



YANSAB, in Q2-19, posted a disappointing set of results with net income of SAR 316.1mn; missing AJC and the market consensus estimates of SAR 415mn and SAR 400mn respectively, due to higher than expected production cost and other expenses. Revenue came in-line with our estimate, whereas Q/Q increase in operating rate was offset by weak product prices. Gross margin declined to 26.35% from 31.04% in Q1-19 due to lower product spreads. Operational efficiency is expected to remain high, in contrast weak product prices and LT negative outlook on MEG might keep top-line under pressure. We reiterate our **“Neutral”** recommendation with a revised TP of SAR 62.5/share.

Improved operating rate, was offset by weak product prices: Yanbu National Petrochemical Co. (YANSAB), in Q2-19, posted net income of SAR 316.1mn (a decline of 61.5%Y/Y and 19.1%Q/Q). Weak profitability is mainly attributed to shrinking product spread on lower product prices and high feedstock prices. Deviation in Q2-19 earnings from our estimates is mainly ascribed to i) higher than expected COGS; despite a noticeable decline in OPEX ii) higher other expenses.

Sales in Q2-19 stood at SAR 1,638mn depicting an increase of 7.6%Q/Q, in-line with our estimate of SAR 1,680mn. Operational efficiency improved to 98% from 91.5% in Q1-19, due to gradual improvement in operating rate after plant maintenance during Q4-18. During the quarter, Asian average prices of YANSAB key products MEG declined by -34.1%Y/Y and -7.1%Q/Q, in addition to the decline in HDPE and LDPE by -1.9%Q/Q and -1.1%Q/Q, respectively.

Gross margin shrinks on low products spreads: Gross profit stood at SAR 431.6mn (a fall of 53.9%Y/Y, and 8.7%Q/Q); significantly below our estimate of SAR 511.5mn owing to lower than expected gross margin. Gross margin declined in Q2-19 to 26.35% vs. 31.04% in previous quarter, which was impacted by lower margins of Propane downstream products (Almost 60% of the total feedstock). MEG-Propane spreads declined to USD 363/Mt in Q2-19 from USD 451/Mt in the previous quarter. Operating profit stood at SAR 329.5mn, where the company witnessed a decline of 15.9%Y/Y in OPEX (SG & A) to record SAR 102mn as compared to our estimate of SAR 113mn and SAR 94mn in Q1-19.

SARmn (unless specified)	Q2-FY18	Q1-FY19	Q2-FY19	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	2,111.5	1,522	1,638	-22.4%	7.6%	-2.9%
Gross Profit	937.6	472.5	431.6	-53.9%	-8.7%	-15.5%
Gross Margin	44.40%	31.04%	26.35%	-	-	-
EBIT	816.2	379	329.5	-59.6%	-13.1%	-17.0%
Net Profit	820.9	390.6	316.1	-61.5%	-19.1%	-23.9%
EPS	1.46	0.69	0.56	-	-	-

Source: Company reports, Aljazira Capital

Outlook for MEG remains challenging, while lower feedstock prices can improve H2-19 performance. monoethylene glycol (MEG) represented 34% of total revenue for FY18 (before capacity increase) 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. (MEG) supply is expected to grow in H2-19 after new capacities come on stream, while demand for its downstream polyester (PET) remains sluggish. We expect MEG price to remain around current levels for H2-19 while we forecast feedstock price to decline by around 18-20%; Aramco further reduced propane prices for July-19 to USD 375/Mt from an average of USD 490/Mt during Q2-19. This should deliver improved gross margins for Yansab during 2H-19, a short term catalyst for the stock. For polyethylene (PE), a tighter Q3-19 supply in southeast Asia amid a concentration of plant turnarounds is expected to provide support for the polyethylene (PE) market in the short-term. (Source: ICIS news)

Neutral

Target Price (SAR) **62.50**

Upside / (Downside)* **5.0%**

Source: Tadawul *prices as of 18th of July 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenue	7,220	7,629	6,678
Growth %	15.9%	5.6%	-12.5%
Net Income	2,377	2,416	1,745
Growth %	3.2%	1.6%	-27.8%
EPS	4.22	4.29	3.10

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY17	FY18	FY19E
Gross Margin	39.7%	37.6%	32.1%
Net Margin	32.9%	31.7%	26.1%
P/E	15.1x	15.10x	19.2x
P/B	2.15x	2.11x	1.97x
EV/EBITDA (x)	9.58x	9.60x	11.18x
Dividend Yield	5.0%	5.8%	5.9%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	33.46
YTD %	12.2%
52 Week (High)/(Low)	77.4/57.60
Shares Outstanding (mn)	562.50

Source: Company reports, Aljazira Capital

Figure1: MEG price performance



Source: Bloomberg, Aljazira Capital

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Our estimates and valuation: Yansab's operating rate and sales volume improved due to, high production efficiency in addition to new capacity of 80Kt/annually of Ethylene Glycol and better seasonal demand. However, weak product prices and bearish long-term outlook for MEG are the key downside for FY19. We believe that the company's margins and sales volume are likely to improve gradually starting from Q3-19, given the recent decline in feedstock prices, expected stability in PE prices and improved seasonal demand. The company's operating rate is likely to stabilize above 98% in the next quarters. Net income was revised down to SAR 1,745mn (EPS 3.10/share) in FY19 compared with earlier estimate of SAR 1,890mn (EPS 3.36/share), recording a fall of 27.8%Y/Y for the year. The company is trading at a forward PE of 19.2x during FY19, this is higher than the current sector average PE of 15.5x. Yansab's strong FCF generation and balance sheet are providing the company with the ability to maintain its attractive dividend yield of 5.9%. We expect the company to generate a strong FCF of SAR 2.7bn, which the possibility of DPS at SAR 3.5/share during FY19. We maintain our **"Neutral"** recommendation on YANSAB with a revised TP of SAR **62.50/share**.

Risks to rating and price target: We value YANSAB on 50% weight for DCF (2.0% terminal growth and 9.9% average WACC), and 25% weight each for P/E (15.0x FY20 EPS) and EV/EBITDA (9.5x FY20 EBITDA) based relative valuation. These yield a target price of **SAR 62.50/share**, implying a 5.0% upside from the current levels. The stock is trading at a P/E of 19.2x based on our FY19 EPS estimate. We maintain **"Neutral"** rating for Yansab until improved outlook on price recovery in the main products. 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.



Investment Update

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY16	FY17	FY18	FY19E	FY20E
Income statement					
Revenues	6,971	7,221	7,628	6,678	7,198
Revenue Growth	0.9%	3.6%	5.6%	-12.5%	7.8%
Cost of sales	(4,273)	(4,351)	(4,763)	(4,536)	(4,751)
Gross profit	2,698	2,870	2,865	2,143	2,447
General & administrative expense	(211)	(456)	(504)	(425)	(430)
Operating profit	2,487	2,414	2,362	1,717	2,017
Operating profit growth	61.5%	-2.9%	-2.2%	-27.3%	17.5%
Other income	100	164	182	148	164
Financial / bank charges	(139)	(57)	(31)	(24)	(23)
Profit before zakat & minority interest	2,447	2,520	2,512	1,841	2,159
Zakat	(146)	(144)	(98)	(99)	(125)
Net profit	2,303	2,377	2,416	1,745	2,038
Net profit growth	90.7%	3.2%	1.6%	-27.8%	16.8%
Balance sheet					
Assets					
Cash and bank balance	1,676	1,052	26	382	1,159
Other current assets	4,694	5,531	6,201	6,512	6,753
Property plant & equipment	13,579	12,954	12,617	11,831	11,044
Other non-current assets	237	228	227	229	232
Total assets	20,186	19,765	19,072	18,954	19,188
Liabilities & owners' equity					
Total current liabilities	2,531	2,323	1,344	1,279	1,362
Long-term loans	1,130	200	-	-	-
Total non-current liabilities	450	501	472	697	780
Share capital	5,625	5,625	5,625	5,625	5,625
Statutory reserves	1,607	1,688	1,688	1,688	1,688
Retained earnings	8,805	9,413	9,858	9,631	9,696
Total owners' equity	16,036	16,725	17,170	16,944	17,009
Total equity & liabilities	20,186	19,765	19,072	18,954	19,188
Key fundamental ratios					
Liquidity ratios					
Current ratio (x)	2.5	2.8	4.6	5.4	5.8
Cash ratio (x)	0.7	0.5	0.0	0.3	0.9
Profitability ratios					
Gross profit margin	38.7%	39.7%	37.6%	32.1%	34.0%
Operating margin	35.7%	33.4%	31.0%	25.7%	28.0%
EBITDA margin	52.6%	50.8%	46.9%	44.3%	45.6%
Net profit margin	33.0%	32.9%	31.7%	26.1%	28.3%
Return on assets	11.4%	11.9%	12.4%	9.2%	10.7%
Return on equity	14.9%	14.5%	14.2%	10.2%	12.0%
Leverage ratio					
Interest coverage (x)	17.88	42.10	76.66	71.94	89.57
Debt / equity (x)	0.07	0.01	-	-	-
Market/valuation ratios					
EV/sales (x)	4.32	4.87	4.77	4.95	4.49
EV/EBITDA (x)	8.20	9.58	10.02	11.18	9.85
EPS (SAR)	4.17	4.22	4.29	3.10	3.62
BVPS (SAR)	28.54	29.76	30.68	30.18	30.30
Market price (SAR)*	54.45	64.00	64.80	59.50	59.50
Market-Cap (SAR mn)	30,628	36,000	36,450	33,469	33,469
Dividend yield	4.6%	4.7%	5.4%	5.9%	5.9%
P/E ratio (x)	13.06	15.15	15.10	19.21	16.46
P/BV ratio (x)	1.91	2.15	2.11	1.97	1.96

Source: the company's report, Aljazira Capital



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- 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.
- 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.
- 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.

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