



US\$2.971bn

Market cap

87%

Free float

US\$7.10mn

Avg. daily volume

Target price

15.80

-5.2% over current

Current price

16.5

as at 24/1/2017

Research Department

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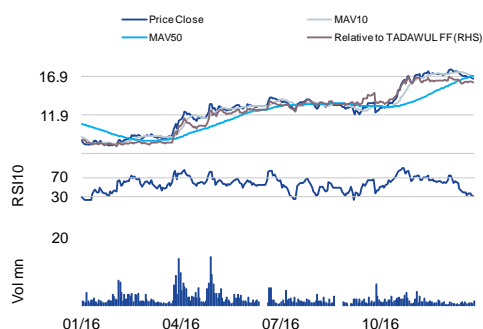
Existing rating

Underweight

Neutral

Overweight

Performance



Source: Bloomberg

Earnings

Period End (SAR)	12/13A	12/14A	12/15A	12/16A
Revenue (mn)	18,199	18,693	15,146	15,210
Revenue Growth	1.5%	2.7%	-19.0%	0.4%
Operating profit (mn)	3,110	2,789	(373)	1,632
OPM	17.1%	14.9%	-2.5%	NA
EPS	1.8	1.6	(2.1)	0.4
EPS Growth	-33.2%	-9.1%	NA	NA

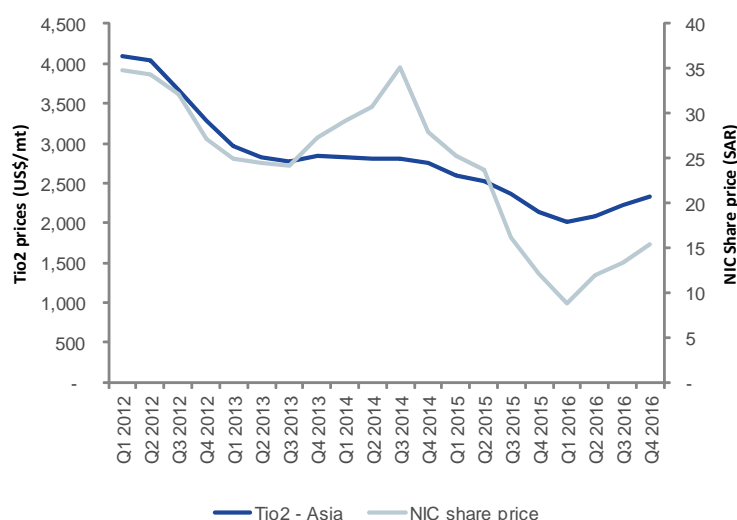
Source: Company data, Al Rajhi Capital

National Industrialization Co. Improving operating performance

National Industrialization Company (NIC) reported a robust set of Q4 numbers. Q4 revenue rose 2.2% q-o-q to SAR3.95bn in line with our estimate but beat consensus estimate (SAR3.43bn) by a wide margin. Gross profit increased ~9% q-o-q indicating benefits from its recent cost cutting measures and the company's operating leverage. As a result, gross margin expanded by more than 150bps q-o-q to 25.4% in Q4. Furthermore, lower G&A expenses helped operating profit (SAR612mn) to beat our SAR444mn forecast. The beat was partially offset by lower other income and higher zakat. Consequently, Q4 bottom line came in at SAR123mn, slightly above our estimate of SAR117mn. The direction for stock in the near term primarily depends on the outlook for TiO2 prices, which we expect to continue improving in 2017 on tight supply conditions. However, most of this is priced in as the stock has rallied ~33% since Q3 and has reached our TP. We remain Neutral on the stock and reaffirm our TP of SAR15.8/share.

Key highlights: a) Post the various cost-cutting initiatives taken in the past, costs have continued to shift downwards leading to a 9% q-o-q increase in gross profit despite only a 2% y-o-y increase in revenue. However, we believe that further improvements will come primarily from operating leverage as TiO2 price improves. b) Apart from cost of sales, G&A Expenses were also lower compared to historical trends, which led to the beat at the operating profit level. c) The stock price has closely moved with TiO2 price in the past (Figure 1) and we expect a similar pattern to continue given the more stable performance of the company's Petrochemical segment. We believe there is some more scope for improvement in TiO2 price given the tighter supply conditions globally d) However earnings may show much better improvement due to the lag between TiO2 prices and TiO2 segment revenues because of the tenures of pricing contracts.

Figure 1 NIC's share price and Tio2 price trend

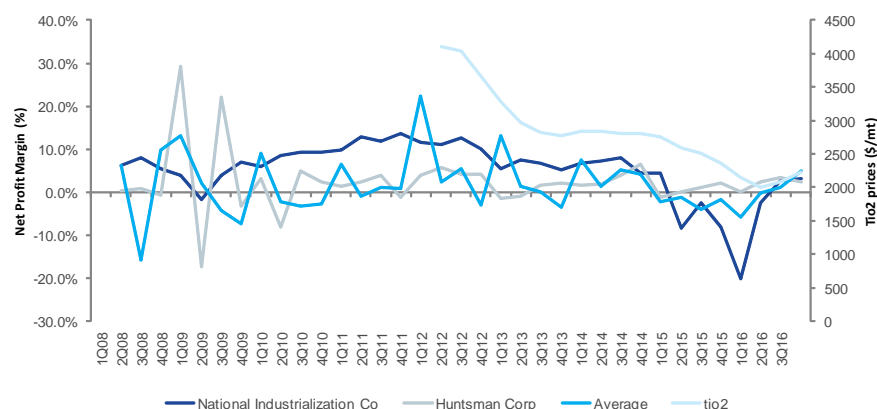


Source: Bloomberg, Al Rajhi Capital



Outlook for TiO₂: As global TiO₂ prices fell in 2015 due to an oversupplied market, margins contracted for the whole sector resulting in many companies reducing their capacities. As per Bloomberg, major TiO₂ producers had shut down approximately 5% of total global production capacity with larger players such as Huntsman shutting down ~16% of its production capacity and Tronos closing 15% of its production capacity. Early January 2017, ICIS reported that stricter environmental regulations in China (30% of the supply) led to lower operating rates in 2016, resulting in tighter supply. Thus as overall supply became constrained and inventory level came down, TiO₂ price increased significantly during H2 2016. In our view, the oligopolistic nature of the market (ex- China) where six players constitute about 70% of the market share also helped in boosting prices upward. Overall we expect prices to increase to around \$2600/mt level by mid-2017 and stabilize around that level. In our framework to forecast TiO₂ price, we track margins of the marginal cost producer in the listed space. We expect that the marginal cost producers' average margins to reverts to historical averages or at-least breakeven levels over a period of time. At current level of TiO₂ price, average margin of the TiO₂ producers (Figure 2) has already increased to reasonably healthy levels in line with the past and hence we believe that the TiO₂ price is likely to stabilize at around \$2,600/mt level in 2017. We believe that even if prices move up significantly, they are unlikely to stay up for a sustained period of time as all the temporarily closed capacity may come back into production putting pressure on prices.

Figure 2 Average TiO₂ producers' net profit margin and Tio2 prices trend



Source: Company data, Bloomberg, Al Rajhi Capital

Earnings to pick up gradually: We note a 2-3 quarter lag between global prices of TiO₂ and the company's TiO₂ segment revenues in the past. As per Bloomberg, global TiO₂ producers have announced a total price hike of ~\$450-\$600/mt in 2016, out of which we estimate Tasnee is likely to have realized only half of the price increase. Furthermore, producers have recently announced another round of price hike of ~\$150/mt, which is likely to be implemented from April. Thereby, we expect earnings to accrue these benefits with a lag.

Valuation and risks: As Q4 top-line and bottom line were mostly in line, we maintain our target price of SAR15.8/share and remain Neutral on the stock. Since Q3, the stock has already advanced by 33% and has reached our TP, providing limited upside potential from the current level. Key downside risks are increasing financial costs due to rising SAIBOR, any further unexpected revision in the feedstock pricing prices and unplanned plant shutdowns. Upside triggers are associated to faster than expected commercial launch of its Jazan plant and sharp increase in product prices.

Figure 3 NIC: Summary of Q4 2016 results

(SAR mn)	Q4 2015	Q3 2016	Q4 2016	% chg y-o-y	% chg q-o-q	ARC est
Revenue	3,377.2	3,864.0	3,950.0	17.0%	2.2%	3,992.9
Gross profit	284.2	922.1	1,004.1	253.3%	8.9%	967.4
Gross profit margin	8.4%	23.9%	25.4%			24.2%
Operating profit	(741.6)	444.6	611.8	NA	37.6%	443.7
Net profit	(686.6)	122.2	123.4	NA	1.0%	116.6

Source: Company data, Al Rajhi Capital



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