Target Price: SAR127/share
Market price: SAR131.6/share
Upside: -3.5% (+Div. Yield: 5.1%)
Rating: Neutral

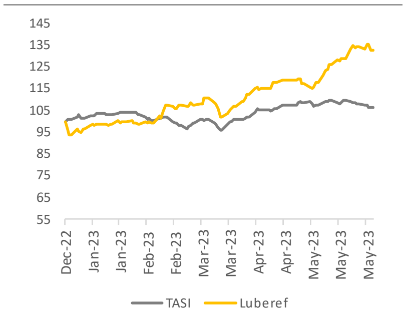
Saudi Aramco Base Oil Company - Luberef

Neutral rating post MSCI EM inclusion/elevated crack margins

Stock data	
TASI ticker	2223
Mcap (SARbn)	22,208
Avg. Trd. Val (SARmn)	131.8
Free Float	30.0%
QFI Holding	3.6%
TASI FF weight	0.34%

Source: Bloomberg

Prices indexed to 100



Source: Bloomberg

- Strong 1Q23 earnings growth (+47% y/y) was owing to increased crack margin due to lower feedstock costs, offsetting sales volume declines due to Jeddah plant shutdown.
- Additional feedstock allocation, recent improvement in OpEx. and MSCI inclusions acted as a tailwind for the stock, however, current high level of crack margins may not sustain.
- Post factoring in the change in the current market dynamics, we raise our target price to SAR127/sh. based on the DCF valuation method (unchanged), but change the rating to Neutral post the rally.

Crack margins expected to normalize: Despite the pressure on demand on account of macro uncertainty and weak oil prices, base oil prices increased 6% y/y in 1Q23, mainly aided by tight supply (primarily due to turnaround activities). On the other hand, feedstock price (Singapore Fuel Oil), tracking oil prices, corrected notably during the quarter, resulting in a robust crack margin of around US$700/t (as per our calculations). Historically, crack margins mostly tracked oil prices, however, this year, the correlation between the two has diminished, due to supply-side factors. Nonetheless, going forward, we expect crack margins to start normalizing in 2H23 once most of these plants start operating at their full capacity post-planned maintenance activities. Accordingly, we expect crack margins to reach ~US$600/t by the end of 2023. Over the long term, we expect crack margins to further normalize to ~US$550/t (last three years' historical average: US$530/t), largely driven by lower product prices.

Increased allocation and OPEX control: Luberef recently amended its deal with Aramco to procure an additional 5,000bpd of Reduce Crude Oil (RCO; the main feedstock for base oil), taking the total volume of RCO received for the Yanbu facility to 50,000bpd. This could increase the total base oil production volume by 93ktpa (Group II: +88ktpa and Group I: +5ktpa; ~8% of 2022 production volume combined). In addition, the company has also inked an agreement to procure an additional 2,000 b/d of vacuum oil (VCO) for its Yanbu facility, which would be used in producing certain grades of base oil products and by-products at its Yanbu facility.

Figure 1: Key financial metrics

SARmn	2022a	2023e	2024e	2025e
Revenue	10,614	9,261	9,228	9,486
Revenue growth	*20%*	*-13%*	*0%*	*3%*
Gross Profit	2,504	2,266	1,961	2,016
Gross Profit margin	*24%*	*24%*	*21%*	*21%*
EBITDA	2,511	2,219	1,882	1,933
Op. income	2,171	1,907	1,581	1,625
Net profit	1,978	1,779	1,495	1,519
Net profit margin	*18.6%*	*19.2%*	*16.2%*	*16.0%*
EPS	11.72	10.54	8.86	9.00
P/E	11.2x	12.5x	14.9x	14.6x

Source: Company data, GIB Capital

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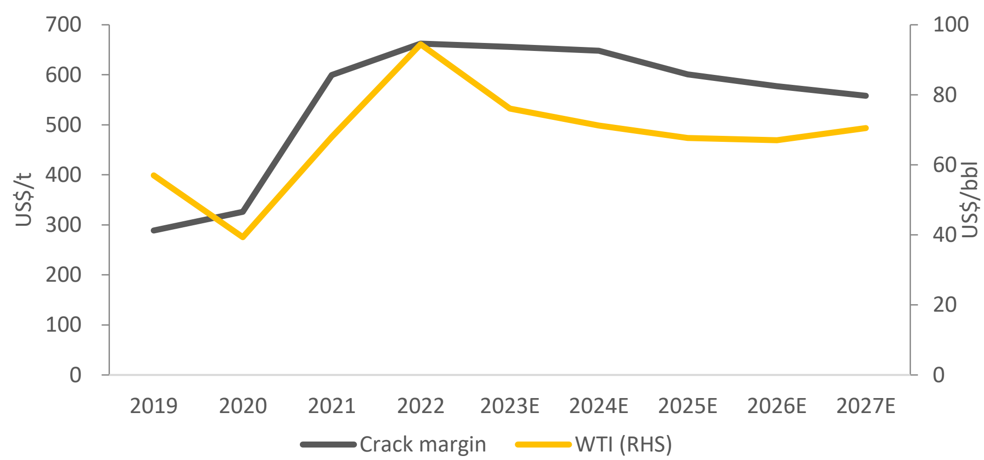
Moreover, as a part of OpEx cost improvement initiatives, the group has successfully optimized its water and power costs by shifting to private players, which is expected to reduce OpEx by SAR28mn annually. These factors would help the company in offset some of the impact from lower cracking spreads going forward.

MSCI inclusion: Post meeting all the inclusion criteria, Luberef was included in MSCI Saudi Arabia Standard Index, effective from 1 June 2023. Similarly, FTSE has also announced the company's addition to FTSE Mid Cap and Global equity indices, effective 19 June 2023. While these inclusions would favor the stock and attract inflows, we believe that most positive fundamentals are already priced in, given that the stock has already gained +44% YTD.

Minimum dividend commitment: At the time of IPO, the company disclosed its commitment to paying a minimum dividend of SAR1,125mn in 2023, implying a DPS of SAR6.7/sh. (63% payout). This offers a healthy dividend yield of ~5%.

Risks to our view: Upside from dividends as the cash generation is strong, better than expected crack margins led by market dynamics are the key company specific upside risks to our valuation.

Figure 2: Crack spreads vs. Oil prices



Source: Company data, GIB Capital

Figure 3: Key financials

Income statement (SARmn)	**2022a**	**2023e**	**2024e**	**2025e**
Revenue	**10,614**	**9,261**	**9,228**	**9,486**
revenue y/y	*20%*	*-13%*	*0%*	*3%*
COGS	8,110	6,995	7,267	7,469
Gross Profit	**2,504**	**2,266**	**1,961**	**2,016**
Gross Profit margin	*24%*	*24%*	*21%*	*21%*
G&A	217	283	292	300
Operating profit	**2,171**	**1,907**	**1,581**	**1,625**
Operating margin	*20%*	*21%*	*17%*	*17%*
Finance costs	74	111	84	51
Net income	**1,978**	**1,779**	**1,495**	**1,519**
Net margin	*19%*	*19%*	*16%*	*16%*
y/y	*32%*	*-10%*	*-16%*	*2%*
EPS	**11.72**	**10.54**	**8.86**	**9.00**
DPS	7.49	6.67	6.20	8.10
Payout	64%	63%	70%	90%
EBITDA	**2,511**	**2,219**	**1,882**	**1,933**
Net debt	(45)	499	801	1,018

Balance Sheet (SARmn)	**2022a**	**2023e**	**2024e**	**2025e**
Inventories	584	504	523	538
Trade Receivables	1,023	893	890	914
Other Current Assets	176	176	176	176
Cash and Equivalents	1,912	2,324	2,457	2,483
Total Current Assets	**3,695**	**3,896**	**4,046**	**4,111**
Intangible Assets	17	18	18	18
Property, Plant & Equipment	4,819	5,003	5,128	5,010
Total Non-Current Assets	**4,950**	**5,133**	**5,257**	**5,138**
Total Assets	**8,645**	**9,029**	**9,303**	**9,249**
Current Liabilities	1,216	1,156	1,207	1,258
Non-current Liabilities	2,346	2,169	1,972	1,749
Equity	5,083	5,737	6,185	6,337
Total Equity and Liabilities	**8,645**	**9,029**	**9,303**	**9,249**
BVPS	30.1	34.0	36.7	37.6

Cashflow (SARmn)	**2022a**	**2023e**	**2024e**	**2025e**
Cashflow from Operations	2,017	2,243	1,809	1,831
Cashflow from Investing	-49	-495	-425	-190
Cashflow from Financing	-1,405	-1,336	-1,251	-1,615
Total Cashflows	**563**	**412**	**134**	**26**

Source: Company, GIB Capital

Figure 4: Key ratios

Key ratios	2022a	2023e	2024e	2025e
Profitability ratios				
RoA	23%	20%	16%	16%
RoE	39%	31%	24%	24%
Sales/Assets	123%	103%	99%	103%
EBITDA margin	23.7%	24.0%	20.4%	20.4%
Net margin	18.6%	19.2%	16.2%	16.0%
Liquidity ratios				
Current Assets/ Current Liabilities	3.0	3.4	3.4	3.3
Debt to Total Equity	44%	36%	31%	27%
Receivable Days	35	35	35	35
Inventory Days	26	26	26	26
Payable days	30	30	30	30
Debt ratios				
Net Debt/EBITDA	0.0	0.2	0.4	0.5
Debt/Assets*	26%	23%	20%	18%
Valuation ratios				
P/E	11.2	12.5	14.9	14.6
P/B	4.4	3.9	3.6	3.5
EV/adj. EBITDA	8.7	9.9	11.7	11.3
FCF yield	9.9%	5.8%	6.7%	7.5%
Div Yield	5.7%	5.1%	4.7%	6.2%

*Source: Company, GIB Capital, * Debt includes bank facilities taken + lease liabilities. Calculations may differ from those reported by the company*

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