National Industrialization Company

Diversified Operations – Industrial
NIC AB: Saudi Arabia

Al Rajhi Capital الراجحي المالية

US$2.708bn	87%	US$3.970mn
Market cap	Free float	Avg. daily volume

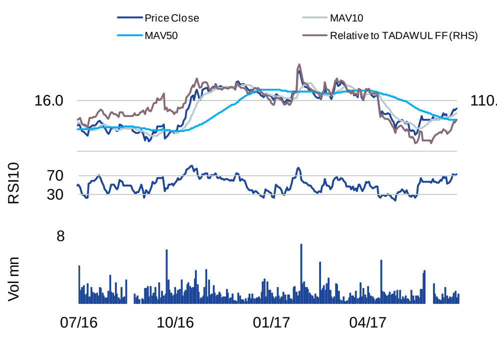
Target price	14.00	-3.8% over current
Current price	14.56	as at 26/7/2017

Research Department
Pritish K. Devassy, CFA
Tel +966 11 2119370, devassyp@alrajhi-capital.com

Existing rating

Underweight | **Neutral** | Overweight

Performance



Source: Bloomberg

Earnings estimates

(SARmn)	2016	2017e	2018e
Revenue	9314	10073	10599
growth	-38.5%	8.1%	5.2%
Operating profit	786	1469	1636
Net profit	145	479	587
growth	nm	nm	22.7%
margin	1.6%	4.8%	5.5%
EPS (SAR)	0.22	0.72	0.88
P/E (Curr)	67.3x	20.3x	16.6x
P/E (Target)	64.7x	19.6x	16.0x

Source: Company data, Al Rajhi Capital

National Industrialization Co.

Q2: On recovery path, but no immediate upside triggers. Revise TP to SAR14/sh

Tasnee reported Q2 profit at SAR94mn, in-line with our estimate (SAR96mn) and lower than average consensus estimate of SAR123mn. Operating income (SAR327mn) was also in-line with our estimate, reaffirming our views on the company. The company is moving in the right direction by cutting unnecessary costs, planning to close unprofitable businesses, improving efficiencies such as clearing excess inventories, selling off its complex Cristal business etc. However the results of these changes may still take time to show and key product prices (mainly TiO2) are still low compared to the past. We do not expect dividends till at least 2018 given its debt and cash flow position unless TiO2 price increases. We remain Neutral and revise TP to SAR14/share (based on average of DCF and relative valuation).

Outlook:

- **Right approach, but unlikely to see results soon:** The company is rightly approaching its problem areas but these are likely to take time. Moreover, presence of many external factors such as TiO2 prices, SAIBOR rates etc. could continue to delay its recovery. We expect Jizan plant (Advanced Metal Industries), which is expected to be commercially launched in 2018, to report losses given its high interest costs.
- **Cash flows to remain constrained:** The company mainly depends on its two key Petchem subsidiaries – SEPC and SPC - for bulk of its profits. Most of its other segments do not generate meaningful profits. These two subsidiaries are accounted as associate investments and dividends from these investments are only on a semi-annual basis(Q1 2017 had negative operating cash flow). Change in accounting treatment of the petchem segments after Q1 2017 (IFRS) has resulted in significant changes such as decrease in debt, revenue and other key items, which makes y-o-y comparison improper. Though capex needs may not be as high as in the past, operating cash flows will be mainly used to service debt implying no dividends in the foreseeable future unless TiO2 price sharply recovers.

Q2 Key highlights:

- **a)** Post IFRS accounting, the top line is primarily related to Tasnee's Cristal business. Q2 revenue increased 7.6% q-o-q to SAR2,670mn on higher sales volume and product prices for most products, beating our and consensus estimates by 7.3% and 6.4%, respectively. As products prices were broadly known already, we believe that higher than expected sales volume and likely better performance of its other downstream businesses could have led to the beat at the top-line. **b)** Gross profit remained almost flat sequentially in Q2, although slightly lower than our estimates due to higher COGS, particularly at Cristal plant. **c)** As per our calculations, SG&A expenses is likely to have remained almost flat sequentially in Q2. **d)** Lower equity income from its associates amid weak product spread pushed operating profit ~4% q-o-q lower to SAR327mn in Q2, in line with our expectation of SAR328mn. f) Net profit came in at SAR93.6mn, down by ~9% q-o-q, in line with our estimate of SAR96.4mn (consensus: SAR123.3mn).

Valuation and risks:

- **Valuation:** The stock is currently trading at a P/E of 16.6x on our 2018E EPS, higher than its peers. Based on our valuation methodology (average of DCF and relative valuation), we keep our TP at SAR14/share and maintain our Neutral rating. For relative valuation we use 15x 12month forward P/E (higher compared to peers and historical levels as EPS is picking off a low base and we price in modest recovery in TiO2 price). We use WACC of ~7%(cost of equity 11.7%) which will increase to 9.5% in the terminal year for our DCF valuation.
- **Risks:** Key upside risks to our estimates are sale of its Cristal segment, recovery in TiO2 prices, sale of Jizan plant, higher than expected cash flows from asset sales of unprofitable businesses while downside risks are weaker spreads, increase in SAIBOR, higher than expected costs of operating Jizan plant and decline in TiO2 prices.

Figure 1 NIC: Summary of Q2 2017 results

(SAR mn)	2Q 2016	Q1 2017	2Q 2017	% chg y-o-y	% chg q-o-q	ARC est
Revenue	2,170.0	2,480.5	2,670.0	23.0%	7.6%	2,488.8
Gross profit	96.4	426.9	425.0	340.9%	-0.4%	440.5
Gross profit margin	4.4%	17.2%	15.9%			17.7%
Operating profit	165.4	340.4	327.2	97.8%	-3.9%	327.8
Net profit	87.5	103.3	93.6	7.0%	-9.4%	96.4

Source: Company data, Al Rajhi Capital

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

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Contact us

Mazen AlSudairi
Head of Research
Tel : +966 1 211 9449
Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

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