

Saudi KAYAN posted a disappointing set of result in Q4-18 with net losses of SAR -110.9mn; significantly below AJC and the market consensus estimates. The result was mainly affected by higher than expected COGS, given the feedstock cost margin increase by 7.0%Q/Q. However, we expect that the substantial increase in COGS could include an additional one-off impact such as inventory write-down after 18% decline in its main product MEG. Gross margin declined on Q/Q basis to 10.38% Vs. 27.53%. Furthermore, sales revenue came 6.8% below our estimates, but still recording high operating rate at 97.5%. Thus, increased cost margin and bearish short-term outlook on the main products could maintain the pressures on Kayan's performance in Q1-19; however, production efficiency and oil & products price recovery are the key support going forward. We remain **"Overweight"** on the stock with a revised TP at SAR 18.50/share, a waiting for full financials details for more clarity.

- Saudi KAYAN in Q4-18 posted weak result of SAR 110.9mn losses (EPS; SAR -0.07); missing AJC and the market consensus estimates of SAR 379.6mn and SAR 335.5mn, respectively. The deviation of Q4-18 earnings from our estimates is mainly ascribed to i) lower than expected gross margin ii) lower than expected volumetric sales iii) a noticeable increase in SG & A expenses by 20%Y/Y. Moreover, we expect that the higher than expected increase in production cost could be attributed to inventory write-down after a significant decline in the company's main products.
- Kayan's sales in Q4-18 stood at SAR 2,635.5mn depicting a growth of 14.3%Y/Y, but below our estimates of SAR 2,827mn. This is mainly ascribed to lower than expected ramping-up in the plants' operating rates. The plant was running with operating rate of 97.5%, lower than the average of 101% in 9M-18 and our estimates of 104%. During the quarter, Asian average prices of Kayan key products MEG declined by -16.9%Y/Y and -17.5%Q/Q, in addition to the decline in HDPE and PP by -9.7%Q/Q and -4.9%Q/Q, respectively.
- Gross profit stood at SAR 273.5mn, indicating an increase of 75.8%Y/Y and a fall of 21.9%Q/Q. Gross margin declined to 10.38% in Q4-18 vs. 27.53% in Q3-18. We believe the gross margin weakness is due to decline in Butane-MEG and Butane-PE spreads. In Q4-18, although Butane (feedstock) average prices declined to USD 532/ton (11%Q/Q), Butane-MEG spread plunged higher by 29.2%Q/Q to USD 222.5/tons from USD 314/tons in Q3-18.
- Operating profit stood at SAR 61.5mn, depicting an increase of 91.9%Q/Q, where the company witnessed an increase of 19.8%Y/Y in OPEX (SG & A) to record SAR 212.0mn as compared to our estimate of SAR 162.0mn and SAR 177.2mn in Q4-17.

**AJC view:** The sensitivity of Kayan's gross margin is very high compared with the other players due to its high dependency on Butane (70-80% of feedstock), especially with the current oil price volatility. Furthermore, MEG and Polycarbonate prices is indicating further pressure due to bearish short-term outlook, which is expected to further weigh on top line and gross margin for at least one more quarter. However, production efficiency, operating rate and oil price recovery are the key support, where the company's operating rate is likely to stabilize at around 102% during FY19. On the other hand, despite the extraordinary increase in SG & A expenses during Q4-18, the company's higher control on OPEX for 9M-18 has become a key support going forward. Our mid-term outlook remains optimistic on the company early signs of better operating rate; and further recovery in product spreads after Q1-19. Saudi Kayan Co. net income for FY19 revised to SAR 1,732mn (1.15 EPS), as compared to our previous estimates of SAR 1,885mn (8.1% Downside). The company is currently trading at a TTM PE of 11.9x compared to a forward PE of 11.6x during FY19, this is lower than the sector average of 13.0x. We remain **"Overweight"** on KAYAN with a revised TP of **SAR 18.50/share**, awaiting for full financials details for more clarity.

## Results Summary

SARmn (unless specified)	Q4-17	Q3-18	Q4-18	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	2,304.9	3,376.1	2,635.5	14.3%	-21.9%	-6.8%
Gross Profit	155.59	929.5	273.5	75.8%	-70.6%	-66.5%
Gross Margin	6.75%	27.53%	10.38%	-	-	-
EBIT	11.6	761.5	61.5	429.4%	-91.9%	-90.6%
Net Profit	(220.3)	471.9	(110.9)	49.7%	NM	NM
EPS	(0.15)	0.32	(0.07)	-	-	-

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

## Overweight

Target Price (SAR) **18.50**

Upside / (Downside)\* **37.0%**

Source: Tadawul \*prices as of 21<sup>st</sup> of January 2019

## Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenue	9,984	12,263	11,615
Growth %	16.0%	22.8%	-5.3%
Net Income	668.2	1,702.2	1,732
Growth %	418.5%	154.8%	1.8%
EPS	0.45	1.13	1.15

Source: Company reports, Aljazira Capital

## Key Ratios

SARmn (unless specified)	FY17	FY18	FY19E
Gross Margin	23.5%	27.4%	28.1%
Net Margin	6.7%	13.9%	14.9%
P/E	23.9x	11.9x	11.6x
P/B	1.2x	1.3x	1.2x
EV/EBITDA (x)	8.3x	7.0x	6.2x

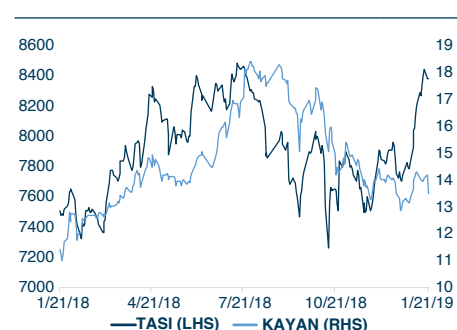
Source: Company reports, Aljazira Capital

## Key Market Data

Market Cap (bn)	20.25
YTD %	7.4%
52 Week High/ Low	18.52/10.98
Shares Outstanding (mn)	1500

Source: Company reports, Aljazira Capital

## Price Performance



Source: Tadawul, Aljazira Capital

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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.

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