

## National Gas and Industrialization Co (GASCO)



***We initiate our coverage for GASCO with a neutral recommendation given its weak top-line growth outlook and rising fixed costs. However, we believe the risks are already priced in. Besides, the expected high dividend payout and defensive nature of the sector should support GASCO's value amid current economic uncertainty.***

29 Sep 2020

<b>Recommendation</b>	<b>Neutral</b>
<b>Current Price (28-09-2020)</b>	<b>SAR30.6</b>
<b>Target Price (52 Weeks)</b>	<b>SAR30.1</b>
<b>Upside/ (Downside)</b>	<b>-1.5%</b>
<b>Shariah Compliance</b>	<b>Pass</b>

## Key Points

**We initiate our coverage for GASCO with a NEUTRAL recommendation and 52 weeks target price at SAR30.1; this represents a downside potential of 1.5%.**

- National Gas and Industrialization Co (GASCO) is the only provider of Liquefied Petroleum Gas (LPG) in the Kingdom. The company supplies over 1,400 thousand tonnes of LPG per year to the Kingdom amounting to SAR1.9bn annual revenues. The company mainly caters to households, as well as commercial and manufacturing facilities that use LPG as a cooking fuel.
- We see a weak growth outlook for GASCO given slower population growth, stringent regulatory environment, and rising fixed costs. More importantly, the company is currently facing significant risk from the possible emergence of competition following the expiry of its monopolistic franchise without renewal since March 2018. This represents the possible end of GASCO's 50 years of monopoly in the Saudi market, imposing material pressure on profitability and cash generation if new market players emerge.
- On the other hand, we believe that GASCO's attractive dividend payout and top-line stability positions it as a defensive stock amid current economic uncertainty and possible market correction. GASCO's revenues should remain relatively stable regardless of economic headwinds given the essentiality of LPG for households (GASCO's main consumer). Besides, given its maturity and modest growth potential, we expect high dividend payout to continue given the company's relatively low expansion needs and adequate debt capacity.

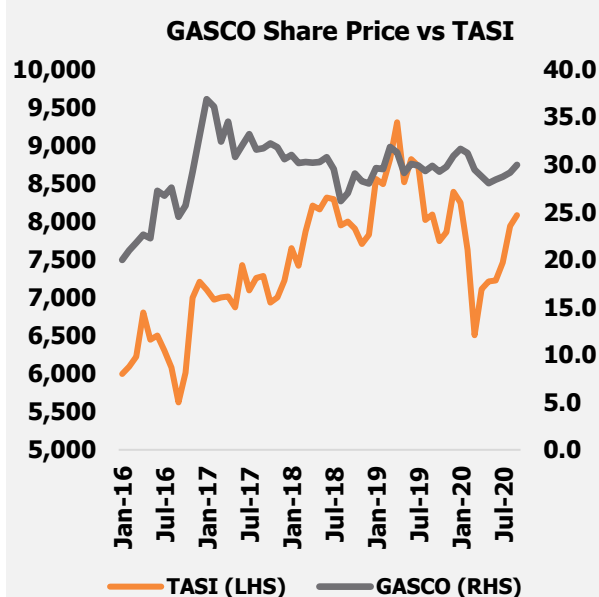
## Key Growth Catalysts

- Attractive dividends payout
- Operating in a defensive sector

## Key Risk Factors

- Highly regulated sector
- Lack of cost control
- Weak revenue growth outlook
- Possible emergence of competition

<b>Reuters Code</b>	2080.SE
<b>Bloomberg Code</b>	NGIC: AB
<b>52 Weeks High</b>	SAR32.85
<b>52 Weeks Low</b>	SAR27.00
<b>Market Cap</b>	SAR2.3bn
<b>P/E (TTM)</b>	40.7x
<b>EPS (TTM)</b>	SAR0.75
<b>Last Dividend (2019)</b>	SAR2.6 <sup>1</sup>
<b>AVG Value Traded</b>	SAR53.2mn



<sup>1</sup> Included exceptional dividends of SAR0.9/share

# Company Overview

## GASCO's Establishment

- GASCO was incorporated in 1963 via the merger of National Gas Company in Dammam together with Saudi Manufacturing and Gas Company. During 1975, all corporations in the gas distribution business were merged with GASCO, following government intervention, as competition intensified which led to poor service levels. Since then, GASCO operates as the only provider of Liquefied Petroleum Gas (LPG) in Saudi Arabia.
- GASCO's main business activity includes transportation, filling, marketing, and distribution of LPG which consists of Butane and Propane; used as cooking fuel. The company purchases LPG from Aramco at a fixed price, fills it in cylinders at its filling stations across the Kingdom with average daily capacity of 450k cylinders, then distributes it to the final consumer through over 2,000 distributors covering the entire Kingdom.
- Being the only provider of LPG, the company caters to all sectors in the Kingdom including households, commercial (e.g. restaurants & hotels), and manufacturing entities. GASCO operates 7 filling stations across the Kingdom and 1 station for gas cylinders maintenance. The company supplies over 1,400 thousand tonnes of LPG and more 100 million gas cylinders on annual basis to the Kingdom.

## GASCO's Revenue at Glimpse

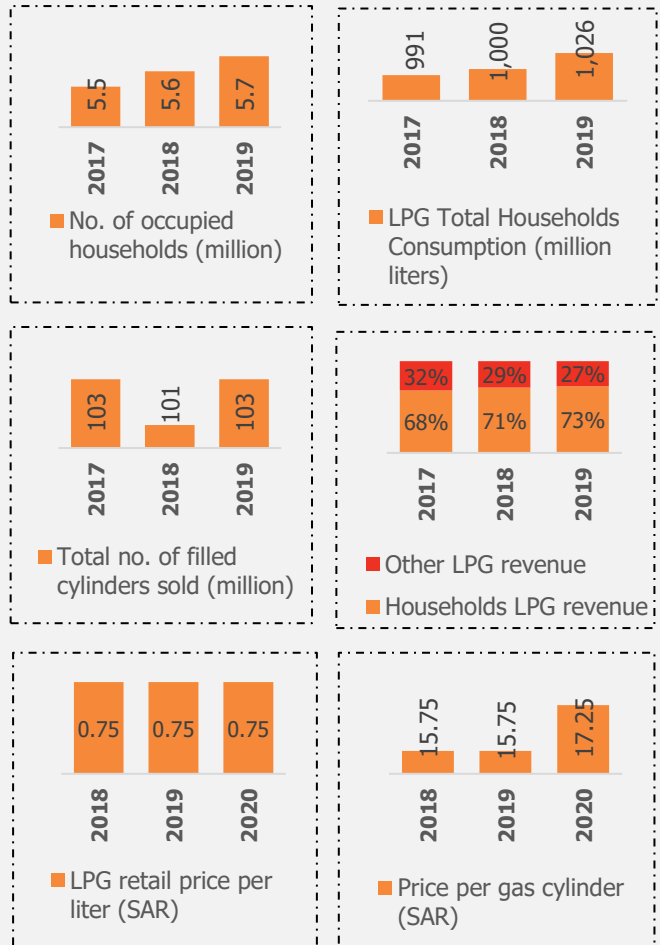
- Gas sales is GASCO's main segment accounting for 94% of total revenue during 2019 and 88% of total revenue during Q2 2020. The segment includes the sale of 11kg bottled gas cylinders as well as filling of users' tanks (which are offered in various sizes) with gas at their locations. Households are this segment's key users accounting for more than 70% of GASCO's gas revenues and more than 60% of demand for filled cylinders.
- Sale of empty gas cylinders and tanks accounted for 5% of GASCO's total revenues during 2019 and 11% of total revenues during Q2 2020. The segment includes the sale of 11kg gas cylinders and empty gas tanks with capacity ranging from 450 liters up to 7,000 liters. Cylinders recorded SAR37mn in revenues compared to SAR52mn during 2019.

## Key Shareholders

Name	Ownership (%)
Public Investment Fund	10.91%
Abdulaziz Abdulrahman Adulaziz Almohsen	6.66%

Source: Tadawul

## GASCO's Key Sales Highlights



Source: GASTAT, company disclosures, Itqan Capital research

## Subsidiaries and Associates

Name	Type	Ownership (%)	Business
Saudi Gas Cylinder Factory	Associate	37.57%	Gas cylinders and tanks manufacturing
Natural Gas Distribution Company	Associate	35.0%	Sale of dry gas
East Gas Company	Associate	35.0%	Maintenance & operation of dry gas distribution network

# Company Analysis

## Key Growth Catalysts

### Attractive Dividends Payout

- GASCO historically maintained a dividend payout ratio higher than 60% over the past years. Being currently in a mature business stage with relatively low CAPEX needs, the company is expected to continue to maintain a high dividend payout ratio especially given its strong liquidity and short cash conversion cycle. Even if CAPEX needs rise, GASCO has adequate debt capacity to finance any expansionary plans given its current low debt ratio (3.9%) and good liquidity position. We project a dividend payout ratio of 90% for GASCO in the forecast period.

### Operating in a Defensive Sector

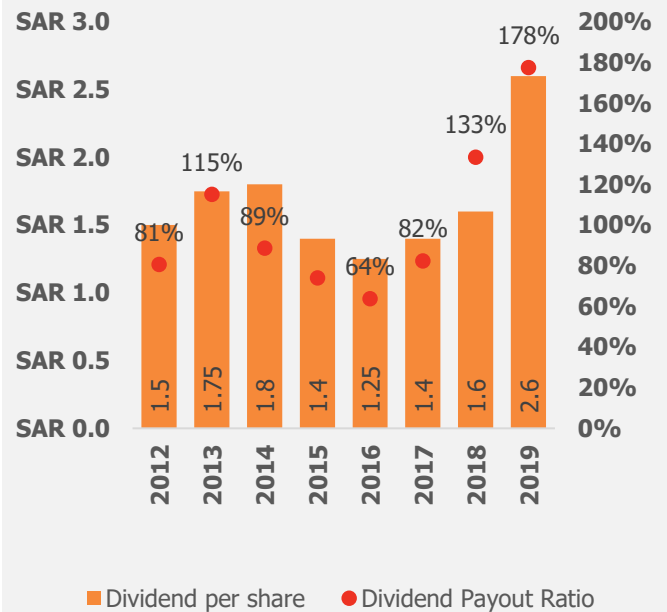
- While the majority of sectors in the Saudi economy are currently suffering from the repercussions of the economic slowdown and tightening consumer spending, GASCO should be able to weather weakening economic conditions. However, it's worth mentioning the company is not completely immune, given its exposure to commercial and manufacturing facilities which are currently experiencing lower demand. The company's beta stands at only 0.6, highlighting the status of GASCO as a recession proof company. Given current economic uncertainty and possible market correction, GASCO is considered as almost a safe haven compared to other sectors.

## Key Risk Factors

### Highly Regulated Sector

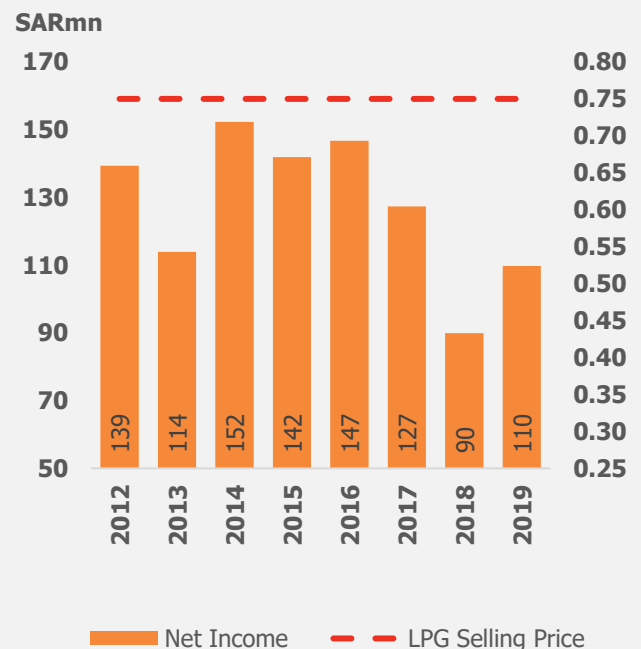
- GASCO is a provider of an essential product for households as well as commercial and manufacturing entities in the Kingdom which is forcing it to operate under a stringent regulatory environment. Around 94.7% of households in the Kingdom use LPG while less than 6% rely on electricity as their sole source of energy. GASCO purchases and sells LPG at fixed prices administered by the government, offering zero flexibility in adapting to changing market conditions and rising fixed costs. As a result, the company reported a 5-year net income CAGR of -5.0% and only 0.2% revenue growth during FY2015-2019.
- Additionally, being the only provider of LPG in the country, GASCO is forced to deliver its product to all areas in the Kingdom even if delivery to some areas is not profitable due to their low population density. Out of the 7 filling stations operated by GASCO, the company reports losses in 3 of them as some areas are not financially feasible, yet GASCO doesn't enjoy the flexibility of exiting those areas.

GASCO's Declared Dividends



Source: Company data, Itqan Capital research

GASCO's Net Income



Source: Company data, Itqan Capital research

# Company Analysis

## Lack of Cost Control

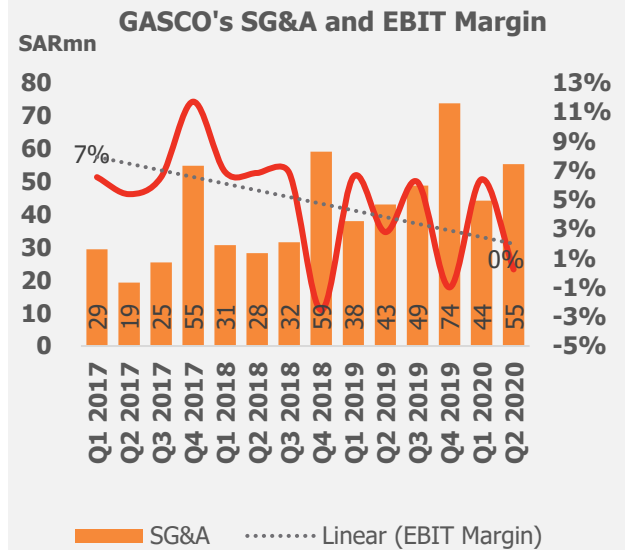
- Despite slow top-line growth over the past few years, GASCO's SG&A expanded by 84.1% between 2016-2019. The trend is continuing to date with SG&A rising by 28.4% Y-o-Y during H1 2020, mainly due to the rise in salaries and other expenses. For the past 3 years, GASCO reported losses during the fourth quarter, as a result of Q-o-Q surge in SG&A expenses resulting in net losses. EBIT margins fell from a high of 7.6% in 2017 to 3.6% in 2019 and 0.2% in Q2 2020. Continued cost rises on annual basis coupled with an expected slow growth outlook is expected to pressure GASCO's EBIT margins going forward.

## Weak Revenue Growth Outlook

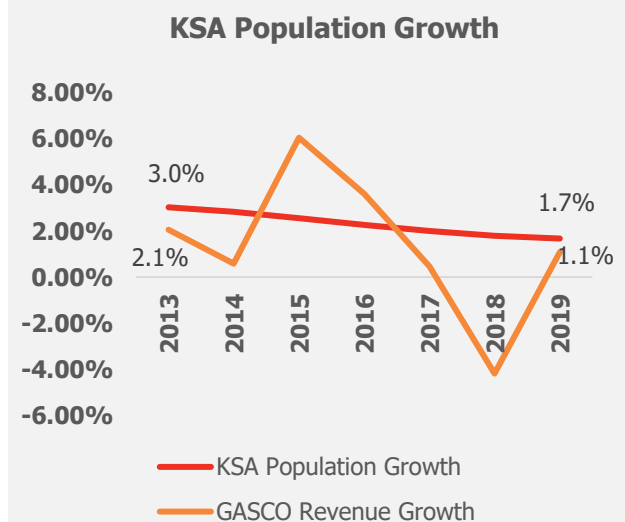
- Growth in demand for LPG in the Kingdom is mainly driven by population growth coupled with growth in economic sectors that use LPG as cooking fuel such as restaurants and hotels. Annual population growth in the Kingdom is around 2% with growth slowing down in recent years. The expected wave of expatriates' exodus in the Kingdom for 2020 might set further pressure on population growth in the Kingdom and accordingly lower demand for LPG. Non-Saudis account for more than 30% of households in the Kingdom and 26% of the population.
- Concerning demand from commercial sectors, restaurants and hotels are among the most hit sectors from current economic slowdown in the Kingdom which are likely to face significant demand pressures in the medium term, reducing their LPG consumption. Accordingly, we expect modest top-line and bottom-line expansion over the forecast period for GASCO driven mainly by the rise in number of households and gradual recovery in commercial demand.

## Possible Emergence of Competition

- During 2013, GASCO was awarded its last extension of franchise license, which used to be renewed every 5 years, which allowed it to operate as a monopoly of LPG filling in the Saudi sector for nearly 50 years. The Council for Competition Protection approved the end of GASCO's monopoly, allowing opening up of the LPG sector for competition for the first time in 50 years. This is bound to impose competitive pressures on GASCO's margins, which are already tightening from the fixed selling prices and rising costs, materially impacting profitability and cash generation. Besides, the sector would still likely remain highly regulated in terms of pricing and obligatory geographical presence for each market player in order to ensure no disruption of supply to consumers. For the mean time, we assumed continued 100% market share for GASCO over the forecast period, however, in the event of emergence of competition, this will result in a significant downside revision for our valuation.



Source: Company data, Itqan Capital research



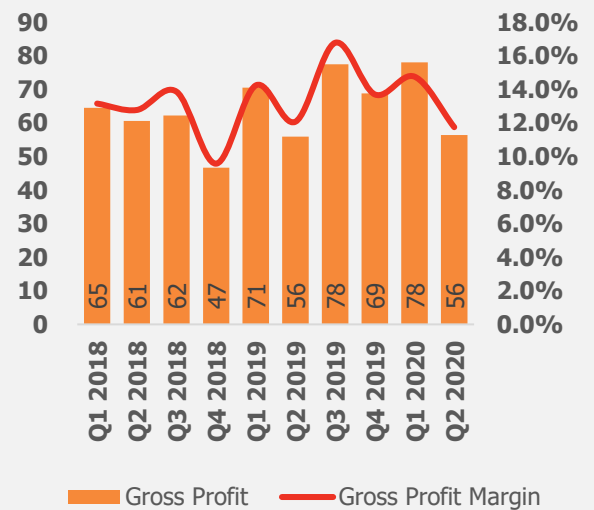
Source: World Bank, Company data, Itqan Capital research

# Company Analysis

## Financial Results

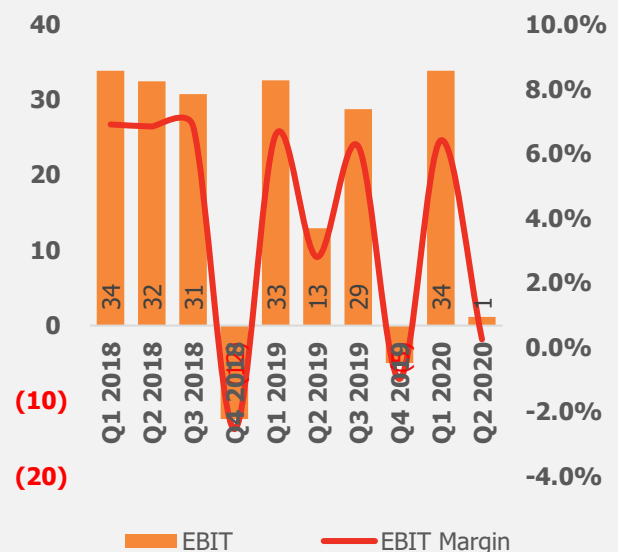
- GASCO's revenues increased by 3.6% Y-o-Y during Q2 2020 recording SAR480mn compared to SAR463mn in Q2 2019. Revenue growth was supported by the significant improvement in empty cylinder and tanks sales which surged by 187% Y-o-Y, while gas sales fell by 4.6%.
- Gross profit remained flat Y-o-Y rising by only 0.8% to record SAR56mn during Q2 2020. Gross margin dropped to 11.8% from 12.1% in Q2 2019 and 14.8% in Q1 2020.
- SG&A hit GASCO's EBIT during Q2 2020 erasing 90% of operating earnings which fell to only SAR1mn compared to SAR13mn and SAR34mn in Q2 2019 and Q1 2020, respectively. Salaries (accounting for 57% of SG&A) costs hiked by 21% Y-o-Y in H1 2020 in addition to the rise in provisions and other expenses. EBIT margin dropped to a record low of 0.2%.
- On the other hand, investment income supported GASCO's bottom line during Q2 2020 as it increased to SAR11mn compared to SAR2mn in Q2 2019 thanks to the rise in income from investment properties. Such rise in investment income is expected to continue in Q3 2020 and going forward as the company rented out a land for a fixed SAR242mn 20-year contract with a grace period ending in Q2 2020. Other non-operating income of SAR6mn (Q2 2019: SAR3mn) also contributed to net earnings growth.
- Income before zakat reported 84.6% rise due to the surge in investment income and other income. It's worth mentioning that the former contributed 80% to GASCO's bottom-line while EBIT contributed less than 10% to net income during Q2 2020.
- We expect continued pressure on GASCO's EBIT margins given the fixed selling prices, slow revenue growth, coupled with fast-growing SG&A costs. On the other hand, investment income coupled with direct costs efficiencies in cost of sales should support the company's bottom-line, partially offsetting the pressure on earnings.

GASCO's Gross Profit & GP Margin



Source: Company data, Itqan Capital research

GASCO's EBIT & EBIT Margin



Source: Company data, Itqan Capital research

# Valuation Rationale

## DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	163	165	166	166	166
Operating CF	176	159	159	160	159
Capex	(82)	(86)	(86)	(85)	(85)
FCFF	93	72	73	74	75
Stub Period (FCF to be discounted)	47	72	73	74	75
PV (FCFF)	45	65	61	57	53
WACC	7.7%	We valued GASCO using DCF approach, considering a WACC is equal to 7.7% (based on a risk-free rate of 3.25%, market risk premium 7.3%, Beta of 0.63).			
Perpetuity Growth	2.0%				
PV-FCFF	281	Based on the DCF valuation, the fair price of GASCO's share price is SAR30.1, which is lower than the traded value by 1.5%.			
PV-TV	932				
Net Debt	177				
Less: End of services benefits	(198)				
Add: Investments	1,064				
Intrinsic Value	2,256				
Shares Outstanding (mn shares)	75				
Equity value per share (SAR)	30.1				
CMP (28/09/2020)	30.55				
Upside / Downside (%)	-1.5%				

## Regional Peers

	Country	Code	Market Price (SR)	Market Cap (SRBN)	P/E	Sales (SRMN)	Net Income (SRMN)
<b>National Gas and Industrialization Co. (GASCO)</b>	<b>KSA</b>	<b>2080.SE</b>	<b>30.55</b>	<b>2,291</b>	<b>40.7</b>	<b>1,973</b>	<b>56</b>
Egyptian Natural Gas Holding Company	Egypt	EGAS.CA	15.49	372	14.5	920	26
Dana Gas PJSC	UAE	DANA.AD	0.72	5,030	NEG	398	(2)
National Gas Company SAOG (NGCI)	Oman	NGCI.OM	1.54	131	25.1	675	5.2
Muscat Gases (MGMC)	Oman	MGMC: MUS	2.06	62	17.7	150	4



# Valuation Rational

## Financial Ratios

	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Return on Average Assets (%)	4.5%	5.3%	4.7%	4.9%	5.2%	5.3%	5.4%
Return on Average Equity (%)	5.6%	6.8%	6.4%	6.7%	7.0%	7.2%	7.3%
Income Before Zakat Margin (%)	4.9%	6.2%	5.5%	5.7%	5.8%	5.9%	6.0%
Net Income Margin (%)	4.7%	5.7%	5.2%	5.4%	5.6%	5.6%	5.7%
Revenue Growth (%)	-4.2%	1.1%	1.7%	2.6%	1.9%	1.9%	1.6%
DPS	1.6	2.6	1.2	1.3	1.4	1.4	1.4
Payout Ratio	133.5%	177.6%	90.0%	90.0%	90.0%	90.0%	90.0%

## Income Statement

	2018A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Revenues	1,902	1,923	1,956	2,006	2,045	2,083	2,116
Cost of revenues	(1,668)	(1,650)	(1,674)	(1,715)	(1,745)	(1,775)	(1,800)
<b>Gross Profit</b>	<b>234</b>	<b>273</b>	<b>282</b>	<b>292</b>	<b>300</b>	<b>308</b>	<b>316</b>
SG&A	(150)	(204)	(210)	(218)	(225)	(232)	(239)
Other income, net	11	53	39	42	45	47	50
Zakat	(4)	(10)	(5)	(6)	(6)	(6)	(6)
<b>Net Income</b>	<b>90</b>	<b>110</b>	<b>102</b>	<b>108</b>	<b>114</b>	<b>117</b>	<b>121</b>

## Balance Sheet

	2018A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Current Assets	328	438	554	537	529	554	579
Non-Current Assets	1,738	1,676	1,668	1,663	1,659	1,655	1,651
<b>Total Assets</b>	<b>2,066</b>	<b>2,115</b>	<b>2,221</b>	<b>2,200</b>	<b>2,189</b>	<b>2,210</b>	<b>2,230</b>
Current Liabilities	229	313	374	370	343	348	353
Non-Current Liabilities	188	205	241	213	217	221	225
<b>Total Equity</b>	<b>1,649</b>	<b>1,596</b>	<b>1,606</b>	<b>1,617</b>	<b>1,628</b>	<b>1,640</b>	<b>1,652</b>
<b>Total Liabilities and Equity</b>	<b>2,066</b>	<b>2,115</b>	<b>2,221</b>	<b>2,200</b>	<b>2,189</b>	<b>2,210</b>	<b>2,230</b>

# Guide to Ratings and Disclaimer

## Guide to Ratings

<b>Buy</b>	An upside potential of more than 20% in 52-week period
<b>Overweight</b>	An upside Potential of more than 10% in 52-week period
<b>Neutral</b>	Will stay in the range of its value (up/down 10%) in a 52-week period
<b>Underweight</b>	A downside potential of more than 10% in 52-week period
<b>Sell</b>	A downside potential of more than 20% in 52-week period

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