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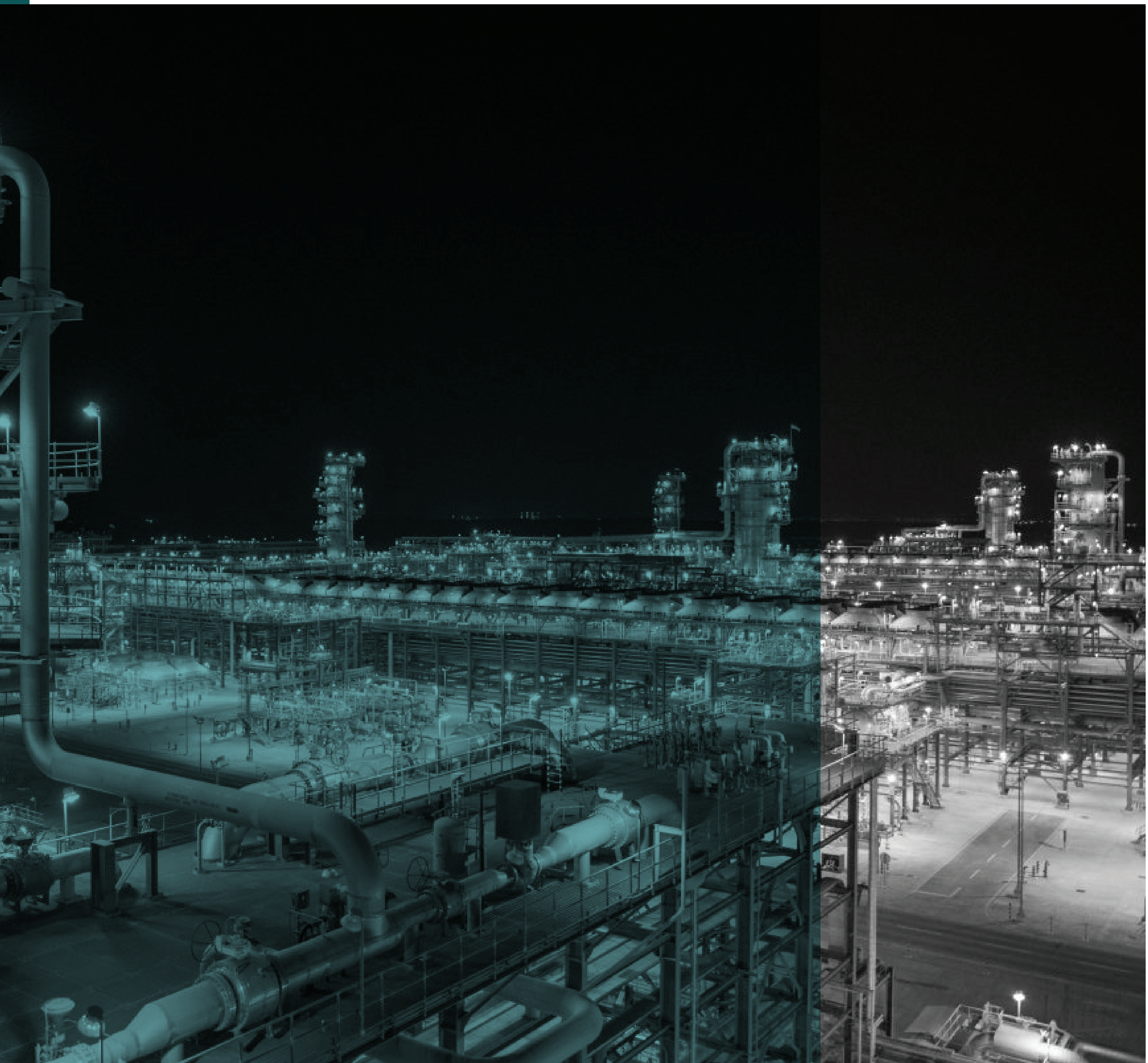


# Saudi Aramco Base Oil Company (Luberef)

## Company Update

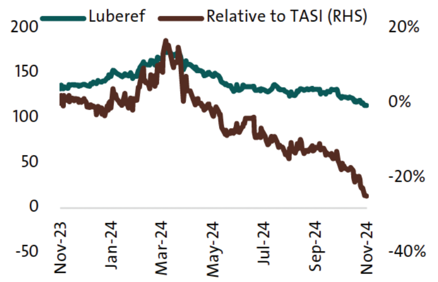
لوبريف
luberef

# Estimates cut, Buy maintain (TP: SAR138, 21% upside)

| Recommendation | BUY |
|---|---|
| Market Price | 114.2 |
| Target Price | 138.0 |
| Upside/Downside | 21% |

| Stock Data | |
|---|---|
| Market Cap Total/FF (USDmn) | 5,139/913 |
| Shares Total/FF (mn) | 168/30 |
| 52 Week Hi-Low(SAR) | 176.6/114.4 |
| 3/6/12 M Volume Traded (mnsh) | 0.42/0.40/0.34 |
| 3/6/12 M Value Traded (USDmn) | 15.8/15.7/12.8 |
| 3/6/12 M Relative Performance (%) | 2/-3/-25 |

**Luberef Stock Price Performance VS TASI**




Source: AIC

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**Luberef-Estimates revised down; Buy (TP: SAR138)**

We cut our earnings estimates for Saudi Aramco Base Oil Company (Luberef) by 9-13% over 2024-2029 and reduce our Target Price to SAR138 (down 10%). Our revised earnings estimates are 5%/1.7% below/above consensus' 2024/2025 estimates. We retain our Buy rating on Luberef. Luberef trades at CY26E PE of 16x and provides an attractive dividend yield of 5%.

**2024: Multiple drags forced estimates revision**

Broadly speaking, our estimate revisions are driven by four reasons; (i) soft global demand backdrop in 2024, deriving swifter-than-expected normalization of base-oil spread (our revised estimates now reflect almost flat margin across the forecast years vs gradual normalization built in before), (ii) drop in by-product margin, particularly diesel, (iii) revision in sales volumes growth estimates to 2% vs 6% estimated before (9M actual volume growth of 1.2% vs earlier management guidance of high single digit), and (iv) one-offs seen in 3Q2024 earnings.

**3Q Earnings: Inventory write-off derived sequential earnings weakness**

Luberef's 3Q2024 earnings of SAR226mn (SAR1.34/sh) came in 12% below consensus expectation and marked the second consecutive quarter of below-par earnings delivery. Sequentially, the crack spreads and volumes softened QoQ (3.5%/4.0% respectively). Furthermore, a sharp drop in fuel oil prices in 3Q led to a non-cash charge of SAR60mn for inventory write-down. In 9M2024, Luberef's earnings came in at SAR764mn, down 38%. Luberef's capacity to generate strong free cash flow remained intact with the company delivering SAR1,0bn FCF in 9M2024 (7% FCF annualized yield).

**Three encouraging updates**

(i) Board approval for pre-FEED study on Group III project. The FID on USD400mn project is likely next year (Preliminary management's estimated IRR of 40%). (ii) Luberef has signed a conditional MoU with APAR Industries for a 100kton blending facility in Lube Hub, the second such MoU. (iii) MoU with Bahri Chemicals for transportation of base-oil will further management efforts to contain the impact of the Red Sea crisis on the base oil's crack margin and export volumes.

**Luberef: Financial Highlights (SARmn)**

| Year to 31 Dec | CY22 | CY23 | CY24E | CY25E | CY26E | CY27E |
|---|---|---|---|---|---|---|
| Revenues | 10614 | 9489 | 9650 | 9842 | 10310 | 9410 |
| Growth | 20.0% | -10.6% | 1.7% | 2.0% | 4.8% | -8.7% |
| PAT | 1978 | 1510 | 1139 | 1206 | 1342 | 1395 |
| EPS (SAR) | 11.8 | 9.0 | 6.8 | 7.2 | 8.0 | 8.3 |
| Growth | 32% | -24% | -25% | 6% | 11% | 4% |
| DPS (SAR) | 7.5 | 10.0 | 5.5 | 5.5 | 7.0 | 7.5 |
| P/E (X) | 11.2 | 14.6 | 19.4 | 18.3 | 16.4 | 15.8 |
| D/Y (%) | 5.7% | 7.6% | 4.2% | 4.2% | 5.3% | 5.7% |
| ROE (%) | 38.9% | 31.0% | 22.4% | 22.5% | 24.3% | 24.6% |

Source: Luberef, AIC Estimates

## Luberef-Estimates revised down; Buy (TP: SAR138)

We have cut our earnings estimates for Saudi Aramco Base Oil Company (Luberef) by 9-13% over 2024-2029 and have reduced our Target Price to SAR138 (down 10%). Our revised estimates are 5%/1.7% below/above consensus' 2024/2025 estimates. We retain our Buy rating on Luberef. Luberef's stock price has corrected 23% in the past six months. Luberef trades CY25E P/E of 16.4x and provides an attractive dividend yield of 5%.

Our buy rating on Luberef is underpinned by; (i) Luberef's ongoing business transformation driven by value-added initiatives , including Growth II project which is slated to come online in 2025, (ii) unlocking of significant synergies (feedstock, downstream sales) with its parent company, Saudi Arabian Oil Company (Aramco) , the world's largest energy company with considerable global presence in upstream and downstream lubricant segment, (iii) company's strong cash flow generation and significant net cash-positive balance sheet, (iv)potential upside from future project, including Group III, and (v) continuation of production from Jeddah facility.

Key risks to our thesis are; (i) general risks associated with optimization of plant post revamp under GII (ii) volatility in base-oil prices (iii) dependence on single supply source for feedstock (iv)by-product margin (v) acceptance of GIII product

## 2024: Multiple drags forced estimate revisions

Broadly speaking, our revisions are driven by four reasons;

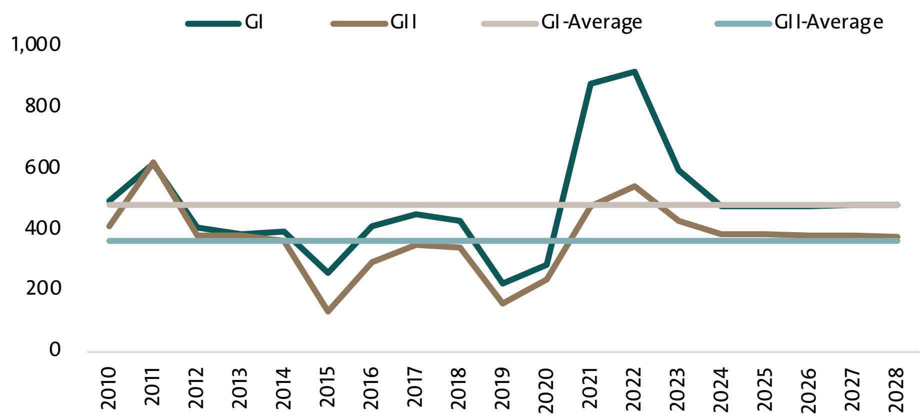
I. The weak demand backdrop in 2024 and adverse movement in prices (fuel oil spread vs oil, jumped 25% YoY while base-oil prices dropped by 8-11% YTD vs fuel oil price movement of +1.4%), deriving swifter-than-expected normalization of base-oil spread. The key reasons for soft base oil demand include destocking in the U.S and lower-than expected demand in China. Overall, Group I and Group II margins have dropped 19% and 10% YTD and trade close to respective long-term averages. Our revised estimates now reflect almost flat margin across the forecast years vs gradual drop expected before.

II. Drop in by-product margin, particularly diesel (spread vs oil dropped 28% YTD. (We estimate SAR30-40mn impact on gross profit due to the adverse movement in spreads of by-products)

III. Revision in sales volumes growth estimates to 2% vs 6% estimated before (9M actual volume growth of 1.2% vs management guidance of high single digit)

IV. One-offs seen in latest earnings performance

**Base-Oil Spread- a sharp mean-reversal over 2023-2024***




Average: 2010-9M2024, Source: Luberef IPO Prospectus, AIC

## 3Q Earnings: Sequential weakness in spread, volume

Luberef's 3Q2024 earnings of SAR226mn (SAR1.34/sh) came in 10% below consensus expectation and marked the second consecutive quarter of below-par earnings delivery. Sequentially, the crack spreads and volumes have softened by 3.5% and 4% respectively. A sharp drop in fuel oil prices before quarter-end led to a non-cash charge of SAR60mn for inventory write-down. In 9M2024, Luebref's 9M2024 earnings came in at SAR764mn, down 38%. Luberef's capacity to generate strong free cash flow remained unaffected with the company delivering SAR1,051mn FCF in 9M, implying FCF yield of 7.3% on annualized basis

**Luberef-9M2024 earnings review**

| SARmn | 1Q24 | 2Q24 | 3Q24 | QoQ | 9M24 | 9M23 | YoY |
|---|---|---|---|---|---|---|---|
| **Sales** | **2185** | **2728** | **2495** | **-9%** | **7408** | **6959** | **6%** |
| Gross Profit | 314 | 387 | 296 | -23% | 997 | 1499 | -33% |
| Operating Profit | 246 | 316 | 217 | -31% | 779 | 1310 | -41% |
| **EBITDA** | **324** | **384** | **285** | **-26%** | **993** | **1558** | **-36%** |
| Profit Before Zakat/taxes | 245 | 311 | 217 | -30% | 773 | 1301 | -41% |
| **Net Profit** | **239** | **299** | **226** | **-24%** | **764** | **1241** | **-38%** |
| EPS | 1.4 | 1.8 | 1.3 | -24% | 4.5 | 7.4 | -38% |
| Gross Margin | 14% | 14% | 12% | | 13% | 22% | |
| **EBITDA Margin** | **15%** | **14%** | **11%** | | **13%** | **22%** | |
| Net Margin | 11% | 11% | 9% | | 10% | 18% | |
| Volumes (000'ton) | 271 | 336 | 322 | -4% | 929 | 918 | 1% |
| Crack Margin (USDton) | 1639 | 1803 | 1739 | -4% | 1727 | 2225 | -22% |

Source: Luberef, AIC

## Three encouraging updates

**MoU with APAR**: Luberef has signed a conditional MoU with APAR Industries, world's third largest transformer oil producer, for a 100kton blending facility in Lube Hub. The new facility will primarily target existing local supply gap in transmission and white oil and will allow Luberef to increase its share of local sales. The company is unlikely to take any equity stake in the project and will act merely as a facilitator.  Earlier, Luberef has signed a similar MoU with Valvoline.

**Board approval for a Pre-FEED study on Group III and Group III+ project following completion of the optionality study**. The FID on USD400mn project is likely next year. The preliminary estimates of IRR of the project stand at 40%. The project targets to leverage synergies within Aramco and use unconverted crude oil as a feed.

**MoU with Bahri Chemicals for transportation of base-oil**. Luberef has faced a double whammy from the ongoing the Red Sea crisis in the form of lower crack margin due to higher freight cost on exports and challenges on handling of significant export volume. The freight cost for some of Luberef's customers has spiked to USD40/ton. The new initiative will allow Luberef to cut down freight cost on export of base-oil by half hence improve base-oil crack margin and provide a major relief on handling of export logistics. Discussion on volumes and other issues are currently underway.

## Analyst Certification:

I/We, Muhammad Fawad Khan, CFA, Abdulrahman Yusef Alnafia, the author/s of this report, hereby certify that that: (i) views expressed in this report reflect the Research Analyst's personal views about all of the securities and (ii) no part of any of compensation of the author/s was, is, or will be directly or indirectly related to the specific recommendations or views expressed by in this report.

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Alinma Investment Company (AIC) follow a four-tier rating system based on total return methodology as per following details

**>+15% Total Return:** Stocks with +15% expected total return (including dividend yield) over the next 12-months are classified as Buy.

**5-15%:** Stocks with total return between 5-15% can be classified as Buy or Neutral.

**>-5%<+5%** total return: Stocks with total return between -5+5% can be classified as Neutral or Underperform

Underperform-Stocks which are expected to have <-5% total return

**Not Covered:** AIC has not assigned any rating on the stock

**Coverage Suspended:** AIC has temporarily suspended the coverage of the stock either in compliance with local regulation or other considerations

Price data for the listed securities is based on 05-Novermber, 2024.

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