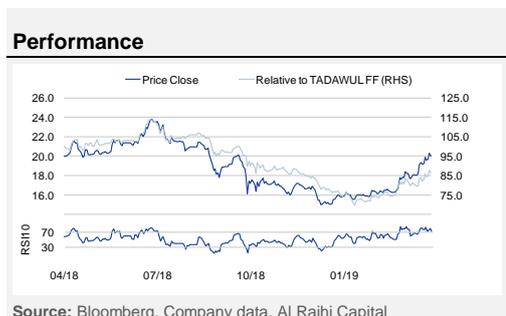




Rating	UNDER REVIEW
Target price	UR
Current price	SAR19.98

Share information			
Market cap (SAR/US\$)	13.36bn / 3.564bn		
52-week range	14.98 - 23.78		
Daily avg value (US\$)	5.76mn		
Shares outstanding	668.9mn		
Free float (est)	87%		
Performance	1M	3M	12M
Absolute	13.5%	26.3%	3.1%
Relative to index	8%	16.8%	-12.6%



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National Industrialization Co.

Tronox-Cristal update: Rally over; Risks seen

Tasnee has rallied ~32% so far in 2019, largely on the expectation of FTC's withdrawal of objections for Tronox to buy Cristal from Tasnee, which was announced on April 11. Post the deal, Tasnee will become leaner by transferring its complex and geographically diverse TiO₂ assets, lower debt and focus on its Petchem assets. However, as per our analysis, post the deal, Tasnee's fair value may decline from current levels. The midpoint of scenarios analysed is SAR17/share (see Valuation section). Overall, we see challenges emerging such as impairment, tight liquidity and lower EPS post the deal. Until further clarity, we remain Under review on the stock.

FTC lifts objections: Back in 2017, Tasnee's 79% owned subsidiary, Cristal had entered into a conditional transaction agreement to sell to Tronox (465kMT of production capacity) its domestic and international titanium dioxide business (858kMT of production capacity) in exchange for 24% (37.58mn class A shares) in pro-forma Tronox. Apart from this, SAR6.274bn (US\$1.673bn) cash will be used to pay Cristal's outstanding debt. The deal was initially expected to close within 13 months but was a subject to satisfaction of certain precedents, governmental and regulatory approvals, which was expected to be time consuming. Last week, FTC, which had earlier objected the deal, gave the deal a go ahead. We show the impact on its financials and valuations in page 3.

Points to note:

- The deal was signed at a time when Tasnee was in losses as TiO₂ price was around US\$2400/ton. Now TiO₂ price has recovered and the opportunity cost for Tasnee would be the healthy EBITDA generating from this segment. Back then, EBITDA from this segment was SAR265mn while now it is ~SAR1.6bn.
- On the other hand, Tasnee would receive dividend income from Tronox. But, Tronox made losses of US\$7mn in FY18, which could imply short term liquidity tightening. As a result, we do not expect Tasnee to hold Tronox for long as it could sell of this stake eventually at favourable valuations to pay off debt partially. However, the total debt of Tasnee is SAR14.5bn as of Dec 2018 while the total market cap it will hold in Tronox is ~SAR1.7bn (The actual debt is much higher as the company has deconsolidated certain subsidiaries). For the same reason, we do not expect dividends from the company.
- Further on liquidity, contrary to market view, Tasnee's shareholders do not receive the cash paid (US\$1.673bn). However as Tasnee will own 19% (24% x 79% Cristal stake) of Tronox, this will benefit Tasnee's shareholders indirectly.
- The deal was approved by FTC as the agreement now would imply selling of Cristal's North American TiO₂ business to INEOS. However this implies lower assets and thereby valuation for Tronox.
- One of the key elements of the deal is the option to sell Tasnee's smelter facility, which has been pending commercial launch for a long time. There have been continuous delays of the launch of Tasnee's smelter facility at Jizan as well as sponge factory at Yanbu Industrial city. As per the board report, the company plans to start operations in its titanium ilmenite



smelter plant by 2H 2019 while the sponge factory is expected to be launched in 1H 2019. Even if the commercial launch happens, we believe it could be still in losses because when project was conceptualized, TiO₂ prices were much higher. Tronox could purchase this facility from Tasnee provided it meets some operational performance indicators otherwise this could continue to be a drag on the financials.

- Post the deal, we expect a reduction in equity for the company depending on the book value of Tronox included.
- There are risks of more impairments that can be expected from Tasnee's other assets. We also note that major shareholders have lowered their stakes in the company.

Prior valuation (before deal): As for valuation of the stock before incorporating the elements of the deal into our model, our fair value was SAR20/share based on equal mix of DCF and relative valuations. Key upside risks were related to higher than expected improvement in TiO₂ price and future sale of AMI.

Valuation (post deal): To derive the value of Tronox post the deal, we apply a forward EV/EBITDA multiple of 7.2x (based on peers – see Appendix for peer multiples) to pro-forma EBITDA post synergies. We value the Petrochem segment at EV/EBITDA of 9.7x, in line with Petchem peers in the Kingdom and assume a minority share of 50% for the segment. To this we add the pro-forma equity value of Tronox held by Tasnee. We assume group level of net debt at SAR5.3bn. Our calculations suggest a fair price of **SAR13.4-15.6/share** (depending on Tronox valuation, see below).

On the other hand if we were to use a P/E of 14x for Petchem and other downstream assets and add Tronox market value separately, the fair value for the stock would be **SAR18.6 to 21.2/share** (depending on Tronox valuation, see below).

The average of the 4 scenarios is SAR17.3/share. We thus believe that the rally is done and there may be downside to current levels. We currently remain UR on the stock until we have further clarity. Despite the valuation impact, we believe exiting TiO₂ business is a wiser decision in the long run for Tasnee considering that it is a relatively smaller industry with supply and demand shocks

Tronox valuation: The market cap of Tronox has ranged from US\$0.9mn to US\$3.3bn after the deal. One could value Tronox at US\$4.9bn post the deal (based on Figure 1), or current market cap of ~USD2.4bn. This implies a contribution from **SAR2.5/share to SAR5.2/share** to Tasnee's fair price.

Figure 1 Tasnee's 19% stake value calculation

(USDbn)	Pro-forma Tronox
Tronox 2018 pro-forma EBITDA	1.15
Target EV/EBITDA multiple	7.2x
Enterprise value	8.3
Less: Debt	3.2
Less: Pension and postretirement healthcare benefits	0.1
Less: Noncontrolling interest	0.2
Add: Cash	0.0
Tronox pro forma equity value	4.9
Tasnee 19% stake value in Tronox	0.9
Tasnee 19% stake value in Tronox (SARbn)	3.5
Tasnee 19% stake value per share in Tronox (SAR per share)	5.2

Source: Company data, Bloomberg, Al Rajhi Capital



Appendix

Peer multiples for Saudi Petchem companies and Tronox

Figure 4 Saudi petchem companies historical multiples (last three years period)

	EV/EBITDA			2018	Price/Earnings		
	Low	High	Avg	Debt/Assets	Low	High	Avg
APPC	7.8	11.9	10.6	21.3%	10.8	15.0	13.1
Yansab	7.3	11.3	9.0	0.0%	11.3	16.9	14.2
SABIC	6.8	8.8	7.6	14.8%	13.5	17.4	15.2
Tasnee	5.9	11.3	8.6	43.2%	7.3	20.7	13.4
Sipchem	6.4	9.1	7.7	46.1%	7.3	20.7	13.4
Kayan	7.1	12.2	9.1	55.8%	10.2	NA	NA
SIIG	6.3	10.8	8.3	31.1%	6.6	11.5	9.0
SAFCO	11.5	21.4	15.1	0.1%	13.7	26.7	19.2
Sahara	7.6	15.3	11.7	19.7%	11.0	22.0	14.8
Petro Rabigh	9.7	20.9	14.6	64.2%	8.8	NA	NA
Petrochem	6.2	10.1	8.4	36.7%	8.4	16.2	12.0
Nama	NA	NA	NA	59.4%	NA	NA	NA
Chemanol	6.5	11.9	8.7	39.7%	NA	NA	NA
Alujain	6.1	6.6	6.3	0.0%	11.0	13.5	12.1
Average	7.3	12.4	9.7	30.9%	10.0	18.1	13.6

Source: Bloomberg, Al Rajhi Capital

Figure 5 Tronox peer multiples comparison

Name	2019E EV/EBITDA	2020E EV/EBITDA	Debt to asset ratio	2019E P/E	2020E P/E
Tronox	7.2x	5.8x	68.1%	15.0x	9.3x
Chemours	6.3x	5.7x	54.0%	8.5x	7.2x
Huntsman	6.0x	5.5x	29.2%	9.0x	7.6x
Lomon Billions	9.4x	8.5x	24.0%	13.4x	10.9x
Kronos	7.2x	6.5x	24.1%	14.3x	11.5x
Average	7.2x	6.4x	39.9%	12.0x	9.3x

Source: Bloomberg, Al Rajhi Capital

Figure 6 2016 Income statement (Pro-forma basis)

(SAR '000)	Before deal financials	After deal financials
Sales	11,439,283	3,840,741
Cash COGS	(7,550,831)	(2,545,075)
D&A	(829,109)	(253,594)
Gross profit	3,059,343	1,042,072
Other operating expenses	(1,802,362)	(852,365)
Income/(Loss) from main operator	1,256,981	189,707
Financial charges	(706,031)	(428,771)
Other income/(expenses), net	80,833	12,200
Impairment	-133,443	(133,443)
Equity income	1,624,490	1,748,125
Net Profit before zakat and minorit	2,122,830	1,387,818
Zakat and income tax	(341,252)	(222,051)
Net Profit before minority	1,781,578	1,165,767
Non-controlling interests	(579,484)	(399,168)
Net income / (loss)	1,202,094	766,599
EPS (SAR)	1.80	1.15
EBITDA	2,086,090	443,301

Source: Company data, Al Rajhi Capital



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