



## Initiation Coverage

April 03, 2018

Recommendation	Neutral
Current Price (SAR)	19.8
Target Price (SAR)	18.6
Upside/Downside (%)	(6.0%)

As of March 30, 2018

## Key Data (Source: Bloomberg)

Market Cap (SAR bn)	13.3
52 Wk High (SAR)	20.30
52 Wk Low (SAR)	12.44
Total Outstanding shares (in mn)	669
Free Float (%)	86.9%

## TASNEE Vs TASI (Rebased)

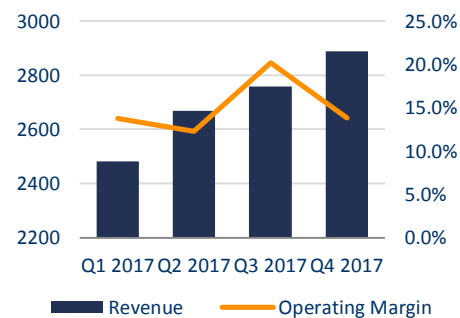


Price Performance (%)	Absolute	Relative
1m	10.1%	4.1%
6m	27.1%	19.0%
12m	13.4%	0.9%

## Major Shareholders (%)

General Organization for Social Insurance	8.69%
Kingdom Holding Co.	6.23%
Gulf Investment Corporation	5.58%

## Quarterly Sales (SAR mn) and Operating Margin

Source: Bloomberg, Company Financials, FALCOM Research; Data as of 30<sup>th</sup> March 2018

In FY 2017, National Industrialization Co. (Tasnee)'s top line grew 25.3% YoY to SAR 10.8bn, driven by an increase in average selling prices of certain products such as titanium dioxide (TiO<sub>2</sub>). Operating income rose 117.2% to SAR 1.6bn from SAR 0.7bn in 2016, led by improvement in operational performance and cost optimization initiatives. Tasnee's net profit for the period stood at SAR 0.7bn, vis-à-vis SAR 0.1bn recorded a year ago. Growth in the bottom line can be ascribed to lower taxes and higher other income. The company achieved positive results in spite of higher finance expenses due to loan re-scheduling and an increase in impairments.

Although the company posted positive results during the fiscal, we are skeptical about the company's business after its 79% owned subsidiary Cristal is selling the majority of its TiO<sub>2</sub> business assets to Tronox. Tasnee's chemicals segment, which produces TiO<sub>2</sub>, constitutes 74% of the company's total revenue, and post the deal's materialization, production capacity would reduce significantly. However, the deal would help in deleveraging the company's balance sheet. Considering these aspects, we remain "neutral" on the stock until further developments.

## Ambiguity over Tasnee's long-term outlook due to Tronox deal

Tasnee's subsidiary Cristal signed an agreement with Tronox to sell its TiO<sub>2</sub> business in exchange for SAR 3.27bn in cash and 24% stake in the combined entity. Tasnee's management believes the deal would deleverage the company's balance sheet, transfer its geographically diverse assets, and help it concentrate on the petrochemicals business. However, following the deal, Cristal's production capacity would decline considerably, which could have a direct impact on the company's top line. Moreover, the TiO<sub>2</sub> business is expected to be under the direct control of Tronox, which would own 76% of the combined entity. Hence, we believe in the event of deal materialization, uncertainty looms over Tasnee's long-term outlook.

## Unlikely to pay dividends in foreseeable future

Tasnee has not paid any dividends from 2016 due to high debt obligations and capital expenditure on the Jazan plant. The company's total borrowings amount to SAR 15.6bn on the balance sheet; and even after using the proceeds (SAR 3.27bn) from the Tronox deal, a significant amount of debt would still remain. We believe although the company's capex may not be as high as in the past, most of its operating cash flow would be used in debt servicing, thereby translating into zero dividend pay-outs.

## Rising propylene and polypropylene prices to drive petrochemical business

Tasnee relies heavily on its two subsidiaries Saudi Polyolefin Company (SPC) and Saudi Ethylene and Polyethylene Company (SEPC) for the petrochemical business. Both SPC and SEPC produce propylene and polypropylene (PP) in addition to ethylene and polyethylene. An increase in propylene and PP prices by 22.11% and 9.8% YoY, respectively, in 2017 translated into an increase of 48.6% YoY in revenues from the petrochemical segment. Rising demand for propylene and PP from China and the Indian subcontinent would further drive prices. Tasnee's petrochemical business is expected to benefit from this trend.

## The downstream segment provides diversification into the non-oil sectors

Tasnee's downstream segment consists of diverse businesses, such as the production of liquid batteries, plastic products, and sodium sulphate and lead. The segment's revenue increased 8.5% YoY to SAR 1.0bn in 2017. We believe the segment could safeguard the company in the future against economic downturn caused by low oil prices.

**Valuation:** We valued Tasnee using the DCF Approach to arrive at a fair value of SAR 18.6 per share. We considered WACC at 8.2%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	10.8	11.3	11.4	11.5
Operating Profit (SAR bn)	1.6	1.9	2.0	2.0
EPS (SAR)	1.1	1.2	1.3	1.4
Operating Margin (%)	15.0%	16.7%	17.3%	17.8%
D/E (x)	1.3	1.1	0.9	0.8
RoE (%)	6.1%	5.9%	5.8%	5.7%
P/E (x)	15.2	16.7	15.3	14.2
Price/BV (x)	0.9	1.0	0.9	0.8
EV/EBITDA (x)	10.3	10.6	10.0	9.4

Source: Company Financials, FALCOM Research



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## Valuation Summary

## Explanation of valuation methodology and assumptions

We valued Tasnee using the DCF Approach to arrive at a fair value of SAR 18.6 per share. We considered WACC at 8.2% with a terminal growth rate of 2.0%. In relative terms, Tasnee is trading at 1yr forward P/E of 16.7x, at a premium of 3.2% to its sector peers and premium of 20.4% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	1,624	1,882	1,961	2,045	2,128	
Taxes	9	(160)	(174)	(187)	(200)	
Depreciation, amortization and impairment	853	900	947	994	1,042	
Changes in working capital	(202)	(201)	(85)	(110)	(86)	
Net capital expenditure	(898)	(963)	(966)	(976)	(979)	
<b>Free Cash Flow to firm</b>	<b>1,386</b>	<b>1,458</b>	<b>1,682</b>	<b>1,766</b>	<b>1,904</b>	
Discount Factor		0.9	0.9	0.8	0.7	
<b>PV of free cash flow to firm</b>		<b>1,374</b>	<b>1,465</b>	<b>1,422</b>	<b>1,417</b>	
<b>Net Present Value (A)</b>					<b>5,677</b>	
<b>Terminal Value</b>					31,328	
<b>PV Terminal Value (B)</b>					<b>23,312</b>	
<b>Assumed Terminal Growth Rate</b>					<b>2.0%</b>	
<b>Discount Rate</b>					<b>8.2%</b>	
<b>Enterprise Value (A+B)</b>	<b>28,989</b>	<b>WACC Assumptions</b>				
Total Cash	2,535	Risk free rate				2.6%
Total Debt	15,617	Equity Risk Premium				9.2%
Minority Interest	3,438	Beta				1.1x
<b>Equity Value in SAR mn</b>	<b>12,469</b>	<b>Cost of equity</b>				<b>13.1%</b>
Number of shares in mn	669	<b>Post tax cost of debt</b>				<b>4.5%</b>
<b>Target Price in SAR per share</b>	<b>18.64</b>	Weight of equity in capital structure				43.0%
<b>CMP in SAR as on March 30<sup>th</sup>, 2018</b>	<b>19.82</b>	Weight of debt in capital structure				57.0%
Upside/(Downside) to current market price	(6.0%)	<b>WACC</b>				<b>8.2%</b>

Source: Company Financials, FALCOM Research Estimates

## Risks

## Upside Risks:

- Higher-than-expected rise in TiO2 and PP prices will result in stronger than expected revenue growth.
- Higher than expected cash flows from the sale of unprofitable business assets.

## Downside Risks

- In the event of deal materialization, Tronox being the major shareholder of the combined entity might decide to shut down some of Cristal's plants.
- Increase in SIBOR rates might increase the finance cost for the company.
- Higher than expected rise in operating costs for Jazan plant might hurt Tasnee's margins.

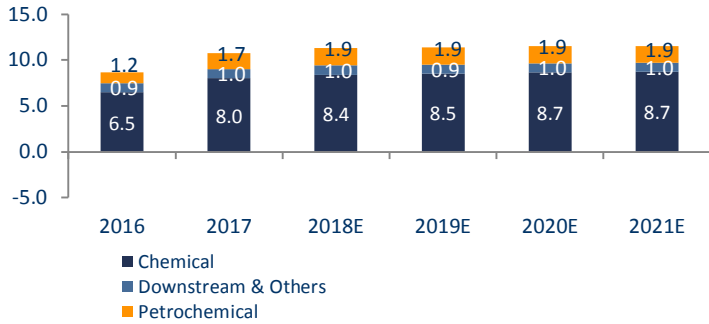


Initiation Coverage

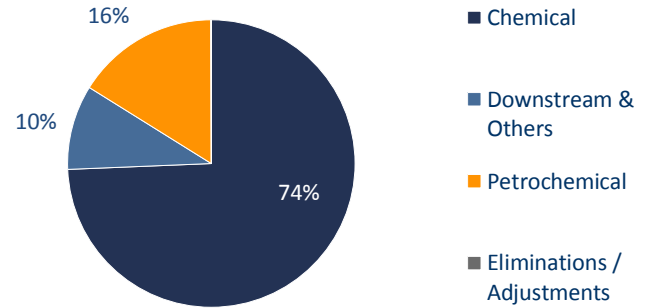
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Key Charts

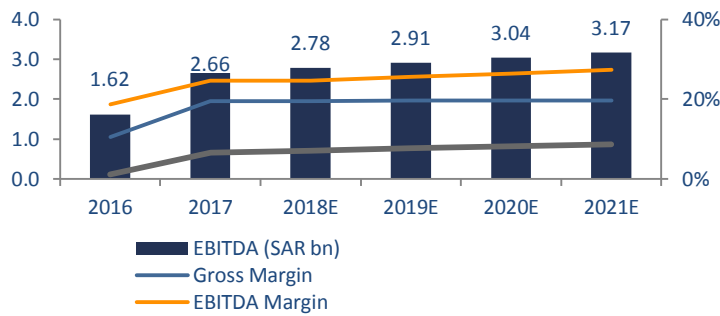
Revenue (SAR bn)



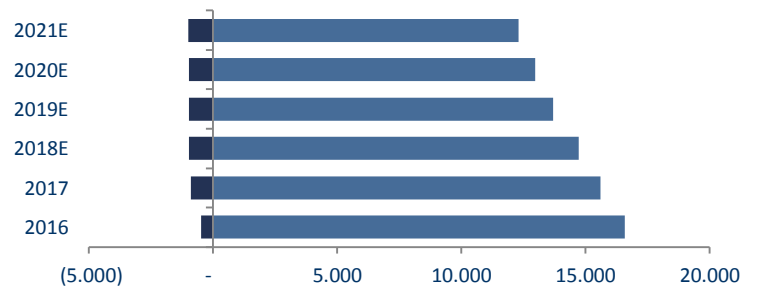
Revenue Split (2017)



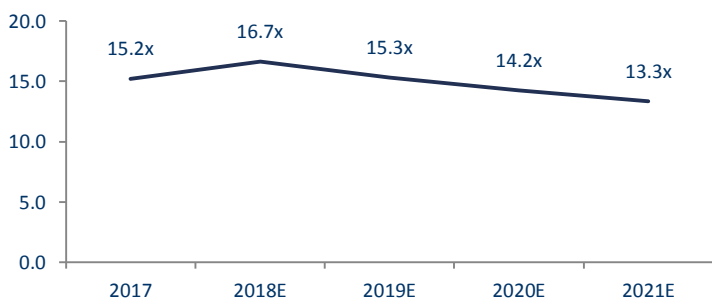
EBITDA & Margins



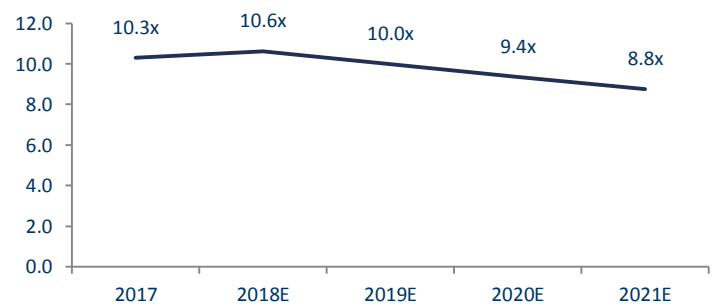
CAPEX and Debt



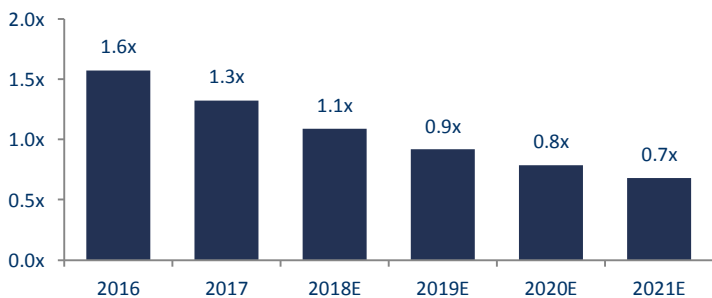
Price to Earnings



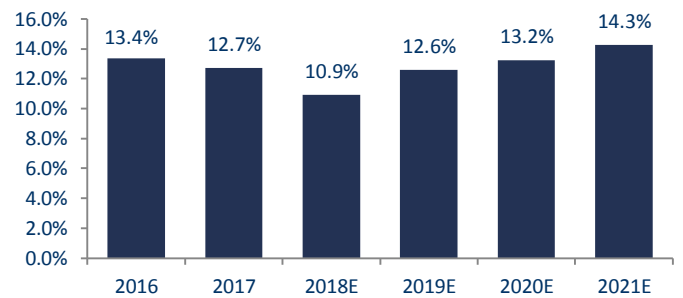
EV/EBITDA



Debt to Equity



Free Cash Flow Yield



Source: FALCOM Research Estimates



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## Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	10,796	11,292	11,354	11,499
Gross Profit	2,104	2,206	2,224	2,258
EBITDA	2,662	2,782	2,907	3,039
EBIT	1,624	1,882	1,961	2,045
Net Interest	(706)	(666)	(620)	(587)
Other	231	242	243	246
PBT	1,149	1,458	1,584	1,704
Zakat	9	(160)	(174)	(187)
Minorities	(442)	(495)	(538)	(579)
Net Income	716	802	872	938
EPS	1.1	1.2	1.3	1.4
DPS	-	-	-	-

BS (SAR mn)	2017	2018E	2019E	2020E
Cash and cash equivalents	2,535	2,897	2,933	3,387
Current Assets (excluding cash)	7,105	7,413	7,500	7,630
Fixed assets	9,328	9,392	9,413	9,396
Intangibles	2,818	2,817	2,816	2,815
<b>Total Assets</b>	<b>33,993</b>	<b>34,961</b>	<b>35,346</b>	<b>36,164</b>
Current Liabilities	5,574	5,639	5,595	5,565
Long Term Debt	14,786	13,940	12,958	12,290
Shareholders Equities	11,790	13,539	14,948	16,465
<b>Total Liabilities</b>	<b>33,993</b>	<b>34,961</b>	<b>35,346</b>	<b>36,164</b>

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	1,733	1,622	1,731	1,838
Working Capital Changes	(202)	(201)	(85)	(110)
Cash Flow from Operating Activities	1,530	1,421	1,646	1,728
Capex	(898)	(963)	(966)	(976)
Cash Flow from Investing Activities	441	(1,118)	(1,122)	(1,133)
Changes in Debt	(978)	(889)	(1,026)	(719)
Dividends	-	-	-	-
Cash Flow from Financing Activities	(1,867)	58	(488)	(140)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	25.3%	4.6%	0.5%	1.3%
EBITDA	64.8%	4.5%	4.5%	4.5%
Operating profit	117.2%	15.9%	4.2%	4.3%
PBT	200.4%	26.9%	8.7%	7.6%
Net Income	606.1%	12.0%	8.7%	7.6%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	19.5%	19.5%	19.6%	19.6%
EBITDA Margin	24.7%	24.6%	25.6%	26.4%
EBIT Margin	15.0%	16.7%	17.3%	17.8%
Net Margin	6.6%	7.1%	7.7%	8.2%
ROE	6.1%	5.9%	5.8%	5.7%
ROCE	5.7%	6.4%	6.6%	6.7%
ROA	2.1%	2.3%	2.5%	2.6%
Debt/Equity	1.32	1.09	0.92	0.79
Net Debt/EBITDA	4.91	4.25	3.70	3.16
FCF Yield	12.7%	10.9%	12.6%	13.2%
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Valuation	2017	2018E	2019E	2020E
PE	15.2x	16.7x	15.3x	14.2x
PB	0.9x	1.0x	0.9x	0.8x
EV/EBITDA	10.3x	10.6x	10.0x	9.4x
EV/EBIT	16.9x	15.7x	14.8x	13.9x
EV/Sales	2.5x	2.6x	2.6x	2.5x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Advanced Petrochemical Company	14.0x	11.1x
Saudi Kayan Petrochemical	16.7x	8.7x
Yanbu National Petrochemicals	16.3x	10.9x
Saudi Arabia Fertilizers	22.6x	16.9x
Saudi Basic Industries	16.1x	8.3x
Saudi Industrial Investment Group	9.6x	8.3x
National Petrochemical Company	15.4x	9.8x
<b>National Industrialization Company</b>	<b>16.7x</b>	<b>10.6x</b>
<b>Sector Median</b>	<b>16.1x</b>	<b>9.8x</b>
<b>TASI</b>	<b>13.8x</b>	<b>11.6x</b>



## FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

**Overweight:** The Target share price exceeds the current share price by  $\geq 10\%$ .

**Neutral:** The Target share price is either more or less than the current share price by 10%.

**Underweight:** The Target share price is less than the current share price by  $\geq 10\%$ .

**To be Revised:** No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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