Tasnee

Diversified Operations – Industrial
NIC AB: Saudi Arabia
26 October 2017

US$2.642bn	87%	US$3.717mn
Market cap	Free float	Avg. daily volume

Target price	**15.00**	1.3% over current
Current price	**14.81**	**as at 24/10/2017**

Existing rating

Underweight | **Neutral** | Overweight

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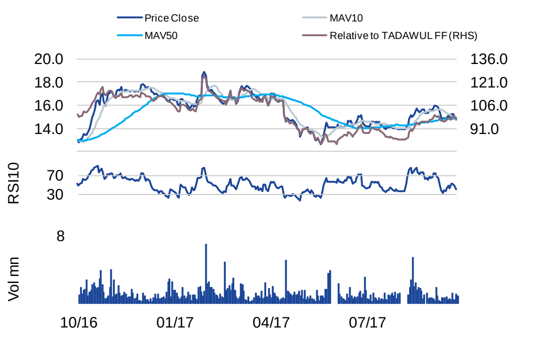
Tasnee (NIC AB)

Associate cos. drive Q3 earnings beat; raise TP to SAR15/sh

Tasnee reported Q3 earnings at SAR192mn, more than doubling on q-o-q basis and significantly above our (SAR122mn) and consensus (SAR132mn) estimates. Sharp improvement in income from associates (particularly SEPC) to ~SAR400mn in Q3 vs. our expectation of SAR287mn is likely the primary reason. If we were to adjust for this, our numbers would have been broadly in-line with actual reported numbers, implying that core operations of Tasnee, which is its titanium business, was in-line with our expectation. Given the strong operating performance in Q3 amid rising TiO2 prices and improved performance of its associates, we revise our estimates upwards, leading to a revises target price of SAR15.0/sh based on an equal mix of DCF and relative valuation. We maintain our Neutral rating for Tasnee. We do not expect dividends till at least 2018 given its debt and cash flow position, unless TiO2 price increases significantly.

Performance



Source: Bloomberg

Earnings

(SARmn)	2016	2017e	2018e
Revenue	9,314	10,625	10,851
Y-o-Y	-38.5%	14.1%	2.1%
Gross profit	907	1,905	1,938
Gross margin	-59.0%	110.0%	1.8%
Net profit	145	564	607
Y-o-Y	NM	289.6%	7.7%
Net margin	1.6%	5.3%	5.6%
EPS (SAR)	0.22	0.84	0.91
P/E (Curr)		17.6x	16.3x
P/E (Target)		17.8x	16.5x

Source: Company data, Al Rajhi Capital

Figure 1 Tasnee Q3 results

(SAR mn)	Q3 2016	Q2 2017	Q3 2017	Y-o-Y	Q-o-Q	ARC est	Comments
Revenue	**2,080**	**2,667**	**2,760**	**32.7%**	**3.5%**	**2,855**	**Slightly missed on lower than expected sales volume**
Gross profit	268	425	537	100.1%	26.3%	519	Marginal miss in top-line was completely offset by likely improvement in production efficiencies at Cristal.
Gross margin	12.9%	15.9%	19.4%			18.2%	
Operating profit	229	327	557	143.9%	70.3%	406	Higher associates income, particaulrly SEPC on improved sales volume and efficiencies led to overall operating margin expansion, beating our estimates at the operating level.
Operating margin	11%	12%	20%			14%	
Net profit	**108**	**94**	**192**	**77.6%**	**104.7%**	**122**	**If we were to adjust for higher associates income, then earnings would have been beaten only by SAR16mn.**
Net margin	5%	4%	7%			4%	

Source: Company data, Al Rajhi Capital

Revision in our estimates: Post strong Q3 operating performance, we revise our estimates upwards to account for improved operating efficiencies at both its own plants and associates' plants. We revise long term sustainable operating margin to an average 15.9%, around 240bps above our earlier estimates. We continue to assume modest recovery in TiO2 price, which is still below its historical level.

Valuation: The stock is currently trading at a P/E of 16.3x on our 2018E EPS, higher than its Saudi peers. Post revision in our estimates, we increase our 12 month TP to SAR15.0/sh based on an equal mix of DCF and relative valuation but maintain our Neutral rating. For relative valuation, we use 14x 12-month 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).

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.

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