex	(1,718)	(1,763)	(1,300)	(1,300)	(1,300)
Right of use	(4,287)	(18)	0	0	0
ST loans & investments	0	0	0	0	0
LT loans & investments	(1,941)	1,193	0	0	0
Adj for asset revaluation	0	0	0	0	0
Chg In other assets & liabilities	3,126	5,685	8,036	(1,405)	(634)
Cash flow from investments	**(4,821)**	**5,098**	**6,736**	**(2,705)**	**(1,934)**
Debt financing	1,259	787	(14,691)	(3,333)	(4,657)
Capital increase	0	0	0	0	0
Dividends paid	(1)	(1)	(1,730)	(2,583)	(1,740)
Warrants & other surplus	153	406	0	0	0
Cash flow from financing	**1,411**	**1,193**	**(16,421)**	**(5,916)**	**(6,397)**
Free cash flow	**1,676**	**(7,514)**	**8,385**	**7,321**	**7,030**

We think ESSO's valuation looks attractive trading on 1.3x P/BV

Expect ESSO to pay first dividend in three years

VALUATION

FY ending Dec	2020A	2021A	2022F	2023F	2024F
Normalized PE (x)	na	na	6.7	7.4	8.3
Normalized PE - at target price (x)	na	na	8.8	9.8	10.9
PE (x)	na	9.5	3.2	9.9	9.5
PE - at target price (x)	na	12.5	4.2	13.0	12.5
EV/EBITDA (x)	na	31.9	4.6	5.6	5.4
EV/EBITDA - at target price (x)	na	37.8	5.6	7.0	6.9
P/BV (x)	2.9	2.2	1.4	1.3	1.2
P/BV - at target price (x)	3.9	2.9	1.8	1.7	1.6
P/CFO (x)	12.4	(7.3)	4.4	4.9	5.1
Price/sales (x)	0.3	0.2	0.2	0.2	0.3
Dividend yield (%)	0.0	0.0	8.2	4.0	4.2
FCF Yield (%)	4.0	(17.8)	19.9	17.3	16.7
(Bt)					
Normalized EPS	(2.3)	(0.5)	1.8	1.6	1.5
EPS	(2.3)	1.3	3.8	1.2	1.3
DPS	0.0	0.0	1.0	0.5	0.5
BV/share	4.1	5.5	8.8	9.3	10.1
CFO/share	1.0	(1.7)	2.8	2.5	2.4
FCF/share	0.5	(2.2)	2.4	2.1	2.0

Sources: Company data, Thanachart estimates

We expect net gearing to improve over the next few years

FINANCIAL RATIOS

FY ending Dec	2020A	2021A	2022F	2023F	2024F
Growth Rate					
Sales (%)	(25.2)	36.5	(1.8)	(0.2)	(2.0)
Net profit (%)	na	na	194.0	(67.4)	4.1
EPS (%)	na	na	194.0	(67.4)	4.1
Normalized profit (%)	na	na	na	(9.9)	(10.1)
Normalized EPS (%)	na	na	na	(9.9)	(10.1)
Dividend payout ratio (%)	0.0	0.0	26.5	40.0	40.0
Operating performance					
Gross margin (%)	(3.7)	2.6	8.5	6.7	6.5
Operating margin (%)	(7.9)	(0.3)	5.5	3.8	3.5
EBITDA margin (%)	(5.8)	1.3	7.2	5.5	5.3
Net margin (%)	(6.5)	(1.1)	3.5	3.1	2.8
D/E (incl. minor) (x)	2.0	1.5	0.5	0.3	0.2
Net D/E (incl. minor) (x)	1.9	1.5	0.4	0.3	0.2
Interest coverage - EBIT (x)	na	na	33.0	38.5	45.9
Interest coverage - EBITDA (x)	na	7.1	43.0	55.8	69.0
ROA - using norm profit (%)	na	na	9.2	8.6	7.9
ROE - using norm profit (%)	na	na	25.3	18.1	15.2
DuPont					
ROE - using after tax profit (%)	na	na	23.8	16.9	14.0
- asset turnover (x)	2.0	2.6	2.5	2.6	2.6
- operating margin (%)	na	na	5.6	3.9	3.6
- leverage (x)	3.5	3.9	2.8	2.1	1.9
- interest burden (%)	103.6	154.7	97.0	97.4	97.8
- tax burden (%)	na	na	64.4	83.2	80.9
WACC (%)	8.0	8.0	8.0	8.0	8.0
ROIC (%)	(20.4)	(1.4)	12.8	12.2	11.2
NOPAT (Bt m)	(9,953)	(597)	6,048	5,371	4,762
invested capital (Bt m)	42,293	47,389	44,030	42,377	40,417

Sources: Company data, Thanachart estimates

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