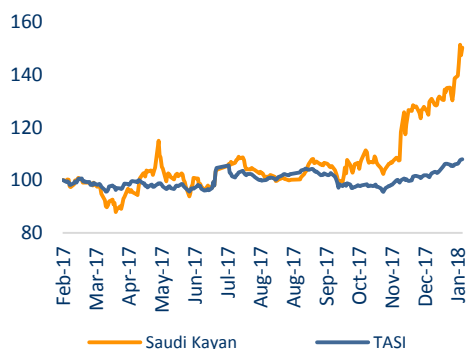


**Initiation Coverage**
**February 5, 2018**

Recommendation	Neutral
Current Price (SAR)	12.7
Target Price (SAR)	13.4
Upside/Downside (%)	5.3%

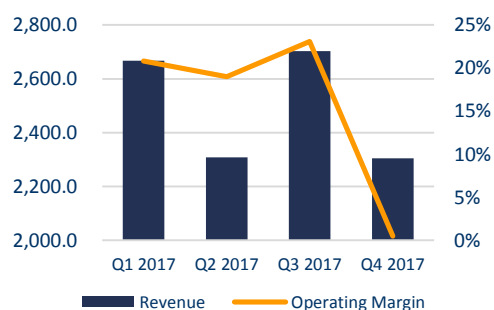
*As of February 01, 2018*

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	19.1
52 Wk High (SAR)	13.0
52 Wk Low (SAR)	7.4
Total Outstanding shares (in mn)	1,500.0
Free Float (%)	64.9%

**Kayan Vs TASI (Rebased)**


Price Performance (%)	Absolute	Relative
1m	20.4%	14.0%
6m	45.6%	37.9%
12m	50.2%	42.4%

Major Shareholders (%)	
Saudi Basic Industries Corp.	35.00

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


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 01<sup>th</sup> February 2018

Saudi Kayan Petrochemical Company (Kayan)'s earnings surged 339% YoY to SAR 668.2mn in FY17 from SAR 153.1mn, driven by higher average selling prices of products and improved operating performance. These factors led to higher margins.

Favourable market conditions, continued cost rationalisation and improved utilisation rates are key positive trends for the company. Moreover, government support to the petrochemical sector, which is expected to continue for the near term, is driving Kayan's growth. However, the company is expected to be negatively impacted by the proposed withdrawal of fuel subsidy and a lag in passing the increase in raw material costs to consumers. Considering the countervailing factors, we recommend a neutral rating with a target price of SAR 13.4.

**Healthy performance despite facility shutdown**

Kayan witnessed a major shutdown in 4Q17, in which its facilities were closed for a significant number of days to perform debottlenecking. Despite constrained production, the company reported revenue of SAR 2.31 billion (down 6% YoY and 15% QoQ) in 4Q17, above street consensus of SAR 1.64 billion. The better-than-expected performance was primarily led by efficient inventory management, which managed to (to a large extent) offset lower production, and a rise in product prices (driven by a price rally in MEG and improvement in PP, PE, and PC prices).

**Government continues to incentivise petrochemical sector:**

KSA has a natural advantage in the petrochemical sector due to its strategic location and abundance of raw materials. Recognising this, through Vision 2030, the government is emphasising its focus on petrochemicals as one of the major future economic drivers. It is expected to continue incentivising the sector as it diversifies the economy and makes it more broad-based. Kayan, being a major player, is bound to benefit from government's sector thrust.

**Weak economy likely to hinder Kayan's ability to pass on cost hike to consumers**

A time lag exists between the increase in raw material costs and the hike in supply prices. If Saudi Arabia's economy does not strengthen, it could adversely affect the company's ability to pass on excess costs to consumers without affecting demand, thus adversely affecting it.

**Subsidy removal will increase feedstock prices and might impact competitiveness:**

In recently announced reform measures, Saudi Arabia government has announced roadmap for reduction of subsidies on the company's main feedstock. As per the reform roadmap, local prices of natural gas and ethane will be raised to 75% of international prices between 2020 and 2021, with the imposition of a price cap in 2021. Also, prices of liquefied natural gas, including propane and butane, will be raised to 90% of international levels in 2020. The removal of these subsidies will increase the company's cost of inputs and blunt its competitive edge vis-à-vis international players

**Valuation:** We valued Saudi Kayan using the DCF Approach to arrive at a fair value of SAR 13.4 per share. We considered WACC at 7.5%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	10.0	10.9	10.8	10.7
Operating Profit (SAR bn)	1.6	1.3	1.3	1.3
EPS (SAR)	0.4	0.3	0.4	0.4
Operating Margin (%)	16.3%	12.3%	12.3%	12.3%
D/E (x)	1.7	1.6	1.4	1.3
RoE (%)	4.8%	3.5%	3.6%	3.8%
P/E (x)	28.6	37.4	35.3	32.4
Price/BV (x)	0.5	0.5	0.5	0.5
EV/EBITDA (x)	10.6	10.8	10.3	9.8

Source: Company Financials, FALCOM Research

Initiation Coverage

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## Valuation Summary

### Explanation of valuation methodology and assumptions

We valued Kayan using the DCF Approach to arrive at a fair value of SAR 13.4 per share. We considered WACC at 7.5% with a terminal growth rate of 2.0%. In relative terms, Kayan is trading at 1yr forward EV/EBITDA of 10.8x, at a premium of 14.2% to its sector peers and discount of 11.6% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	1,630	1,343	1,330	1,322	1,326	
Taxes	(124)	(95)	(101)	(110)	(122)	
Depreciation, amortization and impairment	2,312	2,357	2,418	2,477	2,537	
Changes in working capital	331	(237)	26	18	(9)	
Net capital expenditure	(987)	(1,248)	(1,237)	(1,229)	(1,233)	
<b>Free Cash Flow to firm</b>	<b>3,163</b>	<b>2,120</b>	<b>2,436</b>	<b>2,478</b>	<b>2,500</b>	
Discount Factor		0.9	0.9	0.8	0.8	
<b>PV of free cash flow to firm</b>		<b>1,984</b>	<b>2,122</b>	<b>2,007</b>	<b>1,883</b>	
<b>Net Present Value (A)</b>					<b>7,997</b>	
<b>PV Terminal Value (B)</b>					<b>34,928</b>	
<b>Assumed Terminal Growth Rate</b>					<b>2.0%</b>	
<b>Discount Rate</b>					<b>7.5%</b>	
<b>Enterprise Value (A+B)</b>	<b>42,925</b>	<b>WACC Assumptions</b>				
Total Cash	1,286	Risk free rate				2.7%
Total Debt	24,089	Equity Risk Premium				10.1%
Minority Interest	-	Beta				1.3x
<b>Equity Value in SAR mn</b>	<b>20,123</b>	<b>Cost of equity</b>				<b>15.6%</b>
Number of shares in mn	1,500	<b>Post tax cost of debt</b>				<b>2.1%</b>
<b>Target Price in SAR per share</b>	<b>13.42</b>	Weight of equity in capital structure				40.0%
<b>CMP in SAR as on February 1<sup>st</sup>, 2018</b>	<b>12.74</b>	Weight of debt in capital structure				60.0%
Upside/(Downside) to current market price	5.3%	<b>WACC</b>				<b>7.5%</b>

Source: Company Financials, FALCOM Research Estimates

### Risks

#### Upside Risks:

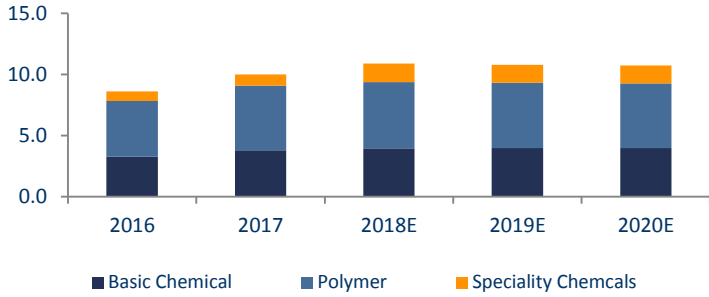
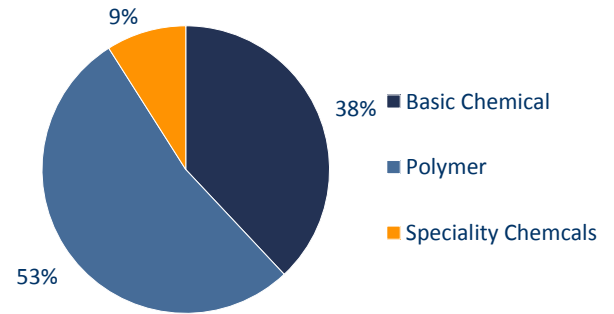
- Geopolitical tensions in the region could reduce, providing a boost to the regional petrochemical demand.
- Kayan could record better-than-expected operational performance.
- Stronger-than-expected capacity utilisation could drive volume growth faster than anticipated.

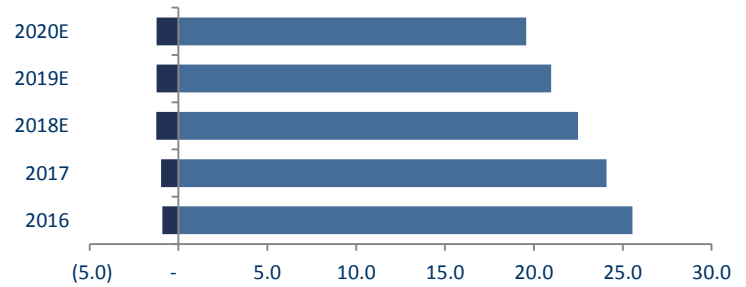
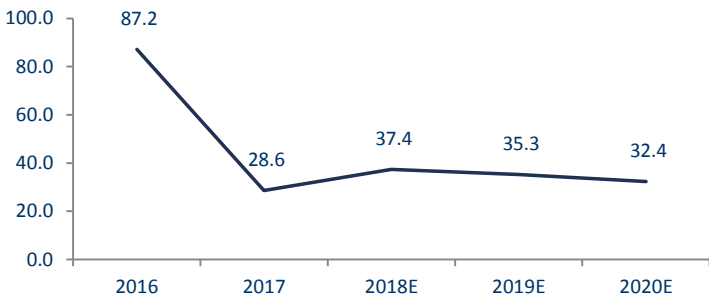
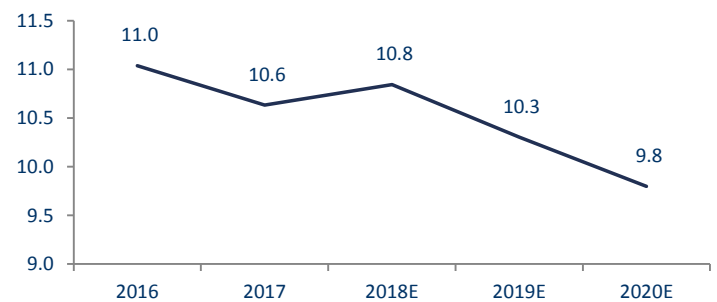
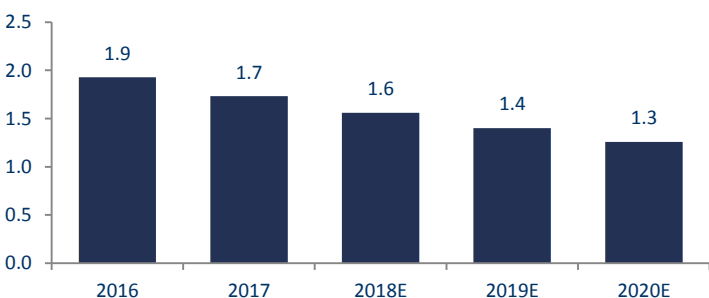
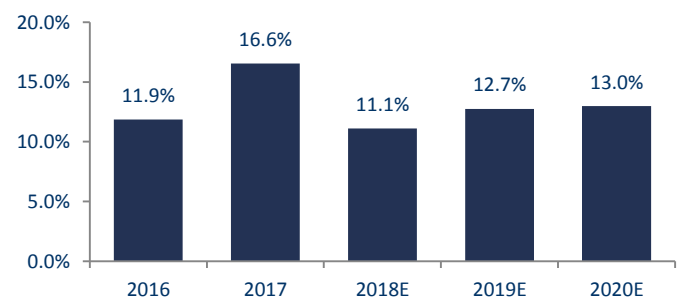
#### Downside Risks

- If KSA's economic growth is slower than our expectation, it could impact Kayan more severely than anticipated.
- Weaker-than-expected capacity utilisation could weigh on revenue growth.
- Removal of government subsidies, if implemented at an earlier date than announced, would negatively affect the company.

Initiation Coverage

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**Key Charts**
**Revenue (SAR bn)**

**Revenue Split (2017)**

**EBITDA & Margins**

**CAPEX and Debt**

**Price to Earnings**

**EV/EBITDA**

**Debt/Equity (x)**

**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	9,984	10,891	10,790	10,721
Gross Profit	2,401	2,183	2,163	2,149
EBITDA	3,942	3,700	3,748	3,799
EBIT	1,630	1,343	1,330	1,322
Earnings from Associates	49	47	45	43
Net Interest	(826)	(825)	(771)	(707)
Other	(61)	41	38	42
PBT	792	606	642	700
Minorities				
Zakat	124	95	101	110
Net Income	668	511	542	590
EPS	0.4	0.3	0.4	0.4
DPS	-	-	-	-

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	2,514	2,312	2,562	3,020
Current Assets	4,297	4,720	4,681	4,654
Fixed Assets	32,754	31,645	30,464	29,216
Intangibles	223	223	223	223
Investments in associates and JVs	303	288	275	261
<b>Total Assets</b>	<b>40,311</b>	<b>39,408</b>	<b>38,424</b>	<b>37,594</b>
Current Liabilities	1,750	1,937	1,923	1,914
Short Term Debt	1,600	1,513	1,411	1,316
Long Term Debt	22,488	20,976	19,565	18,249
Shareholders Equities	13,908	14,419	14,961	15,551
<b>Total Liabilities</b>	<b>40,311</b>	<b>39,408</b>	<b>38,424</b>	<b>37,594</b>

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	3,261	2,868	2,959	3,067
Working Capital Changes	331	(237)	26	18
Cash Flow from Operating Activities	3,592	2,632	2,985	3,085
Capex	(987)	(1,248)	(1,237)	(1,229)
Cash Flow from Investing Activities	(905)	(1,234)	(1,223)	(1,216)
Changes in Debt	(1,560)	(1,600)	(1,513)	(1,411)
Dividends	-	-	-	-
Cash Flow from Financing Activities	(1,560)	(1,600)	(1,513)	(1,411)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	16.0%	9.1%	(0.9%)	(0.6%)
EBITDA	16.6%	(6.1%)	1.3%	1.4%
Operating profit	53.9%	(17.6%)	(0.9%)	(0.6%)
PBT	218.5%	(23.5%)	6.0%	8.9%
Net Income	339.4%	(23.5%)	6.0%	8.9%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	24.0%	20.0%	20.0%	20.0%
EBITDA Margin	39.5%	34.0%	34.7%	35.4%
EBIT Margin	16.3%	12.3%	12.3%	12.3%
Net Margin	6.7%	4.7%	5.0%	5.5%
ROE	4.8%	3.5%	3.6%	3.8%
ROCE	4.4%	3.7%	3.8%	3.8%
ROA	1.7%	1.3%	1.4%	1.6%
Debt/Equity	1.7x	1.6x	1.4x	1.3x
Net Debt/EBITDA	5.8x	5.7x	5.2x	4.8x
FCF Yield	16.6%	11.1%	12.7%	13.0%
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Valuation	2017	2018E	2019E	2020E
PE	28.6x	37.4x	35.3x	32.4x
PB	0.5x	0.5x	0.5x	0.5x
EV/EBITDA	10.6x	10.8x	10.3x	9.8x
EV/EBIT	25.7x	29.9x	29.0x	28.2x
EV/Sales	4.2x	3.7x	3.6x	3.5x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Advanced Petrochemical	12.6x	10.5x
Yanbu National Petrochemicals	15.3x	10.3x
Saudi Arabia Fertilizers	14.0x	15.8x
Saudi Basic Industries	14.0x	7.3x
Saudi Industrial Investment Group	8.4x	9.5x
National Petrochemical Company	12.3x	8.4x
<b>Saudi Kayan Petrochemical</b>	<b>37.4x</b>	<b>10.8x</b>
<b>Sector Median</b>	<b>12.6x</b>	<b>9.5x</b>
<b>TASI</b>	<b>13.8x</b>	<b>11.6x</b>

Initiation Coverage

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## 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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