National Industrialization Co.(TASNEE)

Event Update - Cristal Divestment

ALJAZIRA CAPITAL الجزيرة كابيتال الجزيرة للأسواق المالية

Cristal divestment to go ahead after FTC approval. The sale of the titanium dioxide (TiO2) business to Tronox Ltd. would enable Tasnee to create more value through strategic expansion in core business (petrochemicals), while considerably deleveraging its balance sheet. Margins to improve, ROA expected to jump, Taxes to go down on lower exposure to Cristal foreign operations, whereas pure FCF generation to decline. LT we see divestment as value accretive, as TASNEE increase its focus on high Margin pure Petro play. Shareholders may receive dividend payments in FY20, for the first time since FY15. We downgrade TASNEE to "**Neutral**", with a revised TP of SAR 18.50/share.

FTC settles with Tronox over purchase of Cristal's titanium dioxide business: Tronox Ltd reached a settlement with the U.S. FTC on April 10 to proceed with its purchase of Cristal's titanium dioxide business (Tasnee: 79% ownership). Under the settlement, Tronox agreed to sell Cristal's facilities in Ashtabula, Ohio, representing 23.5% of its total capacity (850KMT). British company INEOS Enterprises agreed to buy the plants for USD 700mn. Tasnee would treat the deconsolidation of Cristal's assets and liabilities from its financial statements in Q2-19 as an investment in an associate. The deal would make Tronox the largest titanium pigment producer in the world, with nine titanium dioxide plants in eight countries and a total capacity of 1.1 million metric tons. The deal would result in Tasnee receiving returns in the form of SAR 6.274bn (USD 1.673bn) in cash and 37.58mn in Class A shares in Tronox Co. (representing approximately 24% of the shareholding in Tronox). The SAR 6.274bn received by TASNEE would be used to fully pay Cristal's outstanding debt.

Tasnee to be able to concentrate on its petrochemical sector and creating more value by adding valuable strategic expansion in core business: We believe that Cristal's asset sales would directly enhance the company's balance sheet and financial ratios owing to a highly leveraged balance sheet and the nature of volatility in the Tio2 business, which put overall margins under pressure in previous years. The company's total obligation stood at SAR 14.4bn (debt to equity stood at 1.1x) and was considered a key short-term concern before the Cristal/Tronox merger was approved by the U.S. FTC. Matured debt stood at SAR 3.2bn and SAR 6.2bn in FY19 and FY20, respectively, which may force the company to request debt rescheduling if the merger is not completed.

In addition to potentially improve total asset productivity and higher returns on total assets, we expect the company to witness margin expansion and improved operating margins for the overall business. The combined business of Cristal and Tronox supports long-term improvement in the TiO2 industry, wherein Tronox would be the largest player in the industry, with a highly integrated and geographically diversified business in the titanium dioxide industry, giving the company further control over the market price of titanium. Going forward, Tasnee would be able to concentrate on the petrochemical sector and create more value through valuable strategic expansion in the core business (petrochemicals), while considerably deleveraging its balance sheet.

Tasnee to witness SAR 1.2bn reduction in debt as it agrees to sell 90% stake in Jizan smelter to Tronox; Tasnee's ownership in smelter to decline to 10% from 89.5%: Advanced Metal Industries Co. (AMIC), equally owned by Tasnee and Cristal, runs two projects: the titanium sponge JV and Jizan titanium slag smelter. AMIC signed an option agreement with Tronox Ltd to sell 90% ownership in the titanium slag smelter facility in Jizan (500kt of TiO2 slag and 220kt of pig iron). AMIC would create a special-purpose vehicle (SPV), incorporated in the Kingdom. Tronox would acquire 90% ownership of the SPV after reaching sustained operations in the slagger. Tronox would assume AMIC's external debt of USD 322mn through ownership in the SPV as well as another USD 125mn loan. Therefore, we believe this agreement would favor both parties as Tasnee's debt value would be lowered by SAR 1.2bn, while significant synergies between Tronox and AMIC would be captured. Tronox plans to start supplying ilmenite ore to the slagger. AMIC, in turn, would provide titanium slag to Tronox, which it would use to create TiO2. Thus, the Jizan smelter would help strengthen Tronox's position as an integrated producer of TiO2. Additionally, we expect the USD 125mn loan to be sufficient to raise the smelter to a sustained level of production prior to the completion of the acquisition.

AMIC and Tronox also agreed to enter into a shareholders' agreement related to their respective rights and obligations as shareholders of the SPV, which allows TASNEE to get 10% profit from the titanium slag smelter facility in Jizan. The new ownership structure is expected to come into effect after operations at the slagger facility continue to sustain, H2-FY20 onward. According to the company, commercial production at the Jizan smelter is expected to commence in H2-19; the titanium sponge JV would begin commercial operations in H1-19.

Neutral

Target Price (SAR)	**18.50**
Upside / (Downside)*	**8.8%**

Source: Tadawul *prices as of 15th of May 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenues	10,796	11,439	3,341
Growth %	25.3%	6.0%	-
Net Income	716.2	1,202.1	875.8
Growth %	682%	67.9%	-
EPS	1.07	1.80	1.31

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY17	FY18E	FY19E
Gross Margin	19.5%	26.7%	44.7%
EBITDA Margin	10.5%	19.3%	18.5%
Net Margin	6.6%	10.5%	26.2%
P/E	15.3x	8.41x	12.91x

Source: Company reports, Aljazira Capital

Tasnee's ownership (Before the deal)

The National Titanium Dioxide – Cristal	79.0%
Titanium Sponge JV	58.2%
Jizan Slagger	89.5%
Saudi Polyolefins Company	75.0%
Saudi Ethylene and Polyethylene	45.3%
SAPCO	39.2%
SAMCO	39.2%

Tasnee's ownership (After the deal)

Tronox Ltd Co	19.0%
Titanium Sponge JV	32.5%
Jizan Slagger	10.0%
Saudi Polyolefins Company	75.0%
Saudi Ethylene and Polyethylene	45.3%
SAPCO	39.2%
SAMCO	39.2%

Source: Company Report, AlJazira Capital

Senior Analyst
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

Key Financial Data

Amount in SARmn, unless otherwise specified	FY16A	FY17A	FY18A	Before Deal 2019E	After Deal 2019E
Income statement					
Revenues	8,620	10,796	11,439	11,752	3,341
Depreciation	(858.3)	(853.1)	(829.1)	(912.0)	(206.0)
Cost of sales	(7,712)	(8,692)	(8,380)	(8,994)	(1,849)
Gross profit	907.0	2,104.2	3,059.3	2,758.9	1,492.3
OPEX	(1,554)	(1,639)	(1,802)	(1,639)	(1,082)
Company share in net income of associated companies	1,394	1,344	1,624	1,542	1,688
Operating profit	747.5	1,809.0	2,881.5	2,661.7	2,098.2
EBITDA	*212*	*1,318*	*2,086*	*2,032*	*617*
Other income	164	231	81	171	42
Provision for legal cases	(10)	(185)	(133)	-	-
Financial charges	(529)	(706)	(706)	(786)	(403)
Profit before zakat & minority interest	372.5	1,148.6	2,122.8	2,047.0	1,737.2
Minority interest	(207)	(442)	(579)	(593)	(540)
Zakat & income taxes of subsidiaries	(74)	9	(341)	(414)	(321)
Net profit	91.5	716.2	1,202.1	1,040.4	875.8
EPS	*0.15*	*1.07*	*1.80*	*1.56*	*1.31*
Key fundamental ratios					
Gross profit margin	10.5%	19.5%	26.7%	23.5%	44.7%
Operating margin	8.7%	16.8%	25.2%	22.9%	62.8%
EBITDA margin	2.3%	10.5%	6.1%	17.3%	18.5%
Net profit margin	1.1%	6.6%	10.5%	9.0%	26.2%
Return on assets	0.3%	2.2%	3.6%	3.3%	8.0%
Return on equity	0.8%	6.4%	9.8%	7.9%	11.5%
Leverage ratio					
Interest coverage (x)	1.41	2.56	4.08	3.39	5.21
Debt / equity (x)	1.57	1.32	1.13	1.13	0.82
Market/valuation ratios					
P/E ratio (x)	115.8	15.3	8.4	10.8	13.0
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company financials, AlJazira research

Based on our FY2019 forecast, we have developed two scenarios for Tasnee's FY19 income statement before and after the sale of Cristal's assets. We expect sales to drop to SAR 3.3bn from SAR 11.8bn, representing the petrochemical segment and others. Conversely, we expect net profit to fall 15.8% to SAR 875mn (EPS, 1.31) from SAR 1040mn (EPS, 1.56). The separation of Cristal's financials in Q2-19 would have an impact on / would benefit overall performance:

(1) Finance expenses came in SAR 303mn lower at 403mn in FY2019 from SAR 706mn in FY2018; Cristal plans to fully repay its debt of SAR 6.274bn (USD 1.67bn) outstanding. This would reduce Tasnee's gross debt and significantly decrease finance expenses, in spite of the impact of the IFRS-16 implementation in FY19, which raised financing cost by SAR 23mn in Q1-19. Additionally, we believe deleveraging the balance sheet could support the company's credit rating and reduce interest on debt.

(2) The transaction would significantly deleverage Tasnee's consolidated balance sheet to SAR 8.1bn in FY19, from SAR 14.4bn, reducing the debt-to-equity ratio to 0.8x from 1.13x. Furthermore, total debt is estimated to decline further by SAR 1.2bn in FY2020 to SAR 6.9bn, weighed by the sales agreement of Jizan smelter to Tronox.

(3) We expect tax and zakat expenses to fall by SAR 93mn due to the significant impact of tax on Cristal's outside operations. This could, conservatively, reduce zakat and tax expenses to SAR 321mn in FY2019.

(4) Tronox reported a net loss of USD 7mn in FY18 and USD 34mn in Q1-19. However, we expect Tronox to contribute with a net profit of SAR 120–150mn to Tasnee in FY19, recognizable as company share in net income of associated company due to 19% ownership in Tronox. Although the company owns just 19% stake in Tronox, its significant influence on Tronox and two seats on Tronox's Board of Directors might be an accounting justification for considering Tronox as an associate, while reversing its profit share in the income statement. Furthermore, the combined business between Cristal and Tronox would support long-term growth in the company's other operating income as the deal would help create an integrated business and capture significant synergies between Tronox and Cristal.

(5) The company plans to reduce the impact of the titanium industry on the overall business model as the titanium gross margin is too tight; this deal is expected to improve gross margins to 44.7% from 26.7% in FY18. Tasnee would be able to concentrate on its high-margin business, creating more value through strategic expansion in the core business (petrochemicals).

(6) Lower variation was witnessed in earnings due to the lower impact of minority interest on the company's total performance as Cristal Co. is no longer a subsidiary. We have revised our forecasts in minority rights by SAR 53mn to SAR 540mn in FY19 from SAR 593mn prior to the close of the deal.

(7) Shareholders may receive dividend payments in FY20, for the first time since FY15, owing to average free cash flow of SAR 1.2bn expected over the next four years, a low leveraged balance sheet, and current cash in hand of SAR 2.9bn.

Titanium sponge JV to contribute SAR 65mn in FY20: The titanium sponge JV is 65% owned by Advanced Metal Industries Co. (AMIC), which is 50:50 owned by Tasnee and the Cristal unit; conversely, the remaining 35% is owned by Japan's Toho Titanium Co. The project, located in Yanbu Industrial City, would initially produce 15,600 tons a year (tpa) of pure titanium. Cristal' titanium dioxide plant would supply the project with main feedstock for producing titanium sponge. We believe the sale of Cristal's assets would reduce the company's ownership in the project to 32.5% from 58%. Moreover, our initial forecasts suggest a small contribution to Tasnee with SAR 65mn in FY20, unlike the Jazan smelter, which we expect to have a minor effect on TASNEE.

AJC's view and valuation: During Q1-19, income from associated companies stood at SAR 347.2mn, implying decline of just 3.8%Y/Y as a result of an improved operating rate and production efficiency, despite a significant decline in products prices. Conversely, the company's OPEX (SG & A) decreased 19.3%Y/Y to SAR 392mn, compared with SAR 486mn in Q1-18, due to a decline in administrative expenses. On the other hand, we expect the titanium market to stabilize over FY19, after remarkable improvement was witnessed in FY18. However, heavy debt and previous high volatility in the titanium markets were the primary reasons for Cristal's abandonment. We believe Tasnee is well-positioned to increase its top-line growth through expanding its core business. The production efficiency and operating rate in the company's petrochemical segment was positively reflected in the top line in H2-18 and would increase in FY19. Upside and downside risk depend mainly on global economic direction and US–China trade relations. Lower-than-estimated finance cost and tax expenses could play out as upside risk to the company's valuation. A larger impact on revenues and margins from global trade tensions and lower-than-expected production efficiency are the key downside risks to the valuation. The company is trading at a forward PE of 12.9x based on our FY19 earnings forecasts, against the local peer average of 14.8x. We update our recommendation to "**Neutral**" on the stock, with a revised TP of **SAR 18.5/share.**

National Industrialization Co.(TASNEE)

Event Update - Cristal Divestment

Name	Ticker	P/E	EV/ EBITDA	Mkt Cap (SAR mn)
YANBU NATIONAL PETROCHEMICAL	YANSAB AB Equity	16.6	10.8	38,194
SAUDI KAYAN PETROCHEMICAL CO	KAYAN AB Equity	14.7	8.6	18,900
NATIONAL PETROCHEMICAL CO	PETROCH AB Equity	11.4	7.0	12,792
SAUDI IND INVESTMENT GROUP	SIIG AB Equity	10.2	7.8	11,700
ADVANCED PETROCHEMICALS CO	APPC AB Equity	14.9	12.3	11,650
NATIONAL INDUSTRIALIZATION C	NIC AB Equity	9.7	13.0	11,224
SAHARA PETROCHEMICAL CO	SPC AB Equity	12.8	-	7,609
ALUJAIN CORPORATION (ALCO)	ALCO AB Equity	-	-	1,550
METHANOL CHEMICALS CO	CHEMANOL AB Equity	24.3	8.0	1,114
NAMA CHEMICALS CO	NAMA AB Equity	-	11.4	572
SAUDI BASIC INDUSTRIES CORP	SABIC AB Equity	18.5	8.1	358,800
Average (Including NIC AB)		**14.8**	**9.7**	

Source: Bloomberg, AlJazira Capital

Table1: DCF Valuation

DISCOUNTED FREE CASH FLOW TO FIRM Year to Dec (SAR mn)	FY19E	FY20E	FY21E	FY22E	FY23E	Terminal Value
Free cash flow	1,227	1,134	1,299	1,227	1,174	19,358
Beta	1.1	1.1	1.1	1.1	1.1	1.1
Debt/ (Debt + equity)	0.4x	0.4x	0.4x	0.4x	0.4x	0.4x
Weighted average cost of capital	8.4%	8.4%	8.4%	8.4%	8.4%	8.4%
Discount period	0.67	1.67	2.67	3.67	4.67	5.67
Discount factor @ WACC	1.0	0.9	0.8	0.8	0.7	0.7
Present value of free cash flow	1,163	992	1,047	913	806	13,287

TOTAL RETURN	
Enterprise value	18,207
Less: Debt	8,130
Add: Cash	2,900
Equity value	12,977
No of shares outstanding (mn)	668.9
Fair value (SAR/share)	19.4
Current price (SAR/share)	16.78
Expected capital gain	**15.6%**

Source: Aljazira Capital

Table3: Valuation Based on Relative Valuation

	SAR/share	Weights	
DCF base value	19.4	50.0%	9.7
EV/EBITDA	15.9	25.0%	4.0
PE Multiple of 14.8x	19.4	25.0%	4.8
Weighted average 12-month price target (SAR/share)			**18.5**

Source: Aljazira Capital

Based on our DCF valuation for de-consolidated financials, we assume 40-60 debt-equity split, which reflects the expected capital structure of TASNEE. Cost of equity is calculated at 10.9% and cost of debt is 4.5%, which yields a WACC of 8.4%. In calculating the terminal value, we forecast a long-term growth rate of 2.2%. The DCF approach ascribes a fair value per share of **SAR 19.4/share**.

We forecast EBITDA of SAR 616.6mn for FY19 and multiply it by industry average EV/EBITDA of 9.7x to come up with an equity value (after adjusting for net debt and cash & adding 19% of Tronox EV/ EBITDA valuation) of SAR 10.64bn, or **SAR 15.9/share**.

On valuation multiples, the stock is assumed to trade at 14.8x for FY19E P/E, in-line with average sector, resulting in **SAR 19.4/share** which in our view is justified considering low risk premium for debt and substantial margin improvement.

We value TASNEE on 50% weight for DCF (2.2% terminal growth and 8.4% WACC), 25% weight each for P/E (14.8x FY19 EPS) and EV/EBITDA (9.7x FY19 EBITDA) based relative valuation, yielding the target price of **SAR 18.5 per share**, implying 8.8% upside from current levels

We value TASNEE on 50% weight for DCF (2.2% terminal growth and 8.4% WACC), 25% weight each for P/E (14.8x FY19 EPS) and EV/EBITDA (9.7x FY19 EBITDA) based relative valuation, yielding the target price of SAR 18.5 per share, implying 8.8% upside from current levels

Table 2: Tasnee EV/EBITDA valuation

All figures in SARmn, unless specified	
Sector EV/EBITDA	9.7
Implicit EV	5,981
Cash	2,900
Debt	(8,130)
Minority interest	3,453
Tasnee 19% ownership in Tronox	6,437
EV/EBITDA - Based net worth	**10,642**
Share outstanding (mn)	668.9
EV/EBITDA - 12 month price target	**15.9**

Table 2: Tronox EV/EBITDA valuation

All figures in USDmn, unless specified	
Sector EV/EBITDA	10.2
Implicit EV	11,135.0
Cash	1,034.0
Debt	(3,134.0)
Tasnee 19% ownership in Tronox	1,716.7
Tasnee 19% ownership in Tronox (SAR)	6,437.4
EV/EBITDA - Based net worth	**6,437**

Source: Aljazira Capital

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

RESEARCH DIVISION

Head of Research
Talha Nazar
+966 11 2256250
t.nazar@aljaziracapital.com.sa

Senior Analyst
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

Analyst
Abdulrahman Al-Mashal
+966 11 2256374
A.Almashal@Aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales
Alaa Al-Yousef
+966 11 2256060
a.yousef@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage
Luay Jawad Al-Motawa
+966 11 2256277
lalmutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province
Abdullah Al-Rahit
+966 16 3617547
aalrahit@aljaziracapital.com.sa

AGM-Head of Sales And Investment Centers Central Region, & acting head Western and Southern Region Investment Centers
Sultan Ibrahim AL-Mutawa
+966 11 2256364
s.almutawa@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer