October 2019

Saudi Kayan Petrochemical Co.

Result Flash Note Q3-19

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Saudi KAYAN posted in-line set of result, in Q3-19, with net profit of SAR 1.25mn; significantly above market consensus loss estimates of SAR 142.3mn. The result was mainly driven by a decline in feedstock cost and finance expenses. However, the company's gross margin improvement is not likely to continue in Q4-19 due to expected higher feedstock prices. Revenue came in-line with our estimates, recording operating rate of 98.2%, higher than the average of 94% in FY18. We reiterate our "**Overweight**" recommendation on the stock with a TP of **SAR 14.50/share**.

- Saudi KAYAN posted net income of SAR 1.25mn in Q3-19; in-line with our estimate of SAR 3.75mn but above the market consensus losses estimates of SAR 142.3mn. The Q/Q improvement in performance was mainly due to i) continued improvement in production efficiency and volumetric sales, despite weak product prices. ii) 27% reduction in feedstock prices iii) decrease in financing costs as a result of the implementation of the company's strategy to reduce financing expenses. On quarterly basis, finance expense is expected to decline by SAR 151.5mn to SAR 223mn from 378.5mn in Q2-19 due to debt restructuring and lower SAIBOR rate.
- Kayan's revenue in Q3-19 stood at SAR 2,303.2mn depicting a decline of 5.2%Q/Q and 31.8%Y/Y. Revenue came in-line with our estimates of SAR 2,282mn, as we believe that the company raised its inventory utilization after the reduction in feedstock supply from Aramco. We assume that the plant was running at higher operating rate of 98.2%, as compared to the average of 94% in FY18. During the quarter, Asian average prices of Kayan key products MEG-Asia declined by -2.2%Q/Q and -40.0%Y/Y, in addition to the decline in HDPE and PP by -6.7%Q/Q and -6.0%Q/Q, respectively.
- Gross profit stood at SAR 375.4mn, indicating a fall of 59.6%Y/Y and an increase of 94.9%Q/Q. Gross margin expanded to 16.30% in Q3-19 vs. 7.92% in Q2-19, against our estimate of 16.90%. During Q3-19, Butane (feedstock) average prices declined by 27.4%Q/Q to USD 358/tonne. MEG-Butane spreads increased to USD 262/Mt in Q3-19 from USD 166/Mt in the previous quarter.
- Operating profit stood at SAR 201.2mn, depicting an increase of 408%Q/Q, where the company witnessed an increase of 14%Y/Y in OPEX (SG & A) to record SAR 174.2mn as compared to our estimate of SAR 157mn and SAR 152.9mn in Q2-19.

AJC view: We believe, the continued high operating rate and improved gross margin, in Q3-19, was offset by weak product prices. The company's strong gross margin is not likely to continue in Q4-19 due to expected higher feedstock prices and lower product spreads. Repaying and debt restructuring strategy are expected to reduce finance cost by SAR 216mn in H2-19 to SAR 450mn from actual SAR 666mn in H1-19. This would improve the company's capability to generate a stronger Cash Flow and reducing debt level to SAR 18.5bn by end of FY19. However, the company needs to concentrate more on controlling its operating expenses. Saudi Kayan Co. is expected to post SAR 826.5mn in net income (0.55 EPS) for FY20, as compared to expected losses of SAR 508mn in FY19. We reiterate our "**Overweight**" recommendation on KAYAN with a TP at **SAR 14.50/share**, aided by strong FCF and expected performance improvement, as we believe short-term risk from weaker petrochemical prices is fully reflected on stock price.

Results Summary

SARmn (unless specified)	Q3-FY18	Q2-FY19	Q3-FY19	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	**3,376.1**	**2,429.2**	**2,303.2**	-31.8%	-5.2%	0.9%
Gross Profit	929.5	192.5	375.4	-59.6%	94.9%	-1.9%
Gross Margin	*27.53%*	*7.92%*	*16.30%*	-	-	-
EBIT	761.5	39.6	201.2	-73.6%	408%	-10.9%
Net Profit	**471.9**	**(273.1)**	**1.25**	-99.7%	NM	-
EPS	0.31	(0.18)	0.0	-	-	-

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

Overweight

Target Price (SAR)	**14.50**
Upside / (Downside)*	**43.6%**

Source: Tadawul *prices as of 21th of October 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E	FY20E
Revenue	9,984	12,263	9,527	10,382
Growth %	16.0%	22.8%	-22.3%	9.0%
Net Income	668.2	1,702.2	(507.6)	826.6
Growth %	418.5%	154.8%	-129.8%	-262.8%
EPS	0.45	1.13	(0.34)	0.55

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY17	FY18	FY19E	FY20E
Gross Margin	23.5%	27.4%	11.9%	20.8%
Net Margin	6.7%	13.9%	-5.3%	8.0%
P/E	23.9x	11.9x	NM	18.3x
P/B	1.2x	1.3x	0.99	0.94
EV/EBITDA (x)	8.3x	7.0x	9.7x	7.1x

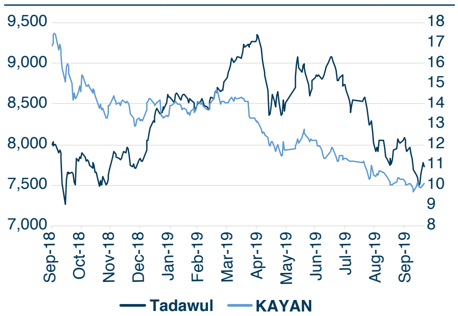
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	15.15
YTD %	-23.8%
52 Week (High)/(Low)	15.74/9.63
Shares Outstanding (mn)	1500

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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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