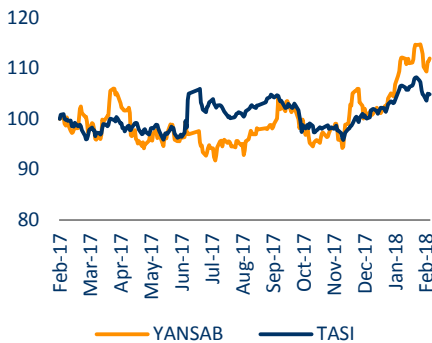


**Initiation Coverage**
**February 15, 2017**

Recommendation	Neutral
Current Price (SAR)	64.4
Target Price (SAR)	66.1
Upside/Downside (%)	2.6%
<i>As of February 14<sup>th</sup>, 2018</i>	
Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	36.5
52 Wk High (SAR)	66.5
52 Wk Low (SAR)	52.0
Total Outstanding shares (in mn)	562.5
Free Float (%)	35.6%

**Yansab Vs TASI (Rebased)**


Price Performance (%)	Absolute	Relative
1m	3.2%	3.5%
6m	17.8%	13.7%
12m	11.9%	7.0%

**Major Shareholders (%)**

Saudi Basic Industries Corp	51.0%
General Org For Social Insurance	11.9%
Saudi Pharmaceutical Ind	1.9%

**Quarterly Sales (SAR mn) and Operating Margin**


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 14<sup>th</sup> February 2018

In 2017, Yanbu National Petrochemical (Yansab)'s sales totalled SAR7.2 bn, a 15.9% increase from the level in 2016. For the quarter, sales rose 31.7% Y-o-Y to SAR2.17 bn. Revenues improved due to higher average selling price for all products, along with an increase in selling volumes.

Continued cost efficiencies and higher utilisation rates are the key positive trends for the company. In addition, a healthy balance sheet and an attractive dividend yield make the stock a good investment bet. However, a weak economy and a proposed increase in feedstock prices may impact profitability. Overall, we recommend a neutral rating with a target price of SAR 66.1.

**Healthy balance sheet gives company financial heft for future growth**

Yansab has been aggressively reducing its debt and aims to become debt-free in 2019. This will give the company the financial flexibility to undertake capacity expansion, giving it an advantage over its more leveraged peers. Moreover, the robust ROEs indicate the company has a good track record of efficient capital deployment.

**High dividend payout provides shareholder comfort**

The company had a high dividend yield of 5.5% in 2017, which is expected to continue going forward. Compared to other traditional investments, Yansab provides attractive risk-adjusted returns. In addition, the company has a high dividend payout ratio, averaging 75% of its net income over the past five years. With the increase in incremental cash flows, resulting from deleveraging the company, a higher dividend per share can be expected.

**Company trades at discount to its peers**

Yansab trades at a 2018 P/E of 12.8x compared to the sector average of 13.1x. This provides valuation comfort to investors, especially when one considers its relatively high dividend payout, sector-leading capacity utilisation and operational efficiency.

**Feedstock price rationalisation could blunt the sector's cost advantage**

Higher feedstock prices could depress Yansab's operating margins when the government goes through with its stated subsidy reduction measures. Previously, in an effort to reform the economy, the government announced the linking of the price of fuels to international prices. Prices of natural gas and ethane are to be raised to 75% of international prices; moreover, prices of liquefied natural gas, including propane, would be raised to 90% of international levels in 2020. The removal of these subsidies would result in lower gross margins and could translate into suppressed earnings.

**Weak economy could restrict Yansab's ability to pass on cost hike to customers**

A weak economy restricts the prospects of passing on the raw material price hike to consumers, as demand could be subdued. If KSA's economic conditions do not improve, the company's profitability could be hit.

**Valuation:** We valued Yansab using the DCF Approach to arrive at a fair value of SAR66.1 per share. We considered WACC at 11.6%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	7.2	8.1	8.0	7.9
Operating Profit (SAR bn)	2.4	2.9	2.9	3.0
EPS (SAR)	4.2	5.1	5.3	5.6
Operating Margin (%)	33.4%	35.8%	36.8%	38.0%
D/E (x)	0.0	NM	NM	NM
RoE (%)	14.2%	16.6%	16.5%	16.6%
P/E (x)	13.9	12.5	12.2	11.6
Price/BV (x)	2.0	2.1	2.0	1.9
EV/EBITDA (x)	9.5	8.7	8.1	7.6

Source: Company Financials, FALCOM Research

Initiation Coverage

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## Valuation Summary

### Explanation of valuation methodology and assumptions

We valued Yansab using the DCF Approach to arrive at a fair value of SAR66.1 per share. We considered WACC at 11.6% with a terminal growth rate of 2.0%. In relative terms, Yansab is trading at one-year forward P/E of 12.5x (at a discount of 2.4%) to its sector peers and at a discount of 9.4% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	2,414	2,892	2,946	3,016	3,177	
Taxes	(144)	(175)	(180)	(190)	(205)	
Depreciation, amortization and impairment	1,090	1,148	1,174	1,199	1,225	
Changes in working capital	(267)	20	124	125	51	
Net capital expenditure	(467)	(484)	(480)	(475)	(484)	
<b>Free Cash Flow to firm</b>	<b>2,627</b>	<b>3,401</b>	<b>3,584</b>	<b>3,676</b>	<b>3,764</b>	
<i>Discount Factor</i>		0.9	0.8	0.7	0.7	
<b>PV of free cash flow to firm</b>		<b>3,089</b>	<b>2,916</b>	<b>2,680</b>	<b>2,459</b>	
<b>Net Present Value (A)</b>					<b>11,144</b>	
<b>PV Terminal Value (B)</b>					<b>26,127</b>	
<b>Assumed Terminal Growth Rate</b>					<b>2.0%</b>	
<b>Discount Rate</b>					<b>11.6%</b>	
<b>Enterprise Value (A+B)</b>	<b>37,271</b>	<b>WACC Assumptions</b>				
Total Cash	1,052	Risk free rate				2.7%
Total Debt	1,131	Equity Risk Premium				10.2%
Minority Interest	-	Beta				0.9x
<b>Equity Value in SAR mn</b>	<b>37,193</b>	<b>Cost of equity</b>				<b>12.0%</b>
Number of shares in mn	563	<b>Post tax cost of debt</b>				<b>4.8%</b>
<b>Target Price in SAR per share</b>	<b>66.12</b>	Weight of equity in capital structure				93.7%
<b>CMP in SAR as on February 14<sup>th</sup>, 2018</b>	<b>64.43</b>	Weight of debt in capital structure				6.3%
Upside/(Downside) to current market price	2.6%	<b>WACC</b>				<b>11.6%</b>

Source: Company Financials, FALCOM Research Estimates

### Risks

#### Upside Risks:

- Higher-than-expected product selling prices can significantly increase top line and bottom line.
- Easing of geopolitical tensions in the Middle East could boost demand for petrochemicals.

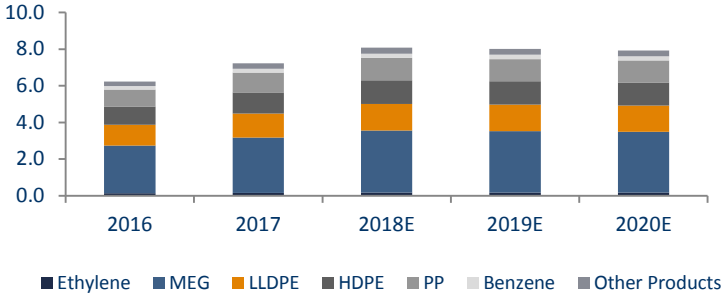
#### Downside Risks:

- Delays in debottlenecking of the ethylene glycol plant could result in lower capacity utilisation rates.
- Reduction between the propane (feedstock) and propylene (product) spread would impact the company's margins.
- Slower-than-expected economic recovery of the Kingdom could impact Yansab adversely.

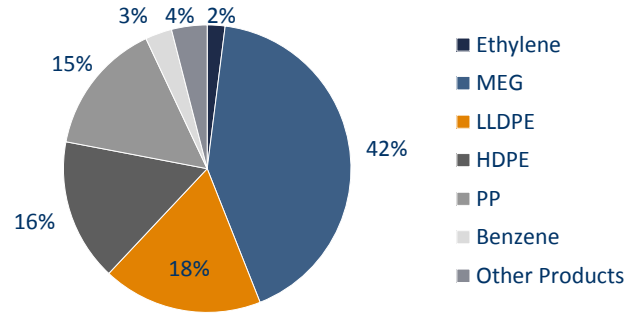


Key Charts

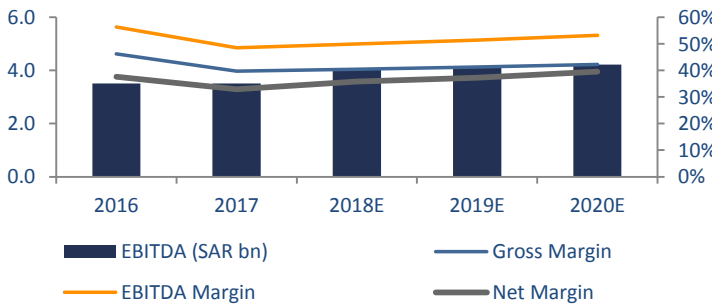
Revenue (SAR bn)



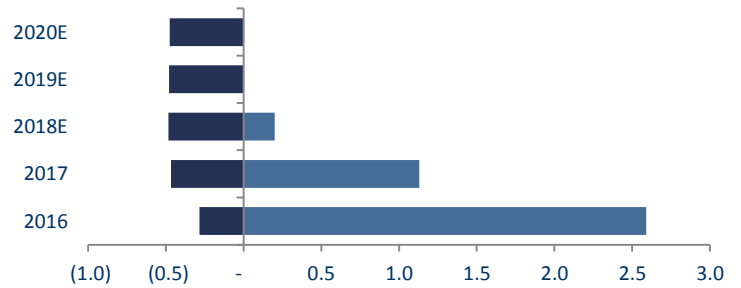
Revenue Split (2016)



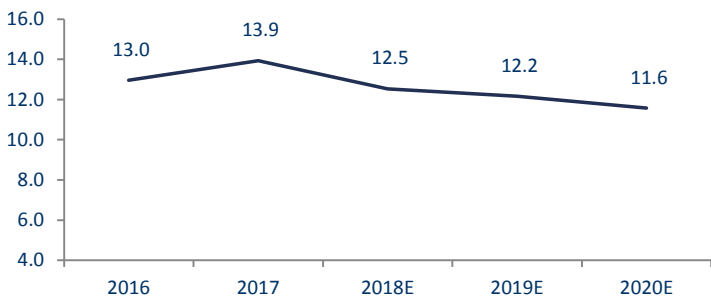
EBITDA & Margins



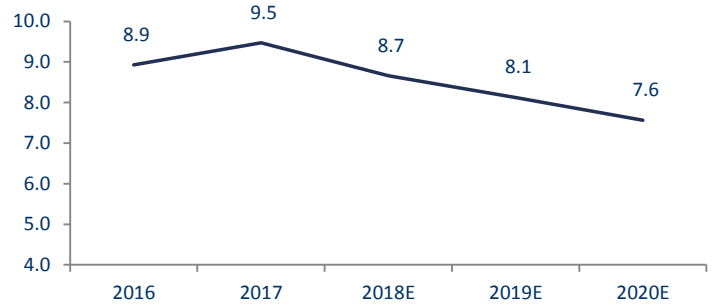
CAPEX and Debt



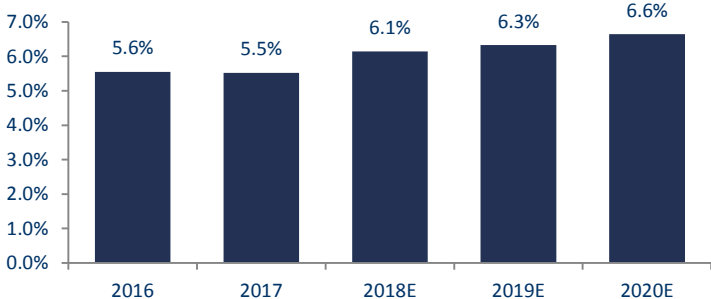
Price to Earnings



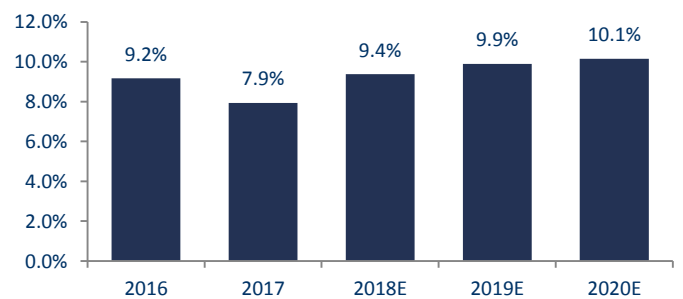
EV/EBITDA



Dividend Yield



Free Cash Flow Yield



Source: FALCOM Research Estimates



Initiation Coverage

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## Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Sales	7,221	8,077	8,007	7,927
Gross Profit	2,870	3,271	3,303	3,349
EBITDA	3,504	4,040	4,120	4,215
EBIT	2,414	2,892	2,946	3,016
Earnings from Associates	-	-	-	-
Net Interest	7	63	103	194
Other	100	111	110	109
PBT	2,520	3,067	3,160	3,320
Minorities	-	-	-	-
Zakat	144	175	180	190
Net Income	2,376	2,891	2,980	3,130
EPS	4.2	5.1	5.3	5.6
DPS	3.3	4.0	4.1	4.3

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	1,052	1,473	2,778	4,349
Current Assets	5,531	5,456	5,347	5,233
Fixed Assets	12,954	12,290	11,596	10,872
Intangibles	34	34	34	34
Investments in associates and JVs	-	-	-	-
<b>Total Assets</b>	<b>19,765</b>	<b>19,447</b>	<b>19,948</b>	<b>20,681</b>
Current Liabilities	1,393	1,339	1,353	1,364
Short Term Debt	930	201	-	-
Long Term Debt	201	-	-	-
Shareholders Equities	16,737	17,405	18,092	18,814
<b>Total Liabilities</b>	<b>19,765</b>	<b>19,447</b>	<b>19,948</b>	<b>20,681</b>

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	3,519	4,039	4,153	4,330
Working Capital Changes	(283)	20	124	125
Cash Flow from Operating Activities	3,236	4,060	4,277	4,454
Capex	(467)	(484)	(480)	(475)
Cash Flow from Investing Activities	(717)	(484)	(480)	(475)
Changes in Debt	(1,458)	(930)	(201)	-
Dividends	(1,685)	(2,224)	(2,292)	(2,408)
Cash Flow from Financing Activities	(3,143)	(3,155)	(2,493)	(2,408)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	15.9%	11.9%	(0.9%)	(1.0%)
EBITDA	(0.1%)	15.3%	2.0%	2.3%
Operating profit	(0.4%)	19.8%	1.9%	2.4%
PBT	1.2%	21.7%	3.0%	5.1%
Net Income	1.4%	21.7%	3.0%	5.1%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	39.7%	40.5%	41.2%	42.2%
EBITDA Margin	48.5%	50.0%	51.5%	53.2%
EBIT Margin	33.4%	35.8%	36.8%	38.0%
Net Margin	32.9%	35.8%	37.2%	39.5%
ROE	14.2%	16.6%	16.5%	16.6%
ROCE	13.6%	16.1%	16.0%	16.2%
ROA	12.0%	14.9%	14.9%	15.1%
Debt/Equity	0.0x	NM	NM	NM
Net Debt/EBITDA	0.0x	NM	NM	NM
FCF Yield	7.9%	9.4%	9.9%	10.1%
Dividend Yield	5.5%	6.1%	6.3%	6.6%

Valuation	2017	2018E	2019E	2020E
PE	13.9x	12.5x	12.2x	11.6x
PB	2.0x	2.1x	2.0x	1.9x
EV/EBITDA	9.5x	8.7x	8.1x	7.6x
EV/EBIT	13.7x	12.1x	11.4x	10.6x
EV/Sales	4.6x	4.3x	4.2x	4.0x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Advanced Petrochemical	12.2x	10.2x
Saudi Kayan Petrochemical	16.9x	8.8x
Saudi International Petrochemical Co	12.9x	7.6x
Saudi Basic Industries	14.6x	7.4x
Saudi Industrial Investment Group	9.1x	8.2x
National Petrochemical Company	12.7x	8.7x
<b>Yanbu National Petrochemicals</b>	<b>12.5x</b>	<b>8.1x</b>
<b>Sector Median</b>	<b>12.8x</b>	<b>8.4x</b>
<b>TASI</b>	<b>13.8x</b>	<b>11.6x</b>



## FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

**Overweight:** The Target share price exceeds the current share price by  $\geq 10\%$ .

**Neutral:** The Target share price is either more or less than the current share price by 10%.

**Underweight:** The Target share price is less than the current share price by  $\geq 10\%$ .

**To be Revised:** No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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