GIB CAPITAL جي آي بي كابيتال

Target Price: SAR110/share
Market price: SAR97.4/share
Upside: 13% (+Div. Yield: 6.8%)
Rating: Overweight

Saudi Aramco Base Oil Company (Luberef)

Initiating Coverage on Aramco's Base Oil Company

Stock data	
TASI ticker	2223.SE
Mcap (SARbn)	16.5
Avg. Trd. Val (SARmn)	4.53
Free Float	29.7%
QFI Holding	1.56%
TASI FF weight	0.25%

Source: Bloomberg

- Luberef is the sole virgin base oil producer in the Kingdom. With efficient operations and premium pricing, it enjoys superior crack margins compared to the industry.
- Despite a drop in base oil prices that could lower crack margins in 2023e, the company is likely to see healthy cash flows, with FCF yielding ~8.6% in 2023e. We expect an attractive dividend yield of ~7% in 2023e.
- We initiate equity coverage on Luberef with an Overweight rating and a target price of SAR110/share based on DCF valuation method.

Transforming its manufacturing capacity: While Luberef's base oil production capacity is likely to remain broadly flat in the coming years, the company is investing US$150-200mn to reallocate product mix, in-line with industry demand. With it, Yanbu facility is likely to be the world's third-largest base oil production facility by 2025 with a total capacity of ~1.3mn MT/year. This would enable further improvement in cost efficiencies, with Luberef already having better utilization rate than peers (87% in 2021 vs <60% for peers). Other advantages include having Aramco's refinery in its backyard for procuring feedstock with long term agreements. Global sales are supported via alliance with partners (S-oil/Motiva).

Strong cashflows: The stock is trading slightly below its IPO price of SAR99/share likely because of weak broader market sentiments led by declining oil prices. For our DCF valuation model, we factor in a longer-term Brent average of US$75/b, which mainly sets the benchmark for base oil and feedstock prices. Despite this, we believe the company will still be able to pay dividends yielding 6.8% (23e) given the strong cash flows. With its size, Luberef is likely to become part of the MSCI/FTSE EM indices and thus is expected to see significant trade inflows.

Risks: The key risks for base oil producers are related to higher-than-expected decline in base oil prices/crack spreads, faster than expected evolution of electric vehicles (EV), as the automotive industry accounts for more than 50% of total base oil demand. Regulatory factors and asset concentration are some other risks.

Figure 1: Key financial metrics

SARmn	2021a	2022e	2023e	2024e
Revenue	8,847	11,520	9,863	9,343
Revenue growth	*101%*	*30%*	*-14%*	*-5%*
Gross Profit	2,042	2,191	1,943	1,679
Gross Profit margin	*23%*	*19%*	*20%*	*18%*
EBITDA	2,096	2,170	1,888	1,628
Op. income	1,756	1,856	1,590	1,333
Net profit	1,502	1,625	1,381	1,158
Net profit margin	*17%*	*14.1%*	*14.0%*	*12.4%*
EPS	8.90	9.63	8.18	6.86
P/E	10.9x	10.1x	11.9x	14.2x

Source: Company data, GIB Capital

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Investment Case

Luberef is a 70% owned subsidiary of Aramco, which makes base oil. Base oil is sold to companies that make lubricants for automobiles, such as car engine lubricants. Majorly there are three types of base oil – Group I, II and III. Group III has better properties than Group II, which in turn has better qualities than Group I. Base oil is a byproduct of the fractional distillation of oil, which is further blended by end lubricant suppliers based on their formulations. Luberef's focus is mainly on superior quality lubricants i.e., Group II and III base oils, which are expected to grow faster than the market. The demand for Group II and III base oils is expected to grow with a CAGR of 3.5% and 4.8% between 2022-30, as compared to a decline for Group I and a meagre 0.7% growth for the total base oil market as per IHS Markit's report. In line with these changing industry dynamics, the group has timely invested in the capacity expansion of its Yanbu plant to 1.1mn MT/year in 2017, with Group II's capacity accounting for 710 thousand MT/year.

Moreover, the base oil producer is further investing US$150-200mn into expanding the capacity of its Yanbu plant to start producing Group III base oils with a capacity of 175 thousand MT/year by 2025e and even increased Group II capacity to 810 thousand MT/year. This implies that after the closure of Jeddah facility by mid-26, the group's total capacity would remain approximately the same as in 2020. But, the capacity comes with a flexibility that allows the group to transform its Group II capacity into Group III and vice-versa according to the demand in the market, i.e., the group can choose to produce only Group II or III with an increased capacity whenever required. Fig. 4 below represents three scenarios under which the Yanbu plant can operate.

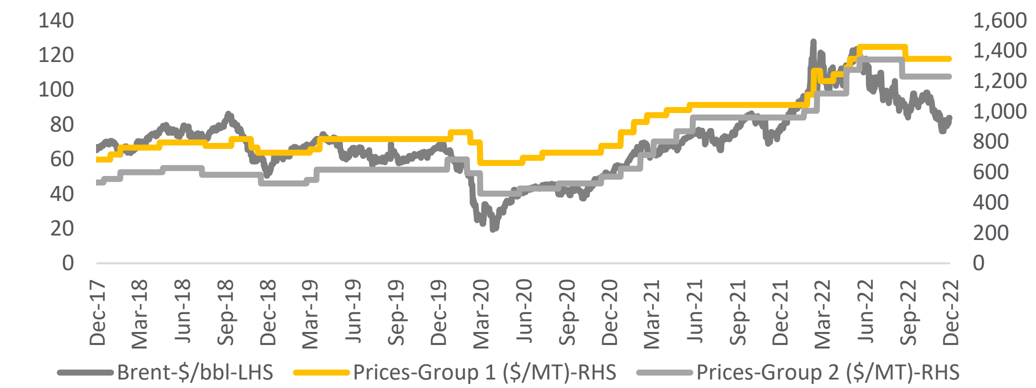
Figure 2: Capacity in thousand MT/Year

		2019	2020	2021	2022	2023	2024	2025	2026
Group 1	Jeddah	275	275	275	275	275	275	275	0*
	Yanbu	270	270	270	270	270	270	270	270
Group 2	Jeddah	0	0	0	0	0	0	0	0
	Yanbu	710	710	810	810	810	810	815	815
Group 3	Jeddah	0	0	0	0	0	0	0	0
	Yanbu	0	0	0	0	0	0	175	175
	Total	**1255**	**1255**	**1345**	**1345**	**1345**	**1345**	**1535**	**1260**
By plant	Jeddah	275	275	275	275	275	275	275	0
	Yanbu	980	980	1085	1085	1085	1085	1260	1260
By Group	Group 1	545	545	545	545	545	545	545	270
	Group 2	710	710	815	815	815	815	815	815
	Group 3	0	0	0	0	0	0	175	175

*Source: Company data, *mid 2026*

The company also derives 46% of its 2021 revenues from byproducts, but these have very thin margins, as c100% of the volumes are sold domestically to Aramco or its affiliates, some of which are sold at the cost of feedstock. One of the key drivers for the stock is the direction of base oil prices. As per our understanding, base oil prices move closely along with oil prices (see chart below). In our view the key medium-term challenge would be how much base oil prices could decline, if Brent price were to stay weak.

Figure 3: Brent prices vs one of the Base oil indices



Source: Bloomberg

Figure 4: Yanbu plant base oil capacity flexibility in thousand MT/year – 2025e

Type	Scenario I*	Scenario II	Scenario III
Group I	270	270	270
Group II	815	1,120	0
Group III	175	0	670
Total	**1,260**	**1,390**	**940**

*Source: Company data, *Scenario I is our base case*

With regards to the input or key raw material, the group uses RCO (reduced crude oil), a residue oil sourced from Arab light crude, as its feedstock. Luberef's peers also use Arab light oil to some extent to source their feedstock. Luberef has the unique advantage of having Saudi Aramco's refinery in its backyard and procuring feedstock directly from Aramco through a long-term contract supplied through a pipeline to Luberef's Yanbu facility. Due to group's premium pricing of its products, Luberef was able to achieve an average premium of US$120/MT on its margins in 2012-20 compared to Industry benchmark. The group's average crack margin for 2012-21 stood at US$489/MT and was at US$494/MT for 1H22. The average feedstock cost for Luberef was US$422/MT between 2012-21. Moreover, the non-feedstock cost was US$119/MT which is 60% lower than its peers.

The Group's higher (87%) utilization rate of its manufacturing compared to its peers (<60%) also helps in cost optimization, as fixed costs per ton are lower when the manufacturing facilities operate at a higher capacity.

Luberef supplies international oil companies, national oil companies and regional players. Luberef sells 30% of base oil volume in the Kingdom. Some of its key customers are Petro Lube (previously known as Petromin Corporation), the Arabian Petroleum Supply Company (APSCO), Alhamrani Fuchs Petroleum Saudi Arabia Ltd, Al Jomaih and Shell Lubricating Oil Company Limited, ENOC Lubricants and Grease Manufacturing Plant LLC and Saudi Aramco's Group. Locally, given the monopoly, base oil is sold at a ~30% premium compared to international prices.

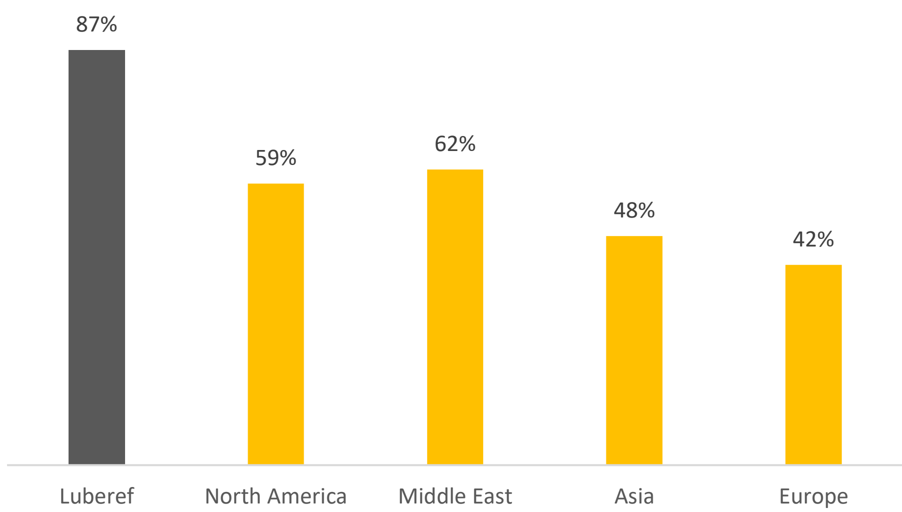
Luberef is also a part of the Aramco Base Oil Alliance with its other members, namely Motiva and S-Oil. Nearly 35% of international base oil volume sales came from sales via the Alliance in 2021. This allows the group to market and sell its products across the globe. Moreover, the commissions charged by the alliance partners for selling products in their designated zones are charged to the customers. Hence, it does not impact the group's margins while marketing its products through alliance partners.

Figure 5: Aramco Base Oil Alliance regions

Partner	Region
Luberef	Middle East (including Pakistan) and Africa
Motiva	North, Central, and South America
S-Oil	Europe and Asia (ex. Middle East, Including India)

Source: Company data

Figure 6: Capacity utilization – Luberef vs regional utilization (2021)



Source: Company Data

While the group's management has not set a fixed dividend policy, the group's continued healthy operating cash flows are expected to cover dividend payments. The group has already declared SAR1.3bn dividends in 1H22 and is expected to pay a further US$150mn (SAR563mn) dividends in 2H22, resulting in a dividend yield of 11% (based on offer price). Moreover, the group further intends to pay a dividend of US$300mn (SAR1.3bn) in 2023, subject to board's approval. We believe once its Yanbu plant's expansion is complete, the group could pay 90% of its profits as dividends from 2026 onwards, as its maintenance capex requirements are quite low.

Jadwa exited its 30% stake through the IPO. Furthermore, concurrent with the IPO, Luberef purchased a fraction (0.34% of total shares) of shares as treasury shares for offering employee incentive program, implying free float of 29.66%.

Luberef has a market cap of ~SAR16.7bn and hence will likely figure in the MSCI and FTSE EM index inclusions and likely to attract significant foreign and local inflows. Additionally, it is still ~70% owned by Aramco after the IPO.

Key assumptions, valuation, and risks

We have assumed an average Brent price of US$82/b in 2023 (after US$99/b in 2022), followed by 78, and 74 in 2024 and 2025 respectively. Given that base oil prices broadly move in line with Brent, this results in a revenue decline CAGR of 8.1% in 2022-25 and a net profit decline of 17% in the same period. The dividends for 2022 and 2023 (as guided) are expected to result in a payout of around ~112% and ~81%, respectively. We have assumed a payout of 90% in 2024, as the company is expected to complete its Yanbu plant expansion in the same period.

Given the uncertainty in near term Brent prices, we use DCF method for valuing the Company which factors a longer-term oil price of US$75/b. On an average, Saudi Material companies, and global oil and lubricant companies trade at a 2023 P/E of 10x. However, there no other pure-play base oil in the region or otherwise, and hence, we have not used relative valuation in absence of comparable peers.

For DCF, we have used a terminal growth of 2.0% and a WACC of 9.3% with a target capital structure of 25% giving us a target price of SAR110/share (rounded off) and initiate on the Company with an Overweight rating.

Figure 7: DCF valuation model

SARmn	23e	24e	25e	26e	27e	28e	29e	30e
EBIT	1,590	1,333	1,054	1,178	1,432	1,588	1,605	1,623
Taxes	*-153*	*-129*	*-102*	*-118*	*-143*	*-159*	*-161*	*-163*
EBIT minus taxes	**1,437**	**1,205**	**952**	**1,060**	**1,289**	**1,429**	**1,445**	**1,460**
(+) Depreciation & amortization	297	295	250	197	144	94	93	92
(+/-) Change in working capital	-53	74	33	32	-3	-18	-12	-5
(-) Capex	-250	-375	-179	-44	-36	-36	-37	-37
(-) Lease payment	-20	-6	-5	-1	2	1	1	1
Free Cash Flow to Firm	**1,411**	**1,192**	**1,051**	**1,244**	**1,395**	**1,469**	**1,490**	**1,511**
Terminal value								**21,260**
PV of FCF (explicit period)	**7,276**							
PV terminal	**10,476**							
EV	**17,752**							
(-) Net debt	-755							
(-) Lease obligations	-113							
(-) Pension/other liabilities	**-322**							
(+) Investment in associates	12							
Equity value	**16,575**							
Number of Shares	**169**							
Equity value per share (1 yr fwd)	**109.0**	SAR						

Source: Company, GIB Capital

Figure 8: Peer comparison – Global Lubricant companies

Name	Mkt Cap (USD)	P/E Ratio (TTM)	P/E - FY1	P/E - FY2	EV/EBITDA - FY1	EV/EBITDA - FY2
Gulf Oil Lubricants India Ltd	248	10.0	8.7	7.6	6.2	5.5
Valvoline Inc	5,641	19.3	29.5	20.8	20.4	17.4
Ashland Inc	5,871	23.1	17.5	16.0	10.5	10.0
NewMarket Corp	3,061	14.1				
WD-40 Co	2,184	33.0	30.7	26.9	22.1	19.5
Pharmicell Co Ltd	529	52.3				
FUCHS PETROLUB SE	4,543	15.4	15.2	14.2	9.7	9.2
T Hasegawa Co Ltd	928	14.8	19.2	15.9		
Koninklijke DSM NV	21,625	21.3	26.3	26.1	15.1	13.1
Green Future Food Hydrocolloid	396	15.8				
Perimeter Solutions SA	1,406			34.4	15.6	10.6
Eastman Chemical Co	9,861	9.7	10.0	10.0	7.8	7.9
Oil-Dri Corp of America	233	13.5				
Amyris Inc	641					
Origin Materials Inc	705	12.9				
Hawkins Inc	824	14.0	14.0	14.6	8.7	9.0
CSW Industrials Inc	1,813	22.8	20.8	19.4	13.1	12.2
Castrol India Ltd	1,429	15.6	13.3	12.3		
Median	**1,418**	**15.5**	**17.5**	**16.0**	**11.8**	**10.3**

Source: Bloomberg

Figure 9: Peer comparison – Global Oil companies

Name	Mkt Cap (USD)	P/E Ratio (TTM)	P/E - FY1	P/E - FY2	EV/EBITDA - FY1	EV/EBITDA - FY2
Saudi Arabian Oil Co	1,842,987	12.0	11.0	12.1	5.6	6.0
Suncor Energy Inc	42,503	6.2	5.1	6.8	3.1	3.7
Ecopetrol SA	19,979	2.9	2.8	3.6	2.8	3.9
Chevron Corp	343,027	9.6	9.3	10.8	5.2	5.7
MOL Hungarian Oil & Gas PLC	5,733	2.5	2.3	3.7	1.8	2.3
Shell PLC	199,866	4.9	5.4	5.5	2.9	3.3
Oil & Natural Gas Corp Ltd	21,683	3.9	3.7	3.6	3.2	3.1
BP PLC	104,828		3.9	4.3	2.4	2.9
Imperial Oil Ltd	29,183	7.0	6.0	7.4	3.7	4.5
Eni SpA	51,113	2.8	3.6	4.8	2.1	2.4
Exxon Mobil Corp	447,576	8.6	7.8	9.7	4.5	5.4
China Petroleum & Chemical Cor	71,298	5.8	5.6	5.8	3.5	3.4
PetroChina Co Ltd	125,355	4.2	4.1	4.7	2.8	2.9
Galp Energia SGPS SA	11,030	9.2	11.1	9.5	3.5	3.6
Petroleo Brasileiro SA	68,565	1.9	1.5	2.1	1.7	2.2
Equinor ASA	117,100	4.9	5.3	5.8	1.2	1.3
Cenovus Energy Inc	37,043	9.9	7.3	7.2	4.0	4.3
Repsol SA	21,679	5.6	3.6	4.8	2.2	2.6
OMV AG	17,112	4.2	3.5	4.5	2.0	2.5
TotalEnergies SE	164,709	7.2	4.5	5.4	2.7	3.2
YPF SA	6,777	5.0	4.1	6.3	2.7	2.5
Median	**51,113**	**5.3**	**4.5**	**5.5**	**2.8**	**3.2**

Source: Bloomberg

Figure 10: Peer comparison – Saudi Material companies

Name	Mkt Cap (USD)	P/E Ratio (TTM)	P/E - FY1	P/E - FY2	EV/EBITDA - FY1	EV/EBITDA - FY2
Saudi Basic Industries Corp	68,214	12.1	14.1	18.7	6.8	7.7
Yanbu National Petrochemical C	5,916	26.4	36.6	28.9	10.1	10.2
Advanced Petrochemical Co	2,766	22.5	30.5	29.5	18.2	19.1
Saudi Kayan Petrochemical Co	5,322			63.2	12.7	9.7
Rabigh Refining & Petrochemical	4,711	6.4		15.4	13.2	9.3
Sahara International Petrochem	6,309	5.3	6.5	10.7	5.1	7.5
Methanol Chemicals Co	448	5.6	6.6	19.3	4.6	7.4
Saudi Industrial Investment Gr	4,256	17.1	23.7	18.5	17.5	16.1
Median	**5,016**	**12.1**	**18.9**	**19.0**	**11.4**	**9.5**

Source: Bloomberg

Risks: The key risks for base oil producers are related to higher-than-expected decline in base oil prices/crack spreads, faster than expected evolution of electric vehicles (EV), as the automotive industry accounts for more than 50% of total base oil demand and regulatory as well as asset concentration risks.

Company Profile

Saudi Aramco Base Oil Company - Luberef was established in 1976 to produce and sell base oil and its byproducts. The group was originally established as Petromin Lubricating Oil Refining Company, which owned 70% of the company's share capital. The rest 30% was owned by Mobil. In 1996, Petromin's 70% stake was completely transferred to Saudi Aramco, followed by the company's renaming to Saudi Aramco Lubricating Oil Refining Company (Luberef) in 1998. In 2007, Mobil sold its 30% stake to Jadwa, resulting in Saudi Aramco and Jadwa owning 70% and 30% stakes, respectively. Subsequently, the group was renamed Saudi Aramco Base Oil Company – Luberef in 2013.

Figure 11: Brief history of the Group's operations

Year	Event
1976	The group was originally established as the Petromin Lubricating Oil Refining Company
1977	The Jeddah Facility was commissioned with a production capacity of 180 thousand MT
1983	The production capacity at the Jeddah Facility increased to 220 thousand MT
1991	The production capacity at the Jeddah Facility increased to 240 thousand MT
1996	Petromin's stake in the Company (70%) was transferred to Saudi Aramco
1997	The Yanbu Facility commissioned with a production capacity of 300 thousand MT
2007	Jadwa bought Mobil's 30% stake in the Company
2013	The Company's total production capacity increased to 575 thousand MT of Group I Base Oils
2014	The Company incorporated Luberef FZE in the UAE
2017	The Yanbu phase I Expansion was completed, and production of group II base oil started
2019	Formation of the Aramco Base Oil Alliance and adoption of the Saudi Aramco trademark
2021	The Company signed an agreement with Saudi Aramco for additional RCO (Feedstock)
2021	The Company was authorized to sell hydrogen
2021	The Yanbu Facility reached its maximum production capacity
2022	Two loading arms were commissioned at Aramco's Yanbu port to enhance exports
2022	The Company converted from a limited liability company to a joint stock company.

Source: Company Data

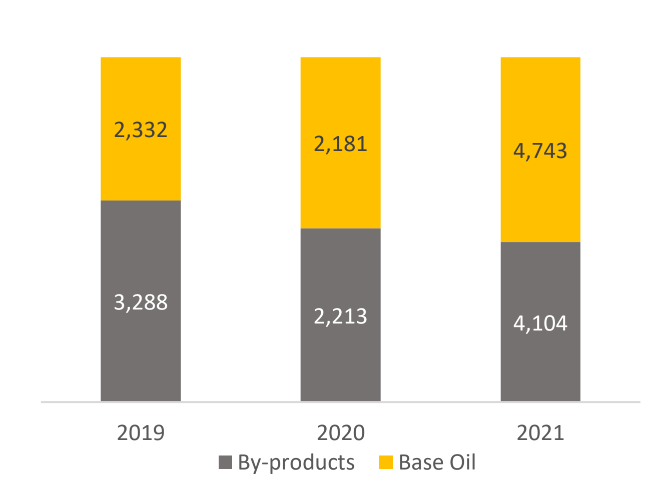
The Company's main business is the production, sale, and distribution of Base oil of Group I and Group II, Group III categories, and base oil byproducts. The group is currently importing group III oil from S-oil and plans to start manufacturing group III oil by 2025. While the group's revenues between base oil and its byproducts are equally split, the share of base oil in total revenues has increased from 42% in 2019 to 53% in 2021.

The group's main region of operation is MENA, the Americas and Europe. The key customers include Petro Lube (previously known as Petromin Corporation), the Arabian Petroleum Supply Company (APSCO), Alhamrani Fuchs Petroleum Saudi Arabia Ltd, Al Jomaih and Shell Lubricating Oil Company Limited, ENOC Lubricants and Grease Manufacturing Plant LLC and Saudi Aramco's Group. The group largely caters to major international oil companies, national oil companies and regional players in the Kingdom and across the globe.

Base Oil, which now accounts for 53.6% of sales in 2021, has grown its share of revenues by increasing faster than by-products in terms of both volumes and prices. While, in terms of volumes, byproducts still account for 67% of total volumes sold by the group, their share of revenues is declining due to lower prices. In 2020, when prices dropped from a muted demand due to COVID, base oil prices fell only 13.7% compared to a 31.5% decline in by-products prices on a y/y basis. Moreover, in 2021, base-oil price recovery was 71.2% in 2021 vs 66% for byproducts on a y/y basis.

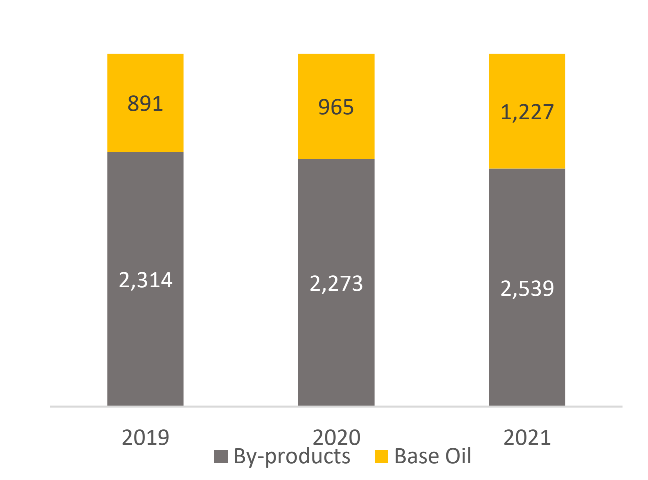
More than 99% of byproducts are sold within the domestic market, while only 30% of base oil is sold in the Kingdom by volume. Excluding Saudi, MENA is still the largest customer of base oil, accounting for the sale of 39% of volumes, followed by India with 20% of volume and the rest account for 12% of the remaining volume in 2021. Moreover, 50% of volume sales came from the top ten customers in 2021. Due to the export nature of base oil is traded at international benchmark prices, giving it a pricing advantage over largely domestically sold byproducts.

Figure 12: Sales by product category (SARmn)



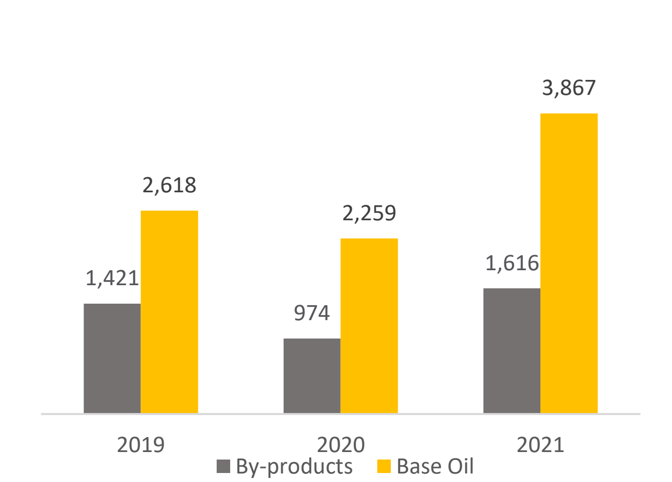
Source: Company data

Figure 13: Volume sales by product category (MT '000)



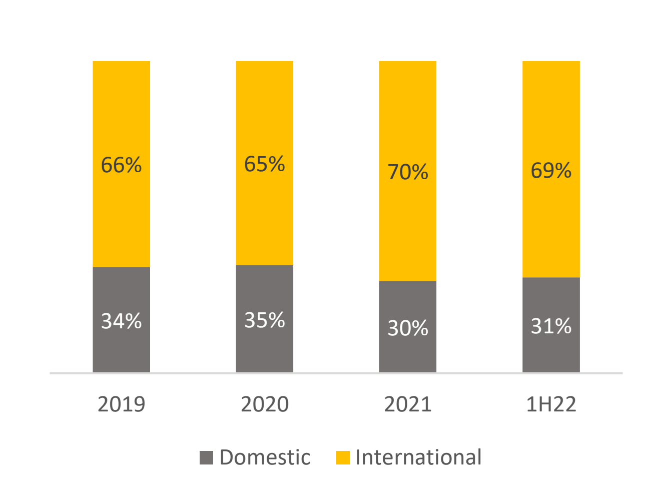
Source: Company data

Figure 14: Average Selling Price of base oil & byproducts (SAR/MT)



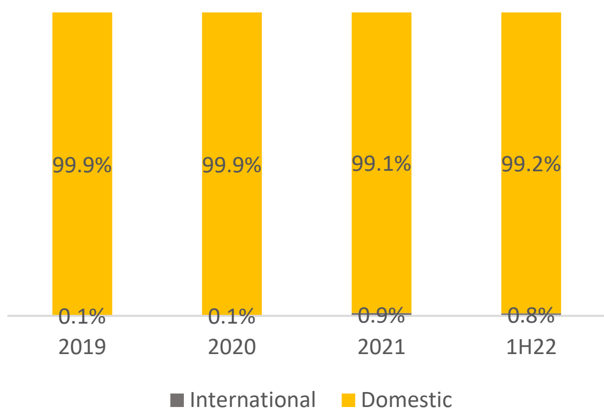
Source: Company data

Figure 15: Base oil sales split by volume



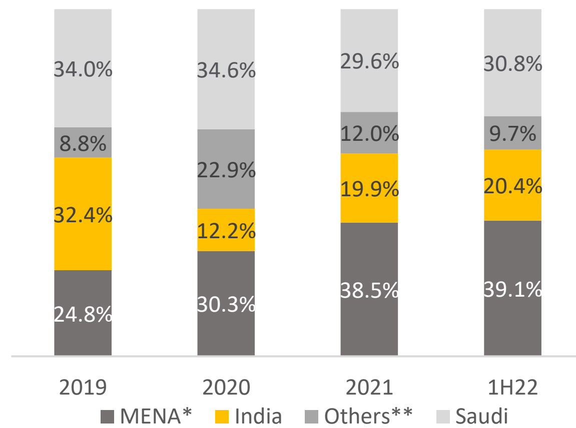
Source: Company data

Figure 16: Byproduct volume sales split



Source: Company data

Figure 17: Base oil volume sales by region



*Source: Company data; *MENA ex Saudi; ** Americas, Brazil, Pakistan, Sudan, Cyprus, Turkey, Singapore, and Tanzania*

Cost Dynamics

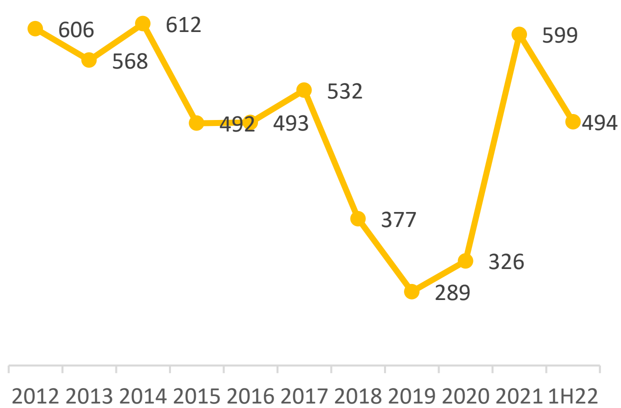
The Group's primary feedstock is RCO – a residual of crude oil left behind in the refining process. The company has a long-term agreement for the supply of RCO from its parent company Saudi Aramco. The group procures the feedstock at a price similar to high-sulfur fuel oil. High sulfur oil prices are, on average lower than brent oil. RCO is supplied directly by Aramco's Yanbu refinery to Luberef's Yanbu facility via pipeline. For Luberef's Jeddah facility, Aramco transports RCO to Aramco's Jeddah terminal, which transports it to the Jeddah facility by pipeline. The group plans to close its Jeddah facility permanently by 2026, as the lease is expiring.

The group's average base oil production cost excluding feedstock was US$119/MT which is 60% lower than the unit production cost of its peers. The group believes the cost advantage comes from a high utilization of 87% of its capacity. Moreover, the group's manufacturing facilities are located in KSA, which has cheaper energy costs compared to other markets and contributes to lower costs. Luberef has the unique advantage of having a low-value RCO at its disposal via a long-term contract with Saudi Aramco and turning it into high-margin base oils.

While by-products also contribute to group-level sales, we believe their margins could be lower for two reasons 1. Most buyers are domestic 2. The group has stated that it sells some of its by-products back to Saudi Aramco at feedstock prices and a certain portion to Aramco's affiliates. Though the actual sales split to Aramco and its affiliates is not reported, this could contribute to By-products being lower-margin products.

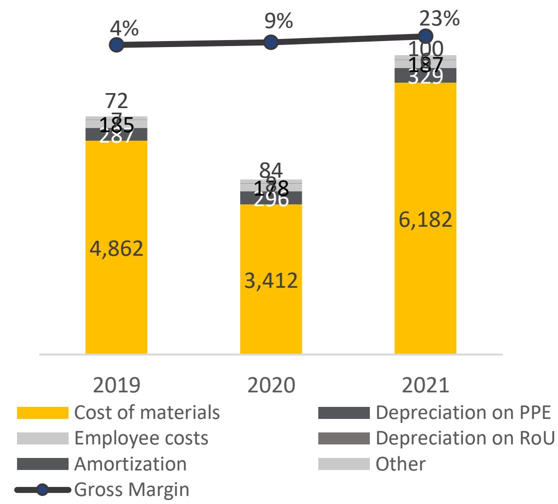
Crack margins are defined as the selling price of a product (base oil or byproduct) less RCO cost. Group's average crack margin for base oil was higher by US$120/MT compared to industry benchmark index crack margin of US$489/MT. Also, the crack margin for byproducts was US$5/MT from 2019-20 and reached US$18/MT in 2021 and US$47/MT for 1H22.

Figure 18: Luberef Base Oil Crack Margins (US$/MT)



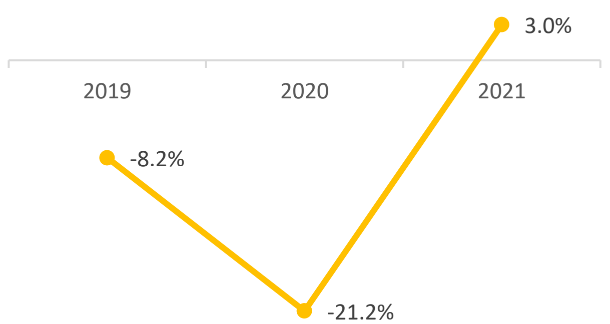
Source: Company data

Figure 19: Gross Margin (%) development & COR (SARmn)*



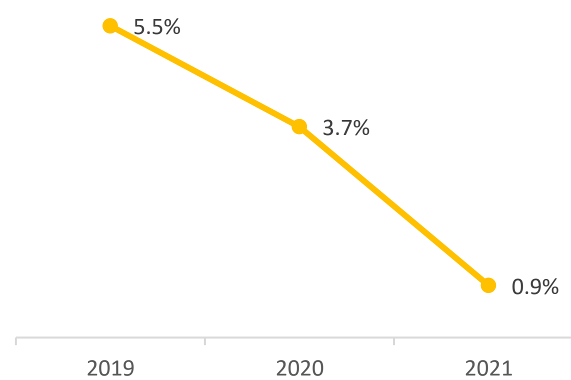
Source: Company data; Cost of Revenues

Figure 20: NWC as a % of Revenues



Source: Company data

Figure 21: Capex as a % of Revenues



Source: Company data

Dividends

The Group had a healthy payout of 68% in 2021 and has already declared 171% of profits to be paid as dividends in 1H22 which is likely to be around 112% for 2022. The group does not have a fixed dividend policy, but all the dividends are paid once the group's reserve requirements are fulfilled. We expect a ~80% payout in 2023e.

Capex

The Group spent an average of 3.4% of its revenues on Capex in the last three years. Luberef's Yanbu expansion plan is expected to cost US$150-200mn of capex between 2022-2024. The majority of the amount is to be spent in 2023 and 2024. Maintenance capex is expected to be US$10-15mn. Turnaround occurs for once every 5 years in each facility for a month.

Key Products

The Group products are divided into two broad categories -base oil and byproducts. Base oil is produced from RCO, a crude oil residual, while the company sells byproducts obtained during this production.

Base Oil

The group sells based on three categories – Group I, II, and III. While the group is currently producing Group I and II oils, it uses its Alliance with S-oil and Motiva, known as Aramco Base Oil Alliance, to import Group III oil. The Alliance also helps the group sell and distribute its products in regions like North, Central, and South America, Europe, and Asia. At the same time, the group sells its products on its own in the MENA region.

The base oil for Group I is at a premium to European base oil market prices, while Group II base oils are sold at a premium to Asian base oil market prices. Group I oils are produced in conventional methods: distillation followed by Extraction and dewaxing. However, Group II oils are made by a sophisticated technique, including hydrocracking after distillation.

Byproducts

As the name suggests, byproducts result from the base-oil extraction process. The group mainly sells two kinds of byproducts 1. Asphalt & HSFO (high-Sulphur fuel oil) 2. White Products - Ultra Low Sulphur Diesel and Naphtha. Asphalt accounted for nearly 80% of byproduct revenues from 2019-21. The group mostly sells byproducts domestically to Saudi Aramco or its affiliates.

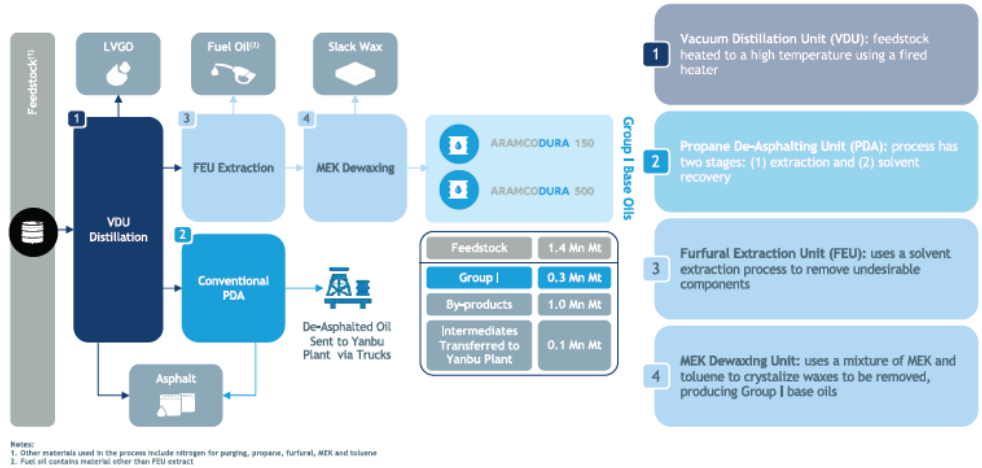
Group's manufacturing facilities

The group has two production facilities at Jeddah and Yanbu, with a total capacity of 1.3MT/year.

Jeddah Facility

This facility was commissioned in 1977 to produce Group I base oil and has a capacity of 275 thousand MT. The Jeddah facility is a conventional solvent-based base oil plant with no capability of complex processes like hydrocracking. Hence, it cannot produce Group II and III base oils. The group expects to close the Jeddah facility permanently by mid 2026 as the current land lease expires. Its turnaround maintenance is expected in 2023.

Figure 22: Jeddah Manufacturing Process

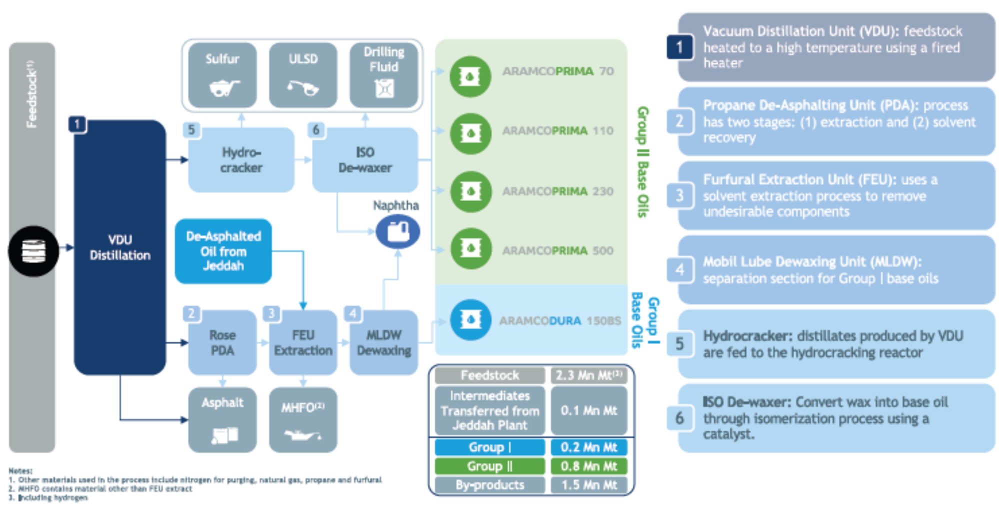


Source: Company Data

Yanbu Facility

This facility was commissioned in 1997 and has a capacity of approximately 1.1mn MT per annum, with Group I and II oil production capacity at 300 and 710 thousand MT per year. The group's expansion plans for 2025 are expected to increase Group II's total to 815 thousand MT and add 175 thousand MT for Group III to reduce its dependency on imports. Group I capacity will be at 270 thousand MT (and no Jeddah facility by 2026). Hence, the company wants to increase its production into high-value Group II and III base oils while contracting Group I's capacity.

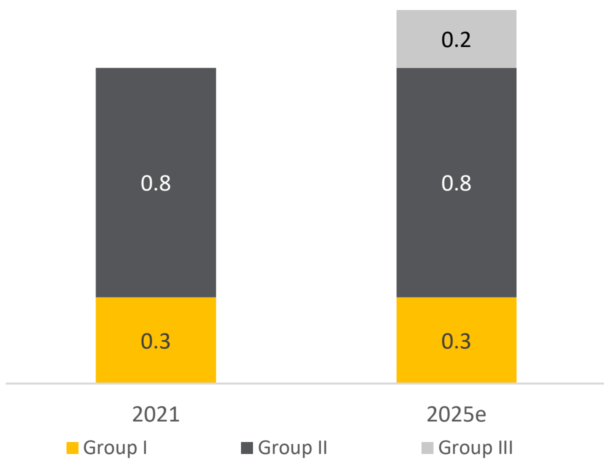
Figure 23: Yanbu Manufacturing Process



Source: Company Data

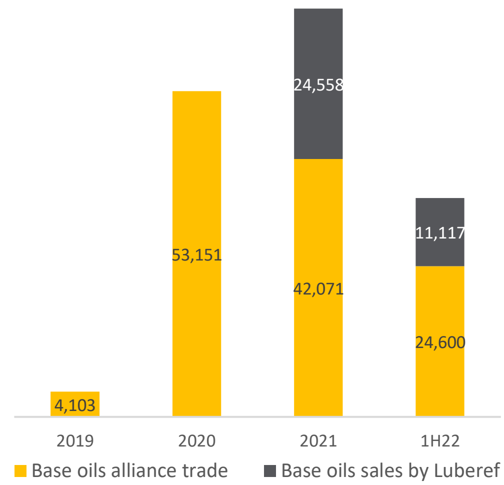
Moreover, the manufacturing capacity for Group II and III will be flexible. The group can increase or decrease the production of group II and II oils according to market demand. The Yanbu Facility is expected to have the capability to produce up to 670 thousand MT of Group III Base Oils with no Group II production or 1,120 thousand MT of Group II Base Oils with no Group III Base Oils production.

Figure 24: Yanbu Plant base oil capacity (MT mn/ year)



Source: Company data

Figure 25: Group III imports and exports



Source: Company data; Base oil sold by Luberef was imported from the Alliance. The group has not started group III oil production.

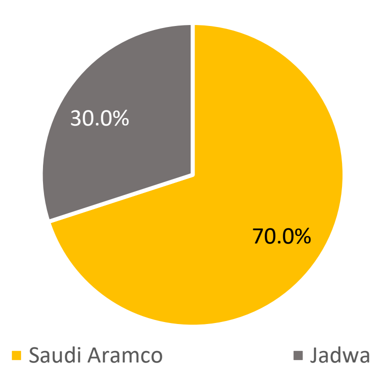
IPO details

Luberef's 50mn shares representing ~ 30% of the group's share capital was offered on Tadawul at an offering price of SAR99/share. Initially, 100% of the offering was limited to institutional shareholders, but 25% of the offering was clawed back and offered to retail investors. The institutional and retails offering was subscribed 29.5x and 2.3x, respectively. SNB Capital was the lead manager on the IPO, while Morgan Stanley, HSBC, and Citi were joint financial advisors and book-runners.

The value of the group's 30% stake at SAR99/share was nearly SAR5bn, valuing 100% of the group at SAR16.7bn which makes it a strong contender for MSCI Saudi and EM indices. The inclusion in MSCI indices could be one of the driving factors for the group's share prices.

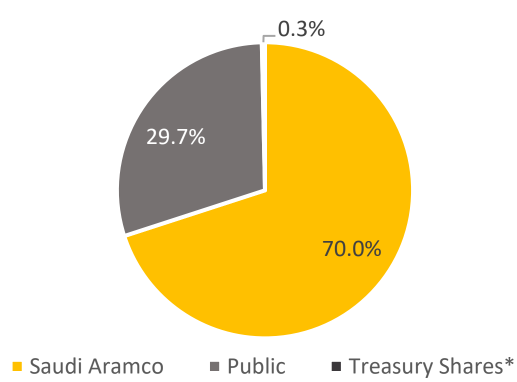
Saudi Aramco's holding of 70% remained unchanged after the IPO. In comparison, the remaining 30% of Jadwa's stake was offered in the IPO, a fraction of which was purchased by the company as treasury shares used for employee stock options. The stock started trading on 28 Dec 2022.

Figure 26: Shareholding before IPO



Source: Company data

Figure 27: Shareholding after IPO



*Source: Company data; * Treasury shares bought back by the group for fulfilling employee incentive program*

Market Dynamics

KSA's economy is largely driven by global oil demand. As the demand for the same is recovering after the COVID-19 downturn in 2020, challenges of geopolitical tensions, inflation and lowering demand from China remain a concern. However, in the long term, the economic outlook for non-OECD countries is forecasted to be robust. In addition, economic growth in the forecast period for the Middle East, particularly the Kingdom of Saudi Arabia, is expected to be supported by continued diversification efforts and population growth.

The primary driver behind base oil demand is the demand for lubricants. Their production economics are deeply linked to the production economics of main refined products, i.e. refining crude oil. Global base oil production stood at 34,887kt in 2021 and is expected to grow at a CAGR of 0.7% between 2022-30.

Global and KSA growth outlook

The global GDP is expected to grow at a CAGR of 2.9% during 2022-30. This should be largely driven by non-OECD countries' anticipated growth of 4.3%, with Asia-Pacific growth of 4.4% for 2022-30, while the OECD countries are expected to grow at a CAGR of 1.9% in the same period.

KSA's economy grew at a CAGR of 3.3% between 2010-19 compared to 2.9% growth for the Middle East. Looking forward, KSA GDP is expected to grow at a CAGR of 2% vs 3% growth for the middle east during 2022-30. Oil prices and investments related to Saudi Vision 2030 are expected to drive growth.

Liquid and Lubricant market

Global demand for liquids grew at a CAGR of 1.7% in 2010-19 and is expected to grow at 0.9% in 2022-30. The liquid products include refined products, blended biofuels, synthetic fuels, liquid petroleum gases, and ethane. The demand for refined products is expected to remain in line with the demand for liquids, mainly driven by Africa, the Middle East, and Asia Pacific. In absolute terms, a supply of 92MMb/day is expected by 2030, up from 83MMb/day in 2021. KSA’s demand for refined products is expected to be higher at 1.6% for 2022-30.

Global lubricant demand stood at 39.1 Mt/year in 2021 and is expected to grow at 1.8% in 2021. For 2022-30, the demand is expected to be slightly lower than the demand for liquids and refined products at a CAGR of 0.8%. The demand will be driven by vehicle population growth and industrial growth and is expected to come from Asia, the Middle East, Africa, and Latin America.

Figure 28: Lubricant demand by region

	CAGR	
Region	**2010-19**	**2022-30e**
North America	-0.3%	-0.6%
Latin America	0.0%	1.2%
Europe	-0.7%	-0.6%
Middle East	-0.4%	1.4%
Asia	0.9%	1.4%
Africa	0.7%	1.4%
Total	**0.3%**	**0.8%**

Source: Company data

Figure 29: Lubricant Demand by market

	CAGR	
Markets	**2010-19**	**2022-30e**
Mature Markets	-1.5%	-0.6%
Growth Markets	0.6%	1.8%
Other Markets	-0.9%	1.0%

Source: Company data

Sector-wise Lubricant Demand

Global demand for lubricants was driven by the Automotive sector during 2010-19, while demands from all the other sectors declined during the same period. For 2022-30, the demand is expected to grow at a CAGR of 0.8%, led by the automotive industry. Meanwhile, some growth will be witnessed in other sectors, including Marine, Industrial, and Process Oils, which had declined during the last decade. The demand in the automotive industry should be driven by heavy-duty engine oil with a CAGR of 1.3% for 2022-30. Moreover, the fleets for heavy-duty vehicles, light-duty vehicles and two-wheelers are expected to grow at a CAGR of 1.9%, 1.6%, and 2.5%, respectively.

Middle East's demand for lubricants is expected to grow faster at a CAGR of 1.4% for 2022-30 compared to global demand. Unlike global demand, the growth rate is expected to be highest for the Industrial oils sector at a CAGR of 1.5% in 2022-30. Middle East lubricants demand growth is expected to increase due to population expansion, economic development, and increased resource extraction and marine activity, partly offset by the improvement in lubricant usage efficiency. Moreover, the demand growth in the Automotive industry is only marginally behind the Industrial sector at 1.4% CAGR for 2022-30, driven by demand for heavy-duty engine oil with an expected 2022-30 CAGR of 1.6%.

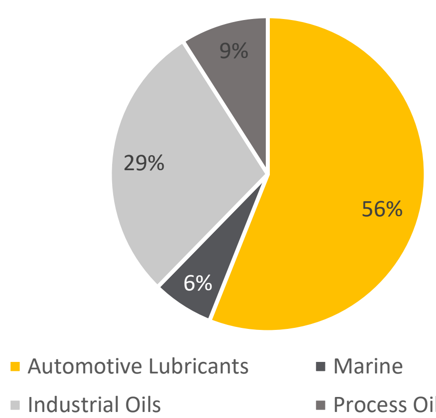
Figure 30: Lubricant demand (CAGR) by Industry

	Global		Middle East		KSA	
Region	**2010-19**	**2022-30e**	**2010-19**	**2022-30e**	**2010-19**	**2022-30e**
Automotive Lubricants	0.6%	0.9%	-0.3%	1.4%	0.4%	1.2%
Marine	-0.6%	0.5%	-0.2%	1.3%	1.3%	0.7%
Industrial Oils	0.0%	0.7%	-1.1%	1.5%	-0.1%	2.3%
Process Oils	0.0%	0.4%	-0.6%	1.4%	-0.4%	2.0%
Total	**0.3%**	**0.8%**	**-0.4%**	**1.4%**	**0.4%**	**1.4%**

Source: Company data

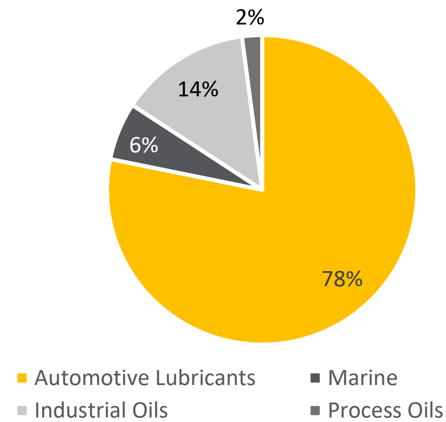
Saudi Arabia's demand for lubricant is expected to be the same as the middle east at a CAGR of 1.4% but higher than global demand in 2022-30. The growth is to be largely driven by population expansion and strong growth in vehicle fleets. The total vehicle fleet is expected to grow to 12.7mn in 2030 from 11.2mn in 2022 at a CAGR of 1.4%. Moreover, heavy-duty engine oil, which accounts for 41% of the total demand, is expected to grow at a CAGR of 1.7% in the same period.

Figure 31: Demand by sector (2022e) - Global



Source: Company data

Figure 32: Demand by sector (2022e) - KSA



Source: Company data

Base Oil – Market dynamics

Base Oil Groups are classified into two types Paraffinic and Non-Paraffinic. Paraffinic base oils, expected to account for nearly 90% of global base oil demand, are divided into three categories – Group I, II, and III, based on their properties, sulfur content, and extraction method.

Figure 33: Lubricant demand (CAGR) by Industry

Type	Properties	Production
Group I	High Sulphur, viscosity between 80-120	Conventional distillation
Group II	Low Sulphur, viscosity between 80-120	Hydrocracking
Group III	Low Sulphur, viscosity higher than 120	Severe hydrocracking

Source: Company data

The demand for base oil grew at a CAGR of 0.2% in 2010-19. The demand in 2021 was 34.9Mt/year and is expected to grow by 1.7% in 2022. For 2022-30, the demand is expected to grow at a CAGR of 0.7%, with Group II and III being the main drivers, with an expected growth rate of 3.5% and 4.8% for the same period. While the demand is expected to decline in North America and Europe, it shall be offset by growth in Asia, the Middle East, Africa, and Latin America.

Figure 34: Base Oil demand growth by region

	CAGR	
Region	**2010-19**	**2022-30e**
North America	-0.4%	-0.7%
Latin America	-0.2%	1.1%
Europe	-0.8%	-0.6%
Middle East	-0.5%	1.3%
Asia	0.8%	1.3%
Africa	0.6%	1.3%
Total	**0.2%**	**0.7%**

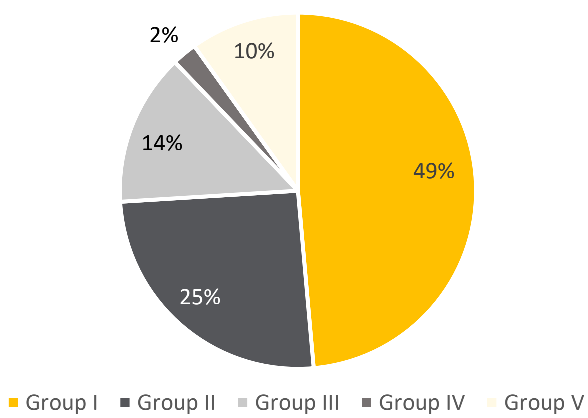
Source: Company data

Figure 35: Base Oil demand growth by oil type - global

	CAGR	
Type	**2010-19**	**2022-30e**
Group I	-2.6%	-2.9%
Group II	5.2%	3.5%
Group III	10.2%	4.8%
Group IV	4.8%	4.4%
Group V	0.1%	0.7%
Total	**0.2%**	**0.7%**

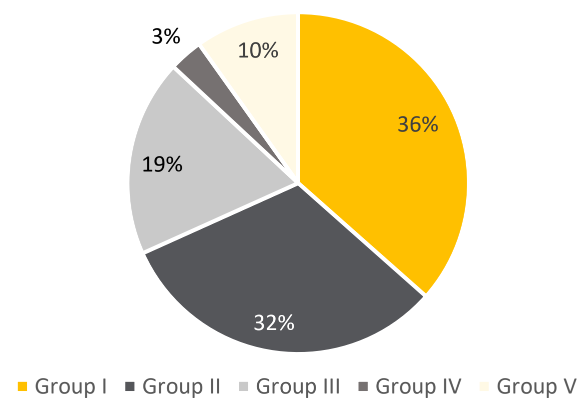
Source: Company data

Figure 36: Demand by type (2022e) - Global



Source: Company data

Figure 37: Demand by type (2030e) - Global



Source: Company data

Base oil represents nearly 90% of total lubricant demand. The demand for Group II and III base oil grew at a CAGR of 5.2% and 10.2% in 2010-19, respectively. Furthermore, Group II and III demand are expected to grow at a CAGR of 3.5% and 4.8% for 2022-30. On the other hand, the Group I base oil demand is expected to decline at a CAGR of 2.9%. In 2021, Group I demand stood at 17.5Mt/year while demand for Group II and III stood at 8.6 and 4.5Mt/year for the same period. However, the expected growth of Group II and III and the decline in Group I will change the demand dynamics in the coming years. The increase is driven by the demand for higher-performance lubricants, especially in the automotive sector.

It should be noted that total capacity in 2022e is expected at 68Mt/year compared with a demand of 36Mt/year. Hence, only meagre growth in capacity is expected. It is interesting to note that Group I's capacity has fallen by about one-fifth since 2010. Group II capacity has more than doubled since 2010 and now exceeds Group I capacity. Group III capacity has increased by 145% vs the 2010 level.

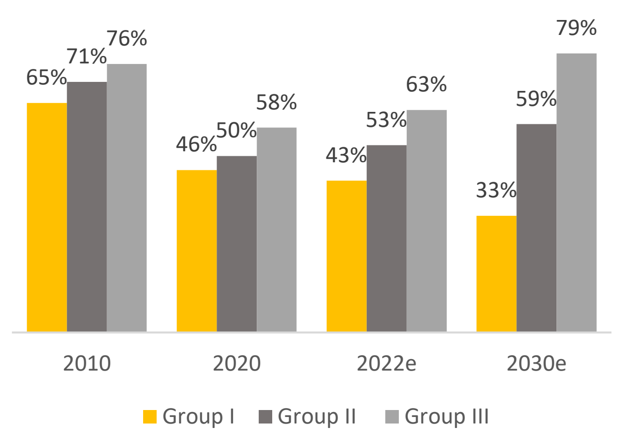
Figure 38: Base Oil capacity growth by oil type - global

	CAGR	
Type	**2010-19**	**2022-30e**
Group I	-2.2%	-0.3%
Group II	8.0%	0.5%
Group III	10.2%	0.0%
Group IV	4.1%	1.6%
Group V	2.0%	0.0%
Total	**2.6%**	**0.1%**

Source: Company data

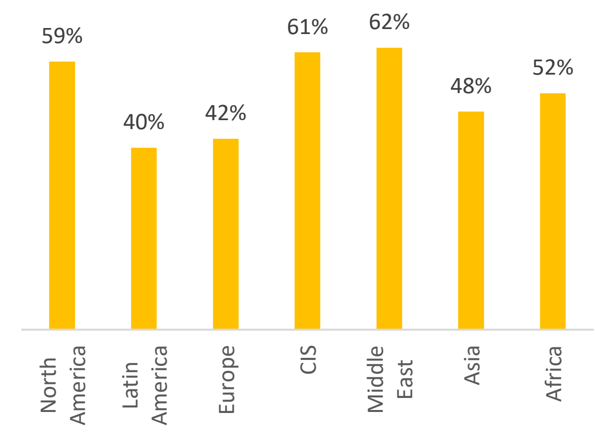
Group I's utilization rate, which used to be 65% in 2010, is only 46% in 2020 and is expected to decline to only 33% by 2030. Moreover, Group III utilization is expected at 79% in 2030. This is in line with Luberef's expansion plans.

Figure 39: Utilization rate by type



Source: Company data

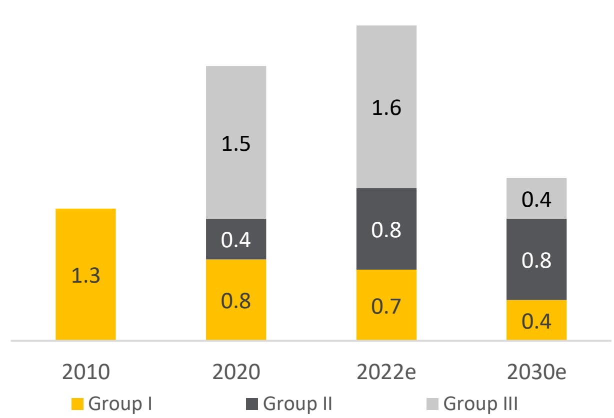
Figure 40: Utilization rate by region (2021)



Source: Company data; CIS: Commonwealth of Independent States

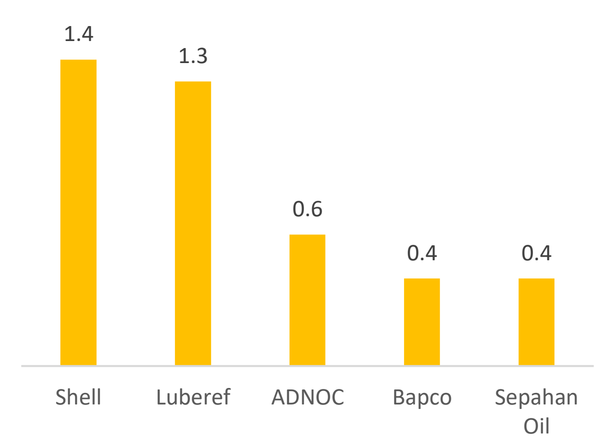
The production in the Middle East stood at 3,109Kt/year, with Group III oils accounting for almost half the output at 1,586Kt/year and Group II and III accounting for the rest. While the production of base oils has grown at a healthy pace but will grow at only a meagre rate of 0.7%.

Figure 41: Middle East base oil production by type (Mt/year)



Source: Company data

Figure 42: Production capacity in the Middle East in Mt/y (2021)



Source: Company data

The demand for base oils declined at a CAGR of 0.6% from 2010-19 in KSA. However, the demand, which stood at 408Kt/year in 2021, is expected to grow at a CAGR of 1.2% in 2022-30. The growth should be largely driven by Group III and II base oils which are expected to grow at a CAGR of 5.9% and 2.2%, respectively, while a decline of 5.5% is expected for Group I base oils in 2022-30. The key drivers behind the growth are KSA's expected GDP growth of 2.2% in 2022-30 and the rising demand for higher-quality lubricants.

The production in KSA stood at 1,173Kt/year, with Group I and II contributing 412 and 761Kt/year, respectively. While the expected capacity for Group I is likely to decline to almost half by 2025, it is expected to remain flat for group II and grow to 200Kt/year for Group III from zero.

Figure 43: Base Oil demand growth by oil type - KSA

	CAGR	
Type	2010-19	2022-30e
Group I	-10.0%	-5.5%
Group II	14.2%	2.2%
Group III	26.1%	5.9%
Group IV	8.3%	6.5%
Group V	0.5%	2.6%
Total	**-0.6%**	**1.2%**

Source: Company data

Base oil Prices

Base oil prices track closely to Crude oil prices; however, prices also depend upon the demand for the product. The prices for Group I oil are more closely related to the crude oil, while higher viscosity products like Group I and II trade at a premium. The base oil prices lag behind the crude oil by 1-3 months. Lueberef uses various benchmarks for pricing oils shown in the table below. The group usually prices their product 2-4% premium over the benchmark for exports. For domestic sales, the premium is based on alternative source supply, i.e. how much it would cost domestic consumers if they were to procure from outside the Kingdom.

Figure 44: Base Oil prices by type

US$/tonne	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Average
Group I													
150 N (EU)	897	1,213	1,084	959	914	565	485	701	734	593	521	997	805
500 N (EU)	927	1,231	1,103	1,009	979	662	577	746	765	624	550	1,270	870
Bright Stock (EU)	1,065	1,406	1,138	1,122	1,110	866	853	798	901	733	620	1,611	1,019
Group II													
60-80 N (Asia)	839	1,258	1,073	984	963	504	433	547	645	557	447	719	748
150 N (Asia)	852	1,251	1,047	1,001	964	546	483	608	715	593	509	799	781
500 N (Asia)	948	1,349	1,127	1,097	983	662	645	779	771	609	578	1,143	891
Group III													
2 cSt (Asia)	1,030	1,455	1,260	976	1,048	793	703	800	872	788	710	1,231	972
3 cSt (Asia)	1,048	1,462	1,271	1,099	1,120	884	788	862	941	860	774	1,348	1,038
4 cSt (Asia)	1,085	1,490	1,307	1,177	1,182	944	798	846	941	860	774	1,348	1,063
6 cSt (Asia)	1,035	1,492	1,318	1,177	1,184	940	793	841	936	855	769	1,343	1,057
8 cSt (Asia)	1,017	1,484	1,292	1,160	1,132	858	703	857	905	836	740	1,223	1,017
Fuel Oil													
3.5% Fuel Oil, 180 cst	463	639	661	609	552	286	228	318	419	366	246	403	432
3.5% Fuel Oil, 380 cst	455	636	649	602	545	278	223	313	412	360	239	395	426

Source: Company data

Base oil Costs & Margins

Manufacturing base oil costs are driven by technology and configuration, plant capacity, feedstock quality, and plant location. The manufacturing cost is lower for processes like hydrocracking used for the production of Group II and III base oils compared to older solvent extraction for Group I base oil plants. Base oil plants running at higher capacity have lower costs. Luberef's capacity utilization for 2021 was 87% compared to less than 60% for its global peers. Luberef procures all of its feedstock from its parent company Saudi Aramco through long-term contracts providing it access to high-quality feedstock. Moreover, the energy costs in the Kingdom are lower than elsewhere.

Usually, Group III base oil plants in the Kingdom enjoy the highest margins, followed by Group I base oil plants in the Middle East and large USGC Group II base oil plants. Group observes the Lowest margins I establish oil plants in Europe.

Summary of Financials

Figure 45: Summarized basic financial statements (SARmn)

Income statement (SARmn)	2021a	2022e	2023e	2024e	2025e
Revenue	**8,847**	**11,520**	**9,863**	**9,343**	**8,944**
revenue y/y	*101%*	*30%*	*-14%*	*-5%*	*-4%*
COGS	6,805	9,329	7,920	7,663	7,638
Gross Profit	**2,042**	**2,191**	**1,943**	**1,679**	**1,306**
Gross Profit margin	*23%*	*19%*	*20%*	*18%*	*15%*
G&A	177	208	193	195	192
Operating profit	**1,756**	**1,856**	**1,590**	**1,333**	**1,004**
Operating margin	*20%*	*16%*	*16%*	*14%*	*11%*
Finance costs	70	76	89	77	53
Net income	**1,502**	**1,625**	**1,381**	**1,158**	**875**
Net margin	*17%*	*14%*	*14%*	*12%*	*10%*
y/y	*1755%*	*8%*	*-15%*	*-16%*	*-24%*
EPS	**8.90**	**9.63**	**8.18**	**6.86**	**5.18**
DPS	6.06	10.82	6.67	6.18	4.92
Payout	68%	112%	81%	90%	95%
EBITDA	**2,096**	**2,170**	**1,888**	**1,628**	**1,304**
Net debt	(755)	(787)	(430)	(368)	(174)

Balance Sheet (SARmn)	2021a	2022e	2023e	2024e	2025e
Inventories	710	792	673	651	649
Trade Receivables	863	1,025	877	831	796
Other Current Assets	186	186	186	186	186
Cash and Equivalents	1,350	1,367	1,775	1,937	2,230
Total Current Assets	**3,108**	**3,370**	**3,511**	**3,605**	**3,861**
Intangible Assets	20	17	17	17	17
Property, Plant & Equipment	5,122	4,940	4,894	4,975	4,855
Total Non-Current Assets	**5,256**	**5,066**	**5,019**	**5,100**	**4,979**
Total Assets	**8,364**	**8,437**	**8,530**	**8,704**	**8,840**
Current Liabilities	1,494	1,685	1,492	1,457	1,453
Non-current Liabilities	2,626	2,708	2,738	2,832	2,927
Equity	4,245	4,043	4,299	4,415	4,459
Total Equity and Liabilities	**8,364**	**8,437**	**8,530**	**8,704**	**8,840**
BVPS	25.2	24.0	25.5	26.2	26.4

Cashflow (SARmn)	2021a	2022e	2023e	2024e	2025e
Cashflow from Operations	1,815	1,937	1,808	1,532	1,241
Cashflow from Investing	-222	-125	-250	-375	-179
Cashflow from Financing	-917	-1,794	-1,151	-995	-768
Total Cashflows	**677**	**18**	**407**	**162**	**294**

Source: Company, GIB Capital

Figure 46: Key ratios

Key ratios	2021a	2022e	2023e	2024e	2025e
Profitability ratios					
RoA	18%	19%	16%	13%	10%
RoE	35%	40%	32%	26%	20%
Sales/Assets	106%	137%	116%	107%	101%
Net margin	17.0%	14.1%	14.0%	12.4%	9.8%
EBITDA margin	23.7%	18.8%	19.1%	17.4%	14.6%
Liquidity ratios					
Current Assets/ Current Liabilities	2.1	2.0	2.4	2.5	2.7
Debt to Total Equity	56%	60%	58%	58%	60%
Receivable Days	36	32	32	32	32
Inventory Days	38	31	31	31	31
Payable days	58	50	50	50	50
Debt ratios					
Net Debt/EBITDA	-0.4	-0.4	-0.2	-0.2	-0.1
Debt/Assets*	28%	29%	29%	30%	30%
Valuation ratios					
P/E	10.9	10.1	11.9	14.2	18.8
P/B	3.9	4.1	3.8	3.7	3.7
EV/adj. EBITDA	7.5	7.2	8.3	9.6	12.0
FCF yield	9.8%	10.9%	8.6%	7.3%	6.4%
Div Yield	6.2%	11.1%	6.8%	6.3%	5.1%

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

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