

# Saudi Aramco Base Oil Co.

Materials  
LUBEREF AB: Saudi Arabia  
8 August 2024



US\$5.67bn  
Market Cap.

30.00%  
Free Float

US\$9.55mn  
Avg. Daily Value traded

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## Neutral

Price Target (SAR): 135.0

Current (8<sup>th</sup> August 2024): 126.00  
Upside/Downside: 7.0% above current

| Valuation Multiples | 23   | 24E  | 25E  |
|---------------------|------|------|------|
| P/E (x)             | 14.1 | 17.4 | 16.1 |
| P/B (x)             | 4.4  | 4.3  | 4.1  |

## Major Shareholders % Ownership

The Saudi Arabian Oil Company 70.00

| Price Performance | YTD   | 3M     | 1M     |
|-------------------|-------|--------|--------|
| Absolute          | -3.2% | -16.1% | -10.6% |
| Relative to TASI  | -2.8% | -9.7%  | -8.0%  |

## Earnings

| (SARmn)       | 2023   | 2024E  | 2025E  |
|---------------|--------|--------|--------|
| Revenue       | 9,489  | 10,016 | 10,100 |
| Y-o-Y         | -10.6% | 5.6%   | 0.8%   |
| Gross profit  | 1,858  | 1,564  | 1,653  |
| Gross margin  | 19.6%  | 15.6%  | 16.4%  |
| EBITDA        | 1,912  | 1,576  | 1,651  |
| EBITDA margin | 20.1%  | 15.7%  | 16.3%  |
| Net profit    | 1,510  | 1,222  | 1,324  |
| Y-o-Y         | -23.7% | -19.0% | 8.3%   |
| Net margin    | 15.9%  | 12.2%  | 13.1%  |
| EPS (SAR/sh)  | 8.9    | 7.2    | 7.8    |
| DPS (SAR/sh)  | 10.0   | 6.5    | 7.0    |
| P/E (Current) | 14.1x  | 17.4x  | 16.1x  |
| P/E(Target)   | 15.1x  | 18.6x  | 17.2x  |
| ROE           | 31.0%  | 24.5%  | 25.8%  |

Source: Company data, Al Rajhi Capital

# Saudi Aramco Base Oil Co.

## Product mix to improve realized yield, but crack margins continue to be under pressure

Luberef's 2Q24 results were ahead of our expectations, with revenue beat of 9% and net profit beat of 6%, supported by higher-than-expected volumes. However, compared to last year, net income declined by 34% y-o-y as crack margins remained under pressure (decline of high teens y-o-y), that more than offset the increase in revenue of 4% y-o-y. Nevertheless, there was sequential improvement in the bottom-line growth of 25% supported by higher volumes (1Q24 had a shutdown) and slightly better crack margins as well as absence of imported feedstock. Despite the shutdown in 1Q24, the company has reiterated its FY24 volume growth guidance at mid-single digit and expects domestic base oil volumes to account for 30% (price premiums in the range of SAR375-750/ton).

Luberef's story revolves around the Yanbu Growth II expansion and the transformation program initiated in 2021. The focus is on increasing the base oil production capacity in Yanbu to 1.3 mn tons and diversifying the product portfolio (group III exposure). At the same time, the company is exploring synergies within the Aramco's systems and continuously seeking additional feedstock such as UCO and HVGO, that can help the company to run its world class facilities at maximum potential utilization levels and produce upto 1.6 mn tons. This flexibility should offset any impact from the closure of Jeddah facility, as the lease expires in FY26. Moreover, the production of group III (base capacity 175k tons, but can produce 670k tons with no group II) should improve the revenue yield and the profitability. The group III product prices command a premium of almost 30% over group II. Thus, the product mix and volume story are pretty encouraging. At the same time, the company has plans of entering into further downstream products such as electrical transformer oil, white oil and wax products via its facility called 'LubeHUB' in close proximity to its Yanbu unit.

Coming to the base oil prices, we have noticed a deterioration in the base oil prices in recent weeks after some improvement in 2Q24. In the month of July (Source: Luberef), group II product prices have declined ~5% and group I by 2% compared to average product prices in 2Q24. Moreover, as per forecasts available from ICIS, further decline in the base oil prices is expected in the next 18 months or so. Thus, we prefer to be conservative on base oil prices. However, on the positive side, we expect feedstock costs to improve in 2H24 as well as FY25. The improvement should come from the decline in fuel oil price as well as normalization of freight costs. The increase in crude oil supply from OPEC (phase out of output cuts starting October) should result in higher availability of RCO resulting in lower feedstock costs. Thus, the impact of lower base oil prices on crack margins should be limited in our view. Nevertheless, we consider marginal decline in crack margins in 2H24 as we wait for signs of decline in fuel oil prices and respite on the geopolitical front. For FY25, we expect a modest improvement in crack margins supported by lower freight costs and better realized prices as the company starts the production of group III products. This should offset the impact of planned shutdown in Yanbu in 2025 (45 days expected) and limit the impact on EBITDA (+5% y-o-y).

Figure 1 Earnings Summary Q2 2024

| (SAR mn)         | Q2 2204 | Q1 2024 | Q2 2023 | ARC est. | Cons Est. | y-o-y  | q-o-q | vs ARC | vs Cons |
|------------------|---------|---------|---------|----------|-----------|--------|-------|--------|---------|
| Revenue          | 2,729   | 2,185   | 2,613   | 2,513    | 2,511     | 4.4%   | 24.9% | 8.6%   | 8.7%    |
| Gross Profit     | 387     | 314     | 551     | 359      | NA        | -29.7% | 23.3% | 7.7%   | NM      |
| G. margin        | 14.2%   | 14.4%   | 21.1%   | 14.3%    | NA        |        |       |        |         |
| Operating Profit | 316     | 246     | 481     | 290      | NA        | -34.2% | 28.5% | 9.0%   | NM      |
| Op. Margin       | 11.6%   | 11.3%   | 18.4%   | 11.5%    | NA        |        |       |        |         |
| Net Profit       | 299     | 239     | 455     | 282      | 288       | -34.3% | 25.0% | 5.8%   | 3.9%    |
| Net Margin       | 11.0%   | 10.9%   | 17.4%   | 11.2%    | 11.5%     |        |       |        |         |

Source: Company data, Al Rajhi Capital

**Valuations:** We value the company based on an equally weighted mix of P/E, EV/EBITDA and Dividend Yield methodologies. The P/E approach, based on a 18x multiple on the average of 2024-2025e EPS implies a fair value of SAR 136/sh. The EV/EBITDA methodology implies a fair value of SAR 134/sh based on a multiple of 14.0x on the average of 2024-2025e EBITDA. While the Dividend yield based methodology at a yield of 5.0% on 2024-2025e DPS (SAR 6.75/sh) implies a fair value of SAR 135/sh. The favorable volume growth story and the changing product mix makes a strong case for higher multiples assigned to the company. Based on an equal mix of all the three approaches, we revise our target price for the company to SAR 135/sh from SAR 164/sh earlier, implying an upside of 7% at the current market price, and accordingly maintain our rating at "Neutral".

**Risks:** We see upside risks from improving crack margins, extension of Jeddah lease and securing additional feedstock such as UCO and HVGO. On the downside, further pressure on base oil prices and no respite on freight costs and higher fuel oil price.

Figure 2 Valuation Summary

| P/E Valuation Methodology            |               |             |              |
|--------------------------------------|---------------|-------------|--------------|
| Average 2024-2025e EPS (SAR/sh)      | 7.54          |             |              |
| Target Multiple                      | 18.0x         |             |              |
| <b>Fair value (SAR/sh)</b>           | <b>136</b>    |             |              |
| EV/EBITDA Valuation Methodology      |               |             |              |
| Average 2024-2025e EBITDA (SARmn)    | 1,613         |             |              |
| Target Multiple                      | 14.0x         |             |              |
| <b>EV (SARmn)</b>                    | <b>22,588</b> |             |              |
| Net debt                             | 24.60         |             |              |
| Equity value (SAR mn)                | 22,612        |             |              |
| <b>Fair value (SAR/sh)</b>           | <b>134</b>    |             |              |
| Dividend Yield Valuation Methodology |               |             |              |
| Average 2024-2025e DPS (SAR/sh)      | 6.75          |             |              |
| Target Yield                         | 5.00%         |             |              |
| <b>Fair Value (SAR/sh)</b>           | <b>135</b>    |             |              |
| Valuation Summary                    |               |             |              |
|                                      | Fair Value    | Weights (%) | Target Price |
| P/E based fair value                 | 136           | 33          | 45           |
| EV/EBITDA based fair value           | 134           | 33          | 45           |
| Dividend Yield based fair value      | 135           | 33          | 45           |
| <b>Target Price (SAR/sh)</b>         |               |             | <b>135</b>   |
| Upside/ (Downside)                   |               |             | 7%           |

Source: Al Rajhi Capital

## Financials

Figure 3 Income Statement

| (SAR mn)                                  | 2023         | 2024E         | 2025E         |
|---|--------------|---------------|---------------|
| <b>Revenue</b>                            | <b>9,489</b> | <b>10,016</b> | <b>10,100</b> |
| Cost of revenues                          | (7,630)      | (8,452)       | (8,447)       |
| <b>Gross profit</b>                       | <b>1,858</b> | <b>1,564</b>  | <b>1,653</b>  |
| Selling and distribution expenses         | (37)         | (30)          | (44)          |
| General and administrative expenses       | (231)        | (244)         | (253)         |
| <b>Operating profit</b>                   | <b>1,590</b> | <b>1,289</b>  | <b>1,357</b>  |
| Finance income                            | 131          | 77            | 65            |
| Finance costs                             | (142)        | (92)          | (48)          |
| <b>Profit before zakat and income tax</b> | <b>1,579</b> | <b>1,274</b>  | <b>1,375</b>  |
| Zakat and income tax                      | (69)         | (51)          | (51)          |
| <b>Profit for the period</b>              | <b>1,510</b> | <b>1,222</b>  | <b>1,324</b>  |
| <b>EPS (SAR/sh)</b>                       | <b>8.95</b>  | <b>7.24</b>   | <b>7.85</b>   |
| <b>EBITDA</b>                             | <b>1,912</b> | <b>1,576</b>  | <b>1,651</b>  |

Source: Al Rajhi Capital estimates

Figure 5 Cash Flow Statement

| (SAR mn)  | 2023           | 2024E      | 2025E       |
|---|----------------|------------|-------------|
| Cash from operations                                | 2,322          | 1,594      | 1,670       |
| Cash from investing                                 | (1,691)        | 935        | (281)       |
| Cash from financing                                 | (1,997)        | (2,204)    | (1,468)     |
| <b>Net change in cash and cash equivalents</b>      | <b>(1,366)</b> | <b>325</b> | <b>(78)</b> |
| <b>Cash and cash equivalents, end of the period</b> | <b>546</b>     | <b>871</b> | <b>793</b>  |

Source: Al Rajhi Capital estimates

Figure 6 Key Ratios

| KPIs                        | 2023  | 2024E | 2025E |
|-----------------------------|-------|-------|-------|
| <b>Gross margin (%)</b>     | 19.6% | 15.6% | 16.4% |
| <b>EBITDA margin (%)</b>    | 20.1% | 15.7% | 16.3% |
| <b>Operating margin (%)</b> | 16.8% | 12.9% | 13.4% |
| <b>Net margin (%)</b>       | 15.9% | 12.2% | 13.1% |
| <b>ROA (%)</b>              | 17.0% | 15.3% | 16.8% |
| <b>ROE (%)</b>              | 31.0% | 24.5% | 25.8% |
| <b>D/E (x)</b>              | 0.4x  | 0.2x  | 0.2x  |
| <b>Net debt/EBITDA (x)</b>  | 0.8x  | 0.2x  | 0.0x  |

Source: Al Rajhi Capital estimates

Figure 4 Balance sheet

| (SAR mn)                                | 2023         | 2024E        | 2025E        |
|---|--------------|--------------|--------------|
| <b>Assets</b>                           |              |              |              |
| Cash and cash equivalents               | 546          | 871          | 793          |
| Inventories                             | 623          | 648          | 648          |
| Trade receivables                       | 1,054        | 1,043        | 1,052        |
| Prepayments and other assets            | 27           | 29           | 29           |
| Short-term deposit                      | 1,635        | 435          | 435          |
| <b>Total current Assets</b>             | <b>3,885</b> | <b>3,026</b> | <b>2,956</b> |
| Property, plant and equipment           | 4,771        | 4,764        | 4,764        |
| Right-of-use assets                     | 167          | 154          | 141          |
| Intangible assets                       | 15           | 14           | 12           |
| Loans to employees                      | 18           | 18           | 18           |
| <b>Total non-current assets</b>         | <b>4,971</b> | <b>4,949</b> | <b>4,936</b> |
| <b>Total assets</b>                     | <b>8,856</b> | <b>7,975</b> | <b>7,892</b> |
| <b>Liabilities</b>                      |              |              |              |
| Trade payables                          | 1,174        | 1,158        | 1,157        |
| Accrued expenses and other liabilities  | 227          | 240          | 242          |
| Current portion of long-term borrowings | 198          | 225          | 259          |
| Lease liabilities                       | 22           | 21           | 19           |
| Zakat and income tax payable            | 79           | 79           | 79           |
| <b>Total current liabilities</b>        | <b>1,701</b> | <b>1,722</b> | <b>1,756</b> |
| Long-term borrowings                    | 1,744        | 717          | 458          |
| Lease liabilities                       | 164          | 151          | 139          |
| Employee benefit obligations            | 329          | 341          | 353          |
| Other non-current liabilities           | 50           | 50           | 50           |
| <b>Total non-current liabilities</b>    | <b>2,286</b> | <b>1,258</b> | <b>1,000</b> |
| <b>Shareholders' equity</b>             |              |              |              |
| Share capital                           | 1,688        | 1,688        | 1,688        |
| Statutory reserve                       | 506          | 506          | 506          |
| Treasury shares                         | (49)         | (49)         | (49)         |
| Retained earnings                       | 2,724        | 2,850        | 2,992        |
| <b>Total equity</b>                     | <b>4,869</b> | <b>4,994</b> | <b>5,137</b> |
| <b>Total liabilities</b>                | <b>8,856</b> | <b>7,975</b> | <b>7,892</b> |

Source: Al Rajhi Capital estimates

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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