

National Industrialization Co.

Petrochemical-Industrial

NIC AB: Saudi Arabia

26 November 2011

الراجحي المالية
Al Rajhi Capital



US\$5.47bn Market cap
87.7% Free float
US\$11.04mn Avg. daily volume

Target price **49.60** 34.9% over current
Consensus price **50.00** 35.9% over current
Current price **36.80** as at 23/11/2011

Research Department

ARC Research Team

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Underweight

Neutral

Overweight

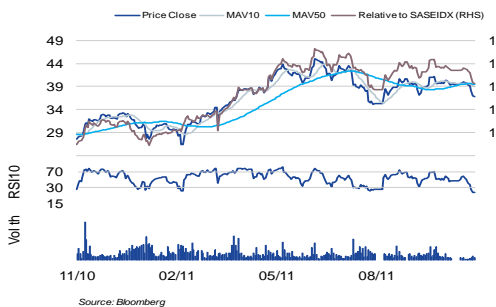
Key themes

We expect Saudi petrochemicals suppliers to outperform global rivals with margins driven by cheap feedstock costs and strong demand coming from Asia. We believe a shift towards heavier, more expensive feedstock in plants from now on will not constrain profits growth as improving prices and higher volumes should offset the higher costs.

Implications

With the well-diversified product portfolio, NIC is one of our top picks. Capitalizing on the cost advantage, the company is moving up in the petrochemicals value chain by offering high-margin specialty chemicals. We believe that the company's healthy dividends and earnings visibility supports our investment case.

Performance



Earnings

| Period End (SAR) | 12/10A | 12/11E | 12/12E | 12/13E |
|------------------|--------|--------|--------|--------|
| Revenue (mn) | 15,989 | 20,061 | 20,553 | 21,549 |
| Revenue Growth | 47.2% | 25.5% | 2.5% | 4.8% |
| EBITDA (mn) | 4,350 | 7,079 | 7,170 | 7,596 |
| EBITDA Growth | 75.6% | 62.7% | 1.3% | 5.9% |
| EPS | 2.91 | 4.66 | 4.83 | 5.05 |
| EPS Growth | 157.7% | 60.4% | 3.6% | 4.6% |

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

National Industrialization Co. Poised for a long haul

We like NIC's diversified business model (presence in industrial and petrochemical segments), which partially cushions the company from the current turbulent environment. Despite near-term headwinds, we believe NIC will continue to deliver a solid performance on the back of robust TiO₂ demand outlook leading to higher margins from the industrial segment and additional production of advanced petrochemicals from late 2013. Further, NIC's healthy balance sheet enables the company to pursue acquisition-oriented growth strategy as well as support healthy dividend payouts. Therefore, we initiate coverage on NIC with an Overweight rating and a target price of SAR49.6.

Resilient business model: NIC has a unique business model compared to other Saudi petrochemical peers, as it is a combination of volatile petrochemical business and relatively stable industrial business. Different characteristics of these two segments and a robust TiO₂ price outlook provide stability to the company and make it partially immune to the volatility in petrochemicals prices, especially in the current times.

TiO₂ business to benefit from robust demand outlook: NIC is the world's second largest and Middle East's only producer of Titanium Dioxide (TiO₂). The company has followed an acquisition-oriented growth path for this segment and acquired multiple assets in 2008-2009. We expect demand for TiO₂ to grow both from emerging and developed markets amid supply constraints, which augurs well with rising prices in the medium term. Banking on the healthy TiO₂ prices, we expect NIC to report a strong revenue growth in the industrial segment with an improvement in operating margin over the next few years.

Move-up the value chain to benefit Petrochemicals segment: NIC's petrochemical business is engaged in production of basic petrochemicals such as ethylene, propylene and its derivatives. However, the company is building facilities with a focus on advanced petrochemicals such as acrylic acid, which will commence operations in late 2013. We expect the segment performance to be negatively affected by lower product prices and volatile demand environment in the near term. However, the company will benefit from the move-up in the value chain and higher margins on advanced products in the medium term.

Improving balance sheet with healthy operating cash-flow: NIC has a well managed balance sheet with net debt to equity ratio of 0.8x and cash balance of SAR4.2bn as of Q3 2011. We expect NIC to post healthy revenue growth with operating margin of more than 28% in 2012. With strong operating cash flows, we expect net debt to EBITDA ratio to decline moderately over the medium term, which will enable NIC to maintain dividend payout of ~30% as well as seek attractive acquisition opportunities.

Valuation: eye catching at current level, we value NIC using a blend of long-run DEP forecasting (70% weight) and comparative multiple analysis (30%). We assign Overweight rating to NIC and a target price of SAR49.6 per share, given its unique business model and its ability to grow even during times of crisis. The stock is currently trading at 2012 P/E multiple of 7.6x compared to peer average of 8.0x. Further, we expect the company to increase its dividends to SAR1.5 per share in 2011 (from SAR1 in 2010), implying a dividend yield of 4.1%.



| Page | |
|------|---|
| 3 | Well-diversified portfolio Resilient business model NIC's revenue distribution is a mix of different products (TiO ₂ and petrochemicals) catering to various geographies, which provides stability to the business model and makes it immune to the volatility in petrochemical prices. |
| 6 | TiO₂: Outlook remains attractive Second largest TiO₂ producer globally With a 13% market share in 2010, NIC is the world's second largest and the Middle East's only producer of TiO ₂ . TiO ₂ produced by the company is mainly used in the paints industry. Over the last few years, NIC has expanded the TiO ₂ business inorganically by acquiring assets in Australia and North America. Robust performance to continue in the medium-term After the 2008 financial crisis, demand for TiO ₂ has been outpacing stagnant supply, leading to a run-up in prices. We expect NIC to post healthy revenue growth in the industrial segment in the coming period on the back of improving prices. |
| 10 | Growing petrochemicals business Benefiting from lower cost and proximity to demand centers Saudi petrochemicals players including NIC were able to increase market share globally due to their impressive cost structure, as feedstock is heavily subsidized by the Saudi government. Petrochemicals companies are leveraging this advantage to expand in the emerging markets. Moving up the value chain by introducing advanced products We see specialty chemicals as a future area of growth within the Saudi petrochemicals industry. We believe NIC is well placed to expand its portfolio in the petrochemical segment by focusing on high-margin and value added chemicals such as acrylic acid and its derivatives. |
| 14 | Financial Performance: We expect NIC's revenues to grow by 9.9% CAGR during the period 2010-2015 on the back of healthy growth in TiO ₂ business and additional production from the acrylic acid project, despite near-term headwinds to petrochemical prices. We expect the company's net margin to remain healthy in the near-term, benefiting from favorable TiO ₂ prices. |
| 19 | Valuation We rate NIC Overweight and set a target price of SAR49.6, implying 34.9% upside potential. Our target price is based on a blend of long-run discounted economic profit (fair value SAR50.8/share with 70% weight) and comparative multiples analysis (SAR46.9/share with 30% weight) valuation methods. |
| 23 | Company financial data |



Corporate summary

Established in 1985, NIC is the first Saudi joint stock industrial company fully owned by the private sector. At present, the government owns 8.2% through the General Organization for Social Insurance. NIC is the world's second-largest and the Middle East's only TiO2 producer. TiO2 produced by the company is mainly used by the paints industry. NIC also produces basic petrochemicals (total production capacity of about 3.3mtpa). The company is currently building acrylic acid unit, which is expected to start production by the end of 2013.

Share information

| | | | |
|---|------------------|------|-------|
| Market cap (SAR/US\$) | 20.51bn / 5.47bn | | |
| 52-week range | 26.36 - 45.10 | | |
| Daily avg volume (US\$) | 11.04mn | | |
| Shares outstanding | 557.4mn | | |
| Free float (est) | 87.7% | | |
| Performance: | 1M | 3M | 12M |
| Absolute | -7.8% | 4.8% | 30.2% |
| Relative to index | -7% | 2% | 33.5% |
| Major Shareholder: | | | |
| Al-Shair Co. for Trading, Industry GOSI | | | 8.4% |
| | | | 8.2% |

Source: Bloomberg, Al Rajhi Capital

Valuation

| Period End | 12/10A | 12/11E | 12/12E | 12/13E |
|--------------------|--------|--------|--------|--------|
| Revenue (SARmn) | 15,989 | 20,061 | 20,553 | 21,549 |
| EBITDA (SARmn) | 4,350 | 7,079 | 7,170 | 7,596 |
| Net Profit (SARmn) | 1,473 | 2,598 | 2,690 | 2,815 |
| EPS (SAR) | 2.91 | 4.66 | 4.83 | 5.05 |
| DPS (SAR) | 1.00 | 1.50 | 1.50 | 1.52 |
| EPS Growth | 157.7% | 60.4% | 3.6% | 4.6% |
| EV/EBITDA (x) | 9.2 | 6.1 | 5.8 | 5.3 |
| P/E (x) | 12.7 | 7.9 | 7.6 | 7.3 |
| P/B (x) | 2.0 | 1.8 | 1.6 | 1.4 |
| Dividend Yield | 2.7% | 4.1% | 4.1% | 4.1% |

Source: Company data, Al Rajhi Capital

National Industrialization Co. Leveraging on balanced growth

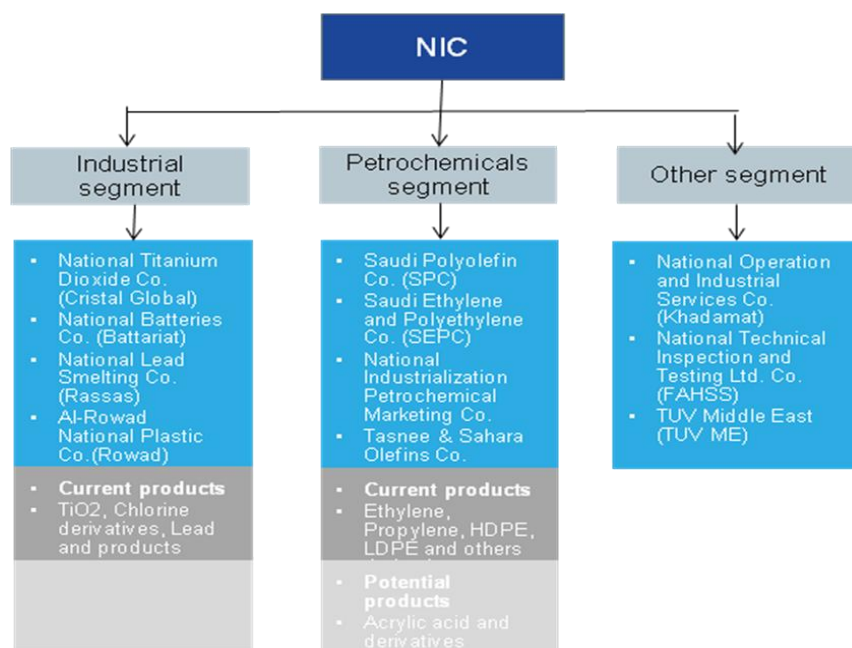
Set for the long haul on the back of diversified product portfolio

Resilient business model

National Industrialization Company's (NIC) resilient business model makes the company attractive in the current volatile environment. The company's revenue distribution is an assorted mix of different products and geographies. NIC operates under two major segments - industrial and petrochemical. The latter, which benefits from cost advantage, mainly targets the growing Asian economies, while the steady industrial segment (mainly TiO2 products) focuses on developed economies like the US and Europe.

These different characteristics of the two business segments (with approximately 50:50 revenue distribution in 2010) provide stability to the business and make it immune to the volatility in oil prices, especially in times of economic downturn.

Figure 1: NIC group structure



Source: Company data



World's second-largest and the Middle East's only TiO2 producer

Low input cost, key advantage for the petrochemical segment

Rising TiO2 prices have stabilized the company's margins in the turbulent times

Favorable demand supply mix to fuel TiO2 growth

The company is the second-largest processor of TiO2 globally, and the only producer in the Middle East through its subsidiary Cristal Global and the mining assets in Bemax (Australia). TiO2 business (production capacity of 0.79mtpa) benefits from the improved demand-supply matrix as we expect the emerging markets to drive strong demand for TiO2 along with global economic recovery. Further, we expect demand from developed markets to increase on redevelopment and renovations of the existing real estate properties. On the supply side, we do not foresee any major capacity additions over the next few years, which can result in supply tightening, exerting upward pressure on the prices in the near-term. We will discuss the TiO2 supply demand dynamics and future performance of the division in detail later in this report.

Petrochemical segment benefits from significant cost advantage

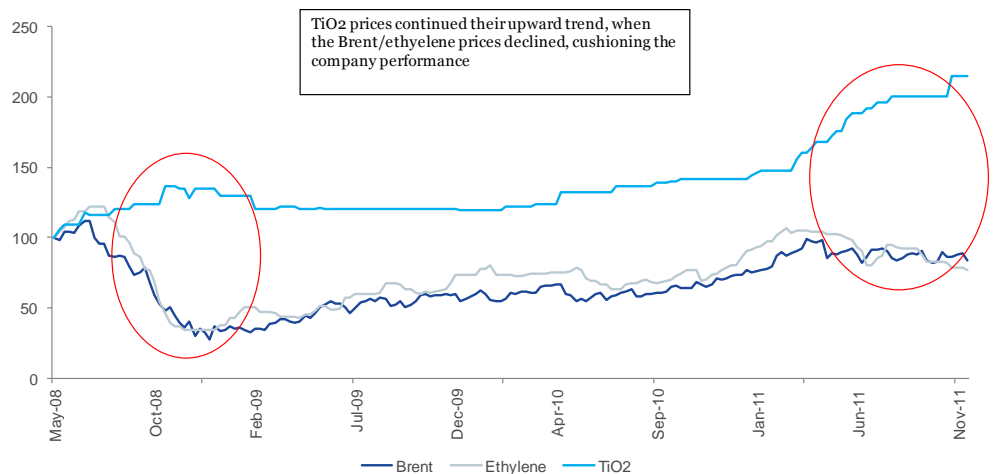
Similar to its peers in Saudi Arabia, the company's petrochemical segment benefits from cheap feedstock cost advantage and proximity to Asian markets. NIC procures gas at a subsidized price of US\$0.75/mmbtu from the state-owned Saudi Aramco, as against the global average price of US\$4-5/mmbtu. As feedstock-related costs account for a sizable portion of the total cash costs, this feedstock subsidy has transformed Saudi Arabian petrochemicals companies into low-cost producers globally.

Revenue contribution from the petrochemical segment increased from about 25% (industrial segment contributed 62%) in 2007 to 47% (industrial – 51%) in 2010 due to capacity expansions in 2009. The company is currently setting up Saudi Acrylic Monomer Company for production of acrylic acid and its derivatives in Al Jubail Industrial City, which is expected to launch commercial production by the end of 2013. Though the short-term headwinds from macroeconomic concerns remain, we expect the company to benefit from this capacity addition as advanced petrochemicals command better margins and are more resilient to the economic downturns. We will talk about the petrochemical product prices and future performance of the division in a detailed manner later in this report.

Diversified product portfolio ensures stable margins

As can be seen in the chart below, during the 2008-09 financial crisis and during the period April-November 2011, Brent prices were under pressure on escalating macroeconomic concerns and a weak demand outlook. Ethylene (basic petrochemical product) prices also declined in line with Brent prices. However, TiO2 prices rose during both these periods on strong demand, thereby enabling the company to report relatively stable gross margin.

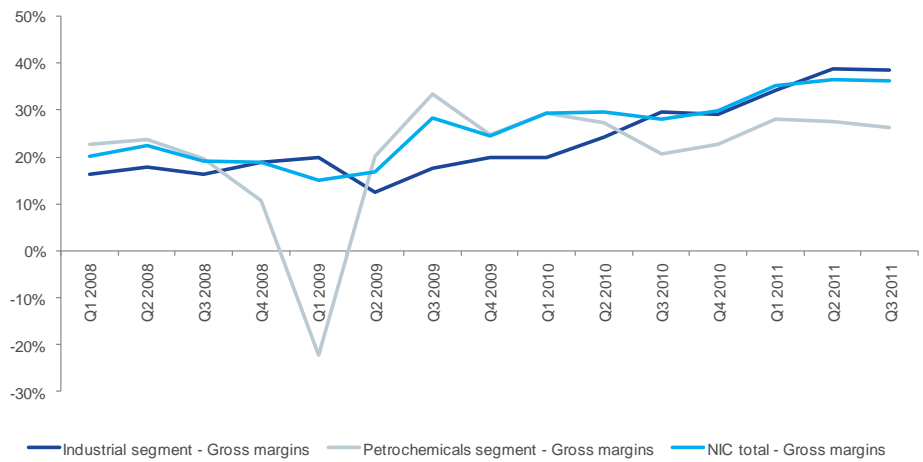
Figure 2 Product prices index



Source: Bloomberg, Al Rajhi Capital



Figure 3 Balanced portfolio paves way for stable gross profit margins



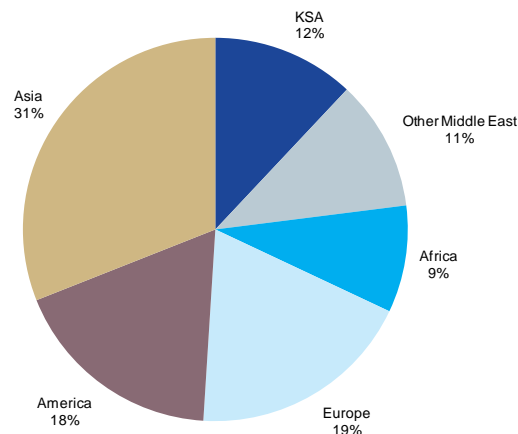
Source: Company data

Emerging markets present a huge opportunity

Well diversified revenue mix

The major demand centers for the petrochemical segment are China, India and other emerging markets, while the industrial segment focuses on the developed markets such as the US and Europe. In 2010, the company generated 31% of its revenues from Asia and 37% from the developed markets (the US and Europe). This well diversified regional revenue distribution reflects a sound corporate strategy, which alleviates risks for individual markets. We believe the company will seek to further penetrate the emerging markets on account of strong economic growth expected in countries like China and India.

Figure 4: Revenue distribution by regions (2010)



Source: Company data

We expect earnings to grow at a CAGR of 19.2% during 2010-2015

Robust performance ahead

We expect NIC's plants to continue operating at more than 90% levels in the medium-term (90-95% utilization in 2010) to meet growing demand. On the pricing part, a blend of fixed price contracts (Asian sales) and spot market contracts (sales to US markets) provides earnings visibility coupled with an opportunity to benefit from short-term volatility in prices. We estimate the company's total revenues to grow at 9.9% CAGR during 2010-2015, reaching SAR25.6bn by 2015, and net earnings to grow at 19.2% CAGR during the same period, reaching SAR3.5bn owing to improved demand and prices particularly for the industrial segment as well as rising utilization levels. We expect the company to achieve a 76% increase in net profit y-o-y in 2011 on the back of robust TiO₂ prices.



TiO₂ business Outlook remains attractive

TiO₂ is used extensively in paints, inks and construction material.

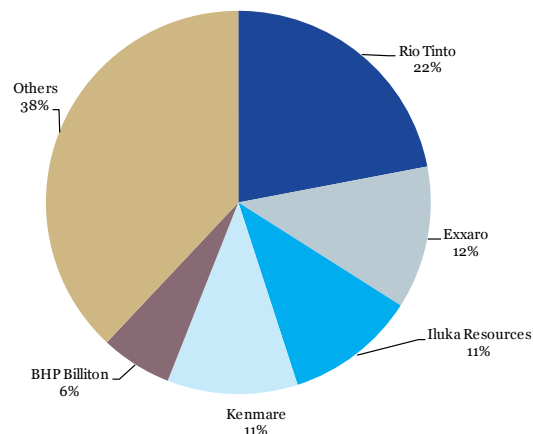
Titanium dioxide (TiO₂) is an inorganic material derived from heavy mineral sands containing Rutile or Ilmenite ores. Other sources are Titanium Slag, Leucoxene, and synthetic Rutile. As TiO₂ has one of the highest refractive indices, it is used extensively as the pigment for producing the effect of white color in paints, inks, plastics and paper.

The raw material: The main feedstocks for TiO₂ are Ilmenite & Rutile ores, which contain 45-65% and ~95% TiO₂ content respectively. Ilmenite is the widely used TiO₂ ore as it is abundantly available in the coastal areas of Australia, South Africa, India, Brazil, Madagascar, and the US. The Rutile deposits, though rich in TiO₂ content, are relatively rare, with production being carried out only in the US, South Africa and Australia. The known reserves of Rutile are only 42mt globally and as a result, the global production was only 0.58mt in 2010 and we expect it to remain stable over the long term. The largest reserves of Rutile sands are in Australia (18mt) with production close to 0.45mt in 2010.

TiO₂ reserves are located in Australia and South Africa

Major feedstock producers: In 2010, the top five TiO₂ feedstock producers accounted for nearly 62% of the 6.3mt of global Ilmenite & Rutile production, which was 9% higher year-on-year. Rio Tinto is the largest supplier of both Ilmenite & Rutile ores, with production of nearly 1.4mt (~22% market share). Geographically, Australia and South Africa were the largest suppliers of feedstock, with a combined production of nearly 2.2mt in 2010.

Figure 5: Major TiO₂ feedstock producers globally (2010)



Source: Industry data

Processing: The processing of TiO₂ is carried out by two commercial processes: sulphate process and chloride process. The sulphate process involves the treatment of ore with sulphuric acid to produce pure TiO₂. The chloride process is the advanced process, developed by DuPont in the early 1960s, which involves the treatment of ore with chlorine. The chloride process is more cost efficient as well as green, but the intellectual property rights (IPRs) are very tightly controlled by DuPont.

The large TiO₂ processors are from the US and the Europe, with smaller players having a presence in China.

Major TiO₂ processors: The top five TiO₂ processors account for more than 60% of production capacity. DuPont (20% production capacity) is the largest processor, followed by NIC's subsidiary Cristal Global (13%). Other large players include Huntman (UK), Kronos (US) and Tronox (US).

End-users: The paints and coatings industry is the largest consumer of TiO₂, which represents 59% of total consumption, followed by plastics (26%), paper (9%), and ink &



NIC is the only TiO2 producer in the Middle East region.

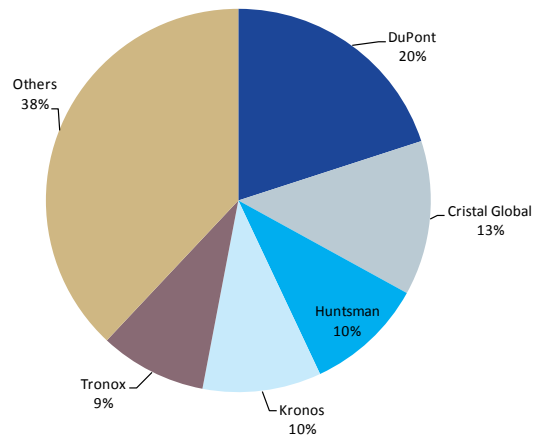
others (6%). TiO2 is also used in food and medicines; however, it requires approvals from various regulatory bodies such as Food & Drug Administration in the US.

Substitutes for TiO2: Aluminum silicate and calcium ciliate can be the substitutes for TiO2 in paint, coatings, ink etc. However, these are only partial replacements for TiO2 due to their lower opacity. In most of the cases, these products are combined with TiO2 to achieve required quality levels. Hence, we believe increase in TiO2 prices will not lead to a significant impact on its demand in near future.

One of the largest TiO2 producers with global presence

NIC is the only producer of TiO2 in the Middle East and the second-largest producer of TiO2 pigments globally (13% market share in 2010) through its subsidiary Cristal Global (66% stake) and the mining assets in Bemax. The company has eight manufacturing plants with a total TiO2 production capacity of 0.79mtpa. It started with 50,000 tpa capacity at its Yanbu plant, and turned it into a global footprint with the acquisition of Millennium Inorganic at a cost of US\$1.2bn in 2007. Along with TiO2, Cristal Global is engaged in the production of titanium chemicals, specialty TiO2, titanium metal and other products, which are mainly used in paints, inks, and plastics.

Figure 6: Major TiO2 producers globally (2010)



Source: Industry data

Over the last few years, NIC continued its acquisition-oriented growth strategy for TiO2 business. It acquired two companies - Bemax and International Titanium Powder (ITP) in 2008. Bemax is a producer of TiO2 feedstock and owns two large tracts in Australia for the mining of Rutile and Ilmenite ores, while ITP is a producer of titanium powder, one of the end-products of TiO2. These acquisitions have enabled the company to have a presence in both feedstock production and end-market application of TiO2, hence providing Cristal Global with a partial backward as well as forward integration. We believe that the company will seek attractive acquisition opportunities in both upstream and downstream activities. However, we expect the company to mainly focus on securing feedstock reserves (backward integration), which will ensure healthy margins and lower volatility in raw material prices.

Buoyant demand with stable supply creates a favorable price scenario

Despite a stable demand in the last few decades, TiO2 prices were under pressure for most of the period because of excess capacities. This scenario changed after the 2008-09 financial crisis, due to buoyant demand amid stable supply scenario, which augurs well with the pricing.

Demand is outpacing stagnant supply post financial crisis, leading to a run-up in prices.



Healthy demand from emerging markets: Post the 2008-2009 financial crisis, demand for TiO₂ recovered rapidly, led by the emerging countries. In 2010, demand for TiO₂ was about 6.4mtpa, which was 98% of the total global production. As TiO₂ is used largely in real estate and construction, demand growth is relatively stable. Further, renovation and reconstruction activities in the developed markets will keep the TiO₂ demand healthy, even during financial downturns. We expect demand to rise by 3-4% CAGR over the next three years, led by the emerging markets such as China and India.

No substantial capacity addition in the near-term: During the 2008-09 financial downturn, demand for TiO₂ dropped significantly (by about 8-10% year-on-year in 2009), and the producers had to take 5-6% of their capacity offline. Majority of this capacity remained offline, while demand increased rapidly, which resulted in supply tightening. The major TiO₂ producers have no significant capacity addition plans over the next five years (only 1mt of capacity addition planned in Asia by 2015), which can lead to supply constraints over the next few years.

Figure 7: Supply tightening of TiO₂ amid healthy demand growth

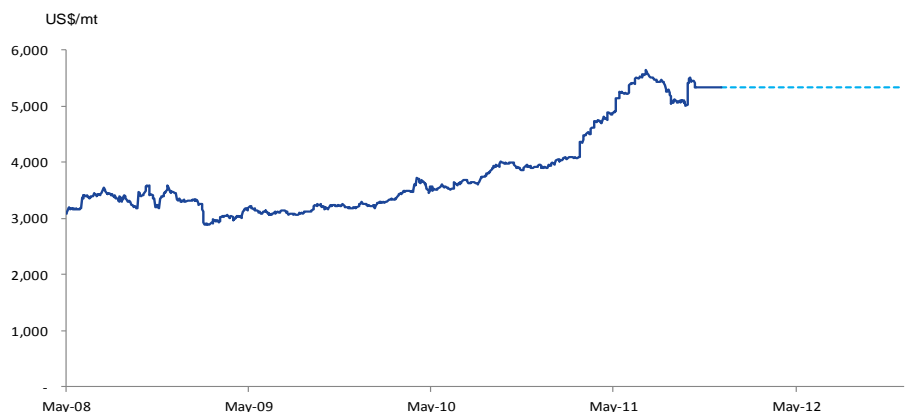


Source: Industry data

TiO₂ prices have been northbound since the start of the year (up 35% YTD).

TiO₂ prices to see northward trend in the near-term: Considering a sharp rise in TiO₂ prices in 2011 (up 35% YTD to US\$5,340/mt as of November 23, 2011), we expect average prices of TiO₂ to be US\$4,935/mt and US\$5,330/mt in 2011 and 2012 respectively in our valuation model (as against average 2011 YTD price of US\$4,870/mt). Our view is justified by a recent US\$500/ton hike in prices by DuPont, the largest TiO₂ producer due to supply tightening and rising raw material costs.

Figure 8: TiO₂ price trend



Source: Bloomberg

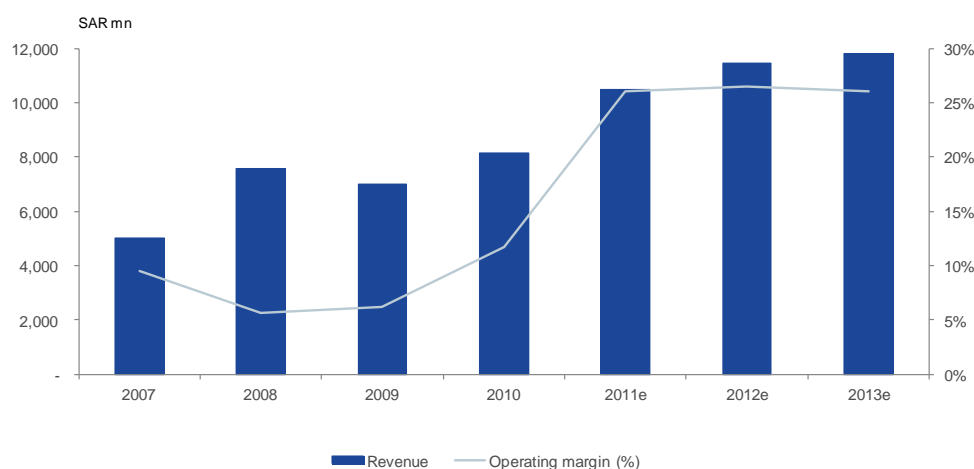


We expect NIC to post healthy revenue growth in the industrial segment on higher TiO₂ prices, and the company's proximity to emerging markets.

Poised to clock healthy margins in the medium-term

NIC has posted strong 17.6% revenue CAGR in industrial segment over the period 2007-2010 on the back of 1) rising production from its acquisition-oriented growth strategy, 2) proximity to key growth markets such as China and India, and 3) a rise in TiO₂ prices over the last three years. The industrial segment reported operating margin of about 6% in 2009 (as well as in 2008) and 11.8% in 2010, which provided partial stability to the overall profit margin during the financial crisis. With the sharp increase in TiO₂ prices, the company's operating margin improved to 26.2% in H1 2011 for the industrial segment. We expect the company to continue with the revenue growth momentum in the near-term and expect the operating margin of the segment in the range of 26-26.5% in 2011 and 2012.

Figure 9: Revenue and operating margins for the Industrial segment



Source: Company data, Al Rajhi Capital

Comparison with peers – Performance in line with global peers

Following table (figure 10) summarizes operational and financial data of industrial segment with its global peers. We believe that Kronos is the closest peer for the company's industrial segment as it derives almost all of its revenues from TiO₂ business.

Figure 10: Industrial segment and its global peers

| Company name | NIC - Industrial Segment | Kronos | Du Pont | Huntsman |
|---|--------------------------|------------------|---------|----------|
| Capacity (TiO ₂ , in MTPA) | 0.79 | ~0.6 | ~1.2 | 0.60 |
| Market share | 13% | 10% | 20% | 10% |
| Markets | Global | Europe and North | Global | Global |
| Total sales (2011e, in SAR mn) | 10,496 | 7,551 | 144,761 | 42,531 |
| Sales growth (CAGR 2007-2011e) | 20.4% | 11.4% | 7.1% | 4.1% |
| Total EBITDA margin (2011e) | 29.3% | 28.9% | 17.6% | 11.1% |
| Total operating margin (2011e) | 24.0% | 26.5% | 13.7% | 7.3% |
| Industrial revenue as a % of total revenue (2010) | 52.3% | 100.0% | 8.5% | 12.8% |

Source: Bloomberg, Al Rajhi Capita



Growing petrochemical business: Riding on lower cost and healthy Asian demand

Saudi petrochemicals producers have hugely benefited from world's lowest feedstock costs for ethane and naphtha, which have handed them an edge over the competition. Additionally, the petrochemicals sector has also reaped the benefits of favorable government initiatives (such as boosting employment through petrochemicals industry, focus on high-margin and value added products in the sector and favorable policies promoting alliances with major foreign players), which aim to shift Saudi Arabia from an economy concentrated largely on crude oil exports to an economy with higher value-added, integrated oil and petrochemical segments. NIC is capitalizing on this advantage by focusing on production of basic petrochemicals (such as ethylene, propylene) as well as value-added & high-margin specialty chemicals (such as HDPE and LDPE).

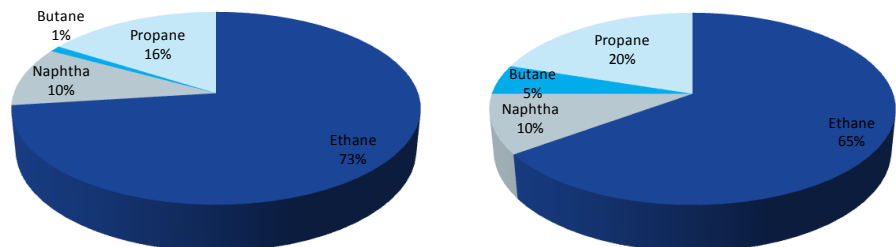
Cheap and reliable feedstock supply gives Saudi players a competitive advantage over global peers

Competitive feedstock cost advantage remains a key advantage

Aramco, a Saudi Government company provides feedstock to the petrochemicals companies in Saudi Arabia at a price of US\$0.75/mmbtu (compared to the average global market price of US\$4-5/mmbtu), which makes companies like NIC global low-cost producers of petrochemicals. Due to this cost advantage, the petrochemical segment of the company generated higher operating margin (21.5% in 2010) as compared to the industrial segment (11.8%).

Even though there is no clarity over a rise in feedstock cost, we think that Saudi Aramco might raise ethane price from US\$0.75/mmbtu to US\$1.25/mmbtu from 2012, owing to potential supply constraints. However, the rise in feedstock costs will be applicable in a phased manner and not only in 2011, as we are not sure how many supply contracts will end in 2011. Further, with no new allocations of ethane since 2006, Saudi petrochemicals players are currently shifting to heavier and more expensive feedstock (such as naphtha, propane and butane). Our scenario analysis suggests that the gross margin for the petrochemical companies can witness a decline of 200-400 bps in 2012 if ethane prices were increased to US\$1 and roughly 60% of the ethane contracts end in 2011. The gross margin decline will be much steeper (~500-700 bps) in case ethane prices were increased to US\$1.25/mmbtu.

Figure 11: Saudi Arabia- Feedstock composition



Source: Industry report

Asia presents a huge opportunity

Saudi petrochemicals exports rise on strong Asian demand

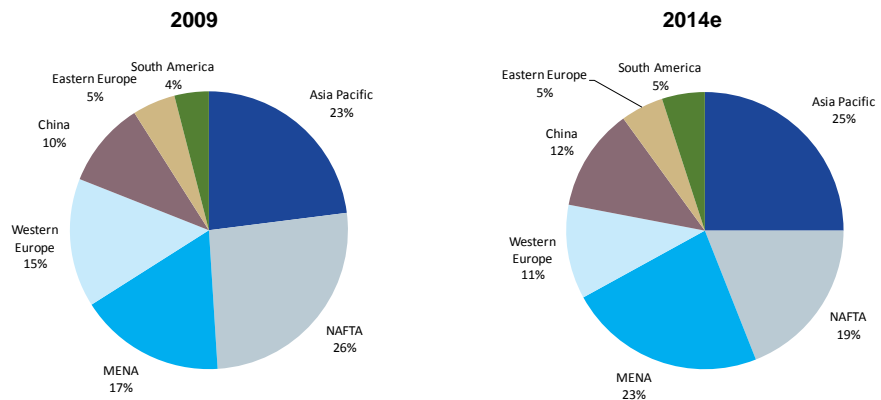
Saudi petrochemicals industry, including NIC, is leveraging its advantage of lower feedstock costs to expand in the Asian markets. Saudi Arabia boosted petrochemicals exports in the first nine months of 2011 on growing demand from Asia and an increased production of ethane feedstock. According to the Saudi Ports Authority, the kingdom exported 23.22mt of petrochemicals from its ports till September 2011, up 6% from 21.98mt a year earlier. NIC



has a strong exposure to Asia and we expect Asian countries like China and India to remain the largest consumers for petrochemicals products with both economies growing at a 7-9% per annum. We expect demand from Asian countries to grow by 6-8% each in 2011 and 2012, which should boost the top-line growth of Saudi petrochemicals companies, including NIC.

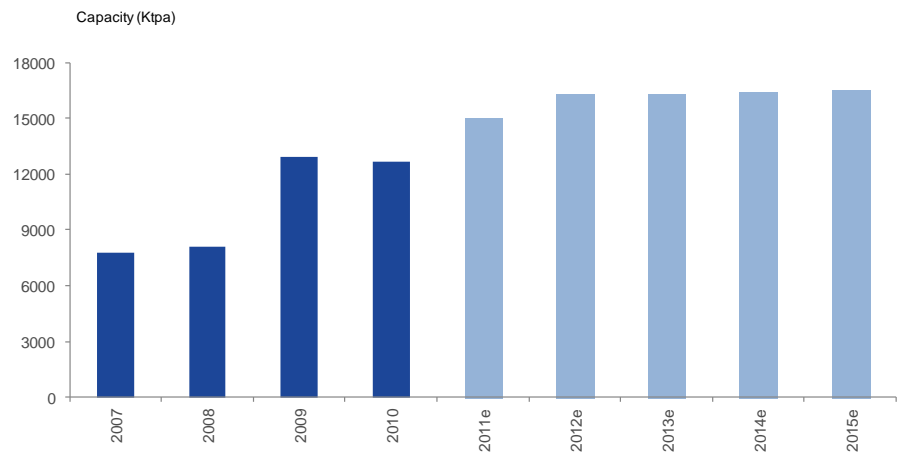
The charts below depict the rising share of the Middle East and Africa (MENA) region in global petrochemicals capacity (ethylene is the most widely used petrochemical product). Most of the additional capacities in the MENA region are coming up in Saudi Arabia, which is promoting the petrochemical sector for employment generation and diversification from the oil & gas sector.

Figure 12: Global ethylene capacity breakdown



Source: BMI, Al Rajhi Capital

Figure 13: Saudi Arabia - Total ethylene capacity



Source: BMI, Al Rajhi Capital

NIC focuses on ethylene, propylene, polypropylene, and their derivatives

Focus on basic petrochemicals

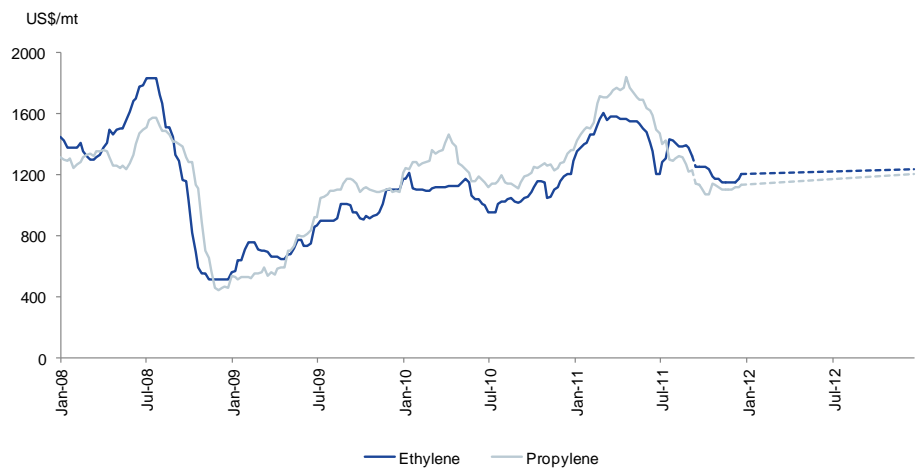
The company commenced commercial operations of propylene and polypropylene at Saudi Polyfins Company in July 2004. In June 2009, the company expanded its product portfolio of the petrochemical segment by starting production of ethylene and polyethylene. These petrochemicals products are used to produce high-margin derivatives such as HDPE, LDPE, which have extensive usage in industries such as plastics, cosmetics, paper, textiles, and fertilizers. NIC's petrochemicals portfolio currently includes ethylene (1mtpa), polypropylene



(0.72mtpa), high-density polyethylene (HDPE, 0.4mtpa), low-density polyethylene (LDPE, 0.4mtpa), and propylene (0.74mtpa).

Prices of a majority of basic petrochemicals recovered in early 2011 on the back of improved Asian demand and higher oil prices. However, post April 2011, product prices declined noticeably on escalating European debt crisis and weaker-than-expected industrial growth in China. We expect the prices of ethylene to be US\$1,385/mt and US\$1,220/mt in 2011 & 2012 respectively (average YTD 2011 price: US\$1,400), while prices of propylene are estimated to be US\$1,450/mt and US\$1,240/mt in 2011 & 2012 respectively (average YTD 2011 price: US\$1,500).

Figure 14: Prices of base petrochemicals



Source: Bloomberg, Al Rajhi Capital

Acrylic acids and its derivatives will be introduced for the first time in the Middle East

Moving up the petrochemicals value chain

With a total investment of SAR2.6bn, NIC recently formed a JV with Dow Chemical to build a new petrochemicals complex through its subsidiary Saudi Acrylic Monomers Company. This will give the company exposure to new products such as acrylic acid and its derivatives (acrylate esters, butyl acrylates, super absorbent polymers (SAP), and detergent polymers). The complex is likely to commence operations in late 2013, with a production capacity of 0.36mtpa of acrylic acid and related esters. This project will utilize propylene produced by Saudi Ethylene and Polyethylene Company (NIC's subsidiary). Boosted by the additional production from the high-margin acrylic acid project, we expect a 19.3% y-o-y revenue growth in 2014 with an operating margin expansion of around 140 bps.

NIC has also announced a JV with Saudi Kayan and Aramco-Dow (JV between Dow and Aramco) (33% stake each) to set-up a Butanol facility, which will be used for the production of butyl acrylate. The company expects the project to come online in Q2 2014, with a total investment of US\$480mn; however, we await more details such as production capacity and utilization rates.

Development of the downstream petrochemicals industry like specialty chemicals will result in higher margin for the company. But at the same time, delay in the commissioning of new plants cannot be ruled out due to the uncertain investment climate. It is worth noting that the company is already behind schedule by a year than its original 2012 launch for its acrylic acid project.

Steady growth on higher volumes

NIC has clocked a strong 50% CAGR in petrochemical segment revenue over the period 2007-2010 on the back of 1) commercial launch of ethylene and polyethylene project in mid-2009, 2) recovery in petrochemicals prices post 2008-09 global recession, and 3) strong

We estimate petrochemical segment to continue to report healthy operating margins

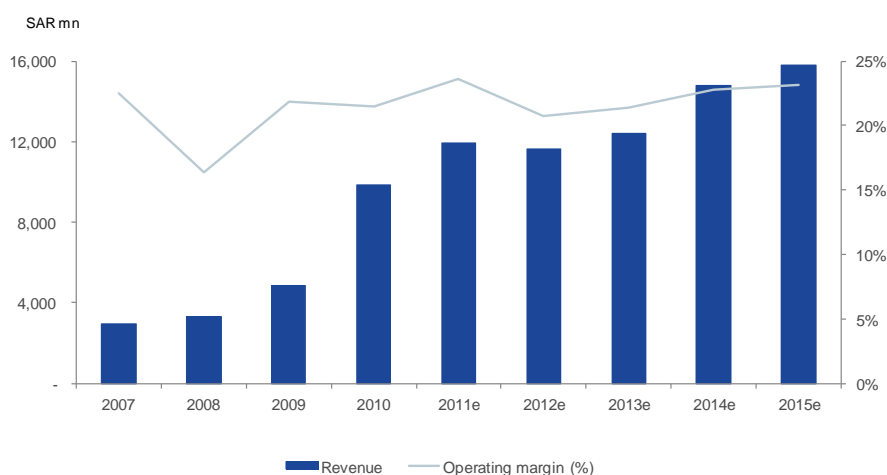


Asian demand. After witnessing a sharp decline in operating margin for the petrochemicals segment to 16.3% in 2008 owing to global recession (from 22.5% in 2007), the margin recovered to 21.5% in 2010, and further to 24.1% in H1 2011.

We estimate the company to report a CAGR of 9.9% in revenue from the petrochemical segment during 2010-2015 (mainly due to the launch of the acrylic acid project in 2013). We expect operating margin of this segment to remain in the range of 21-23.5% in the medium-term, with a decline in margin to 20.7% in 2012 considering our assumption for an increase in the feedstock cost.

Petrochemical segment operating margin to decline in 2012 assuming a rise in feedstock costs coupled with lower petrochemical prices

Figure 15: Revenue and operating margins for the petrochemical segment



Source: Company data, Al Rajhi Capital

Comparison with peers – Lower margins on basic product portfolio

From the following table (figure 16), we can see that operating margin of petrochemical segment are lower as compared to Yansab and Kayan, as it lacks advanced petrochemicals products like MEG, which are benefitting from improvement in prices.

Figure 16: Petrochemical segment and its global peers

| Company name | NIC - Petrochemical Segment | Yansab | SABIC | Kayan |
|---|-------------------------------------|--|---|--|
| Total capacity (MTPA) | 3.6 | 4.0 | 60+ | 5.9 |
| Markets | Asia, Europe, Middle East | Asia, Europe, Middle East | Europe, US, Middle East, and Asia Pacific | Asia, Middle East |
| Products | Ethylene, polypropylene, HDPE, LDPE | Ethylene, propylene polypropylene, HDPE, LDPE, MEG | Ethylene, methanol, propylene, polypropylene, HDPE, LDPE, MEG | Ethylene, propylene polypropylene, HDPE, LDPE, MEG |
| Total sales (2011e, in SAR mn) | 11,909 | 9,638 | 192,649 | 2,285 |
| Sales growth (CAGR 2007-2011e) | 42.1% | N/A | 11.2% | N/A |
| Total EBITDA margin (2011e) | 30.2% | 49.7% | 33.7% | 52.7% |
| Total operating margin (2011e) | 23.6% | 39.1% | 27.4% | 35.0% |
| Petrochemicals revenue as a % of total revenue | 46.2% | 100.0% | 78.0% | 100.0% |

Source: Al Rajhi Capital, Yansab and Kayan started operations recently, and hence sales CAGR 2007-2011 is not available



NIC's financial performance: Steady improvement ahead

On a growth trajectory

Healthy top-line growth
expected in the coming years

NIC's total revenues in 2010 increased significantly by 47.2% year-on-year to SAR16bn (+23.7% y-o-y to SAR14.93bn in 9M 2011). Revenues from the petrochemical business (before intersegment eliminations) more than doubled to SAR9.9bn, mainly on account of ethylene project launch in mid-2009 and an increase in prices across all its products. Revenues from the industrial segment registered a year-on-year growth of 16.4% to SAR8.1bn on account of high capacity utilization rates and an increase in prices. Head office and other segment revenue grew 21.6% year-on-year to SAR299mn during the same period.

Total revenue grew at a 30.3% CAGR during 2007-2010 due to acquisitions in the industrial segment and organic expansions in the petrochemical segment. We expect the average utilization rate to remain in the range of 90-95% in the near-term, which means that the company still has room for improvement in the utilization rates. However, we expect prices of the petrochemicals products to remain under pressure for the next 1-2 quarters due to volatility in oil prices and moderating demand growth from the Asian markets. From mid 2012 onwards, we expect prices to pick up with an improvement in demand. Consequently, we estimate revenue to grow at a CAGR of 9.9% over 2010-2015, to reach SAR25.6bn.

Shift in the revenue mix post
2013 due to commencement of
acrylic acid project

In 2007, the industrial segment contributed 61.6% of total revenue, while the remaining revenue was derived from the petrochemical segment. With the launch of the ethylene and polyethylene projects in 2009, contribution from the petrochemical segment increased to 47.3% in 2010. The industrial segment comprised 50.8%, while the Head office and other segment contributed remaining 2% of the total revenue in 2010. We estimate revenue contribution from the petrochemical segment (including eliminations) to decline to 43-44% of total revenue during 2012-2013 due to volatility in product prices and moderate growth demand. From 2014 onwards, however, we estimate contribution to increase at 47-49% of the total revenue due to the launch of the acrylic acid project. We expect revenue from the 'Head office and other' to remain 1-1.5% of the total revenue.

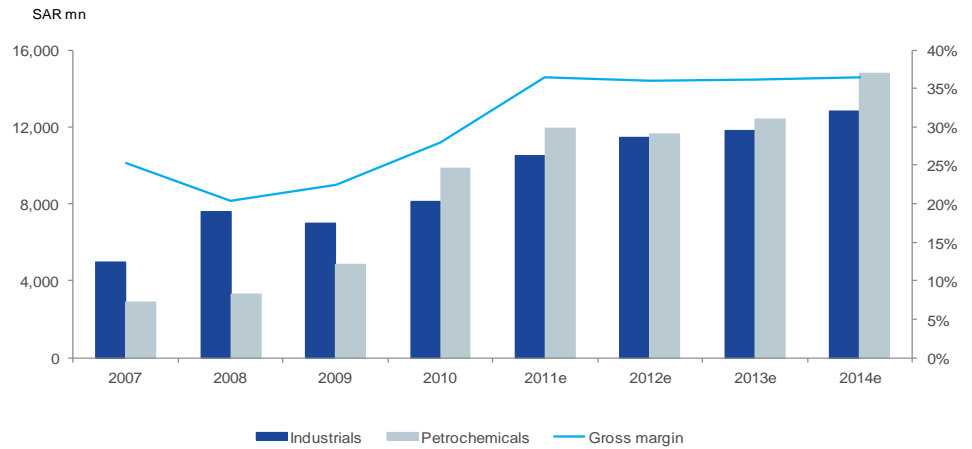
Figure 17: Segment forecast

| Segmental forecasts | 2010 | 2011e | 2012e | 2013e | 2014e | 2015e |
|-------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Sales | | | | | | |
| Industrial segment | 8,129 | 10,496 | 11,439 | 11,833 | 12,793 | 12,985 |
| Petrochemical segment | 9,864 | 11,908 | 11,655 | 12,379 | 14,773 | 15,828 |
| Head office & other | 299 | 299 | 299 | 299 | 299 | 299 |
| Eliminations | (2,303) | (2,642) | (2,840) | (2,963) | (3,332) | (3,469) |
| Total | 15,989 | 20,061 | 20,553 | 21,549 | 24,534 | 25,644 |
| Operating income | | | | | | |
| Industrial segment | 955 | 2,729 | 3,031 | 3,076 | 3,326 | 3,376 |
| Petrochemical segment | 2,117 | 2,810 | 2,418 | 2,650 | 3,365 | 3,662 |
| Head office & other | 1,569 | 1,197 | 1,347 | 1,437 | 1,437 | 1,437 |
| Eliminations | (1,576) | (1,000) | (1,000) | (1,000) | (1,000) | (1,000) |
| Total | 3,065 | 5,737 | 5,796 | 6,163 | 7,128 | 7,475 |
| Operating margin | | | | | | |
| Industrial segment | 11.8% | 26.0% | 26.5% | 26.0% | 26.0% | 26.0% |
| Petrochemical segment | 21.5% | 23.6% | 20.7% | 21.4% | 22.8% | 23.1% |
| Head office & other | 524.2% | 400.0% | 450.0% | 480.0% | 480.0% | 480.0% |
| Eliminations | 68.4% | 37.8% | 35.2% | 33.8% | 30.0% | 28.8% |
| Total | 19.2% | 28.6% | 28.2% | 28.6% | 29.1% | 29.2% |

Source: Company data, Al Rajhi Capital



Figure 18: Segmental revenue



Source: Company data, Al Rajhi Capital
* Revenue before intersegment elimination

Margins are improving

Gross margin to remain stable at 36-36.5% in the medium-term

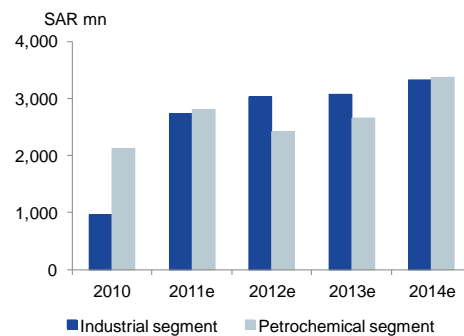
The company's gross margin has improved substantially from the 2008 levels (from 20.3% in 2008 to 28% in 2010 and 36.3% in 9M 2011) on the back of an improvement in product prices for TiO₂ as well as petrochemicals. We expect gross margin to decline marginally to 36% in 2012 due to rising feedstock costs and weaker demand for petrochemicals.

After witnessing a decline of nearly 400 bps in 2008 (from 21.7% in 2007 to 17.8% in 2008) due to the economic downturn, the EBITDA margin improved significantly to 23% in 2009 and 27.3% in 2010 due to increased volumes and higher price realization following the global recovery. With rising prices for TiO₂ and additional production from high-margin petrochemicals, we expect EBITDA margins to grow to 35-36% over the next five years. In line with the improvement in EBITDA margins, we expect the operating margin to improve to 28-29% over the next five years (from 19.1% in 2010).

Petrochemical segment generated higher margins compared to industrial segment due to cost advantage in 2009 and 2010

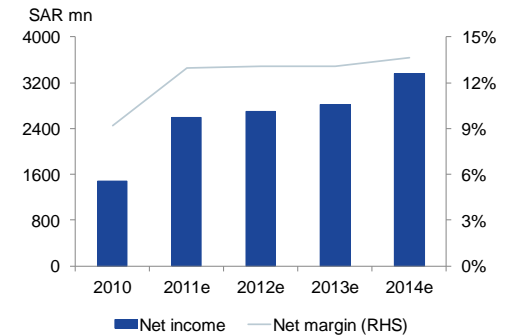
The petrochemical segment reported an operating margin of about 22% in both 2009 and 2010 on the back of feedstock cost advantage, while the industrial segment posted an operating margin of 6.2% and 11.8% during 2009 and 2010 respectively. Strong recovery in TiO₂ prices led to an improvement in operating margin of the industrial segment to 26.2% in H1 2011, while the petrochemical segment's operating margin was 24.1%. Looking ahead, we estimate the petrochemical and industrial segment to report operating margin in the range of 21-23% and 26-26.5% respectively over the next five years.

Figure 19.1: Operating income



Source: Al Rajhi Capital

Figure 19.2: Net income & Net margin



Source: Al Rajhi Capital



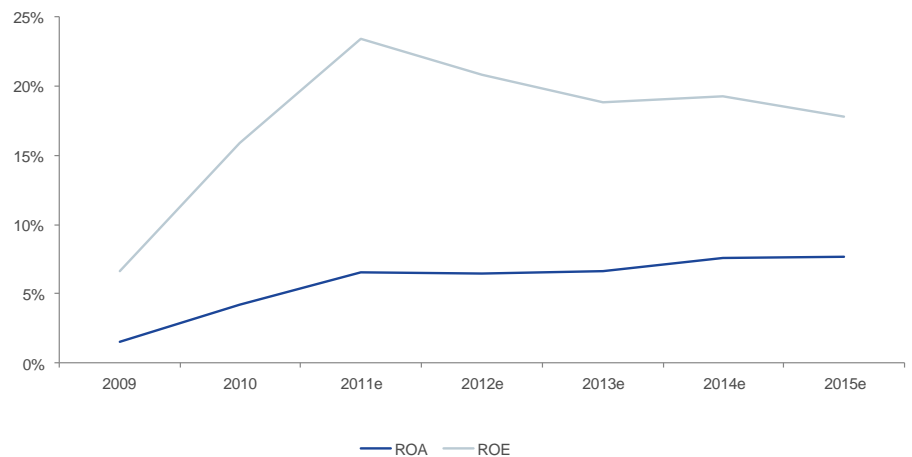
We expect the company's ROA to improve to 7.6% by 2015 from 6.6% in 2011

Higher net debt historically resulted from expansion organically as well as inorganically

NIC reported net margin of 9.2% (net profit of SAR1.5bn) in 2010 and 12.7% in 9M 2011. We expect the company to report net margin of ~13% over the next couple of years as the pressure on petrochemical product prices will be more than offset by the rise in TiO₂ prices. Further, we do not expect the company to earmark provisions for legal expenses in the next few years (SAR150mn in 2011), which will translate into better profitability. Further, after the commercial launch of higher-margin acrylic acid business in 2013, we expect net margin to increase gradually to 14% by 2015.

ROA started to recover with the start of commercial production in petrochemicals units during 2009. We estimate ROA to improve from 4.2% in 2010 to 6.6% in 2011, and then stabilize at around 7.5% in the medium-term, which is in line with its major peers such as Yansab and SABIC. Furthermore, we estimate ROE of 23.4% in 2011 as compared to 15.9% reported in 2010. We expect ROE to decline post 2011 on higher base effect (growth in retained earnings will outpace the growth in net profit).

Figure 20: ROA & ROE ratios



Source: Company data, Al Rajhi Capital

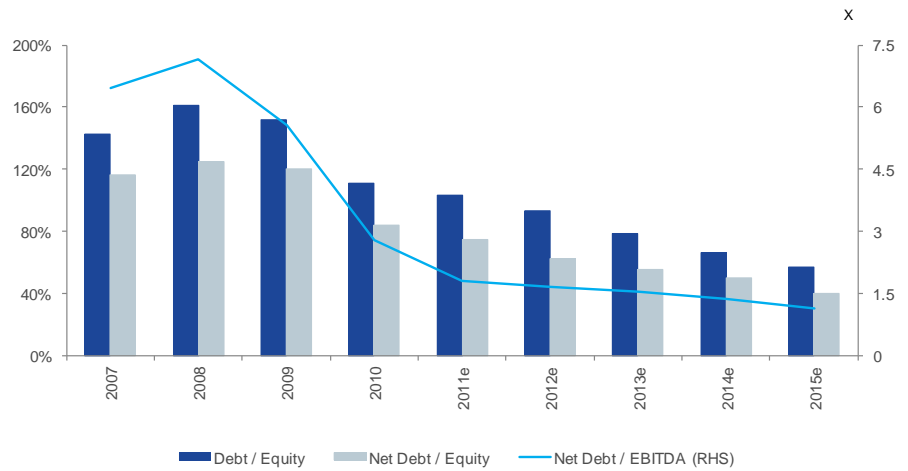
Improving financial health

NIC's net debt increased from SAR9.9bn level in 2007 to SAR13.5bn by Q3 2011 (SAR12.1bn in 2010) due to its aggressive acquisition-oriented growth strategy. The company's major acquisitions include Millennium Holdings (acquisition cost SAR5.5bn in 2007), Be-Max (SAR0.7bn in 2008) and ITP (SAR0.4bn in 2008). The net debt (as of Q3 2011) is equivalent to 1.9x of our 2011 EBITDA estimate, which is slightly higher than other Saudi petrochemical companies such as Yansab (1.2x) and Sipchem (1.8x). We expect the net debt/EBITDA ratio to decline gradually to ~1.2x by 2015 on the back of healthy cash flows, partially offset by higher capex during the next 2-3 years.



We expect net debt/EBITDA ratio to decline to 1.2x by 2015.

Figure 21: NIC's debt position



Source: Company data, Al Rajhi Capital

Capex-led growth continues

In order to expand its product portfolio, NIC has invested heavily in industrial as well as petrochemical segments. During 2007-2010, the company spent more than SAR18bn on construction of petrochemicals units and acquisition of businesses in the industrial segment. The average quarterly capex of the industrial segment was about 14% of the revenue during Q1 2007 to Q3 2011, while the capex for the petrochemical segment was about 40% of revenue during the same period.

The company reported free cash flow of SAR373mn in 2010. Due to ongoing investments in the acrylic acid project (SAR0.9bn spent as of 2010), we estimate free cash outflow of around SAR674mn in 2011. Assuming ~15% capex to sales ratio for the period 2012-2014 (which also includes potential acquisitions), we estimate that the company will generate stable free cash flow post 2011 with the FCF yield of ~0.5-1% over the medium-term. FCF yield is an important indicator of the company's operational performance and its cash generating ability. Higher FCF yield enables the company to pay additional dividends and debt repayments.

Figure 22: Capex, operating cash flow & FCF yield – 2008 to 2015e



Source: Company data, Al Rajhi Capital;
 Note: FCF yield is calculated at current market capitalization



Another strong performance in H2

NIC reported strong Q3 results on the back of strong y-o-y increase in product prices

Q3: Beneficiary of rising TiO2 prices

Revenues increased by 35% y-o-y in Q3 mainly due to a strong increase in product prices. The average selling prices for ethylene, polypropylene and propylene jumped 32%, 30% and 14% y-o-y respectively in Q3. TiO2 prices also improved by 47% y-o-y in Q3. On a q-o-q basis, revenues increased by 5% in Q3 on rising TiO2 prices and stable utilization levels.

Boosted by the strong product prices y-o-y, NIC reported gross margin of 37.2% in Q3 2011 compared to 28.2% in Q3 2010. NIC reported EBITDA margin of 36% in Q3 versus 25.7% reported in corresponding quarter of previous year. This trickled down to a strong net profit of SAR725mn, implying an exceptional net margin of 13.6% in Q3

Furthermore, on the back of healthy cash flows, NIC was able to reduce its net debt to equity ratio to 0.8x at the end of Q3 from 0.9x a year earlier.

Figure 23: NIC - 2011Q3A vs. 2010Q3A and 2011Q2A

| (SAR) mn | 2010Q3A | 2011Q3A | 2011Q2A | YOY % chg | QOQ % chg |
|------------------|---------|---------|---------|-----------|-----------|
| Total Revenues | 3,964.1 | 5,333.3 | 5,063.9 | 34.5% | 5.3% |
| Gross profit | 1,116.9 | 1,986.1 | 1,846.6 | 77.8% | 7.6% |
| Gross margin | 28.2% | 37.2% | 36.5% | | |
| Operating profit | 700.7 | 1,582.2 | 1,449.7 | 125.8% | 9.1% |
| Net income | 373.0 | 725.0 | 594.2 | 94.4% | 22.0% |
| Net margin | 9.4% | 13.6% | 11.7% | | |

Source: Company data, Al Rajhi Capital

We expect the Q4 2011 to be strong supported by stable TiO2 prices

Q4 estimates: another strong round

We expect the company to report another strong performance in Q4 2011 despite a decline in petrochemical prices. We estimate NIC to post revenues of SAR5.13bn in Q4, up 31% y-o-y, although 4% lower than Q3, affected by lower petrochemical product prices (-6% q-o-q). NIC will again demonstrate benefits from its diversified revenue streams as we expect the TiO2 business revenues to remain stable, arresting the overall q-o-q decline in revenues. Further, we expect the utilization rate to remain at 95% same as Q3.

We believe that the gross margin will decline slightly in Q4 by 20 bps q-o-q to 37% as petrochemical prices are under pressure due to the escalating global economic concerns. We expect the company to report net profit of SAR699mn in Q4 (13.6% net margin) versus SAR725mn in Q3.

Figure 24: NIC - 2010Q4A vs. 2010Q4EA & FY2010A vs. FY2011E

| (SAR) mn | 2010Q4A | 2011Q4E | YOY % chg | FY2010A | FY2011E | YOY % chg |
|------------------|---------|---------|-----------|----------|----------|-----------|
| Total Revenues | 3,918.3 | 5,132.1 | 31.0% | 15,989.4 | 20,060.8 | 25.5% |
| Gross profit | 968.7 | 1,898.9 | 96.0% | 4,474.8 | 7,321.6 | 63.6% |
| Gross margin | 24.7% | 37.0% | | 28.0% | 36.5% | |
| Operating profit | 649.6 | 1,498.6 | 130.7% | 3,046.5 | 5,736.9 | 88.3% |
| Net income | 378.0 | 698.9 | 84.9% | 1,472.6 | 2,598.1 | 76.4% |
| Net margin | 9.6% | 13.6% | | 9.2% | 13.0% | |

Source: Company data, Al Rajhi Capital



Valuation: Upward trend to continue

Summary of our approach

Our key long-run method of forecasting is discounted economic profit (DEP) forecasting

Our key method of valuation for the Saudi petrochemicals players is long-run discounted economic profit (DEP), sometimes also called discounted long-run EVA (economic value added). This is a simple variation on discounted cash flow and is mathematically equivalent. In our models, we make explicit forecasts for income statement, balance sheet and cash flow out to 2022. We then assume a steady fading of return on invested capital, i.e. excess return, down to the cost of capital over a period of up to 30 years from the end of our period of explicit forecasting. This approach avoids a common problem in long-run modeling; namely, that the analyst stops forecasting at some arbitrary point when the company in question is still generating high returns. In terms of financial theory, this is implausible, and excess returns will eventually disappear through competition, regulation or some other means.

Our DEP valuations are sensitive to many factors, including assumed revenue growth, EBITDA margin and capex/sales ratio in 2022, i.e. the last year of explicit forecasting. Another important variable is the assumed duration of the period of competitive advantage remaining at current levels, i.e. the period during which the company generates returns above weighted average cost of capital (WACC). Deciding on the length of the period of the competitive advantage is naturally a subjective exercise involving many variables and scenario. We have assumed 30 years for NIC on the ground that NIC's diversified revenue streams, healthy financials, and stable TiO₂ business will enable the company to achieve positive cash flows for the next 30 years. Further, it would take several years for its rivals to challenge the company effectively due to its unique business model.

We estimate NIC's WACC at 12.2%

However, as with any DCF-based approach, the factor to which the DEP valuation is most sensitive is WACC. We have assumed a WACC of 12.2% for NIC on the back of higher market risk premium; however, low interest rate on debt has slightly offset the high cost of equity. We attribute this low rate to the fact that around 25% of NIC's outstanding loans (as of 2010) are obtained from the Saudi Industrial Development Fund and Public Investment Fund, which carries lower interest rate. On the other hand, beta i.e. the company's systematic risk is 1.3x based on Bloomberg data. Higher beta indicates that the stock is more volatile and therefore riskier, but offers potential for higher returns. WACC is in turn highly sensitive to assumed terminal capital structure. Estimating terminal capital structure is again a rather subjective exercise. We estimate a terminal debt/total capital ratio of 25% for NIC in the medium-term.

We have also valued the NIC based on relative valuation method

In addition to long-run DEP, we use comparative multiples analysis to value NIC in relation to other regional players. Under this approach, we use comparisons of valuation measures – notably, EV/EBITDA multiples – with other companies with similar business model to estimate the fair value. As the company has a well-diversified portfolio, we have evaluated each business segment separately. We have used two valuation methods particularly for NIC as the company has two different business segments (industrial and petrochemicals), which have entirely different characteristics.

We have taken a weighted average of the two methods as our target price by giving a weight of 70% to the long-run DEP method and 30% to the comparative multiples analysis method as we believe that the long-run DEP method is a better indicator of performance and pricing in the real world, given no major investments plans (excluding ongoing acrylic acid project) are lined up by the company in the near future.



We assume a period of competitive advantage of 30 years for NIC

NIC's value lies both in invested capital as well as in future economic returns

Long-run DEP approach

In the long-run DEP method of estimating NIC's fair value, we use a WACC of 12.2%. We calculate WACC as shown in the table (figure 25) below.

Figure 25: NIC - weighted average cost of capital (WACC)

| | |
|--------------------------------------|--------------|
| Risk-free rate | 2.0% |
| Expected Mkt Return - Risk-free Rate | 10.0% |
| Adjusted Beta | 1.30 |
| Cost of Equity | 15.0% |
| Pre-tax Cost of Debt | 4.4% |
| Effective Tax rate | 10.3% |
| After-tax Cost of Debt | 4.0% |
| Target D/(D+E) | 25.0% |
| WACC | 12.2% |

Source: Bloomberg, Al Rajhi Capital

In DEP forecasting, appraised fair enterprise value may be broken down into two elements: opening invested capital, i.e. the debt and equity capital that has already been deployed in the business, and discounted economic profit, i.e. the present value of future economic returns (returns above cost of capital). During 2007-2010, NIC made huge investments to grow both through organic and inorganic routes. As the company has already started generating returns on these investments, we believe the value of the company lies in invested capital as well as in future economic returns. Discounted economic profit, i.e. the present value of future economic returns or returns above cost of capital, represents about 43% of our fair enterprise value of SAR45.7bn. Discounted economic profit is shown in the table below (figure 26) as "total value created/destroyed". From the appraised fair enterprise value, we add non-core investments made by the company and subtract net debt & minority estimates to give estimated fair equity value of SAR28.3bn. On this basis, we estimate NIC's fair value per share at SAR50.8.

Figure 26: NIC valuation - discounted economic profit

| | |
|---|-----------------|
| Total value created / (destroyed) (SAR mn) | 19,781 |
| Opening Invested capital | 25,916 |
| Total Enterprise Value (SAR mn) | 45,697 |
| Add: | |
| Associates and non-core assets | 582 |
| Less: | |
| Value of Debt (2011E) | (12,815) |
| Minority Interests | (5,135) |
| Equity Value (SAR mn) | 28,328 |
| No. of Shares (mn) | 557 |
| Fair Value per share | SAR 50.8 |

Source: Al Rajhi Capital estimates

We should note that the stock market values NIC at a premium to its invested capital; hence the enterprise value/invested capital (EV/IC) ratio of 1.5x for 2011. This suggests that the stock market also expects NIC to generate economic profits over time. (Note: the EV/IC ratio may be thought of as a more sophisticated price/book value ratio; which is currently at 1.8x). At our DEP fair value of SAR50.8, the EV/IC ratio would be 1.9x, which represents a premium to invested capital and indicates that the company has invested in capital which will continue to generate returns above cost of capital in the long-term. It's worth noting that the EV/IC ratio of 1.9x at our DEP fair value is largely in line with major peers such as SABIC (1.8x) and Yansab (1.7x).



The table (figure 27) below shows fair value for NIC at different assumed periods of competitive advantage (but with all other assumptions unchanged):

Figure 27: NIC - fair value at different assumed periods of competitive advantage

| Years | Fair value per share (SAR) |
|---------------------------|----------------------------|
| 25 | 49.8 |
| 30 (core scenario) | 50.8 |
| 35 | 51.5 |
| 40 | 52.1 |

Source: Al Rajhi Capital

Comparative multiples approach

We have used comparative multiples approach as NIC is present in two different business segments

We have valued NIC's industrial and petrochemical segments separately by applying trading multiples for 2012 of comparable global peers. The tables (figure 28 and 29) below show market values and valuation multiples for these companies compared to NIC.

Figure 28: NIC's industrial segment: comparative multiple analysis

| Companies | Region | Market Cap | Enterprise Value | EV/EBITDA (X) | |
|----------------------------------|--------|------------|------------------|---------------|------------|
| | | (US\$mn) | (US\$mn) | 2011 | 2012 |
| Du Pont | Global | 40,726 | 53,965 | 7.9 | 7.3 |
| Huntsman | Global | 2,273 | 6,035 | 4.8 | 4.4 |
| Kronos | Global | 2,069 | 2,315 | 4.0 | 3.4 |
| Tronox | Global | 1,620 | 1,918 | 4.1 | 1.5 |
| Celanese Corporation | Global | 6,250 | 8,536 | 6.3 | 6.3 |
| Rockwood Holdings Inc. | Global | 3,059 | 4,741 | 5.5 | 5.3 |
| Aggregate Market Multiple | | | | 6.8 | 6.2 |

Source: Bloomberg, Al Rajhi Capital

Figure 29: NIC's petrochemical segment: comparative multiple analysis

| Companies | Region | Market Cap | Enterprise Value | EV/EBITDA (X) | |
|--------------------------------------|-------------|------------|------------------|---------------|------------|
| | | (US\$mn) | (US\$mn) | 2011 | 2012 |
| Saudi Basic Industries Corp | Middle East | 73,192 | 100,185 | 6.4 | 5.9 |
| Yanbu National Petrochemical Company | Middle East | 6,404 | 9,522 | 7.2 | 6.0 |
| Advanced Petrochemical Company | Middle East | 999 | 1,172 | 6.1 | 6.8 |
| Aggregate Market Multiple | | | | 6.2 | 5.7 |

Source: Bloomberg, Al Rajhi Capital

We have used global TiO2 producers to value NIC's industrial segment, while the petrochemical segment is valued by comparing it with Saudi petrochemical companies

Based on the aggregate EV/EBITDA multiples for the comparable companies, we estimate a fair value per share for NIC at SAR46.9. We have assigned only 30% weight to this valuation method as these peers are not exactly comparable with NIC in terms of size (market cap), product profile and geographical presence. As the acrylic acid project is yet to start commercial productions, our comparative valuation does not factor in the earnings contribution from this project. Consequently, we have considered the book value of investments (construction cost as of 2010) made by the company to arrive at a valuation under this method.



Figure 30: NIC: Comparative valuation

| | EBITDA (2012e) SAR mn | Multiple (x) | Enterprise value |
|-------------------------------------|-----------------------|--------------|------------------|
| Industrials segment | 3,589 | 6.2 | 22,207 |
| Petrochemical segment | 3,581 | 5.7 | 20,471 |
| Total EV | | | 42,678 |
| Associates and non-core assets | | | 582 |
| Project WIP (Acrylic acid project) | | | 842 |
| Debt (2011e) | | | (12,815) |
| Minorities | | | (5,135) |
| Value of the equity (SAR mn) | | | 26,151 |
| Number of shares (mn) | | | 557 |
| Share price (SAR) | | | 46.9 |

Source: Al Rajhi Capital

NIC's fair value

As mentioned, we use two valuation methods: long-run EVA and comparative multiples analysis. For the multiples analysis, we have used EV/EBITDA multiples for the industrial and petrochemical segments. We have ruled out 'head office and other' segment from the comparative valuation because its revenue contribution is very small (less than 2% in 2010).

We have arrived at the target price of SAR49.6 per share by giving 70% weight to the long-run EVA method (fair value of SAR50.8 per share), and 30% to the comparative multiples method (fair value of SAR46.9 per share). Our target price implies 34.9% upside to the current share price of NIC.

Figure 31: NIC - Valuation summary

| Valuation method | Value (SAR) | Weight | Fair Value (SAR) |
|----------------------------------|-------------|--------|------------------|
| Long-run DEP valuation | 50.8 | 70% | 35.6 |
| Comparative valuation | 46.9 | 30% | 14.1 |
| Target price for NIC | | | 49.6 |
| Potential Upside/Downside | | | 34.9% |

Source: Al Rajhi Capital

We believe that the stock still has an upside potential, despite a 35% run-up in the stock price over the last 12 months, considering its 1) well diversified business model which suits the current economic climate, 2) robust performance from the TiO₂ business 3) healthy financials and track record of successful acquisition and 4) petrochemicals capacity additions to move up the value chain. Further, the company is still trading at attractive valuations as compared to its peers, which indicates healthy upside potential from current levels.

Risks associated with our assumptions

It is important to highlight that our valuation relies heavily on future forecasts which are uncertain. We have come up with several assumptions including growth, cost of capital, and market trend to predict future performance. We have tried to arrive at the most accurate assumptions; however, reality may deviate from our forecasts depending on new macroeconomic factors, slowing demand for the company's products and negative regulatory changes such as a hefty rise in feedstock costs. Competition is another factor that can influence our assumptions. New entrants or/and transformation of current rivals' business models might cause competitive pressures, and hence influence our overall assumptions and forecasts.

We set a target price of SAR49.6 based on a 70/30% weighting for our two different valuation approaches



Revenue growth in the next two years will be lower due to weaker petrochemical prices

Healthy growth in EPS on marginal improvement in profitability

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Dividend payout to improve to ~30% in 2011

P/E and EV/EBITDA will decline going forward on better profitability

| Income Statement (SARmn) | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|---|---------------|---------------|---------------|---------------|---------------|
| Revenue | 10,863 | 15,989 | 20,061 | 20,553 | 21,549 |
| Cost of Goods Sold | (8,429) | (11,515) | (12,739) | (13,154) | (13,748) |
| Gross Profit | 2,434 | 4,475 | 7,322 | 7,399 | 7,801 |
| Government Charges | | | | | |
| S.G. & A. Costs | (940) | (1,428) | (1,585) | (1,603) | (1,638) |
| Operating EBIT | 1,494 | 3,046 | 5,737 | 5,796 | 6,163 |
| Cash Operating Costs | (8,386) | (11,639) | (12,982) | (13,384) | (13,953) |
| EBITDA | 2,477 | 4,350 | 7,079 | 7,170 | 7,596 |
| Depreciation and Amortisation | (983) | (1,304) | (1,342) | (1,374) | (1,433) |
| Operating Profit | 1,494 | 3,046 | 5,737 | 5,796 | 6,163 |
| Net financing income/(costs) | (534) | (617) | (697) | (737) | (869) |
| Forex and Related Gains | 2 | 25 | - | - | - |
| Provisions | (39) | (11) | (150) | - | - |
| Other Income | 119 | 175 | 111 | - | - |
| Other Expenses | | | | | |
| Net Profit Before Taxes | 1,064 | 2,636 | 5,014 | 5,072 | 5,307 |
| Taxes | (92) | (82) | (528) | (507) | (531) |
| Minority Interests | (453) | (1,081) | (1,888) | (1,875) | (1,961) |
| Net profit available to shareholders | 519 | 1,473 | 2,598 | 2,690 | 2,815 |
| Dividends | (346) | (507) | (836) | (836) | (845) |
| Transfer to Capital Reserve | - | - | - | - | - |
| | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| Adjusted Shares Out (mn) | 460.7 | 506.8 | 557.4 | 557.4 | 557.4 |
| CFPS (SAR) | 4.24 | 7.61 | 10.46 | 10.65 | 11.14 |
| EPS (SAR) | 1.13 | 2.91 | 4.66 | 4.83 | 5.05 |
| DPS (SAR) | 0.750 | 1.000 | 1.500 | 1.500 | 1.515 |
| Growth | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| Revenue Growth | 8.2% | 47.2% | 25.5% | 2.5% | 4.8% |
| Gross Profit Growth | 19.3% | 83.8% | 63.6% | 1.1% | 5.4% |
| EBITDA Growth | 41.7% | 75.6% | 62.7% | 1.3% | 5.9% |
| Operating Profit Growth | 54.6% | 103.9% | 88.3% | 1.0% | 6.3% |
| Net Profit Growth | -13.5% | 183.5% | 76.4% | 3.6% | 4.6% |
| EPS Growth | -23.1% | 157.7% | 60.4% | 3.6% | 4.6% |
| Margins | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| Gross profit margin | 22.4% | 28.0% | 36.5% | 36.0% | 36.2% |
| EBITDA margin | 22.8% | 27.2% | 35.3% | 34.9% | 35.3% |
| Operating Margin | 13.8% | 19.1% | 28.6% | 28.2% | 28.6% |
| Pretax profit margin | 9.8% | 16.5% | 25.0% | 24.7% | 24.6% |
| Net profit margin | 4.8% | 9.2% | 13.0% | 13.1% | 13.1% |
| Other Ratios | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| ROCE | 5.7% | 11.2% | 17.6% | 16.9% | 17.4% |
| ROIC | 6.3% | 11.9% | 19.8% | 17.8% | 17.8% |
| ROE | 6.9% | 17.3% | 25.5% | 22.4% | 20.2% |
| Effective Tax Rate | 8.6% | 3.1% | 10.5% | 10.0% | 10.0% |
| Capex/Sales | 19.9% | 11.9% | 16.5% | 15.0% | 15.0% |
| Dividend Payout Ratio | 66.5% | 34.4% | 32.2% | 31.1% | 30.0% |
| Valuation Measures | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| P/E (x) | 32.6 | 12.7 | 7.9 | 7.6 | 7.3 |
| P/CF (x) | 8.7 | 4.8 | 3.5 | 3.5 | 3.3 |
| P/B (x) | 2.2 | 2.0 | 1.8 | 1.6 | 1.4 |
| EV/Sales (x) | 3.5 | 2.5 | 2.2 | 2.0 | 1.9 |
| EV/EBITDA (x) | 15.2 | 9.2 | 6.1 | 5.8 | 5.3 |
| EV/EBIT (x) | 25.2 | 13.1 | 7.5 | 7.2 | 6.6 |
| EV/IC (x) | 1.5 | 1.5 | 1.5 | 1.3 | 1.2 |
| Dividend Yield | 2.0% | 2.7% | 4.1% | 4.1% | 4.1% |

Source: Company data, Al Rajhi Capital



Healthy improvement in cash balances on positive FCF

Net debt to EBITDA ratio to decline steadily in the medium term

| Balance Sheet (SARmn) | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
|--|----------------|----------------|----------------|----------------|----------------|
| Cash and Cash Equivalents | 3,585 | 3,886 | 4,916 | 4,902 | 4,169 |
| Current Receivables | 2,014 | 2,108 | 3,182 | 3,329 | 3,232 |
| Inventories | 2,716 | 2,889 | 3,695 | 3,745 | 3,879 |
| Other current assets | 1,522 | 1,712 | 1,577 | 1,577 | 1,577 |
| Total Current Assets | 9,867 | 10,620 | 13,370 | 13,554 | 12,857 |
| Fixed Assets | 18,505 | 19,185 | 21,305 | 23,132 | 25,050 |
| Investments | 485 | 582 | 760 | 760 | 760 |
| Goodwill | 2,471 | 2,471 | 2,471 | 2,471 | 2,471 |
| Other Intangible Assets | 1,226 | 1,121 | 1,138 | 1,020 | 901 |
| Total Other Assets | 613 | 766 | 563 | 563 | 563 |
| Total Non-current Assets | 23,301 | 24,126 | 26,236 | 27,946 | 29,745 |
| Total Assets | 33,168 | 34,746 | 39,606 | 41,499 | 42,602 |
| Short Term Debt | 3,296 | 3,603 | 2,939 | 2,939 | 2,939 |
| Accounts Payable | 982 | 798 | 1,026 | 1,040 | 1,077 |
| Accrued Expenses | 1,262 | 1,466 | 1,848 | 1,873 | 1,939 |
| Zakat Payable | 104 | 113 | - | - | - |
| Dividends Payable | 80 | 73 | - | - | - |
| Other Current Liabilities | 28 | 12 | - | - | - |
| Total Current Liabilities | 5,781 | 6,108 | 5,813 | 5,852 | 5,956 |
| Long-Term Debt | 14,106 | 12,385 | 14,792 | 14,792 | 13,811 |
| Other LT Payables | 496 | 502 | 502 | 502 | 502 |
| Provisions | 1,325 | 1,354 | 1,272 | 1,272 | 1,272 |
| Total Non-current Liabilities | 15,927 | 14,241 | 16,566 | 16,566 | 15,585 |
| Minority interests | 3,670 | 5,135 | 6,125 | 6,125 | 6,125 |
| Paid-up share capital | 4,607 | 5,068 | 5,574 | 5,574 | 5,574 |
| Total Reserves | 3,183 | 4,194 | 5,528 | 7,382 | 9,361 |
| Total Shareholders' Equity | 7,790 | 9,262 | 11,102 | 12,956 | 14,935 |
| Total Equity | 11,459 | 14,397 | 17,227 | 19,082 | 21,061 |
| Total Liabilities & Shareholders' Equity | 33,168 | 34,746 | 39,606 | 41,499 | 42,602 |
| Ratios | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| Net Debt (SARmn) | 13,817 | 12,101 | 12,815 | 12,829 | 12,582 |
| Net Debt/EBITDA (x) | 5.58 | 2.78 | 1.81 | 1.79 | 1.66 |
| Net Debt to Equity | 120.6% | 84.1% | 74.4% | 67.2% | 59.7% |
| EBITDA Interest Cover (x) | 4.6 | 7.0 | 10.2 | 9.7 | 8.7 |
| BVPS (SAR) | 16.91 | 18.28 | 19.92 | 23.24 | 26.79 |
| Cashflow Statement (SARmn) | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| Net Income before Tax & Minority Interest | 1,064 | 2,636 | 5,014 | 5,072 | 5,307 |
| Depreciation & Amortisation | 983 | 1,304 | 1,342 | 1,374 | 1,433 |
| Decrease in Working Capital | (1,449) | (421) | (1,473) | (158) | 67 |
| Other Operating Cashflow | (560) | (1,245) | (2,252) | (2,382) | (2,492) |
| Cashflow from Operations | 38 | 2,274 | 2,632 | 3,906 | 4,315 |
| Capital Expenditure | (2,161) | (1,900) | (3,305) | (3,083) | (3,232) |
| New Investments | 792 | 15 | (242) | - | - |
| Others | (421) | (63) | (144) | - | - |
| Cashflow from investing activities | (1,790) | (1,949) | (3,691) | (3,083) | (3,232) |
| Net Operating Cashflow | (1,752) | 325 | (1,060) | 823 | 1,083 |
| Dividends paid to ordinary shareholders | (461) | (346) | (507) | (836) | (836) |
| Proceeds from issue of shares | - | - | - | - | - |
| Effects of Exchange Rates on Cash | - | - | - | - | - |
| Other Financing Cashflow | 2,066 | 1,092 | 2,596 | - | - |
| Cashflow from financing activities | 1,724 | (25) | 2,089 | (836) | (1,817) |
| Total cash generated | (28) | 301 | 1,030 | (13) | (734) |
| Cash at beginning of period | 3,613 | 3,585 | 3,886 | 4,916 | 4,902 |
| Implied cash at end of year | 3,585 | 3,886 | 4,916 | 4,902 | 4,169 |
| Ratios | 12/09A | 12/10A | 12/11E | 12/12E | 12/13E |
| Capex/Sales | 19.9% | 11.9% | 16.5% | 15.0% | 15.0% |

Source: Company data, Al Rajhi Capital



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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"**Overweight**": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"**Neutral**": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"**Time horizon**": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"**Fair value**": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"**Target price**": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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