الإنمــاء للاستـثـمـار
alinma investment
شـراكـــــــة مثمـــــرة
مرخصة من هيئة السوق المالية برقم 37-09134

Saudi Aramco Base Oil Company (Luberef)

Initial Report

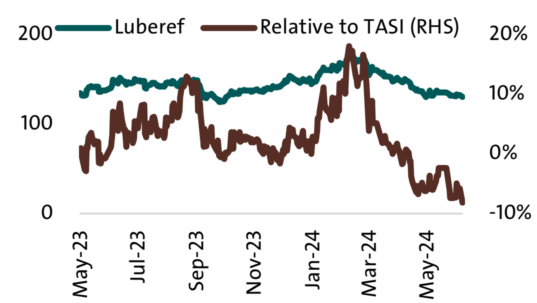
لوبريف
luberef

Continued delivery on transformation set to deliver more value (Buy)

Recommendation	BUY
Market Price	131.2
Target Price	153.0
Upside/Downside	17%

Stock Data	
Market Cap Total/FF (USDmn)	5,884/1,765
Shares Total/FF (mn)	168/51
52 Week Hi-Low(SAR)	176-114
3/6/12 M Volume Traded (mnsh)	0.3/0.4/0.6
3/6/12 M Value Traded (USDmn)	12/15/22
3/6/12 M Relative Performance (%)	-13/-6/-7

Luberef Stock Price Performance VS TASI



Source: AIC

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Luberef-Continued delivery on transformation set to deliver more value

We initiate coverage on Saudi Aramco Base Oil Co (Luberef), a significant global player in the base-il segment, with a Buy rating and DCF-based Price Target of SAR153 (17% upside + D/Y of 5%). We believe Luberef's business transformation strategy, underway since 2021, promises to deliver further value addition for investors and better prepare Luberef to navigate the emerging industry dynamics.

Key Reasons for our Buy Rating

1: Demand outlook for core products is encouraging: Luberef stands to benefit from favorable global demand outlook for its core products with 4.7% CAGR over 2022-2028.

2: Optimization of production Yanbu comes at the right time: Production optimization on Yanbu facility promises (i) to deliver cumulative 45% jump in base-oil product (ii) entry into high-margin Group III products by 2026 via ~USD150mn capex and (iii) to add to operational flexibility. We estimate ~2-year payback for the project.

3-Strong free cash flow generation and high payout: We estimate Luberef can generate SAR10-11/sh FCF (Yield: 7-8%) supported by future projects, likely healthy product spreads and the company's low OP-EX. Luberef is likely to maintain payout at the higher end of management guidance of 60-80% payout.

4: Three areas of future upside: (i) Continuation of operation on Jeddah facility (not part of base-case estimates) beyond 2026, (ii) firming of company's plans for a new USD300-400mn project (GIII & GIII+ products) with IRR of 40% (management estimates), and (iii) company's entry into downstream segment.

34% correction has opened up valuation

A 34% correction in stock price from its high on the back of soft 1Q24 earnings print and continued normalization of margin from post-COVID highs provides a good opportunity in our view. The stock trades at an undemanding P/E of 14.6x (2026E, EX Jeddah) vs market P/E of 17x. Our 2024/2025 EPS estimates are 12-13% below consensus.

Key Risks

(i) general risks associated with optimization of plant post revamp under Growth II project (ii) by-product margin, and (iii) dependence on the single source of feedstock.

Luberef: Financial Highlights (SARmn)

Year to	CY22	CY23	CY24E	CY25E	CY26E	CY27E
Revenues	10614	9489	10094	9941	10454	9355
Growth	20.0%	-10.6%	6.4%	-1.5%	5.2%	-10.5%
PAT	1978	1510	1315	1367	1515	1532
EPS (SAR)	11.8	9.0	7.8	8.1	9.0	9.1
Growth	32%	-24%	-13%	4%	11%	1%
DPS	7.5	10.0	7.3	7.3	7.3	7.5
P/E (X)	11.2	14.6	16.8	16.1	14.6	14.4
D/Y (%)	5.7%	7.6%	5.5%	5.5%	5.5%	5.7%
ROE (%)	38.9%	31.0%	26.5%	26.7%	28.0%	27.0%

Source: Luberef, AIC Estimates

Luberef-Investment Case

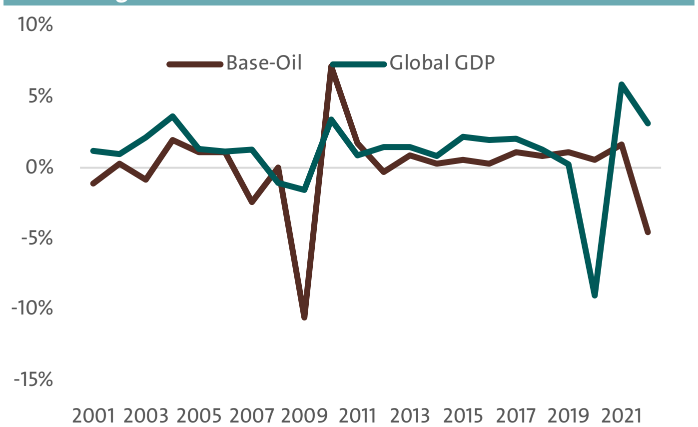
We initiate coverage on Saudi Aramco Base Oil Co (Luberef), a significant global player in the base oil segment, with a Buy rating and TP of SAR153/sh (17% upside). Luberef's business transformation plan to address optimization issues and leverage its unique position of being part of Saudi Aramco Oil Company (Aramco), the largest global energy player, will continue delivering strong value addition for its shareholders and better prepare the company to weather through the changing industry landscape, in our view. We lay down our investment case on Luberef below;

1: Demand outlook for core products is encouraging

Luberef stands to benefit from favorable global demand outlook for its core products with 4.7% estimated CAGR

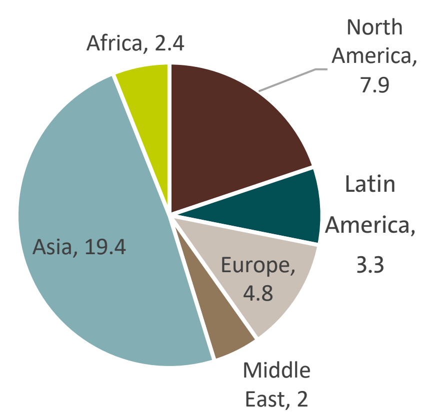
Luberef stands to benefit from favorable global demand outlook for its core products with 4.7% estimated CAGR for Group II* (GII) and Group III (GIII) products over 2023-2028. Demand for GI products is expected to decline by 1.5-2% in the same period. Taken together, the global demand for base-oil is expected to remain largely muted in the range of 0.8-1.2%. It is pertinent to mention our base-case excludes GI production from Jeddah from the middle of 2026. Jeddah is a source of 60% of total GI production of the company.

Growht in global GDP & base-oil demand



Source: Statista, IMF, AIC Research

Asia has the highest share in the global base-oil demand (mn ton)



Source: Luberef, AIC

We have based our assessment of global demand on estimates quoted by Luberef in its 2023 annual report, assessment of key demand drivers (transportation and industry) and EV conversion trend, demand outlook for oil and other market reports. All in all, the factors which affect overall oil demand (energy transition, emission targets, technology) will also have direct and indirect bearing on the outlook for base-oil demand, in our view.

Changing landscape of base-oil demand

Base-oil consumption has undergone a shift in the past decade with the changing dynamics in the transport sector

Base-oil consumption has undergone a shift in the past decade with the changing dynamics in the transport sector, one of the two major sources of base-oil consumption, and the emergence of China as the global center for industrial activity and healthy growth in industrial activity in India.

*Please refer to Appendix I for classification of Base-oil group

Transport segment

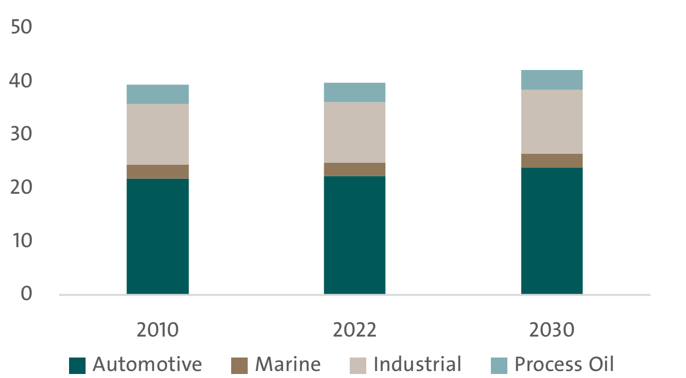
EV adoption in recent years have accelerated among vehicle owners

The segment now accounts for 56% of total consumption in 2022. Growing focus on fuel efficiency in vehicles, (ii) emission standards, (iii) engine design and (iv) conversion of vehicles to hybrid or electric sources of energy, have affected the demand profile of base-oil in the transport segment. This is reflected in a steep drop in consumption of low-grade product, GI, by +30% since 2010 and above-trend growth in consumption of GII and GIII products (CAGR of 5% and 10% over the same period respectively). EV transition and future use of base-oil in heavy duty vehicles are likely to be two major themes which may determine the future trend of consumption of base-in transport segment.

EV transition in passenger & light duty vehicles: EV adoption in recent years have accelerated among vehicle owners, partially driven by monetary support provided by the government for the ownership of electric vehicles. As a result, the contribution of EV vehicles in the new vehicle has jumped to 14% as per market estimate, up from 2.6% in 2019. Notwithstanding growing EV adoption, EV vehicles account for only a modest portion ~4% of total global vehicles population in 2023. It is interesting to note passenger vehicles account for ~25% demand of base-oil only.

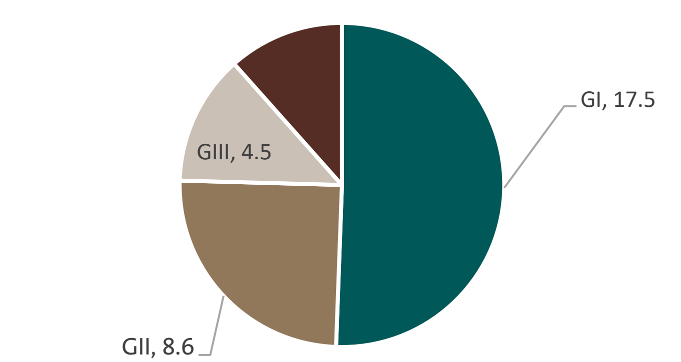
Continued reliance on fuel-engine in heavy duty engines: A significant portion of demand for base oil comes from Heavy Duty Engine Vehicle (~30% of demand), Light Duty Vehicles (LDV), and aviation segment. Electric options for LDVs are available, however, no commercially viable electric options are available for the latter.

Lubricant consumption by Sector (mnton)



Source: Luberef, AIC Research

Base-Oil Demand Profile by Group (mnton)



Source: Luberef, AIC Research

Industrial & marine segment

In the industrial & marine segment (35% of total consumption), demand outlook is more intertwined with increased industrial activity in the emerging market and global economic growth (projected to have average growth of 3.2% in the medium-term as per IMF estimates). China and India are likely to be two major contributors to future demand growth in the industrial segment.

Change in emission standards by IMO (International Maritime Organization) has resulted in substitution of liquid fuel with gas. Hydrogen-based fuel usage in ICE for marine transportation may become popular in the medium-term.

2: Production Optimization on Yanbu facility

Luberef's Business Transformation Plans rests on three pillars;

(i) Increase production of base oil,
(ii) Generate value through synergies within Saudi Aramco's value chain in energy and associated products,
(iii) Reducing expenditure by focusing on operational efficiency.

Luberef's Business Transformation Plans rests on three pillars

The company's transformation strategy, set in motion in 2021, has already resulted in significant value addition for Luberef's shareholders (pls see below). Building on the company's strategy, the management has come up with new projects which promise to create further value for company' shareholders.

Production optimization on Yanbu facility via Growth II project, a key plank for the company's future value creation, is one such project, and comes at the right time. The Growth II project strongly complements the company's business transformation strategy, in our view. Under the new initiative, Luberef is making USD150mn investment at Yanbu facility and associated infrastructure. Furthermore, the company is looking to optimally utilize its future processing unit by securing fresh allocation of Unconverted Crude Oil (UCO) and produce additional base-oil volumes

Growth II project promises to deliver multiple advantages for the company which include;

- Lift its base-oil production by significant 45% via introduction of Group III base-oil and enhanced production of GI and GII products
- Add to flexibility in switching between GII and GIII as per market demand.
- Meet domestic demand of Group III oil (estimated at almost half of future production of the plant by 2026)
- Building future capacities to better seek synergies Aramco's lubricant and retail asset
- Make up for potential production and earnings losses due to possible closure of Jeddah facility

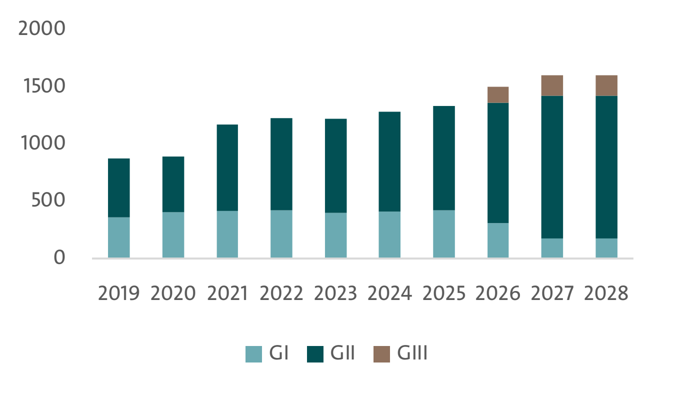
Given healthy margin in GII and GIII products and significant addition in base-oil production and relatively modest capex, we estimate the project can have a payback period of less than ~2-years.

Significant domestic demand for GIII products...

Consumption growth for Group III base oil products has remained solid both in the Kingdom and key export destinations

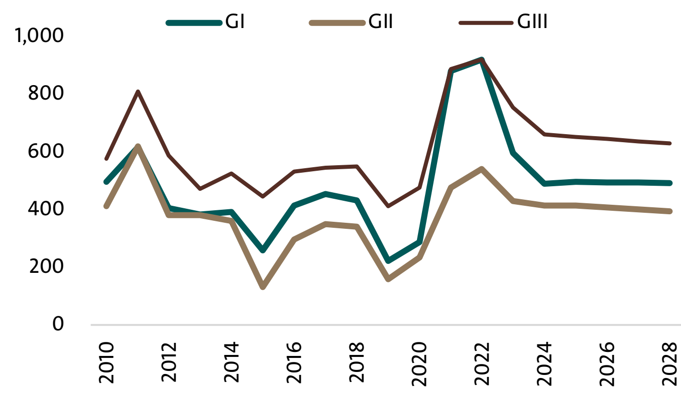
Consumption growth for Group III base oil products has remained solid both in the Kingdom and key export destinations. Overall, demand has exhibited 10% CAGR since 2010. In-fact, Group III base-oil has emerged as a significant contributor to overall base-oil demand over the same period. Luberef eyes an addition of 175kton production of GIII via Growth II project which is equivalent to 3.3% of global demand for the product. The market for GIII products in the Kingdom is estimated at 70-75kton in 2026 or ~50% of future production capacity. This suggests Luberef will have to look for an export market for half of future production only.

Luberef's base-oil production has consistnely increased since 2019



Source: Luberef, AIC

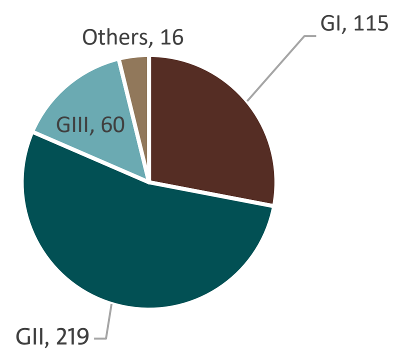
Despite correction, base oil spreads remained above LT average



Source: Luberef. AIC Estimates

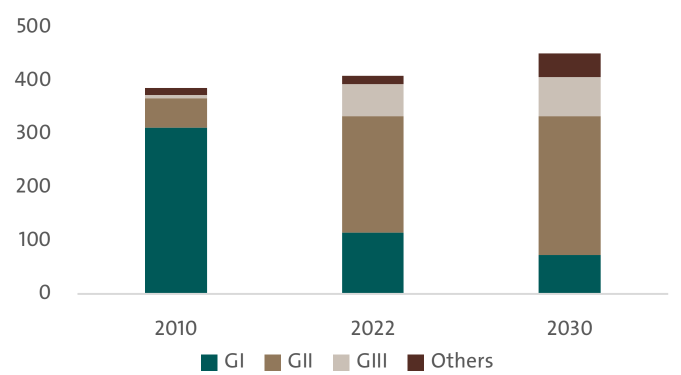
Overall, the size of the base-oil market in the Kingdom is estimated at 400kton or roughly 30% of Luberef's total production in 2023. Transport sector is the largest consumer of lubricant products followed by the industrial sector. GII products contribute over 50% of total demand while GI accounts for 27% of total consumption. Consumption of base oil in the Kingdom has followed the global trends with demand for GI showing a consistent decline since 2010, while consumption of GII and GIII products exhibiting above-trend growth. All in all, the total demand in the Kingdom has remained flat since 2010/ Looking ahead, base-oil consumption is expected to grow at a CAGR of 1.2% by 2030 to 451kton as per latest market studies quoted by Luberef.

Base-oil demand profile in Saudi Arbaia (kton, 2022)



Source: Luberef, AIC

Base-oil demand in Saudi Arabia to have 1.2% CAGR upto 2030



Source: Luberef. AIC Estimates

…with margin at 70% premium to GII base oil

The premium for GIII base-oil prices has averaged close to USD800/ton in the past three years. Similarly, the average premium for GII products has fared at USD446/ton. While we believe the premium in recent year is usually higher and continue to see the room for normalization over the medium-term, we believe spreads will likely remain at elevated levels in the near-term relative to average seen over 2010-2020 due to (i) growing demand of GII and GIII products, (ii) higher cost involved in production of GIII base oil and (iii) technical advantages of GIII base-oil over other grades.

The domestic pricing of GIII products is expected to follow the trends seen in pricing for GI and GII products. The company commands 15-20% premium over respective global benchmark prices. The premium reflects various advantages of sourcing base-oil from local sources vs import for the local lubricant blenders.

Upgrade of Various production units to lift base-oil production

The optimization of base oil production from Yanbu via Growth II project consists of two phases;

The optimization of base oil production from Yanbu via Growth II project consists of two phases

1-A USD150mn project to enhance production capacity by upgrading and debottlenecking the existing units in GII train at Yanbu. The scope of the project includes

- Enhancing the capacity of Vacuum Distillation Unit (VDU) to 65 MBD (000'barrler per day) from existing 50MBD. Luberef expects fresh allocation of feedstock from its parent company, Saudi Aramco, or transfer of current allocation for Jeddah plant to Yanbu plant to operate the expanded capacity at Yanbu.
- Expanding and upgrading Hydro Cracking Unit (HCU), a key process for producing GII and GIII grades, from 26 MBD to 35 MBD
- Increasing processing capacity of Iso dewaxing unit from 19 MBD to 29 MBD.
- Installation of required infrastructure to handle additional volumes of base-oil and by-products for local and export markets

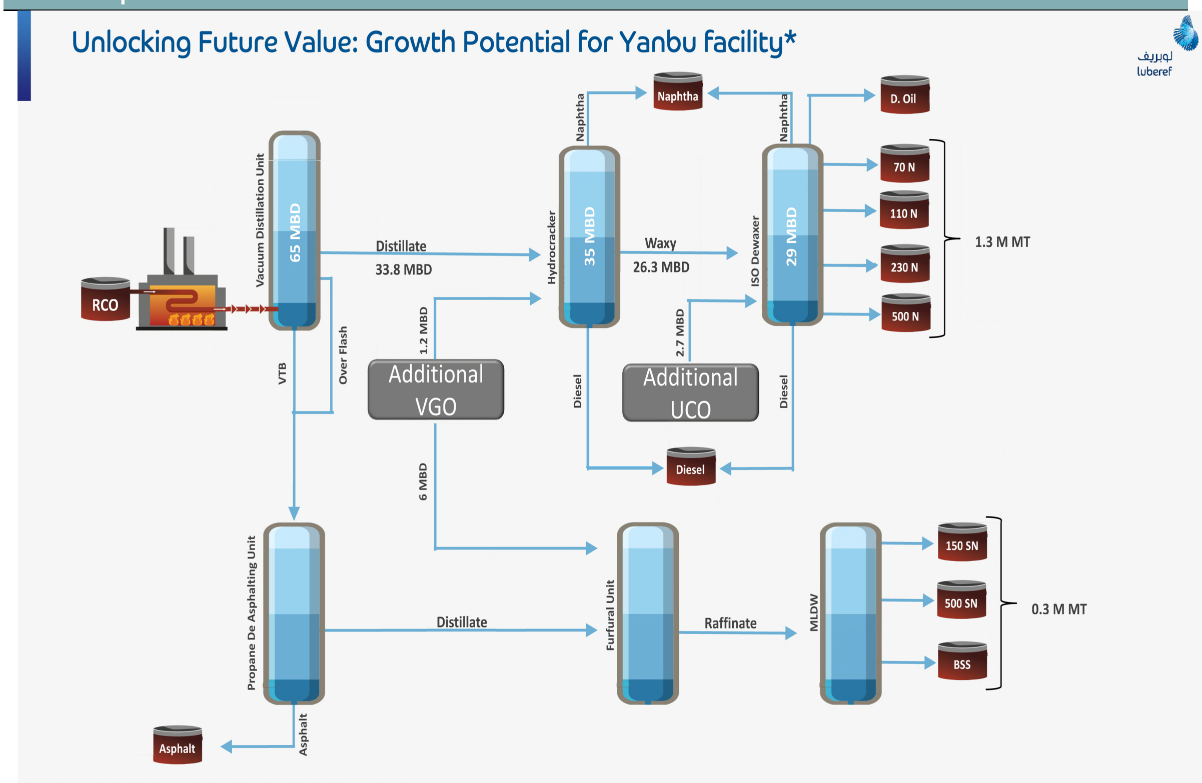
2-The second leg of optimization will likely kick-in after the smooth operations of the upgraded facilities on GII/GIII train have been achieved. This includes sourcing Unconverted Crude Oil (~2700bpd) within the refining assets of Saudi Aramco to be processed at Iso dewaxing unit in order to produce a higher quantity of base-oil.

Transformation Potential of Yanbu Facility

Optimization Initiative	Year	Additional Base Oil Production	Base Oil Production
Base Production of 45MBPD	2021		900
Additional 5k production from VDU	2023	100	1000
HVGO Synergy (upto 3kbpd for Hydrocracker)	2024	126	1126
Growth II Project Commencement	2025	124	1250
Unconverted Crude Oil Synergy	2026	350	1600

Source: Luberef, AIC

Luberef Optimization at Yanbu



Source: Luberef 1Q24 Earnings Presentation

Encouraging results from Business Transformation Strategy

The management's initiatives under the Business Transformation Strategy to optimize production from commissioning of the Growth I project at Yanbu facility and enhance reliability of operation in Jeddah have delivered strong results. This is evident in the 40% jump in total base-oil production (GII at Yanbu facility accounts for 40% jump) since 2019, improved yield of hydrocracking unit in the GII train, and increased reliability of the plant. Luberef has maintained a high operating rate on Jeddah facility (~90% adjusted for turnaround in 2023) despite challenges associated with the plant's prolonged operating history. Combination of operational efficiencies, economies of scale and substitution of gas used in the production process, has improved company's operation cost, and made Luberef one of the lowest cost producers as per consultant Report published at the time of company's listing.

3-Strong Free Cash Flow generation and high pay-out

We estimate Luberef can generate SAR10-11/sh FCF (cash flow yield of 7-8%) by 2026

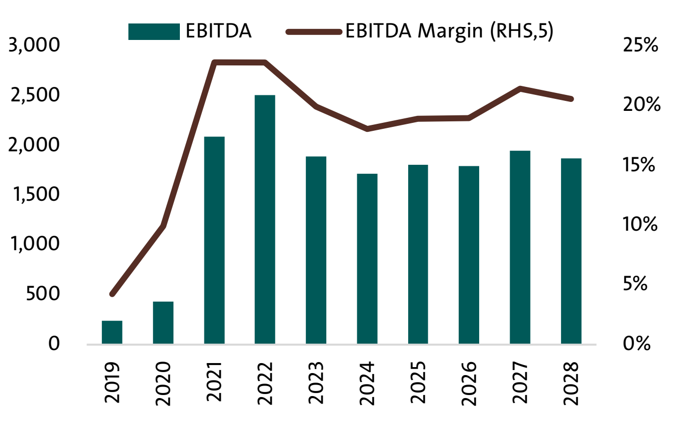
We estimate Luberef can generate SAR10-11/sh FCF (cash flow yield of 7-8%) by 2026 supported by the company's GII project commissioning, low OP-EX post optimization of operation, future projects and likely healthy product spreads. Strong free cash flows generation will likely add to (i) company's ability to deliver on the management guidance of healthy cash payout of 60-80% of earnings (we reckon payout is likely to remain on the higher end of guidance), (ii) create room for financing future growth projects and, (iii) sustain an unleveraged balance sheet.

Significant de-leveraging achieved

Luberef has already achieved significant deleveraging of its balance sheet in the past three years on the back of improved cash flow generation. Luberef has also proactively looked for opportunities to prepay debt due to the high interest rate environment. As a result, the company's net-debt to equity ratio declined from a high of 47% in 2019 to negative 1% in 2023. In 1Q24, net debt to equity ratio has further improved to -3% following prepayment of SAR980mn of LT debt during the period.

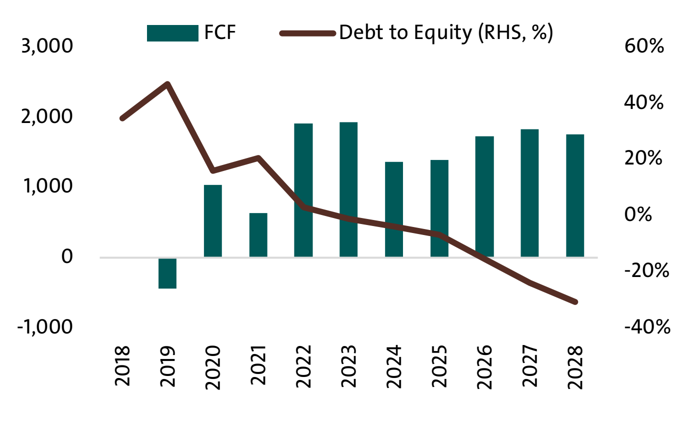
Since 2018, Luberef has lifted its cash flow from operation from a meagre SAR0.08b in 2019 to SAR2.2bn by 2023 Looking ahead, we expect Luberef to sustain its operating cash flow in the range of SAR1.7-1.9bn p.a.

Luberef's EBITDA (SARmn) lifted on favorable price and product



Source: AIC, Luberef

...which has solidified company's financial position (SARmn)



Source: AIC, Luberef

4-Three areas of future upside

Continuation of operation on Jeddah facility beyond 2026

Our base-case estimates assume closure of operations in Luberef's Jeddah facility from 2026

Our base-case estimates assume closure of operations in Luberef's Jeddah facility from 2026. The lease for the use of the land and feedstock supply agreement (both obtained from the parent company, Aramco) are due to complete the five-year extension given in 2021. While we do see technical and commercial reasons for yet another extension of the contracts, we have opted to include operations from only Yanbu facility post 2026. Based on our estimates, continuation of production in Jeddah can result in upto 20/15% upside to Luberef's earnings/valuation.

Jeddah facility has been in operation since the company's foundation and has acted as a hub for base-oil in the Kingdom. Jeddah facility converts 26kbpd of reduced crude oil, a low value product, from Saudi Aramco to high value products. Jeddah is a major source of GI base oil for both the Kingdom and regional users. The Jeddah facility is located very close to Jeddah port and is surrounded by important Saudi Aramco's oil facilities. The future extension in the two agreements for Jeddah facility will likely be subject to, among other considerations, authorities' future plans of the alternative use of the area as tourist destination. However, we wait for clarity on the issue before incorporating the future operations from Jeddah.

Firming of company's plans for new project for GIII and GIII+

Luberef is looking to set up a new USD300-400mn GIII and GIII+ facility in order to further leverage the key advantages of feedstock supply from Aramco

Luberef is looking to set up a new USD300-400mn GIII and GIII+ facility in order to further leverage the key advantages of feedstock supply from Aramco. To this end, Luberef has already commissioned a study to identify a location for the facility in the Kingdom. The new project may produce 500-700kton (11-15% estimated global demand) of GIII and GIII+ products and will go a long way in further consolidating Luberef's position in the high-margin segment and improving the company's product mix. We believe the management is likely to make a final investment decision (FID) on the project by next year with target project commissioning by 2027-2028. The future supply demand balance and materialization of projected growth in GIII demand ahead of FID would be the most important inputs for the project in our view. The management believes the IRR on the project could be as high as 40%.

Entry into downstream segment

Luberef is also looking to move further downstream into manufacturing of specialty products (transmission oil, rubber process oil, metal working fuel) via technical and equity partnership with other companies. Two key advantages for future investors are easy availability of significant quantities of feedstock from Luberef and proximity to source of feedstock supply at Lube Hub, an industrial park adjacent to Luberef's Yanbu facility earmarked for future projects in the base oil downstream industry.

The future projects in Lube Hub, will fulfil multiple objectives:

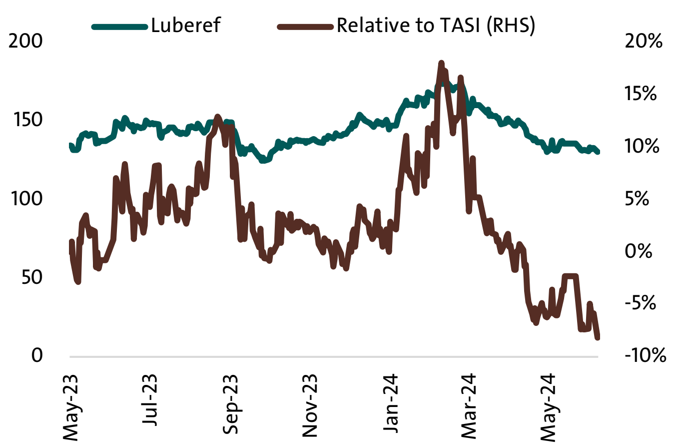
- Import substitution of the downstream products and possible export opportunities
- Allow company's entry into downstream business
- Fulfil a condition by Ministry of Energy (MOE) set at the time of additional allocation of gas and propane in 2022

34% correction has opened up valuation

A 34% correction in stock price from its peak in Mar-24 has opened up valuation in the stock

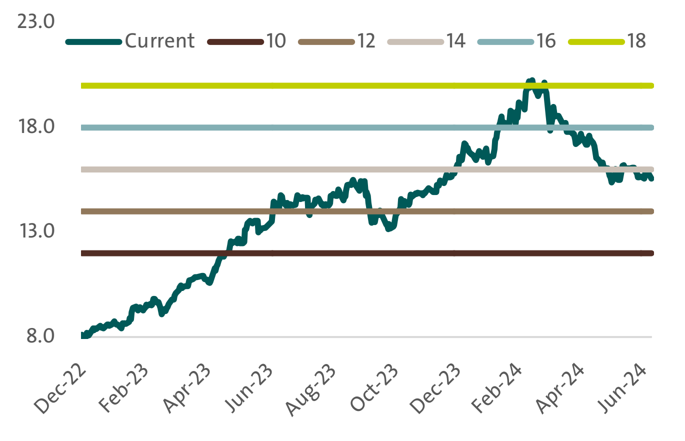
A 34% correction in stock price from its peak in Mar-24 on the back of soft 1Q24 earnings print, mostly non-recurring (pls see below for details) and continued normalization of base-oil margin, and more recently, continued normalization of base-oil spread from post-COVID high, has opened up valuation in the stock, in our view. The stock trades at an undemanding P/E 14.6x on 2026E earnings (Ex-Jeddah) vs market P/E of 17x (2024E). Based on our DCF-based valuation, Luberef offers 17% upside to our Target Price of SAR153/sh alongside a healthy dividend yield of 5% (CY24E).

Luberef has underperformed TASI by 12% in 12M



Source: Bloomberg, AIC

Luberef's P/E trades close to its average since listing



Source: AIC

Multiple Catalysts on the Horizon

We see a number of triggers on the horizon which can potentially unlock the valuation discount;

- 2Q24 earnings which will likely rebuild investors' confidence on company's earnings potential and future payouts
- Further optimization of production on Yanbu facility in 3Q24 ahead of commissioning of GII project (company targets mid-single digit jump in base-oil production in 2024)
- Project updates on progress on Luberef's Growth II project. This will allow us to de-risk product mix, yield and timing of the project commissioning.
- Progress on future investments in base-oil market (likely by end of this year or early next year)
- Clarity over continuation of operation of Jeddah facility (possible by year-end at the time of firming of company's medium-term plans

We arrive at valuation of SAR153/sh based on FCF by using WACC of 8.9% and terminal growth rate of 2%.

Valuation

Discounted Cash Flow (DCF) method is our preferred method of valuation for Luberef due to future dynamics of the company's cash flows and earnings. Specifically, the uncertainty of continuation of operation at Jeddah facility (our base-case) and commissioning of a significant project at Yanbu facility in 2026 (cold commissioning likely by end of 2025) will likely introduce significant variations in both earnings and cash flow for Luberef. We believe the DCF method can better capture the value of future earnings and cash flows over the forecast period.

1-Discounted Cashflow Method

We have elected to use the Free Cash Flow to Firm (FCF) method for the free cash flow valuation of the company. We arrive at a valuation of SAR153/sh based on FCF by using WACC of 8.9% and terminal growth rate of 2%.

The estimated valuation suggests implied P/E of 17.0/16.8x for 2026/27E and EV/EBITDA of 15/13x respectively. We believe the implied valuation multiples are broadly in line with current multiples for Luberef's listed peers and overall market valuation.

Luberef: DCF Valuation

SARmn	2024E	2025E	2026E	2027E	2028E
Operating Profits	1,394	1,347	1,504	1,499	1,453
Add: Depreciation & Amort	265	267	286	289	291
Less: ∆in Working Capital	(93)	40	(4)	52	1
: Capital expenditures	(297)	(442)	(73)	(84)	(85)
FCFF	1,269	1,211	1,713	1,756	1,660
PV of FCFF	1,269	1,162	1,510	1,422	1,344

Summary of Valuation	
Long term growth rate (g)	2.00%
Terminal value	**24,687**
Present value of terminal value	19,132
Present value of future cash flows	6,707
Enterprise Value	25,839
Less: Net debt	2,128
Add: Cash & Cash Equivalent	2181
Equity value	**25,892**
Shares	168.8
Equity value per share	**153.44**
Implied P/E (2027E)	17.0
Implied EV/EBITDA (2027E)	14.2

Source: AIC Estimates

Basic Valuation Assumptions	
Risk Free rate	4.5%
Market Risk Premium	5.0%
Adjusted Beta (x)	1.0
Cost of Equity	**9.5%**
Share of Equity	83%
Cost of Debt	**6%**

Source: AIC

Sensitivity Analysis on terminal growth and Cost of Equity

The following table presents the sensitivity of Luberef's FCFF valuation based on changes in terminal growth and Cost of Capital. Based on the sensitivity, we obtain a valuation range of SAR126-212/sh assuming ranges of terminal growth of 1-4% and WACC of 7.9-9.9% respectively.

Sensitivity of DCF valuation to terminal growth and Cost of Capital

		Terminal Growth				
		1.0%	1.5%	2.0%	2.5%	3.0%
Cos of Capital	7.9%	156	165	177	190	206
	8.4%	146	154	164	175	189
	8.9%	138	145	153	163	174
	9.4%	130	137	144	152	161
	9.9%	124	129	135	142	151

Source: AIC Estimates

3-Relative Valuation

Selection of Peers

Luberef is a unique petroleum product producer with very limited comparables among listed peers

Luberef is a unique petroleum product producer with very limited comparables among listed peers. However, companies in the downstream lubricant business, the consumer of base-oil products, and chemical companies, may serve as a good benchmark for relative valuation of the stock. We have selected 10 companies which operate in the downstream business within developed and emerging markets.

We highlight following observations on Luberef's relative valuation vis a vis selected listed peers;

I. Luberef trades at a modest premium to its peers based on both P/E and EV/EBITDA multiples on 2023/2024 earnings. Commissioning of the Growth II project and its ensuing earnings and cash flows impact by 2026-2027 will likely erode premium valuation. We also hasten to highlight that our estimates incorporate conservative trajectory on base-oil margin over the medium-term.

II. Luberef's ROE estimate of +30% in the forecast period is quite superior to its peers and reflects the company's inherent advantage of scale, operational efficiency and access to feedstock.

Luberef's Relative Valuation											
Stock name	Country	Market Cap	Price	P/E		P/BV		EV/EBITDA		ROE	
		USDm	Local	2024E	2025E	2024E	2025E	2024E	2025E	2024E	2025E
Eastman Chemical	USA	11264	98.6	12.4	10.7	2.0	1.8	8.9	8.1	16%	17%
Valvoline	USA	5647	41.1	27.5	22.9	43.8	24.9	15.2	13.2	159%	108%
FUCHS SE	Germany	5590	34.4	13.9	12.5	2.3	2.1	9.6	8.8	16%	16%
Ashland Inc	USA	4635	98.8	20.4	16.2	1.5	1.5	11.5	9.8	9%	7%
WD-40 Co	USA	2988	228.0	42.2	37.7	13.9	N/A	28.0	25.8	32%	37%
Castrol India Ltd	India	2961	180.7	26.9	24.7	11.2	10.5	18.5	16.9	41%	41%
Hawkins Inc	USA	1906	88.2	24.8	24.8	4.5	4.0	13.3	13.3	11%	16%
Gulf Oil	India	700	880	N/A	16.9	N/A	4.0	N/A	11.8	20%	24%
Oil-Dri Corp	USA	444	85.7	N/A	N/A	N/A	N/A	N/A	N/A	13%	19%
S Oil	SK	5420	67900	6.9	6.1	0.8	0.7	4.9	4.5	15%	13%
Mean				**16.5**	**14.8**	**2.4**	**2.1**	**10.8**	**10.1**	**17%**	**18%**
Luberef	**Saudi Arabia**	**5848**		**16.8**	**16.1**	**4.4**	**4.3**	**12.9**	**13.4**	**26%**	**26%**

Source: Bloomberg

Key Risks to Our Investment Case

Following are key downside risks to our investment case for Luberef;

I-Risk risks associated with optimization of plant post revamp under GII

The risk of the company facing tethering issues post commissioning of its Growth II project cannot be ruled out. Luberef's Growth I project at Yanbu facility underwent multiple issues which effectively hindered the plant's optimization for high-yield products and utilization. Luberef's business transformation plan mostly revolved around fixing the technical issues on Yanbu facility. That said, we highlight the company's Growth II project is a significantly scaled down version of the Growth I project both in terms of size and complexity. Secondly, the management has gained significant learning since the start of Growth I project which is evident in the consistent increase in production from Yanbu facility and the stable plant's operations.

II-Volatility in base oil spreads

We estimate every 2% change in base-oil spread relative to our forecast (US$10-12/ton) will result in ~3.5% movement in earnings.

We have also calculated Luberef's earning sensitivity to base-oil spread. We estimate every 2% change in base-oil spread relative to our forecast (US$10-12/ton) will result in ~3.5% movement in earnings. GII and GIII products are likely to assume relatively more importance for Luberef given growing share of GII and GIII production and earnings post commissioning of the Growth II project.

It is pertinent to highlight that our earnings and cash flow estimates built in almost flat base-oil spreads over the forecast period in-line with recent trends seen in the market. All in all, the COVID-19 premium on base-oil spreads has all but evaporated over the course of 2023 and most of 1H24. The base-oil spreads on GI and GII products have corrected by 64% and 49% from the peak seen in 2022. The correction in base-oil spread broadly reflects, (i) supplies responding to extraordinary levels of margin in 2021 and 2022, and (ii) more recently due to adverse movements in spreads of gasoil and fuel oil.

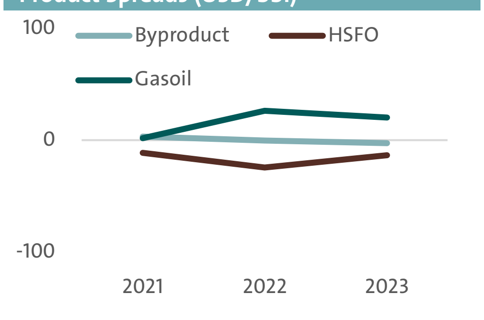
Lower diesel spreads in 2Q vs crude due to softer than expected diesel demand during summer driving season demand in the U.S has added to near-term supply pressure for base-oil as refiners increase focus on high-margin base-oil products. Meanwhile, improvement in fuel oil spread vs crude oil in 1H24 has effectively increased cost pressure for the base-oil producers given only 2-3% QoQ increase in absolute levels of base-oil prices vs 12% jump in fuel oil cost in the same period. We expect to see reversal in the trends for diesel and fuel oil in 2H24 due to cut-back in refining run-rate and improved supply of heavy crude.

III-Dependence on single feedstock facility

Luberef was required to make alternative arrangements for the feedstock for Yanbu facility due to the turnaround of Aramco's refining facility in Yanbu. The sourcing of feedstock from alternative sources entailed additional freight cost for the company quoted at SAR50mn by the management. It is pertinent to highlight that the company has entered a long-term feedstock supply agreement with Saudi Aramco

IV-by-product margins

Product Spreads (USD/bbl)



Source: Luberef, AIC

While base oil is a high-margin product relative to other petroleum products, the production process of base oil entails production of significant quantities of white oil (Ultra-low sulfur diesel, naphtha, drilling fluids) and other by-products (mainly asphalt, heavy fuel). As per 2023 report, Luberef produced 1.65x and 3.85x by-products per ton of base-oil at Yanbu and Jeddah facility respectively in 2023. White oil products comprise 3% of total by-products or 9% of total production (base oil + by-products). Luberef has signed a long-term sale agreement with Aramco for a majority of by-products produced at both the facilities. The selling price for black products is closely linked with the purchase price of feedstock with a certain discount. However, white oil products are sold at a market price. The variation in product spreads for white oil products may impact our margin and earnings estimates for the company.

1Q24 Earnings-Soft patch due to multiple drags

- Luberef's 1Q24 earnings came in at SAR239mn, down 54% YoY and 15% QoQ. Multiple drags, mostly temporary, affected the company's earnings in 1Q24.
- Gross Margin of the company recorded at 15%, down 114bps QoQ (15% YoY). Key reasons include
    - I. Normalization of margins on products from a high seen in 2022 remained a major reason behind the drop in margin. Netback margin (difference in gross revenue and feedstock cost/sales volume) dropped to SAR1798/ton (excluding the impact of sourcing of feedstock from imported sources), down from SAR2,551/ton in 1Q23.
    - II. Turnaround of hydrocracking unit at Yanbu facility which resulted in loss of production for at least 15-days
    - III. Additional cost of sourcing oil from other imported sources due to sourcing of feedstock from alternative sources (the management estimated SAR185/ton impact in 1Q on netback margin)

IV. The impact of red-sea situation

- Overall, quarterly sales volumes remained stable YoY at 270kton in 1Q24. Product mix and volume were impacted due to turnaround QoQ.
- Company's EBITDA came in at SAR324mn, down 58% YoY with an EBITDA margin of 12% (+10bps QoQ).
- Luberef has made a prepayment of a long-term loan which has further improved the company's gearing ratio to -3% from -1% in 4Q24.

Luberef 1Q24 Results

SARmn	1Q23	1Q24	YoY	4Q23	QoQ
Sales	1,797	1,916	7%	2,530	-24%
Gross Profit	555	294	-47%	360	-18%
Operating Profit	474	240	-49%	281	-14%
EBITDA	555	318	-43%	354	-10%
Profit Before Zakat	470	242	-48%	283	-14%
Net Profit	446	228	-49%	269	-15%
EPS	2.65	1.36	-49%	1.60	-15%
Margin					
Gross Margin	31%	15%	-1551	14%	114
EBITDA Margin	31%	17%	-1425	14%	263
Net Margin	25%	12%	-1289	11%	130

Source: Luberef, AIC

Overview of the Company

About the Company

Luberef is a significant global player in the base-oil market with 2% share by capacity and 4% by production.

Saudi Arabia Base Oil Company (Luberef) is a significant global player in the base-oil market with 2% share by capacity and 4% by production. Luberef was founded in 1976 with a capacity of 180ton of GI base oil in Jeddah. The company constructed another base-oil plant at Yanbu in 1997 with production capacity of 300kton of base-oil. The two plants underwent a number of changes to bring the company's installed production capacity of base-oil to 1.345mn ton (1.1mnton in Jeddah and 0.275mn ton in Yanbu).

Products

Luberef currently produces GI and GII base oils from its facilities located in Jeddah and Yanbu. The company markets its products under three major categories which include aramcoDura™ for Group I, aramcoPrime™ for Group II and aramcoUTLRA™ falling under Group III category. The completion of the Growth II project on Yanbu facility, slated for the end of 2025, will allow the company to start producing Group III base-oil as well.

Luberef has also entered an arrangement with two major base oil producers, Motiva in the U.S and S-Oil in South Korea, both majority-owned by Saudi Aramco, to establish a marketing alliance, called Aramco Base Oil Alliance.

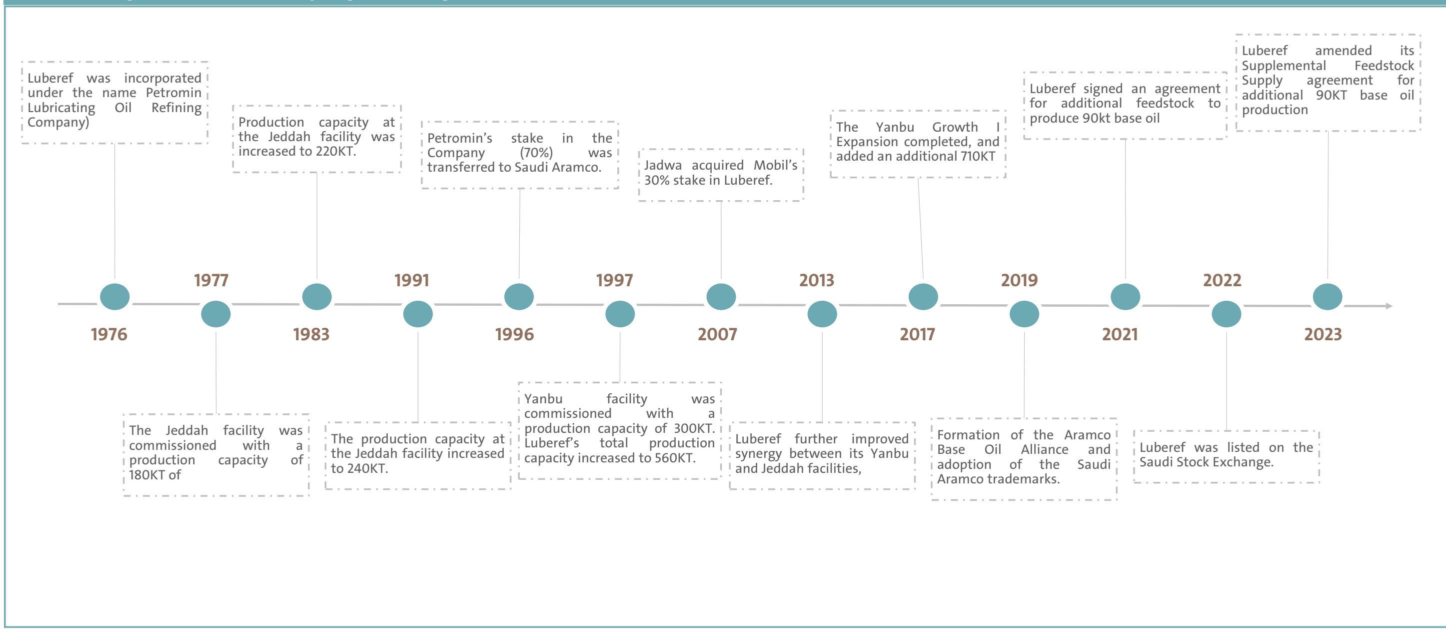
The alliance markets base-oil products under a single brand name and coordinates on R&D, respective territory of alliance members for product distribution and other issues. Luberef meets demand for GIII products within and outside the Kingdom by importing products from the alliance members.

Facilities

Jeddah: Commissioned in 1977 with production capacity of 180k of GI base oil, Jeddah base-oil plant was seen as a major step towards achieving self-sufficiency in petroleum products, increasing industrialization and diversifying the country's export-base of the Kingdom. The plant's production capacity increased to 275kton as a result of debottlenecking and linking Jeddah facility with Yanbu for partial processing of feed from the plant.

Yanbu: Yanbu facility started production in 1997 with a capacity of 300kton of GI base oil. The facility is also used to process feed produced at Jeddah facility in order to achieve better yield of GI products. In 2017, Yanbu facility underwent a major expansion and upgrade, termed as Growth I project. Successful commissioning of the project allowed Luberef to start producing high-margin GII base-oil products and added 710kton to the plant's capacity. Current capacity of the plant stands at 1.1mn ton.

Luberef: Major events in company's history

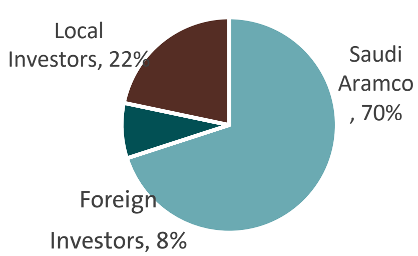


Source: Company Reports

Shareholding Details

Petromin and Mobil were the two founding JV partners at the time of the company's inception in 1976 with 70% and 30% stake respectively. In 1996, 70% stake of Petromin was transferred to Saudi Aramco. In 1998, Mobil also decided to divest its stake in the company which was subsequently sold to Jadwa Investment. Luberef was listed on Saudi's Tadawul in 2022 as a result of a secondary offering of 30% stake (~50mn shares) of Jadwa Investment. The enlisting of the company fulfilled a major condition for obtaining waiver on paying corporate tax on income attributed to Aramco (70%). Before listing, Luberef was required to pay corporate tax on the part of income attributable to Aramco (70%) and zakat for the remaining portion. Currently, foreign ownership in the company stands at ~8% (27% of free float).

Luberef Shareholding: (May-24)



Source: TASI

Luberef-SWOT Analysis

Strengths	Opportunities
▪ A pure-play base oil producer with significant presence in global market ▪ Long-term feedstock supply arrangement for high paraphrenic fuel more suitable for base-oil production ▪ Location of the plants allowing access to key demand centres in Europe, Asia and the U.S. ▪ Access to low-cost sources of fuel and other products	▪ Moving to downstream segment in transmission, process or other fuel ▪ Optimization of base-oil production from Yanbu facility post commissioning of Growth II project ▪ Possible synergies with Aramco's downstream businesses in base-oil (S-Oil, Motiva), lubricant (Valvoline) and retail (Valvoline, Gas Oil, other retail assets) ▪ A thriving local economy and focus on diversification of economic activity and industrialization
Weakness	**Threats**
▪ Potential suspension of operation from Jeddah facility following completion of fuel supply, lease and other agreements, resulting in production losses and leaving the company to be solely reliant on Yanbu facility ▪ A large portion of sales comes in the form of exports which exposes the company to various challenges ▪ Dependence on single refining sources for major part of feedstock supply	▪ Energy Transition throwing up unforeseen challenges for product acceptance ▪ Faster than expected normalization of product spreads in base-oil ▪ Future expansion in the industry, particularly in key demand centres ▪ Refining margin movement as low-margin of white oil products may encourage more production of base-oil

Source: AIC

Key Financials

Income Statement						
SARmn	**2022**	**2023**	**2024E**	**2025E**	**2026E**	**2027E**
Revenue	10,614	9,489	10,094	9,941	10,454	9,355
Cost of Revenue	-8,180	-7,630	-8,379	-8,296	-8,641	-7,596
Gross Profit	**2,434**	**1,858**	**1,715**	**1,645**	**1,813**	**1,759**
Selling and dist. expenses	-27	-37	-56	-39	-40	-41
G&A Expenses	-211	-230	-214	-230	-233	-177
EBIT	**2,171**	**1,590**	**1,446**	**1,377**	**1,540**	**1,542**
Finance income	35	131	33	61	37	45
Financial costs	-74	-142	-115	-40	-25	-11
Zakat	-154	-69	-49	-31	-37	-44
Profit after Tax	**1,978**	**1,510**	**1,315**	**1,367**	**1,515**	**1,532**
EPS	11.76	8.98	7.82	8.13	9.01	9.11
DPS	7.51	10.00	7.25	7.25	7.25	7.50

Source: Luberef, AIC Estimates

Balance Sheet						
	2022	**2023**	**2024E**	**2025E**	**2026E**	**2027E**
Assets	**8,644**	**8,856**	**7,788**	**7,631**	**7,734**	**7,619**
Non-Current Assets	**4,819**	**4,771**	**4,803**	**4,978**	**4,765**	**4,561**
PPE	4,819	4,771	4,803	4,978	4,765	4,561
Current Assets	**3,695**	**3,885**	**2,785**	**2,452**	**2,768**	**2,858**
Cash and cash equivalents	1,912	546	114	183	348	383
Trade receivables	1,023	1,054	1,079	1,035	1,060	948
Inventories	584	623	666	659	687	604
Short-term deposit	148	1,635	900	550	650	900
Equity	**5,082**	**4,869**	**4,965**	**5,112**	**5,408**	**5,678**
Share capital	1,688	1,688	1,688	1,688	1,688	1,688
Statutory reserve	418	506	506	506	506	506
Retained earnings	3,033	2,724	2,820	2,968	3,264	3,534
Liabilities	**3,562**	**3,987**	**2,823**	**2,519**	**2,326**	**1,940**
Non-Current Liabilities	**2,082**	**1,957**	**787**	**535**	**296**	**69**
Long-term borrowings	1,941	1,744	672	452	232	12
Lease liabilities	97	164	53	31	9	0
Other non-current	44	49	62	52	55	56
Current Liabilities	**1,086**	**1,622**	**1,652**	**1,605**	**1,640**	**1,488**
Trade payables	674	1,174	1,148	1,136	1,184	1,041
Accrued expenses & Others	237	227	227	227	227	227
Current portion of LT liabilities	175	221	277	242	229	220

Source: Luberef, AIC Estimates

Summary of Cash Flows

	2022	2023	2024E	2025E	2026E	2027E
Operating Activities	1,938	2,247	1,463	1,667	1,809	1,867
Investing Activities	(30)	(324)	(297)	(442)	(73)	(84)
Financing Activities	-1466	-3249	-1597	-1156	-1572	-1748

Source: Luberef, AIC Estimates

Key Ratios

Liquidity Ratios	Units	2022	2023	2024F	2025F	2026F	2027F
Current Ratio	X	3.40	2.40	1.69	1.53	1.69	1.92
Quick Ratio	X	2.86	2.01	1.28	1.12	1.27	1.52
Cash Ratio	X	1.90	1.34	0.61	0.46	0.61	0.86
Working Capital	SARmn	2,609	2,263	1,133	847	1,129	1,370
WC turnover	SARmn	4.1	4.2	8.9	11.7	9.3	6.8
Turnover Ratios							
Total Asset Turnover		0.81	0.93	0.77	0.77	0.74	0.81
Inventory Turnover		1.9	1.6	1.7	1.7	1.7	1.7
AR Turnover		1.4	1.2	1.2	1.3	1.3	1.3
AP Turnover		1.6	0.9	1.0	1.0	1.0	1.0
DIO	Days	196	224	218	218	218	218
DSO	Days	264	304	293	285	278	278
DPO	Days	226	422	375	375	375	375
CCC	**Days**	**234**	**106**	**135**	**128**	**120**	**120**
Capital Structure Ratios							
Debt to Equity	X	44%	44%	20%	14%	9%	4%
Debt Ratio	%	26%	24%	13%	10%	6%	3%
Debt Coverage	x	9.49	7.03	1.17	4.34	5.51	6.19
Profitability Ratios							
GP Margin	%	23%	20%	17%	17%	17%	19%
Operating Margin	%	24%	20%	17%	17%	17%	20%
NP Margin	%	19%	16%	13%	14%	14%	16%
ROE	%	39%	31%	26%	27%	28%	27%
ROA	%	23%	17%	17%	18%	20%	20%
Market Ratios							
Market Price	SAR/sh	131.20	131.20	131.20	131.20	131.20	131.20
PE	X	11.2	14.6	16.8	16.1	14.6	14.4
Dividend Yield	%	5.72%	7.62%	5.53%	5.53%	5.53%	5.72%
Pay-out Ratio	%	64%	111%	93%	89%	80%	82%
BVPS	SAR/sh	30.2	29.0	29.5	30.4	32.2	33.8
PBV	X	4.36	4.55	4.46	4.33	4.09	3.90
EV/EBITDA	X	8.6	11.4	12.6	13.1	11.8	11.8

Source: Luberef, AIC Estimates

Appendix I

Base-oil Classification

Base Oil Category	Process	Sulfur (%)	Saturates) %)	Viscosity Index
Group I	Solvent Refined	>.03	<90	80-120
Group II	hydrotreated	<.03	>90	80-120
Group III	Hydrocracked	<.03	>90	>120
Group IV	Poly Alpha Olefin, Traditional Synthetic Lubes			
Group V	All Other base-oils, primarily Naphthenic			

Source: Luberef's Prospectus

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

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Saudi Aramco Base Oil Company (Luberef)

Initial Report