National Industrialization Company.

Diversified Operations – Industrial

13 March 2019

Al Rajhi Capital

US$2.943bn	87%	US$7.43mn
Market cap	Free float	Avg. daily volume

Target price	20.00	20.9% over current
Current price	16.54	as at 11/3/2019

Research Department

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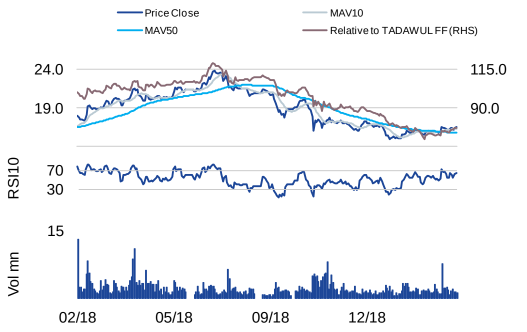
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

(SARmn)	2017	2018	2019e
Revenue	10,796	11,439	11,107
Y-o-Y	25.3%	6.0%	-2.9%
Gross profit	2,104	3,059	2,775
Gross margin	19.5%	26.7%	25.0%
Net profit	716	1,202	1,017
Y-o-Y	NM	67.9%	-15.4%
Net margin	6.6%	10.5%	9.2%
EPS (SAR)	1.07	1.80	1.52
DPS (SAR)	-	-	-
Payout ratio	0.0%	0.0%	0.0%
P/E (Curr)	15.4x	9.2x	10.9x
P/E (Target)	18.7x	11.1x	13.2x

Source: Company data, Al Rajhi Capital

NIC / Tasnee (NIC AB)

Two perspectives on Tasnee. Maintain OW

2018 EPS was up c68% y-o-y but Q4 EPS was down 43% y-o-y and came ~47% below our expectation. The miss in top-line was ~9% and is likely to have been driven by price discounts and lower operating rates. There was an impairment of SAR60mn as well, which was not unusual given end of year accounting. We believe there are two ways to look at Tasnee. One way is to see the company's cash flow generating ability with around SAR3.6bn EBITDA (including associate income) in 2018. With limited capex, the FCF yield is attractive at around 10%. The industry's over supply situation has improved and is expected to continue improving. Thus the prices are structurally expected to be stable. The other way is to look at the delay over Tronox deal, complex structure of the company, delay in commercial launch of plants, high debt and emphasis on accounting provisions. However, given NIC's possible inclusion in EM indices and healthy cash flows, we expect the positives to outweigh the concerns. Q1 2019 earnings will amplify investment sentiments in either direction. Post Q4 results, we revise our TP to SAR20/sh., but still rate the stock Overweight with an upside of ~21%.

Figure 1 Tasnee Q4 18 results

SAR 'mn	4Q17	3Q18	4Q18	Q-o-Q	Y-o-Y	ARC Est.
Revenues	2,889	2,901	2,727	-6%	-6%	2,984
Gross Income	716	773	597	-23%	-17%	809
Net Income	328	259	186	-28%	-43%	350
TiO2 prices ($/mt)	2,896	3,129	3,020			2,950 (Current)

Source: Company data, Al Rajhi Capital

We have identified the key positive factors and concerns that could determine the direction of the stock as below. One of the key concerns seem to be the delay in Tronox deal. However we believe investors should keep in mind that after the deal was announced, average TiO2 prices have rallied by around ~17% which translates completely into profits for Tasnee, because of operating leverage. Hence any delay in the deal is positive as the cash flows are fully with Tasnee. What we mainly like in the deal is the option to sell AMIC in the future because it is unlikely to be profitable even after full commercial operations as per our understanding.

Figure 2 Key positives and concerns

	Positives	Concerns
1	EBITDA of SAR3.5bn is healthy enough for SAR0.5bn capex and part debt repayment of SAR14.5bn	Interest payment is around SAR0.7bn and debt repaid was only SAR1.1bn in 2018
2	Despite a marginal decline in TiO2 prices, the outlook for TiO2 is stable	Weak recovery in factors such as real estate and construction demand globally, which are demand drivers for TiO2
3	FCF yield is 10%, one of the highest in Saudi Arabia	High debt levels would consume most of this EBITDA implying low probability of dividends before 2021
4	A delay in tronox deal is positive because the company gets to retain the cash flows till the sale happens	Cancellation of tronox deal could imply more significant write offs of its AMIC plant
5	Possible inclusion in MSCI EM Index	Possibility of impairments in the future across various assets
6	The company has multiple assets which barely make profits and these could be sold to lower debt	The new plants to be commercially launched could be marginally negative on bottom-line
7	Price to Earnings (12M trailing) is still below historical and peer average at around 9.2x	Price to Earnings of 4Q annualized number is 19x

Source: Company data, Al Rajhi Capital

Valuation and risks: We value using an equal mix of combination of FCF based (10.75% cost of equity and 4.5% cost of debt, implying 12 month forward price of SAR20.3/sh) and PE valuation (12x on 2019 EPS of 1.5, implying 12 month forward price of SAR20.2/sh). Based on this, we have a target price of SAR20/sh. (rounded) and an Overweight rating (upside 21%). Key downside risks are further impairments and drop in TiO2 prices.

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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.

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