

Saudi Aramco Base Oil Co.

Materials
LUBEREF AB: Saudi Arabia
16 Nov 2023



US\$6.13bn Market Cap. 30.00% Free Float US\$26.09mn Avg. Daily Value traded

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Saudi Aramco Base Oil Co.

Earnings resilient despite cost headwinds, TP raised to SAR140/sh

Neutral

Price Target (SAR): 140.00

Current: 136.20
Upside/Downside: 2.8% above current

Valuation Multiples	22	23E	24E
P/E (x)	11.6	14.3	14.4
P/B (x)	4.5	4.6	4.6
EV/EBITDA (x)	8.7	10.8	10.6

Major Shareholders % Ownership

The Saudi Arabian Oil Company	70.00
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Price Performance	YTD	1M	3M
Absolute	48.0%	1.6%	-6.5%
Relative to TASI	42.8%	-2.7%	-3.7%

Earnings

(SARmn)	2022A	2023E	2024E
Revenue	10,614	9,308	9,266
Y-o-Y	20.0%	-12.3%	-0.5%
Gross profit	2,504	1,915	1,934
Gross margin	23.6%	20.6%	20.9%
Net profit	1,978	1,604	1,593
Y-o-Y	31.7%	-18.9%	-0.6%
Net margin	18.6%	17.2%	17.2%
EPS(DAR)	11.7	9.5	9.4
DPS(SAR)	5.0	7.6	7.6
Payout ratio	42.7%	80.0%	80.0%
P/E (Current)	11.6x	14.3x	14.4x
P/E(Target)	11.9x	14.7x	14.8x

Source: Company data, Al Rajhi Capital

Luberef reported Q3 2023 revenues at SAR2,549mn, down by 6.3% y-o-y primarily driven by narrowing base oil crack margins despite a rise in volumes. Although the company registered a steep decline of 42% in crack margins on a y-o-y basis in Q3 2023 with spreads declining from c. \$800/mt to c. \$470/mt, the decline in revenues was partially offset by a 15% rise in volumes in the same period. On a sequential basis, revenues were marginally lower by 2.4% on the back of lower spreads (\$470/mt versus \$580/mt in Q2 2023) largely due to rising feedstock costs.

In our earlier note post Q1 2023 results, we iterated that high crack margins were not sustainable owing to the decline in crude oil prices and hence we expected the margins to revert to more normalized levels in H2 2023. In our view, at the current levels, there exists a limited downside in the crack margins from hereon. Going forward, we expect the spreads between base oil realized prices and feedstock costs to hover around \$500/mt in the near term. Hence, net margins are expected to sustain around FY23 levels for the coming year supported with higher efficiencies. Nevertheless, the company's endeavor to expand its Yanbu Facility has the potential to fuel substantial earnings growth post 2025. The Growth-II expansion project shall enable Luberef to produce both Group II and Group III base oils. It is worth noting that Group III base oils command higher premium as compared to Group II oils. This shall underpin strong margin expansion for the company in later years. Moreover, we expect the company to consistently generate robust free cash flows thereby enabling it to maintain high dividend payout ratios and continue rewarding its shareholders. Meanwhile, cost headwinds in Q3 2023 are expected to taper off in the coming quarters owing to the recent dip in crude oil prices. We believe oil prices in FY24 to be close to the average levels of 2023, thus making the feedstock prices less volatile. Overall, post-Q3 2023 earnings, we revise our estimates upwards and increase our target price to SAR140/sh, from the earlier target price of SAR134.50/sh, implying an upside of 2.8% at the current price levels. Accordingly, we maintain our rating at 'Neutral'.

Q3 2023 Results: Q3 2023 revenues for Luberef came in at SAR2,549mn, slightly below our estimates of SAR2,588mn. The gross profit fell by 39.5% y-o-y on the back of fall in revenues and on account of a rise in feedstock costs fuelled by the momentum in oil prices. Hence, Q3 2023 gross margins declined to 15.4% bps versus 23.9% in Q3 2022. Higher feedstock costs also exerted pressure on the operating margins which were down by 700bps y-o-y to 13.9%. Overall, net income registered a 28.3% y-o-y decline primarily driven by the compression in base oil crack margins and a higher financing burden.

Figure 1 Earnings Summary Q3 2023 (*)

(SAR mn)	Q3 2023	Q2 2023	Q3 2022	ARC est.	Cons Est.	q-o-q	y-o-y	vs ARC	vs Cons
Revenue	2,549	2,613	2,722	2,588	2,522	-2.4%	-6.3%	-1.5%	1.1%
Gross Profit	393	551	650	339	NA	-28.6%	-39.5%	16.0%	NM
G. margin	15.4%	21.1%	23.9%	13.1%	NA				
Operating Profit	356	481	570	268	NA	-26.0%	-37.6%	32.5%	NM
Op. Margin	13.9%	18.4%	20.9%	10.4%	NA				
Net Profit	340	455	475	251	289	-25.2%	-28.3%	35.4%	18.0%
Net Margin	13.4%	17.4%	17.4%	9.7%	11.4%				

Source: Company Data, Al Rajhi Capital

Valuations: We value the company based on a weighted average mix of DCF (40% weight) and Dividend yield (60% weight) methodologies. The DCF approach at a 1% terminal growth and WACC range of 10.82%-12.00% during the forecasted period implies a target price of SAR141/sh. The Dividend yield based methodology at a yield of 5.5% on 2024e DPS implies a target price of SAR137/sh. Thus, we revise our target price for the company to SAR140/sh from SAR134.50/sh earlier, implying an upside of 2.8%, and accordingly maintain our rating at 'Neutral'.

Risks: The key downside risks to our valuation assumptions are i) unplanned shutdowns, ii) delay in commencement of Group 3 production facilities and iii) adverse movement in oil prices.



Financials

Figure 2 Income Statement

(SAR mn)	2023E	2024E	2025E
Revenue	9,308	9,266	9,113
Cost of revenues	(7,393)	(7,331)	(7,172)
Gross profit	1,915	1,934	1,942
Selling and distribution expenses	(40)	(41)	(42)
General and administrative expenses	(193)	(192)	(189)
Other (expenses) / income - net	10	10	10
Fair value (loss) gain on derivative instruments	0	0	0
Operating profit	1,692	1,711	1,720
Finance income	132	70	31
Finance costs	(146)	(113)	(84)
Profit before zakat and income tax	1,679	1,668	1,667
Zakat and income tax	(75)	(74)	(74)
Profit for the period	1,604	1,593	1,593

Source: Company Data, Al Rajhi Capital

Figure 3 Cash Flow Statement

(SAR mn)	2023E	2024E	2025E
Operating activities	2,120	2,002	1,984
Investing activities	(315)	(395)	(155)
Financing activities	(1,966)	(1,827)	(2,028)
Change in cash	(162)	(220)	(198)
Cash and cash equivalents, start of the period	1,912	1,750	1,531
Cash and cash equivalents, end of the period	1,750	1,531	1,332

Source: Company Data, Al Rajhi Capital

Figure 4 Balance Sheet

(SAR mn)	2023E	2024E	2025E
Assets			
Cash and cash equivalents	1,750	1,531	1,332
Inventories	532	528	516
Trade receivables	897	893	878
Prepayments and other assets	24	24	24
Short-term deposit	148	148	148
Total current Assets	3,352	3,124	2,899
Property, plant and equipment	4,806	4,858	4,664
Right-of-use assets	88	82	76
Intangible assets	18	19	19
Employees' home ownership receivables	2	2	2
Loans to employees	16	16	16
Total non-current assets	4,930	4,976	4,777
Total assets	8,282	8,100	7,676
Liabilities			
Trade payables	615	610	596
Accrued expenses and other liabilities	208	207	204
Current portion of long-term borrowings	197	225	259
Lease liabilities	10	9	8
Zakat and income tax payable	130	130	130
Total current liabilities	1,159	1,181	1,197
Long-term borrowings	1,745	1,520	1,261
Lease liabilities	91	84	78
Employee benefit obligations	254	246	238
Deferred tax liabilities	0	0	0
Other non-current liabilities	44	44	44
Total non-current liabilities	2,134	1,895	1,622
Shareholders' equity			
Share capital	1,688	1,688	1,688
Statutory reserve	506	506	506
Treasury shares	(57)	(57)	(57)
Retained earnings	2,852	2,888	2,720
Total equity	4,989	5,025	4,857
Total liabilities	8,282	8,100	7,676

Source: Company Data, Al Rajhi Capital

Figure 5 Key Ratios

KPIs	2023E	2024E	2025E
Gross margin (%)	20.6%	20.9%	21.3%
EBITDA margin (%)	21.8%	22.2%	22.8%
Operating margin (%)	18.2%	18.5%	18.9%
Net margin (%)	17.2%	17.2%	17.5%
ROA (%)	19.4%	19.7%	20.8%
ROE (%)	32.1%	31.7%	32.8%
D/E (x)	0.4x	0.4x	0.3x
Net debt/EBITDA (x)	0.1x	0.1x	0.1x

Source: Company Data, Al Rajhi Capital

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