



Sasol Ltd (SOL SJ)

Date: 24 February 2021

Investment case review – corner turned?

Key message: We have reviewed our profit estimates for Sasol following the recent results announcement. We have also raised our estimates for oil prices to reflect the current high price environment.

- **Earnings upgrades, not as large as they look:** We raise our HEPS estimate from R13.55/share to R30.20 to include the reversal of currency and hedge related losses. We increase our core HEPS from R15.73 to R19.72. Our estimate for HEPS for FY22 increases to R32.65. The upgrade is mostly as a result of higher oil prices. Spot earnings remain around 20% higher than our estimates.
- **Sasol Energy:** Prices were low, but revenues surprised on the upside. The business benefited from inventory gains as oil acquired at lower prices were refined during the half. These gains should not recur in 2H but higher product prices should drive profits in 2H.
- **Base Chemicals:** Revenues were supported by the weaker rand but price realisation in polymers and solvents were below the average benchmarks. There is a lag and prices should be higher in 2H. We expect lower prices in the longer run as fundamentals deteriorate.
- **Performance Chemicals:** Profits remain under pressure as key markets in the organics segment remain weak. We expect higher prices in 2H as PKO, benzene and kerosene prices have increased.
- **LCCP:** Sasol guides that the EBITDA run rate at current prices is at \$30mn/month. Based on this guidance and other datapoints we expect EBITDA of \$116mn for the full year (\$155mn at spot prices).
- **Cost savings:** Sasol's cost savings brought cash fixed costs down to R28bn in 1H (-6%). Restructuring costs and the reintroduction of short-term incentives should however see higher costs in 2H. Sasol guides that total cash fixed costs are targeted at less than R60bn for the year.
- **Depreciation:** All the business units benefitted from lower depreciation following the impairments at the end of FY20. Depreciation should decline once more in 2H following the LCCP and Gemini disposals.
- **Balance sheet:** We expect Net debt: EBITDA at 1.9x at year end. The balance sheet appears to be secured against minor price moves. Sasol should plan for more volatility and dividends are unlikely for 18 months.
- **Rating:** Based on the higher near-term profits we raise our target price for Sasol to R210/share. We maintain an Outperform rating.

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Rating		OVERWEIGHT
Share price	R/share	194.8
Target price	R/share	210.0
Expected dividend	R/share	0.0
Total expected return	%	7.8%
Market cap	Rmn	123 501
Shares outstanding	mn	634

Financial summary

ZARmn	FY19	FY20	FY21E	FY22E	FY23E
Revenue	203 438	190 711	197 982	211 060	222 752
EBITDA	47 051	34 976	42 854	53 127	53 895
Net Income	4 299	(91 109)	21 226	20 250	18 222
Headline EPS	30.54	(11.79)	30.20	32.64	29.25
Core headline eps	38.13	14.79	19.72	33.37	29.97
Dividend	5.9	0.0	0.0	0.0	11.0
Dividend yield	1.7%	0.0%	0.0%	0.0%	4.3%

Source: Company data, Chronux Research estimates

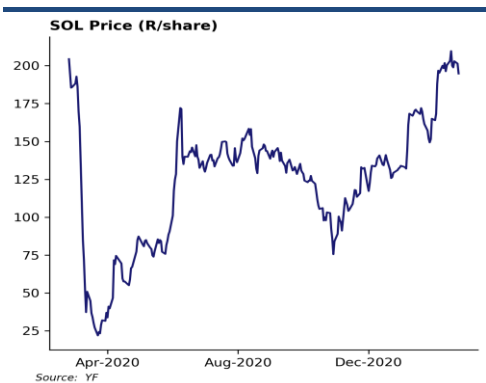


Figure 1 Financial summary

Financial year to June	FY19	FY20	FY21E	FY22E	FY23E
ZAR/\$ exchange rate	14.06	15.44	15.85	15.75	16.55
Brent oil price	69.77	54.53	49.25	55.00	55.00
Per share data					
Earnings	6.97	(147.46)	34.35	32.64	29.25
Headline earnings (diluted)	30.54	(11.79)	30.20	32.64	29.25
NAV	356.65	249.70	248.10	272.94	309.07
Dividend	5.90	0.00	0.00	0.00	11.00
Valuation ratios					
P/E ratio	11.47	(11.21)	6.68	6.18	6.89
EV/EBITDA	7.36	7.58	5.44	4.43	4.57
P/B	0.98	0.53	0.81	0.74	0.65
Dividend yield	2.9%	0.0%	0.0%	0.0%	5.5%
Income Statement (ZAR mn)					
Sales	203 438	190 711	197 982	211 060	222 752
Operating costs	(194 814)	(301 394)	(163 806)	(179 378)	(191 709)
EBIT	8 624	(110 683)	34 176	31 682	31 043
Net interest expense	(466)	(6 381)	(5 973)	(2 807)	(3 336)
Non-operating expenses	0	0	0	0	0
Pretax profit	9 232	(117 411)	28 794	29 887	28 782
Tax	(3 157)	26 139	(7 026)	(8 136)	(8 840)
Minorities	(1 776)	163	(542)	(1 501)	(1 721)
Net income	18 942	(7 285)	18 730	20 250	18 222
Cash flow statement (ZARmn)					
Depreciation/amortisation	18 330	22 573	17 311	17 711	18 767
Cash from operations	50 049	36 545	41 880	52 270	53 247
Changes in working capital	2 410	5 838	(3 776)	(3 147)	(1 310)
Other non-cash items	23 096	125 002	(10 199)	1 865	2 361
Available cash	44 208	29 729	29 921	37 203	38 940
Capital expenditure	(56 142)	(34 544)	(19 737)	(24 542)	(24 281)
Acquisitions/disposals	(469)	(4 006)	47 202	0	0
Investing cash flow	(56 611)	(38 550)	27 465	(24 542)	(24 281)
Changes in borrowings	27 178	68 226	(62 914)	(19 000)	(14 735)
Dividend paid	(11 475)	0	0	0	(2 055)
Financing cash flow	23 501	26 858	(62 914)	(19 000)	(14 735)
Change in cash	(377)	18 037	(5 529)	(6 339)	(2 131)
Balance sheet (ZARmn)					
Total assets	469 956	479 137	395 711	391 282	408 486
Cash and equivalents	16 676	34 713	29 185	22 844	20 715
Current assets	62 138	143 230	91 262	93 574	97 003
Fixed assets	391 141	301 193	275 264	274 865	290 768
Total liabilities	244 173	319 914	236 941	214 966	207 276
Long-term liabilities	195 075	226 796	169 769	151 437	100 551
Current liabilities	49 098	93 118	67 172	63 529	106 725
Total shareholders' funds	225 783	159 223	158 770	176 316	201 210
Net cash/debt	(124 266)	(178 553)	(103 017)	(87 258)	(78 250)
Key ratios					
Operating margin	4%	-58%	17%	15%	14%
RoE	3%	0%	14%	13%	11%
RoIC	7%	4%	5%	5%	5%
WACC	11%	10%	10%	10%	10%
Net debt/equity	57%	116%	67%	52%	41%

Source: Company data, Chronux Research estimates

We have reviewed our earnings estimates for Sasol to reflect the recent 1HFY21 results report as well as in the light of higher current oil and chemical prices. We have incorporated the reversals of currency losses (hedges and translations) into our estimate for headline earnings and raise our headline earnings estimate from R13.55/share to R30.20/share. Our estimate of core earnings is also raised from R15.73/share to R19.72/share. We also raise our estimate for headline earnings for FY22 to R32.65/share, assuming oil prices remain higher for longer. The upgrades are largely as a result of higher than expected oil prices. Based on the higher near-term profit and cash flow expectations we raise our target price from R175/share to R210/share. We maintain an Outperform rating.

Much higher earnings than initially expected – time to upgrade

Sasol's reported headline earnings of R19.06/share for 1HFY21 were well ahead of our estimates (before the publishing of the trading statement). We analyse key areas of difference that impacted earnings in 1H.

- **Reversal of currency related losses:** Sasol reported an unrealised gain of R5bn on hedging instruments. The bulk of this gain (R3.2bn) resulted from a reversal of unrealised gains on currency hedges incurred at the end of FY20. The company also reported a currency translation gain of R4.6bn, driven by a R6.4bn revaluation of an internal loan between Sasol Financing International and Sasol Investment Company. The company also reported currency translation losses of R1.8bn as the rand strengthened against the US dollar. Net translation gains and gains on derivatives impacted earnings by R14.48/share in the half.
- **Sasol Mining:** Production at the Sasol Mining business was flat on 1HFY20 and remains below optimum levels. Productivity has increased however, and management is guiding toward further improves in 2H. Management guides to increased demand for export coal and external coal purchases were slightly lower as inventory levels normalised. Internal selling prices increased by 4% but prices achieved for export coal at \$40/t were well below the Richards Bay list price of \$67/t, most likely due to timing differences. Overall, we expect an increase in revenues in profits in 2H, mainly due to the increase in export coal prices.
- **Sasol EPI:** The upstream business reported a 25% decline in revenues, mainly as a result of a 32% decline in internal gas selling prices (driven by lower oil prices). These lower gas prices benefited the downstream businesses, but prices should recover in 2H following the recent increases in oil prices.
- **Sasol Energy:** This business surprised on the upside and revenues decreased by 27%, despite a 10% decrease in white product sales and basic fuel prices being 27% lower than 1HFY21. Gas sales volumes increased but prices would not have changed significantly pending Sasol's application for new gas prices. The business also benefitted from gains in inventories as crude oil that was acquired at lower prices at the end of FY20 was refined and higher prices realised during the half. This benefit should not recur in 2H. The annual shutdown was performed in 2HFY20 instead of 1HFY21 which benefitted the business in the half. We expect a further improvement in sales in Sasol Energy, but margins should be negatively impacted by higher gas prices as well as the refining of more costly oil in the period. Depreciation in the business declined by more than R1bn following the asset impairments at the end of FY20.
- **Base Chemicals:** This segment benefitted from significantly higher volumes (+8%) as well as a 13% weaker rand. Achieved polymer prices in US dollars were 17% lower while solvent prices increased by 5%. These price realisations were well below the published prices where polymer prices increased by 6% and solvent prices increased by 23%. This is most likely a lag effect as prices increased towards the end of the period and price realisations should be higher in 2H. The impact of higher prices in 2H could be offset by higher internal gas prices, however. Depreciation in the Base Chemicals segment also declined by R1bn (including the LCCP) as a result of the FY20 impairments.
- **Performance Chemicals:** This segment remains under pressure and revenues reported in US dollar decline to the lowest level in all the years the company has reported on the segment. \$ revenues declined by 5% but as a result of the weaker rand, revenues in rands were 7% higher. Volumes in the organics segment in particular remains under pressure as certain market segments (automotive and oil & gas drilling) remain under pressure. Product prices also remain weak and realised prices declined by 6%. Organics prices were 6% lower, waxes were 8% lower and prices for advanced materials declined by 28%. Management has indicated that prices in the mid-cut alcohols range are moving higher with PKO prices and higher kerosene and benzene prices should support higher LAB prices in 2H.

- **LCCP:** Sasol indicates that the LCCP incurred a loss of 2.1bn at the EBIT level and based on our estimate this translates to an EBITDA loss of \$54mn, impacted by the shutdowns due to the hurricanes as well as the delayed start-up of the LDPE plant. Sasol guides that at current prices the business is generating EBITDA of \$30mn per month. The company also indicates that insurance payments on the damage of the LCCP has been received early in 2H and based on previous guidance we expect this to be around \$25mn. Based on these datapoints and using our own chemical price assumptions for the financial year we estimate EBITDA of \$116mn for the full year.
- **Cost savings:** Sasol announced that it saved fixed costs of R3.7bn before cost inflation and R3.2bn after including cost inflation and total cash fixed costs ended the half at R28.64bn. In the cost buckets we note that employee costs declined by R2bn, mainly due to asset disposals and shifting of employees after disposals. The stronger currency should assist with lower cash fixed costs in 2H and Sasol guides to full year cash fixed costs below R60bn (at most R2.4bn or 4% higher than cash fixed costs achieved in FY20 and 2H costs at most R2.8bn or 10% higher than 1H). Cash fixed costs in 2H should be higher due to the inclusion of restructuring costs and payments of severances as well as a return of short-term incentives which have not been paid in the last year. These costs will be allocated to the different business units, impacting 2H profits in all of these businesses. The cost saving as a result of disposals and headcount reductions are sustainable but short-term incentives will impact costs in future.
- **Depreciation:** We highlight that depreciation charges declined by R1.9bn following the large impairments made at the end of FY20. Depreciation is set to take a further step down as the disposals towards 1H end becomes effective.

We show Sasol's key cost elements in Figure 2, highlighting (i) higher maintenance costs, despite the shutdown at Synfuels not happening, (ii) higher sequential employee costs and (iii) the decrease in depreciation.

Figure 2 Sasol's key cost elements, ZARmn

	FY19	1HFY20	2HFY20	FY20	1HFY21	YoY	HoH
Materials and consumables	90589	46373	43736	90109	41247	-11%	-6%
Selling and distribution	7836	3831	4557	8388	4128	8%	-9%
Maintenance expenses	10277	5265	5174	10439	5695	8%	10%
Employee expenses	30667	16445	14222	30667	14396	-12%	1%
Other expenses	9880	6965	3666	10631	-1521	na	na
Depreciation	22575	10977	11598	22575	9048	-18%	-22%
Total	174862	89856	86410	176266	72993	-19%	-16%

Source: Chronux Research estimates

- **Expensed interest:** Sasol's total interest bill amounted to R4.4bn of which R602mn was capitalised. The company guides to expensed interest of R7-8bn for the full year. This guidance appears high, especially in the light of debt that has been repaid following the asset disposals in 1HFY20. Our estimate is at the bottom of the range.
- **Tax:** Sasol reported a full year tax rate of 16.2%, utilising tax losses to the amount of R1.8bn in the period. This lowered the effective tax rate by 10%. This loss should flow through to the full year impacting the tax rate by at least 6%. Exempt income also lowered the income statement tax by R948mn which should flow through to the second half. We therefore expect an effective tax rate of 24% for the full year.

Oil price higher than expected – a short term upgrade

Oil prices have been consistently higher than our expectations which prompt us to upgrade our expectation for the full year from \$45.95 to \$49.25/bbl. We now assume an oil price in 2H of \$55.78/bbl compared to a previous price of \$49.17/bbl. The higher oil price assumption also flows through to chemical prices and our petrochemical price deck has been upgraded to reflect these higher oil prices. Our assumptions for Sasol's key commodity prices are shown in Figure 3 and we highlight that we still expect weakness in petrochemical margins in FY22 and FY23 as logistics constraints are lifted and new supply floods to the market. Slightly lower oil prices could also impact on chemical prices negatively. We expect a gradual recovery in refining margins, but margins should only approach long run mid cycle margins in FY23 or beyond.

Figure 3 Chronux commodity price estimates

		FY19	FY20	FY21E	FY22E	FY23E	Spot
Oil Price	US\$/bbl	69.77	54.53	49.25	55.00	55.00	62.14
Exchange Rate	R/US\$	14.06	15.44	15.85	15.75	16.55	14.69
Refining margin	US\$/bbl	10.27	9.34	4.83	9.91	10.53	6.87
Coal prices	US\$/t	89.20	65.03	70.00	66.30	67.63	83.00
Ethane	US\$/gal	33.18	17.02	23.00	24.23	24.62	24.75
Ethylene Price (Asia)	US\$/t	992	707	844	809	782	865
Ethylene price (US)	US\$/t	450	362	544	509	382	913
Propylene	US\$/t	935	745	856	817	816	990
LDPE	US\$/t	1 076	920	1 174	1 051	958	1 470
LLDPE	US\$/t	1 063	830	933	968	897	1 020
Polypropylene	US\$/t	1 199	935	1 050	1 011	1 011	1 240
MEG	US\$/t	892	593	607	573	547	700
Solvents	US\$/t	961	872	987	990	1 005	
BC Basket price	US\$/t	905	770	828	779	766	
PC Basket price	US\$/t	1 844	1 729	1 743	1 766	1 763	

Source: Nymex, CEF, PolymerUpdate, Chronux Research estimates

Based on these updated chemical price assumptions as well as the 1HFY21 results discussed above we upgrade our headline earnings estimate from R13.50/share to R30.20/share (including the reversal of losses on currency and hedges for the first time). Our divisional forecasts are shown in Figure 4.

Figure 4 Sasol divisional profit and loss statement, ZARmn

To June (Rm)	FY19	FY20	FY21E	FY22E	FY23E
Mining	20 876	19 891	22 089	22 966	24 512
EPI	5 184	5 204	5 101	5 314	5 650
Energy	83 803	67 907	64 248	76 435	80 753
Base Chemicals	48 813	45 526	50 673	47 553	49 130
Performance Chemicals	68 296	66 689	66 416	69 909	73 920
Lake Charles Project	0	9 860	14 741	15 426	16 832
Group functions	78	30	30	0	0
Revenue (internal and external)	227 049	215 107	223 299	237 603	250 798
Mining	6 570	4 959	6 911	6 907	7 565
EPI	2 971	3 205	2 075	2 250	2 325
Energy	21 373	11 348	12 443	13 668	14 535
Base Chemicals	8 620	6 070	9 166	6 043	5 184
Performance Chemicals	11 679	10 079	10 000	10 601	10 821
Lake Charles Project	(3 791)	(966)	2 076	8 118	8 974
Group functions	(2 534)	(5 424)	3 765	281	181
EBITDA	44 887	29 271	46 437	47 868	49 584
Depreciation & Amortisation	(18 222)	(22 578)	(17 378)	(17 831)	(18 933)
Other (cost savings)	0	0	(2 500)	1 700	700
Capital Items	(18 645)	(110 834)	3 300	0	0
Translation gains (losses)	604	(6 542)	4 320	(49)	(299)
Total operating income	8 624	(110 683)	34 178	31 688	31 053
Income from associates	1 074	(347)	591	1 012	1 075
Profit before interest and tax	9 697	(111 030)	34 770	32 700	32 128
Interest paid	(8 195)	(10 823)	(8 296)	(4 970)	(5 343)
Interest received	787	922	1 137	935	827
Interest capitalised	6 942	3 520	1 186	1 227	1 214
Net interest	(466)	(6 381)	(5 973)	(2 808)	(3 302)
Profit before tax	9 232	(117 411)	28 797	29 892	28 826
Tax	(3 157)	26 139	(7 028)	(8 138)	(8 852)
Profit after tax	6 075	(91 272)	21 769	21 755	19 974
Minorities	(1 776)	163	(542)	(1 501)	(1 721)
Attributable earnings	4 299	(91 109)	21 227	20 254	18 253
Headline adjustment	14 643	83 824	(2 496)	0	0
Headline earnings	18 942	(7 285)	18 731	20 254	18 253
Headline earnings per share	30.54	-11.79	30.20	32.65	29.30
Core headline earnings per share	38.13	14.79	19.72	33.38	30.02

Source: Company data, Chronux Research estimates

As shown above, our estimate of Sasol's core earnings (Sasol's methodology) comes to R19.72/share and our estimate of earnings based on adjusted EBITDA is at R19.80/share as shown in Figure 5.

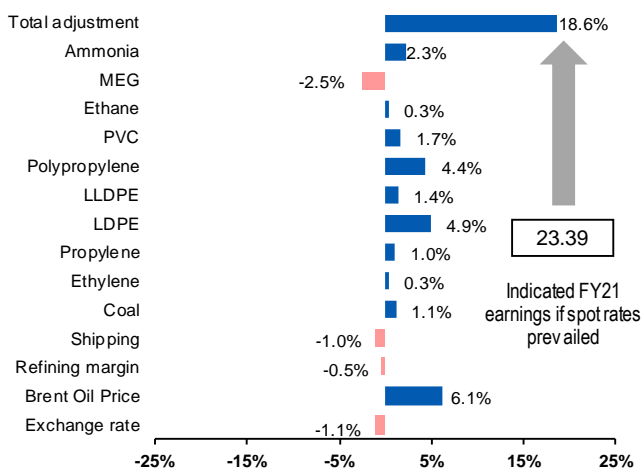
Figure 5 Sasol's earnings estimated from adjusted EBITA

	FY18	FY19	FY20	FY21E	FY22E
Adjusted EBITDA	51 533	47 051	34 976	42 850	53 117
Depreciation and amortisation	(16 425)	(18 222)	(22 578)	(17 378)	(17 831)
EBIT	35 108	28 829	12 398	25 471	35 286
Net interest	(5 611)	(7 408)	(9 901)	(7 159)	(4 035)
Profit before tax	29 497	21 421	2 497	18 313	31 251
Tax at 30%	(8 849)	(6 426)	(749)	(5 494)	(9 375)
Profit after tax	20 648	14 995	1 748	12 819	21 876
Minority interest	(1 417)	(1 776)	163	(542)	(1 501)
Attributable profit	19 231	13 219	1 911	12 277	20 375
Earnings per share	31.23	21.31	3.09	19.80	32.84
Sasol's reported core earnings	36.03	38.13	14.79	19.72	33.38

Source: Company data, Chronux Research estimates

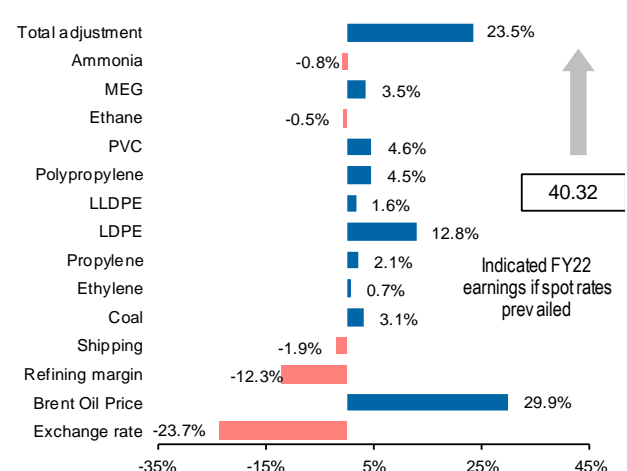
Our earnings estimates remain well below earnings if spot prices remained for the full year. We show our estimates of earnings if spot prices remained in Figures 6 and 7.

Figure 6 Core HEPS at spot rates, FY20E



Source: Chronux Research estimates

Figure 7 Headline earnings at spot rates, FY22E



Source: Chronux Research estimates

The sensitivity of our estimates for core headline earnings are shown in Figures 8 and 9. We also show the sensitivity of adjusted EBITDA to oil price and currency assumptions in Figures 10 and 11.

Figure 8 FY21E Core HEPS sensitivity, ZAc/share

	Average Exchange Rate (R/US\$)									
	13.85	14.35	14.85	15.35	15.85	16.35	16.85	17.35	17.85	
34.0	(1 374)	(1 191)	(1 011)	(833)	(651)	(468)	(286)	(112)	59	
37.0	(924)	(724)	(527)	(333)	(135)	64	262	452	639	
40.0	(473)	(257)	(44)	166	381	596	811	1 017	1 220	
43.0	(22)	210	439	666	897	1 129	1 359	1 582	1 801	
46.0	429	677	923	1 165	1 412	1 661	1 908	2 146	2 382	
Average Brent Oil Price (US\$/bbl)	49.3	917	1 184	1 447	1 707	1 972	2 238	2 502	2 759	3 012
52.0	1 330	1 612	1 890	2 165	2 444	2 725	3 005	3 276	3 544	
55.0	1 781	2 079	2 373	2 665	2 960	3 257	3 553	3 841	4 125	
58.0	2 232	2 546	2 856	3 164	3 476	3 790	4 102	4 406	4 706	
61.0	2 683	3 013	3 340	3 664	3 992	4 322	4 650	4 970	5 288	
64.0	3 134	3 481	3 824	4 164	4 509	4 854	5 199	5 535	5 869	

Source: Chronux Research estimates

Figure 9 FY22E HEPS sensitivity, ZAc/share

	Average Exchange rate (R/US\$)								
	13.75	14.25	14.75	15.25	15.75	16.25	16.75	17.25	17.75
30.0	(2 404)	(2 163)	(1 923)	(1 682)	(1 441)	(1 200)	(960)	(722)	(484)
35.0	(1 354)	(1 079)	(804)	(529)	(255)	(45)	153	351	550
40.0	(347)	(47)	180	407	633	860	1 086	1 312	1 538
45.0	492	747	1 001	1 256	1 510	1 764	2 019	2 273	2 526
50.0	1 257	1 540	1 823	2 105	2 387	2 670	2 951	3 233	3 515
55.0	2 023	2 334	2 644	2 955	3 265	3 575	3 884	4 194	4 504
60.0	2 789	3 128	3 466	3 804	4 142	4 480	4 818	5 155	5 493
65.0	3 555	3 922	4 288	4 654	5 020	5 385	5 751	6 116	6 481
70.0	4 321	4 715	5 110	5 503	5 897	6 290	6 684	7 077	7 470
75.0	5 087	5 509	5 931	6 353	6 774	7 196	7 617	8 038	8 459
80.0	5 853	6 303	6 753	7 203	7 652	8 101	8 550	8 999	9 448

Source: Chronux Research estimates

Figure 10 FY21E adjusted EBITDA sensitivity, ZAc/share

	Average Exchange Rate (R/US\$)								
	13.85	14.35	14.85	15.35	15.85	16.35	16.85	17.35	17.85
34.0	19 638	19 794	19 950	20 109	21 544	23 600	25 657	26 268	26 430
37.0	23 303	23 590	23 878	24 168	25 735	27 924	30 113	30 856	31 149
40.0	26 968	27 386	27 806	28 227	29 927	32 247	34 569	35 443	35 869
43.0	30 632	31 182	31 734	32 287	34 118	36 571	39 025	40 031	40 589
46.0	34 296	34 978	35 662	36 346	38 310	40 895	43 481	44 619	45 309
49.3	38 268	39 093	39 920	40 747	42 854	45 582	48 312	49 593	50 426
52.0	41 623	42 569	43 517	44 466	46 693	49 543	52 393	53 795	54 749
55.0	45 287	46 365	47 444	48 525	50 885	53 866	56 849	58 384	59 469
58.0	48 950	50 160	51 372	52 585	55 077	58 190	61 305	62 972	64 190
61.0	52 613	53 956	55 299	56 644	59 268	62 514	65 761	67 560	68 910
64.0	56 277	57 751	59 227	60 704	63 460	66 838	70 217	72 149	73 631

Source: Chronux Research estimates

Figure 11 FY22E adjusted EBITDA sensitivity, ZAc/share

	Average Exchange rate (R/US\$)								
	13.75	14.25	14.75	15.25	15.75	16.25	16.75	17.25	17.75
30.0	8 381	10 328	12 270	14 211	16 151	18 091	20 031	21 971	23 911
35.0	14 864	17 036	19 207	21 379	23 551	25 724	27 897	30 071	32 245
40.0	21 328	23 732	26 136	28 541	30 947	33 353	35 761	38 168	40 577
45.0	27 787	30 424	33 062	35 701	38 341	40 982	43 623	46 265	48 908
50.0	34 243	37 114	39 987	42 860	45 734	48 609	51 485	54 362	57 239
55.0	40 698	43 804	46 911	50 018	53 127	56 237	59 347	62 458	65 570
60.0	47 153	50 493	53 834	57 176	60 519	63 864	67 208	70 554	73 900
65.0	53 607	57 182	60 757	64 334	67 912	71 490	75 070	78 650	82 231
70.0	60 061	63 870	67 680	71 492	75 304	79 117	82 931	86 746	90 561
75.0	66 515	70 559	74 603	78 649	82 696	86 743	90 792	94 841	98 891
80.0	72 969	77 247	81 526	85 806	90 088	94 370	98 653	102 937	107 221

Source: Chronux Research estimates

Not only about the earnings – cash flow and balance sheet under the spotlight

The recovery of the balance sheet, the need for a rights issue and Sasol's ability to reinstate dividends remains a central theme in the investment case. Based on our updated assumptions we expect positive free cash flow (excluding disposals) of around 10bn in FY21, increasing to R12bn in FY22. At spot rates we estimate free cash flow of R13.5bn in FY21 and R17.5bn in FY22.

- Working capital outflow:** We expect an outflow of working capital as the company settles outstanding payables on the LCCP project (FY20: R3.5bn) and crude oil inventories rise on higher prices. Crude oil volumes in inventory should be lower however as Natref continues to run at reduced rates.

- **US tax relief:** We believe Sasol received a partial payment of the R5.4bn tax relief offered by the US Government in 1H with the bulk being paid early in 2H. This should impact cash flow tax significantly in FY21.
- **Capital expenditure:** We assume capital spending at the higher end of Sasol's guided range for FY21 (R18-20bn) and beyond (R20-25bn).
- **Asset disposals:** We assume Sasol completes the sales of the air separation units as well as the CTRG plant in the current financial year.

We show our estimates of free cash flow in Figure 12.

Figure 12 Sasol free cash flow statement, ZARmn

To June (Rm)	FY19	FY20	FY21E	FY22E	FY23E
Operating profit	26 665	6 692	29 058	30 037	30 651
Capital Items	(18 645)	(110 834)	3 300	0	0
Translation gains (losses)	604	(6 542)	4 320	(49)	(299)
Total operating income	8 624	(110 683)	36 678	29 988	30 353
Depreciation	17 793	22 125	16 925	17 378	18 480
Amortisation	537	448	386	333	287
Change in provisions	3 051	5 131	622	1 489	1 975
Impairments	18 645	110 834	(3 300)	0	0
Other	1 400	8 690	(9 436)	3 073	2 136
Cash from operations	50 049	36 545	41 875	52 260	53 231
Change in working capital	2 410	5 838	(3 776)	(3 147)	(1 310)
Cash generated	52 459	42 383	38 100	49 113	51 921
Net Finance Charges	(5 812)	(7 154)	(7 159)	(4 035)	(4 516)
Tax paid	(3 946)	(5 659)	(1 026)	(7 886)	(8 457)
Dividends received	1 506	159	0	0	0
Retained operating cash	44 208	29 729	29 914	37 192	38 949
Maintenance Capex	(23 557)	(19 017)	(19 356)	(23 552)	(24 281)
Expansion capex	(32 585)	(15 527)	(380)	(990)	0
Other	(469)	(4 006)	47 202	0	0
Cash used in investing	(56 611)	(38 550)	27 465	(24 542)	(24 281)
Free cash flow	(12 403)	(8 821)	57 379	12 650	14 668
Shares issued	0	0	0	0	0
Dividends	(11 475)	0	0	0	0
Change in debt	27 178	68 226	(62 914)	(19 000)	(14 735)
Other (incl translations)	(3 677)	(41 368)	0	0	0
Cash from financing	12 026	26 858	(62 914)	(19 000)	(14 735)
Change in cash	(377)	18 037	(5 535)	(6 350)	(67)

Source: Company data, Chronux Research estimates

Based on these estimates we anticipate the company will close the year with \$5.3bn of net debt (R80.6bn) and net debt: EBITDA should fall just below 2x (Figure 13).

Figure 13 Sasol's balance sheet ratios

To June (Rm)	FY19	FY20	FY21E	FY22E	FY23E
Balance sheet					
Net cash (debt)	(121 902)	(172 091)	(96 562)	(80 811)	(69 742)
Lease liabilities	(7 445)	(17 719)	(15 919)	(14 119)	(12 319)
Net cash (debt) (ex lease liabilities)	(114 457)	(154 372)	(80 643)	(66 692)	(57 423)
Adjusted EBITDA	46 891	34 976	42 850	53 117	53 878
Net debt: EBITDA	2.6	4.9	2.3	1.5	1.3
Net debt: EBITDA (ex lease liabilities)	2.4	4.4	1.9	1.3	1.1
Net debt: equity	57%	116%	67%	52%	39%

Source: Company data, Chronux Research estimates

We estimate that if oil prices decline to \$35/bbl that the company will be at risk of breaching the debt covenant of 3.0x by the end of FY22. While we see this as an unlikely scenario, the company should

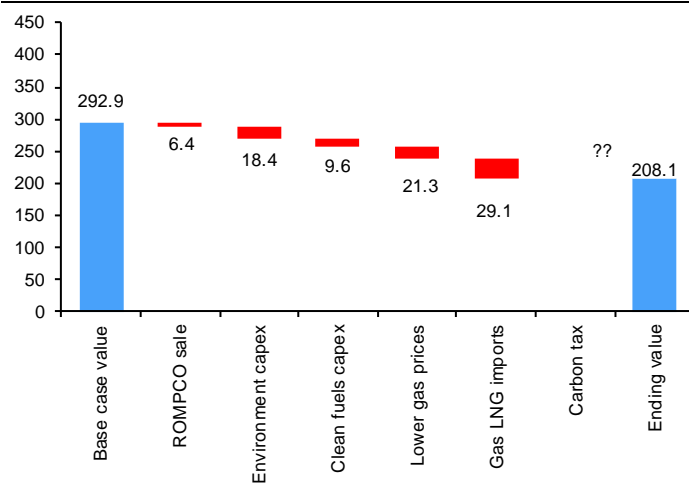
ensure its balance sheet remains strong in order to withstand a period of low oil prices. There are also significant liquidity events on the horizon as Sasol has large tranches of debt to repay in the next three years. We would therefore not expect a dividend to be paid in either 2HFY21 or FY22.

Bottom line: Sasol's balance should be secured to withstand minor price moves. The company should however plan for volatility which should preclude the payment of dividends for at least 18 months.

Sasol – what is it worth with many uncertainties?

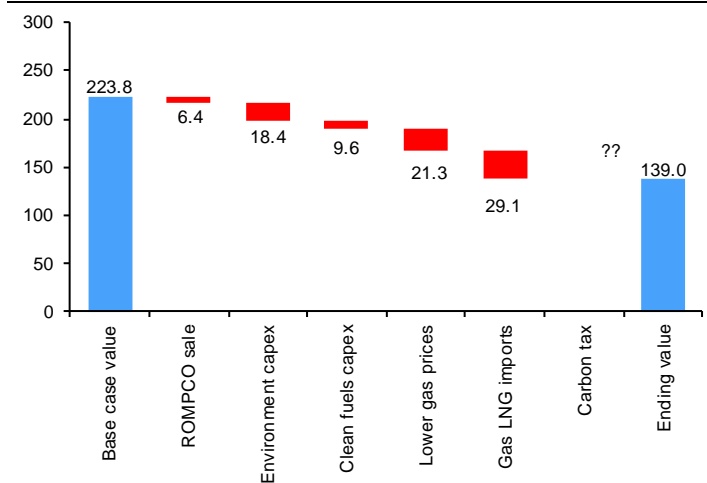
We value Sasol using an economic profit valuation and assuming worst case scenarios on a number of environmental issues. These include the near-term emission spending required, the changes in gas prices, spending on clean fuels as well as the depletion of Sasol's gas reserves in Mozambique and the likelihood of imports. Our valuation is shown in Figure 14 at a \$60/bbl long run oil price and we show the same valuation at a \$50/bbl oil price in Figure 15.

Figure 14 Sasol valuation at a \$60/bbl oil price



Source: Chronux Research estimates

Figure 15 Sasol valuation at a \$55/bbl oil price



Source: Chronux Research estimates

While we still include worst case scenarios in our valuations, we do highlight the following:

- Sasol has recently applied for new gas prices, following the constitutional court hearing on gas prices. Sasol has used a different methodology to Nersa and proposed higher gas prices. Nersa has asked for public comment. We are waiting for the finding to assess the true impact on Sasol's future profits as well as refunds to customers.
- Sasol has announced the FID on the Mozambican gas PSA project after a new field development plan was filed with the Mozambican authorities. Sasol guides that at mid case assumptions for gas reserves at the PSA would postpone the decline in production by three years. This could reduce the negative impact of declining gas reserves, but we are awaiting more concrete data on reserves.
- Sasol is assessing the viability of Natref if there is no recovery of capital spend on Clean Fuels II. The company could close the refinery which would negate the negative impact of the clean fuels capital spend on value. The production at Natref and blending synergies with Synfuels will be lost but could be replaced by imports. Sasol indicated that they will provide more clarity in coming months but the impact on valuation is not clear at this stage. The closure of Natref will impact Total SA as well as the Sasol Tswariso joint venture.

Bottom line: We raise our target price for Sasol to R210/share based on the higher near-term profits. We maintain our Overweight rating on the share.

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