

Saudi KAYAN posted a disappointing set of result for Q2-19, with net loss of SAR -273.1mn; broadly in-line with our estimate of SAR 291.1mn but above market consensus estimates of SAR 220mn. The result was mainly affected by high feedstock cost and an increase in finance cost by SAR 91mn due to debt restructuring. Sales revenue came in-line with our estimates, recording a strong operating rate of 97.5%. We expect that the substantial decline in feedstock price could shift the bottom line to profitability in Q3-19. We revised our recommendation to "Overweight" on the stock with a revised TP at SAR 14.50/share.

**Weak margins and product prices hit bottom-line:** Saudi KAYAN posted net losses of SAR 273.1mn in Q2-19 (EPS; SAR -0.18). Weak result is ascribed to shrinking product spread on high feedstock prices, weak product prices and high finance expenses; despite a 17%Y/Y decline in SG & A expenses. Deviation of Q2-19 net income from our estimates is mainly attributed to i) lower than expected production cost ii) higher finance cost. Finance expenses increased by SAR 91mn to SAR 378.4mn from SAR 287.3mn in Q1-19, which could be due to additional expenses for debt restructuring.

**Continued high operating rates, indicates operational efficiency:** Kayan's sales in Q2-19 stood at SAR 2,429.2mn depicting a decline of 4.5%Q/Q, in-line with our estimates of SAR 2,460mn. Based on our calculation, operating rate improved to 97.5%, higher than the average of 93.5% in FY18. During the quarter, Asian average prices of Kayan key products MEG-Asia declined by -10.3%Q/Q and -41.4%Y/Y, in addition to the decline in HDPE and LDPE by -1.9%Q/Q and -1.1%Q/Q, respectively.

**Gross margin shrinks on high feedstock cost:** Gross profit stood at SAR 192.5mn, indicating a fall of 85.2%Y/Y and 26.5%Q/Q. Gross margin further declined to 7.93% in Q2-19 vs. 10.28% in Q1-19, but above our estimate of 5.95%. During Q2-19, Butane (feedstock) average prices increased by 5%Q/Q to USD 493/tonne. MEG-Butane spreads declined to USD 361/Mt in Q2-19 from USD 437/Mt in the previous quarter. Operating profit stood at SAR 39.6mn, depicting a decline of 96.5% Y/Y. The company witnessed a decline of 17%Y/Y in OPEX (SG & A) to record SAR 152.9mn as compared to our estimate of SAR 160mn and SAR 184.2mn in Q2-18.

SARmn	Q2-FY18	Q1-FY19	Q2-FY19	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	3,524.2	2,544.3	2,429.2	-31.1%	-4.5%	-1.2%
Gross Profit	1,300.7	261.8	192.53	-85.2%	-26.5%	26.4%
Gross Margin	36.91%	10.28%	7.93%	-	-	-
EBIT	1,116.5	98.5	39.58	-96.5%	-59.8%	-
Net Profit	878.65	(197.5)	(273.1)	NM*	-38.3%	6.2%
EPS	0.59	(0.13)	(0.18)	-	-	-

Source: : Company Reports, AlJazira Capital \*NM: Not meaningful

**Debt restructuring, lower financing cost to mitigate the impact on net income by SAR 230mn in FY20:** Kayan has a relatively high leveraged balanced sheet, with long-term obligation of SAR 22.7bn and financing expenses of SAR 1.04bn in FY18. Kayan announced that the refinancing of its debt would cut financing cost by SAR 71mn in H2-19 and SAR 230mn in FY20. This we believe will mitigate the impact on the bottom line, improving the company's capability to maintain a strong cash flow and reducing debt level to SAR 19.5bn by end of FY19. We expect finance cost to decline to SAR 245mn in Q3-19 vs. SAR 378.4mn in Q2-19 and SAR 287.3mn in Q1-19. However, net Debt/EBITDA would stay high at 5.4x in FY19 against only 4.1x in FY18, limiting the company's ability to pay dividend in the next three years.

## Overweight

Target Price (SAR) 14.50

Upside / (Downside)\* 28.8%

Source: Tadawul \*prices as of 22<sup>nd</sup> of July 2019

### Key Financials (in SAR mn, unless specified)

SARmn (unless specified)	FY17	FY18	FY19E	FY20E
Revenues	9,984	12,263	9,928	10,289
Growth %	16.0%	22.8%	-19.0%	3.6%
Net Income	668.2	1,702.2	(100)	956
Growth %	418.5%	154.8%	NM	NM
EPS	0.45	1.13	(0.07)	0.65

Source: Company reports, AlJazira Capital

### Key Ratios

SARmn (unless specified)	FY17	FY18E	FY19E	FY20E
Gross Margin	23.5%	27.4%	16.0%	23.6%
Net Margin	6.7%	13.9%	-1.0%	9.3%
P/E	23.9x	11.9x	High	17.7x
P/B	1.2x	1.3x	1.1x	1.02X
EV/EBITDA(x)	8.3x	7.0x	8.7x	7.0x

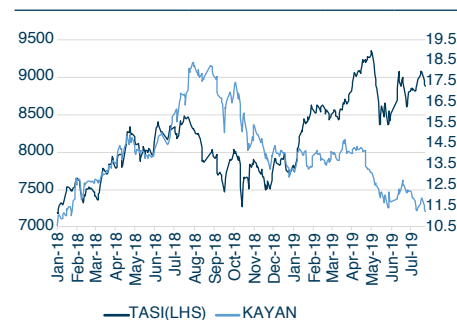
Source: Company reports, AlJazira Capital

### Key Market Data

Market Cap (mn)	17.04
YTD %	-12.6%
52 Week (High / Low)	18.52/11.18
Shares Outstanding (mn)	1500

Source: Company reports, AlJazira Capital

### Stock Performance



Source: Company reports, AlJazira Capital

Senior Analyst

Jassim Al-Jubran

+966 11 2256248

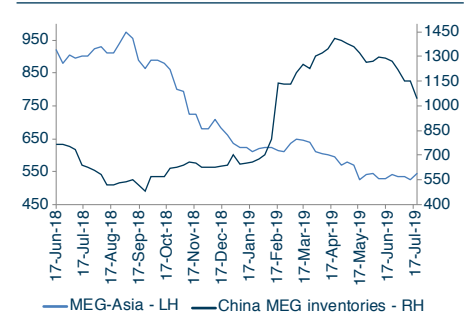
j.aljabran@aljaziracapital.com.sa

**Lower feedstock prices could turn Kayan Co. to profitability during Q3-19 with a net income of SAR 170 – 200mn:** We expect MEG and PC prices (50% of total product portfolio) to remain around current levels for Q3-19, while we expect a slight improvement for polyethylene prices (PE) in the short-term due to a tighter supply in southeast Asia amid a concentration of plant turnarounds (Source: ICIS news). We forecast feedstock price to decline by around 20-23%; Aramco further reduced butane prices for July-19 to USD 355/Mt from an average of USD 493/Mt during Q2-19. This should deliver improved gross margins at 23.1% during Q3-19 from only 7.93% in Q2-19, with a net income of SAR 170 – 200mn.

**Our estimates and valuation:** We believe, the continued high operating rate, in Q2-19, was offset by weak product prices and an increase in overall COGS and finance cost. The sensitivity of Kayan's gross margin is very high as compared to other players, due to its high dependency on Butane (80% of feedstock), especially with the current oil price volatility. Repaying and debt restructuring to reduce finance cost by an estimated SAR 175mn in H2-19 to SAR 490mn from actual SAR 666mn in H1-19. Decline in SG & A expenses during Q2-19, has become a key support going forward, where the company seems to have more control on operating expenses. Bearish S-T outlook on main product MEG and Polycarbonate prices (50% of the total product portfolio) has been eased, which is expected to mitigate the impact on top line and gross margin during H2-19. Furthermore, our mid-term outlook remains optimistic on the company due to improved operating rate; and expected noticeable recovery in product spreads after Q2-19. Saudi Kayan Co. is expected to post SAR 956mn in net income (0.64 EPS) for FY20, as compared to expected losses of SAR 100mn in FY19. **"Overweight"** recommendation on KAYAN with a revised TP at **SAR 14.50/share**.

**Risks to rating and price target:** We value Kayan on 50% weight for DCF (2.0% terminal growth and 9.4% average WACC), and 25% weight each for P/E (15.0x FY20 EPS) and EV/EBITDA (9x FY20 EBITDA) based relative valuation. These yield a target price of **SAR 14.50/share**, implying a 28.8% upside from the current levels. We revised our recommendation to **"Overweight"** for Kayan, aided by strong FCF, improved margins going forward, and stable S-T outlook on MEG and Polycarbonate as we believe short-term risk from weaker petrochemical prices are fully reflected on stock price and the company's performance. Lower than expected GP margin and lower-than-expected operational performance are considered as the downside risk to the valuation, while higher-than-expected product prices recovery and products' healthy global demand could drive the top line in FY19.

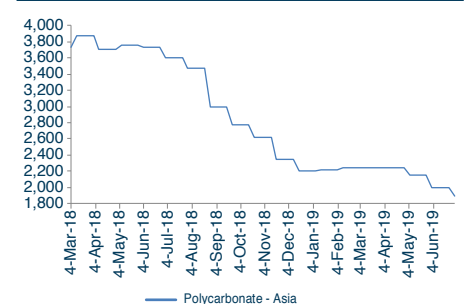
Figure2: MEG-Prices Vs. China MEG inventories



Source: Aljazira Capital, Argaam, ICIS news

Monoethylene glycol (MEG) and Polycarbonate (PC) represented 50% of total topline for KAYAN, price of MEG reached its lowest level since FY09 to USD 525/Mt due to the high inventory level in east China and weak demand for downstream product. We expect MEG price to remain around current levels for H2-19 after consecutive weeks of declines, as MEG inventories in east China start to decline.(source: ICIS)

Figure3: Polycarbonate-Price



Source: Aljazira Capital, Argaam

Polycarbonate (PC) is widely used in the auto industry and housing industry for the manufacturing of products such as appliances, home electronics and some building materials. Asia (PC) prices reached its lowest at USD 1900/Mt from USD 3800/Mt in Mar-18 as (PC) markets are well-supplied. However, on the S-T Asia polycarbonate (PC) markets are expected to stabilize with limited fluctuations, due to demand improvement.

## Key Financial Data

Amount in SAR mn, unless otherwise specified	2016	2017	2018	2019E	2020E
<b>Income statement</b>					
Revenues	8,609	9,984	12,263	9,928	10,289
<b>Revenue Growth</b>	<b>7.9%</b>	<b>16.0%</b>	<b>22.8%</b>	<b>-19.0%</b>	<b>3.6%</b>
Cost of sales	(6,803)	(7,635)	(8,898)	(8,340)	(7,858)
<b>Gross profit</b>	<b>1,805</b>	<b>2,349</b>	<b>3,365</b>	<b>1,588</b>	<b>2,430</b>
Selling & general expenses	(746)	(719)	(705)	(633)	(636)
<b>Operating profit</b>	<b>1,059</b>	<b>1,629</b>	<b>2,661</b>	<b>955</b>	<b>1,794</b>
<b>Operating profit growth</b>	<b>-278.5%</b>	<b>53.8%</b>	<b>63.3%</b>	<b>-64.1%</b>	<b>87.8%</b>
Financial charges	(868.4)	(910.3)	(1,004.2)	(1,155.8)	(941.7)
Other income	(22.3)	(60.0)	87.7	24.1	15.2
Income/(loss) from SaBuCo	36.0	49.5	48.5	60.6	98.9
<b>Income before zakat</b>	<b>204.5</b>	<b>792.3</b>	<b>1,881.1</b>	<b>13.2</b>	<b>1,095.3</b>
Zakat	(96.7)	(124.1)	(178.8)	(113.2)	(139.4)
<b>Net income</b>	<b>107.8</b>	<b>668.2</b>	<b>1,702.2</b>	<b>(100.0)</b>	<b>956.0</b>
<b>Net income growth</b>	<b>NM</b>	<b>519.9%</b>	<b>154.8%</b>	<b>-105.9%</b>	<b>-105.9%</b>
<b>Balance sheet</b>					
<b>Assets</b>					
Cash & equivalent	1,387	2,514	2,377	2,315	1,122
Other current assets	4,675	4,246	6,797	6,610	7,111
Property, plant & equipment	34,141	32,754	30,723	29,331	27,987
Other non-current assets	827	798	798	853	947
<b>Total assets</b>	<b>41,031</b>	<b>40,311</b>	<b>40,695</b>	<b>39,109</b>	<b>37,166</b>
<b>Liabilities &amp; owners' equity</b>					
Total current liabilities	3,493	3,350	3,296	4,722	3,212
Long-term debt	21,184	19,813	18,461	15,416	13,898
Total other non-current liabilities	3,102	3,240	3,239	3,327	3,411
Share capital	15,000	15,000	15,000	15,000	15,000
Statutory reserves	49	49	49	39	135
Retained earnings	(2,419)	(1,762)	28	(17)	890
Total equity	12,630	13,287	15,078	15,022	16,025
<b>Total equity &amp; liabilities</b>	<b>40,410</b>	<b>39,690</b>	<b>40,074</b>	<b>38,488</b>	<b>36,545</b>
<b>Key fundamental ratios</b>					
<b>Liquidity ratios</b>					
Current ratio (x)	1.7	2.0	2.8	1.9	2.6
Cash ratio (x)	0.40	0.75	0.72	0.49	0.35
<b>Profitability ratios</b>					
Gross profit margin	21.0%	23.5%	27.4%	16.0%	23.6%
Operating margin	12.3%	16.3%	21.7%	9.6%	17.4%
EBITDA margin	40.5%	40.1%	41.9%	34.6%	0.0%
Net profit margin	1.3%	6.7%	13.9%	-1.0%	9.3%
Return on assets	0.4%	1.6%	4.2%	-0.3%	2.5%
Return on equity	1.2%	4.9%	11.5%	-0.6%	5.9%
<b>Leverage ratio</b>					
Interest coverage (x)	1.2	1.8	2.6	0.8	1.9
Debt / equity (x)	1.7	1.5	1.3	1.2	0.9
<b>Market/valuation ratios</b>					
EV/sales (x)	3.8	3.3	3.0	3.0	2.9
EV/EBITDA (x)	9.5	8.3	7.1	8.7	7.0
EPS (SAR)	0.10	0.45	1.13	(0.07)	0.64
BVPS (SAR)	8.8	9.3	10.5	10.4	11.1
Market price (SAR)*	8.85	10.68	13.50	11.30	11.30
Market-Cap (SAR mn)	1,328	1,602	2,025	1,695	1,695
P/E ratio (x)	87.30	23.98	11.90	(169.48)	17.73
P/BV ratio (x)	1.00	1.15	1.29	1.08	1.02

Source: The company report, Aljazira Capital, Tadawul

RESEARCH DIVISION

Head of Research

**Talha Nazar**

+966 11 2256250

t.nazar@aljaziracapital.com.sa

Senior Analyst

**Jassim Al-Jubran**

+966 11 2256248

j.aljabran@aljaziracapital.com.sa

Analyst

**Abdulrahman Al-Mashal**

+966 11 2256374

A.Almashal@Aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales

**Alaa Al-Yousef**

+966 11 2256060

a.yousef@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage

**Luay Jawad Al-Motawa**

+966 11 2256277

l.almutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province

**Abdullah Al-Rahit**

+966 16 3617547

a.alrahit@aljaziracapital.com.sa

AGM-Head of Sales And Investment Centers

Central Region, & acting head Western and

Southern Region Investment Centers

**Sultan Ibrahim AL-Mutawa**

+966 11 2256364

s.almutawa@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

**Disclaimer**

The purpose of producing this report is to present a general view on the company/economic sector/economic subject under research, and not to recommend a buy/sell/hold for any security or any other assets. Based on that, this report does not take into consideration the specific financial position of every investor and/or his/her risk appetite in relation to investing in the security or any other assets, and hence, may not be suitable for all clients depending on their financial position and their ability and willingness to undertake risks. It is advised that every potential investor seek professional advice from several sources concerning investment decision and should study the impact of such decisions on his/her financial/legal position and other concerns before getting into such investments or liquidate them partially or fully. The market of stocks, bonds, macroeconomic or microeconomic variables are of a volatile nature and could witness sudden changes without any prior warning, therefore, the investor in securities or other assets might face some unexpected risks and fluctuations. All the information, views and expectations and fair values or target prices contained in this report have been compiled or arrived at by Al-Jazira Capital from sources believed to be reliable, but Al-Jazira Capital has not independently verified the contents obtained from these sources and such information may be condensed or incomplete. Accordingly, no representation or warranty, express or implied, is made as to, and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. Al-Jazira Capital shall not be liable for any loss as that may arise from the use of this report or its contents or otherwise arising in connection therewith. The past performance of any investment is not an indicator of future performance. Any financial projections, fair value estimates or price targets and statements regarding future prospects contained in this document may not be realized. The value of the security or any other assets or the return from them might increase or decrease. Any change in currency rates may have a positive or negative impact on the value/return on the stock or securities mentioned in the report. The investor might get an amount less than the amount invested in some cases. Some stocks or securities may, by nature, of low volume/trades or may become like that unexpectedly in special circumstances and this might increase the risk on the investor. Some fees might be levied on some investments in securities. This report has been written by professional employees in Al-Jazira Capital, and they undertake that neither them, nor their wives or children hold positions directly in any listed shares or securities contained in this report during the time of publication of this report, however, The authors and/or their wives/children of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. This report has been produced independently and separately by the Research Division at Al-Jazira Capital and no party (in-house or outside) who might have interest whether direct or indirect have seen the contents of this report before its publishing, except for those whom corporate positions allow them to do so, and/or third-party persons/institutions who signed a non-disclosure agreement with Al-Jazira Capital. Funds managed by Al-Jazira Capital and its subsidiaries for third parties may own the securities that are the subject of this document. Al-Jazira Capital or its subsidiaries may own securities in one or more of the aforementioned companies, and/or indirectly through funds managed by third parties. The Investment Banking division of Al-Jazira Capital maybe in the process of soliciting or executing fee earning mandates for companies that is either the subject of this document or is mentioned in this document. One or more of Al-Jazira Capital board members or executive managers could be also a board member or member of the executive management at the company or companies mentioned in this report, or their associated companies. No part of this report may be reproduced whether inside or outside the Kingdom of Saudi Arabia without the written permission of Al-Jazira Capital. Persons who receive this report should make themselves aware, of and adhere to, any such restrictions. By accepting this report, the recipient agrees to be bound by the foregoing limitations.

Asset Management | Brokerage | Corporate Finance | Custody | Advisory

Head Office: King Fahad Road, P.O. Box: 20438, Riyadh 11455, Saudi Arabia, Tel: 011 2256000 - Fax: 011 2256068