Saudi Kayan Petrochemical Co.

Result Flash Note Q1-19

Saudi KAYAN posted a disappointing set of result, in Q1-19, with net loss of SAR -197.5mn; significantly below AJC and market consensus. The result was mainly affected by higher than expected COGS, finance expenses and OPEX. We expect that the substantial increase in COGS could indicate to a lack of cost control or additional inventory write-down. Sales revenue came in-line with our estimates, recording operating rate of 99.2%. Due to lack of clarity on cost margin and bearish short-term outlook on the main products; we revised our recommendation to "**Neutral**" on the stock with a revised TP at SAR 15.80/share.

- Saudi KAYAN posted net losses of SAR 197.5mn in Q1-19 (EPS; SAR -0.13); missing AJC and the market consensus estimates of SAR 138.3mn and SAR 208.3mn, respectively. The deviation of Q1-19 net income from our estimates is mainly ascribed to lower than expected gross margin, as improvement was expected after inventory write-down in Q4-18, and 11.6%Y/Y decline in feedstock prices during Q1-19. We expect the higher than expected production cost could be attributed to lack of cost control or an additional inventory write-down. Furthermore, an increase in finance cost and SG & A expenses also contributed negatively to the bottom line.
- Kayan's sales in Q1-19 stood at SAR 2,544.3mn depicting a decline of 3.5%Q/Q, in-line with our estimates of SAR 2,520mn. The plant was running at an operating rate of 99.2%, higher than the average of 97.7% in Q4-18. During the quarter, Asian average prices of Kayan key products MEG declined by -17.1%Q/Q and -36.3%Y/Y, in addition to the decline in HDPE and PP by -10.5%Q/Q and -8.4%Q/Q, respectively.
- Gross profit stood at SAR 261.8mn, indicating a fall of 69.6%Y/Y and 4.3%Q/Q. Gross margin further declined to 10.28% in Q1-19 vs. 10.38% in Q4-18 against our estimate of 19.9%. During Q1-19, Butane (feedstock) average prices declined by 11.6%Q/Q to USD 470/tonne. According to our estimates, the company should have witnessed margin expansion in 50% of its product portfolio. PP-Butane cost margin declined to 34.8% in Q1-19 from 36.1% in the previous quarter. Thus, we believe that the significant Q/Q increase in the COGS is not justified after one-off impact of inventory write-down during Q4-18.
- Operating profit stood at SAR 98.5mn, depicting a decline of 86.3%Y/Y, where the company witnessed an increase of 16.2%Y/Y in OPEX (SG & A) to record SAR 163.3mn as compared to our estimate of SAR 135mn and SAR 140.6mn in Q1-18.

AJC view: We believe, the continued high operating rate, in Q1-19, was offset by an increase in overall COGS. 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. Furthermore, in addition to the 26.4%Y/Y increase in the company's finance expenses (SAR 287mn Vs. SAR 227mn in Q1-18), the increase in SG & A expenses during Q1-19, has become a concern going forward. The company needs to concentrate more on controlling its operating expenses. MEG and Polycarbonate prices are indicating further pressure due to bearish short-term outlook in the market, which is expected to further weigh on top line and gross margin during Q2-19. However, our mid-term outlook remains optimistic on the company due to improved operating rate; and expected further recovery in other product prices and spreads after Q2-19. Saudi Kayan Co. EPS for FY19 revised down to 0.36 EPS, as compared to our previous estimates of 1.15 EPS. We updated our recommendation to "**Neutral**" on KAYAN with a revised TP at **SAR 15.80/share**.

Results Summary

SARmn (unless specified)	Q1-FY18	Q4-FY18	Q1-FY19	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	**2,727.3**	**2,635.5**	**2,544.3**	-6.7%	-3.5%	0.9%
Gross Profit	861.63	273.5	261.8	-69.6%	-4.3%	-48.0%
Gross Margin	*31.59%*	*10.38%*	*10.28%*	-	-	-
EBIT	721.1	61.5	98.5	-86.3%	60.1%	-73.0%
Net Profit	**462.6**	**(110.9)**	**(197.5)**	NM	-78.1%	NM
EPS	0.31	(0.07)	(0.13)	-	-	-

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

Neutral

Target Price (SAR)	**15.80**
Upside / (Downside)*	**10.9%**

Source: Tadawul *prices as of 22th of April 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenue	9,984	12,263	11,352
Growth %	16.0%	22.8%	-7.4%
Net Income	668.2	1,702.2	539.3
Growth %	418.5%	154.8%	-68.3%
EPS	0.45	1.13	0.36

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY17	FY18	FY19E
Gross Margin	23.5%	27.4%	19.9%
Net Margin	6.7%	13.9%	4.8%
P/E	23.9x	11.9x	37.3x
P/B	1.2x	1.3x	1.2x
EV/EBITDA (x)	8.3x	7.0x	8.4x

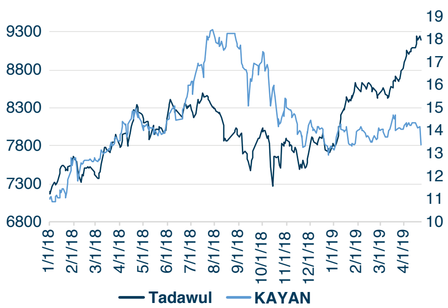
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	20.1
YTD %	7.3%
52 Week (High)/(Low)	18.52/12.86
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