Rabigh Refining and Petrochemical Co. (Petro Rabigh)

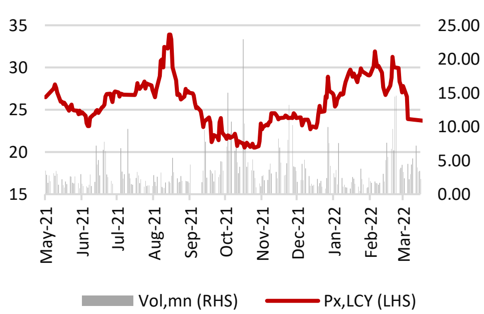
Target Price: SAR 30.3

Upside: 32.7%

Recommendation	**Buy**
Bloomberg Ticker	Petror:AB
Current Market Price (SAR)	22.8
52wk High / Low (SAR)	33.9 / 20.5
12m Average Vol. (mn)	3.5
Mkt.Cap. (SAR bn)	20.0
Shares Outstanding (mn)	876
Free Float (%)	25.0%
3m Avg Daily Turnover (SAR mn)	107.3
6m Average Daily Turnover (SAR mn)	90.0
PE 2022e (x)	28.2x
EV/EBITDA 2022e (x)	11.8x
Dividend Yield '22e (%)	0.0%
Price Performance:	
1 month (%)	-17.4%
3 months (%)	-0.2%
12 months (%)	4.0%

Source: Refinitiv, as of 22nd May 2022

Price -Volume Performance



Source: Refinitiv

- **Petro Rabigh is witnessing rising prices for its key products and higher sales volume**
- **Ongoing Russia-Ukraine crisis is triggering a rise in refined product margin as Russia is a major exporter of refined products**
- **Margins to remain comparatively stable despite the rise in key raw material (crude oil) underpinned by tightening in the refined product market**
- **Target price revised upward on the backdrop of rising product prices and improved demand amid the ongoing uncertainty and the supply crunch witnessed in the refined product market and rerated the stock to Buy**

Rabigh Refining and Petrochemical Co.'s (Petro Rabigh) topline in 1Q22 beat our expectation on the back of better-than-expected revenue generation mainly due to higher output and higher refined product prices. Despite the higher cost of sales resulting from higher crude oil prices (main feedstock), Petro Rabigh could still report a higher net income. Overall, global refinery margins worldwide have increased because of the rise in refined product prices. This rise is mainly due to a supply crunch as supply from Russia, and China has reduced. Concerning Russia, before the onset of the war and the sanctions imposed, Russia exported approximately 1 million barrels of gasoil per day. However, post Russia's invasion of Ukraine and the ongoing war, the US has banned oil imports from Russia. This was followed by Britain, which will stop imports from Russia in a phased manner over the end of the year. In Addition, the gasoil exports from China reduced this year which further intensified the supply crunch. According to IEA, throughputs in April fell 1.4 mb/d to 78 mb/d, the lowest since May 2021. This situation has triggered the global refining margins to go up despite the rise in crude oil prices. Furthermore, there has been a sizeable amount of refinery capacity shut post Covid-19, further limiting the overall supplies. According to IEA, for the first time in 30 years, global refining capacity closures exceeded new capacity in 2021.

On tracking refining margins for Topping refinery (this is used in one of the Rabigh's refineries) and comparing that to the average selling price per barrel for Rabigh's refining business, we observed the relationship between topping margins and average selling price is not an exact correlation. In fact, in 1Q21 and 2Q21, even when topping refining margins fell, the average selling price for Rabigh's refined products did not fall. Petro Rabigh derives ~61% of revenues from the refining business. We observe that the Saudi refining and retail fuel sales market operates in a controlled environment (retail fuel prices have been capped since last year to prevent volatility of international crude prices from being passed on to consumers). In this environment, we expect Petro Rabigh to benefit in a limited manner from the rise in refining margins. Global research suggests that the current high levels of refining margins are not sustainable and are likely to fall in 3Q or 4Q of 2022 as global supply is partly restored. In this context, we believe Rabigh will benefit from the rise in refining margins to a limited extent.

1Q22 earning synopsis: Rabigh's revenue in 1Q22 stood at SAR 14.4 bn, up by 42.1% YoY (+9.8% QoQ), mainly driven by favourable market conditions for the company's refined products, which account for ~61% of topline Company's net profit for the quarter stood at SAR 0.7 bn, up by 11.6% YoY (+61.5% QoQ). This was

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achieved mainly because the prices of refiners' outputs such as gasoline and diesel have risen even more sharply than the price of crude oil (main feedstock), resulting in increased refining margin. The company suffered from accumulated losses since the first quarter of 2020, led by lower profit margins from refined and petrochemical products. The loss kept increasing until 3Q20 to reach SAR 2,807.6 mn from the loss of SAR 762.7 mn in 1Q20. However, the accumulated loss has been reduced since then, driven by improved product margins and better market conditions. During the three months ended March 31, 2022, the company has been able to completely extinguish its accumulated losses of SAR 701.7 mn in FY21 and recorded retained earnings of SAR 60.8 mn in 1Q22.

Valuation and risk: Post 1Q22 earnings, we revise up our topline estimate on Petro Rabigh for FY22 by 6.3%, in the backdrop of improved demand and tightness in the refining product market. We expect the refining margins to stay at current levels before stabilizing in Q3 or Q4 of 2022, resulting from likely ease in ongoing Russia-Ukraine tension and the resulting sanctions on Russia. We have increased our FY22 net profit expectations by 6.3% to SAR 1,355.7 mn, led by increased refining margins which were partly offset by rights issue offering expenses of SAR 60 mn. The EPS estimate for FY22 is lower at SAR 0.81 vs SAR 1.58, earlier led by equity dilution resulting from rights issue offering. Considering the upside from higher refining margins but adjusting for the rights issue, our new target price for Petro Rabigh is SAR 30.3 per share. Hence, we would give this stock a Buy rating. Our revised target price implies an upside of 32.7% over the current market price. Currently, the stock trades at 28.2x P/E and 11.8x EV/EBITDA, based on our FY22 estimates. The downside risks to our valuation include sudden ease in the Russia-Ukraine war, which will reduce refined product margins. Pick up in exports from China stemming from more extended periods of lockdown and the resulting slack in domestic demand. Key upside risks to our valuation include the continuation of the ongoing war and the widening of sanctions imposed.

Rights Issue Details: The company is offering a rights issue (RI) of 795,000,000 equity shares with a nominal value of SAR 10 each at an offer price of SAR 10 per share to raise SAR 7.95 bn. The company is offering 0.907534 rights for each share held by its shareholders on the eligibility date. The shareholders eligible for the rights are the ones who own shares in the company at the date of the Extraordinary General Assembly relating to the capital increase and who are registered in the company's shareholder register at Edaa at the end of the second trading day following the Extraordinary General Assembly due to be held on June 08, 2022.

The dates are yet to be disclosed by the company regarding the start and end of the subscription and trading period. The company is spending SAR 60 mn. for this RI. From the net proceeds, Petro Rabigh will utilize SAR 5.96 bn to repay the loans owed to the founding shareholders (Saudi Aramco and Sumitomo Chemical) by capitalizing the due amounts, and the remaining SAR 1.93 bn will be used for partial repayment of the equity bridge loans.

The issue is lead managed by HSBC Saudi Arabia. The company has appointed HSBC Saudi Arabia, SNB Capital, Alinma Investment, AlJazira Capital, GiB Capital, Riyad Capital, Saudi Fransi Capital and ANB Capital as underwriters.

Post RI, Petro Rabigh's share capital of SAR 8.76 bn will stand enhanced to SAR 16.71 bn.

Change in fundamentals: i) In a bid to eliminate the company's accumulated losses incurred due to a large deficit in FY20 and strengthen the overall financial position, the company initially planned to reduce its capital and subsequently increase it via rights issue offering. However, on March 3, 2022, the company scrapped its plan to reduce capital as it improved its financial performance, which significantly reduced its accumulated loss during FY21. With improved market conditions and product margins, the company recorded retained earnings of SAR 60.8 mn after eight quarters in 1Q22. ii) The company is well on track to increase its share capital via a rights issue. The company will use 75.6% of the net proceeds, which amounts to SAR 5.96 bn, to repay the entire original principal amount of SAR 4.58 bn and accrued interest amounting to SAR 1.39 bn under the Rabigh 1 shareholder loan agreement by 2Q22, which will help reduce the company's overall debt levels. The company will utilize the remaining 24.4% of the net proceeds, which amount to SAR 1.93 bn, to partially repay the amounts under equity bridge loans by October 2022, further reducing the debt levels.

Take on rights issue: At an offer price of SAR 10, the rights issue is priced quite attractively. Majority of the shareholders (Saudi Aramco and Sumitomo chemicals) appear to be on board. There is a high probability that the rights issue will get fully subscribed. Accordingly, we have assumed a 100% subscription. The company will receive net proceeds of SAR 7.89 bn from the rights issue. The existing shareholding will be substantially diluted; however, the infusion of cash will help the company deleverage its balance sheet by repaying debt, reflecting positively on the backdrop of the rising interest rate scenario.

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Financial and valuation summary

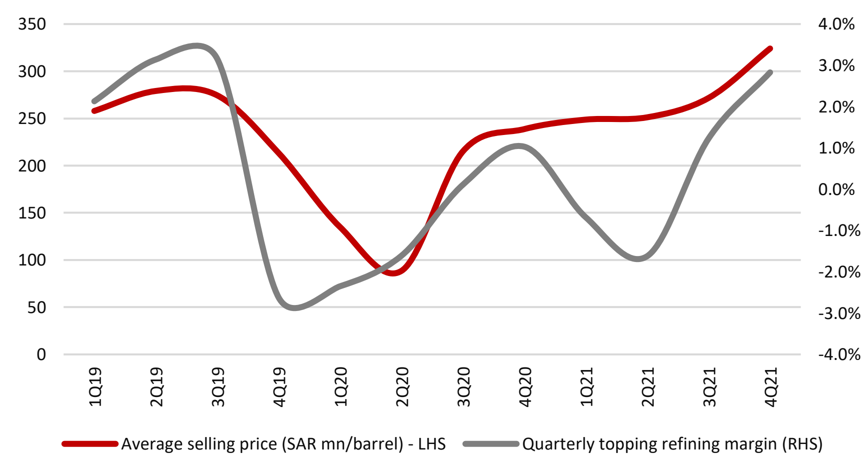
Year (SAR mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Sales	34,062	21,870	45,638	46,649	49,251	51,941
Gross profit	1,718	(903)	4,756	3,978	4,182	4,614
EBITDA	2,832	758	5,606	5,535	5,859	6,240
Operating profit	439	(2,436)	2,299	2,204	2,499	2,841
Net income	(544)	(3,781)	2,037	1,356	1,633	1,948
EPS	NA	NA	2.32	0.81	0.98	1.17
P/E (x)	NA	NA	11.4	28.2	23.4	19.6
EV/EBITDA (x)	25.2	87.1	11.4	11.8	11.2	10.5
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company Reports, U Capital Research *P/E and EV/EBITDA from 2022 onwards calculated on price of 22/05/2022*

Refining margins for different refining technology

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22
Quarterly hydrocracking refining margin	4.2%	3.8%	5.7%	-0.7%	0.5%	-0.2%	0.2%	1.1%	-0.1%	0.3%	3.4%	6.1%	15.5%
Quarterly hydroskimming refining margin	3.4%	4.5%	4.7%	-2.0%	-1.7%	-1.2%	0.5%	1.1%	0.0%	-0.6%	1.8%	4.2%	8.7%
Quarterly topping refining margin	2.1%	3.1%	3.2%	-2.6%	-2.4%	-1.6%	0.1%	1.0%	-0.7%	-1.6%	1.2%	2.8%	6.6%

Comparison of topping refining margin to Petro Rabigh's average selling price per barrel



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(SAR mn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Income Statement						
Sales	34,062	21,870	45,638	46,649	49,251	51,941
COGS	(32,344)	(22,773)	(40,882)	(42,671)	(45,068)	(47,327)
Gross profit	**1,718**	**(903)**	**4,756**	**3,978**	**4,182**	**4,614**
Selling & marketing expenses	(406)	(661)	(835)	(793)	(739)	(779)
General & administrative expenses	(960)	(928)	(881)	(1,014)	(1,043)	(1,098)
Operating profit	**439**	**(2,436)**	**3,192**	**2,204**	**2,499**	**2,841**
Finance charges	(1,022)	(1,505)	(1,089)	(592)	(556)	(520)
Finance income	264	202	196	10	9	9
Income before tax	**(319)**	**(3,739)**	**2,299**	**1,621**	**1,952**	**2,329**
Zakat and Income tax	(225)	(42)	(263)	(265)	(320)	(381)
Net income for the period	**(544)**	**(3,781)**	**2,037**	**1,356**	**1,633**	**1,948**
Balance Sheet						
Cash and bank balances	316	1,016	3,972	7,184	9,079	11,026
Trade receivables	5,364	3,990	8,257	7,637	8,165	8,587
Inventories	3,406	3,071	3,806	4,277	4,772	4,536
Property, plant and equipment	46,111	46,050	44,090	42,523	40,763	39,782
Right of use assets	12,039	11,342	10,669	9,782	9,003	8,223
Long term loans	3,450	2,983	179	145	138	131
Total assets	**74,030**	**70,694**	**73,362**	**74,498**	**74,914**	**75,323**
Trade and other payables	9,402	7,690	12,398	14,137	14,920	15,483
Total borrowings	40,455	43,212	38,729	29,262	27,471	25,680
Total lease liabilities	12,306	11,766	11,234	10,843	10,410	9,993
Share capital	8,760	8,760	8,760	16,710	16,710	16,710
Statutory reserve	252	252	252	252	252	252
Retained earnings	1,034	(2,804)	(702)	652	2,285	4,233
Total stockholders' equity	**10,041**	**6,203**	**8,306**	**17,610**	**19,243**	**21,191**
Total liabilities & stockholders' equity	**74,030**	**70,694**	**73,362**	**74,498**	**74,914**	**75,323**
Cash Flow Statement						
Cash from operating activities	1,829	944	5,297	2,143	4,850	5,705
Cash from investing activities	(1,815)	(2,336)	2,829	(551)	(730)	(1,550)
Cash from financing activities	(961)	2,092	(5,170)	(2,183)	(2,225)	(2,207)
Net changes in cash	(948)	700	2,956	(591)	1,895	1,947
Cash at the end of the period	316	1,016	3,972	7,184	9,079	11,026
Key Ratios						
Current ratio	0.4	0.5	0.5	0.9	1.0	1.1
Inventory turnover ratio	9.8	7.0	11.9	11.2	10.0	10.2
Debtors' turnover ratio	6.0	4.7	7.5	6.4	6.2	6.2
Creditors turnover ratio	3.4	2.7	4.1	3.0	3.1	3.1
Gross profit margin	5.0%	-4.1%	10.4%	8.5%	8.5%	8.9%
Operating margin	1.3%	-11.1%	7.0%	4.7%	5.1%	5.5%
Net profit margin	-1.6%	-17.3%	4.5%	2.9%	3.3%	3.8%
EBITDA margin	8.3%	3.5%	14.2%	11.9%	11.9%	12.0%
Average return on equity	-5.3%	-46.6%	28.1%	10.5%	8.9%	9.6%
Average return on assets	-0.8%	-5.2%	2.8%	1.8%	2.2%	2.6%
Debt/Equity (x)	5.25x	8.86x	6.02x	2.28x	1.97x	1.68x
Interest coverage ratio (x)	0.43x	-1.62x	2.93x	3.72x	4.49x	5.46x
P/E	-24.57x	-3.36x	11.44x	28.15x	23.38x	19.59x
EV/EBITDA	25.22x	87.07x	9.86x	11.81x	11.15x	10.47x
EV/Sales	2.10x	3.27x	1.56x	1.40x	1.33x	1.26x
EPS (SR)	-0.62	-4.32	2.32	0.81	0.98	1.17
Dividend payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net debt (SR 'million)	52,445	53,962	45,990	32,921	28,802	24,647
Net debt/ EBITDA	18.52	71.15	7.08	5.95	4.92	3.95
ROCE	0.8%	-4.4%	6.8%	6.2%	8.0%	10.4%

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Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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