Executive Summary

**Investment Recommendation**

Trecora resources is currently rated as a BUY. TREC's target price is $14.38. With their current stock price at $8.88, we forecast their stock price to appreciate by 65.7%.

**Investment Highlights**

- **Potential monetization of AMAK Ownership**
  Trecora Resources (TREC) plans to do the 33.4% of Al Masane Al Kobra (AMAK). A Saudi Arabian mining company that currently owns 53.4% of AMAK. AMAK's year-to-date ETBE oil is through the third quarter of 2019 up $21 million from 2017 because of operations becoming more consistent, resulting in a higher generation of cash flow.

- **Manufacturing Transformation Plan**
  TREC has implemented a manufacturing transformation plan which is being led by the company's Chief Manufacturing Officer, John Townsend. The plan is put into place to help improve productivity and safety. A standard of simplified, efficient, and consistent work processes being put into action in hopes of improving quality without compromising safety. The plan will slightly affect to ensure the efficiency across the board.

**Unmatched Flexibility**

TREC has been able to successfully change their company as the industry evolved. TREC has evolved from a crude oil basedown to a mining company. When they have the opportunity to expand into the hydrocarbons field, they ran with it and became a leader in producing primary light hydrocarbons. TREC also provides a variety of custom processing through their specialty segment.

**Key Risks**

- **Fluctuation on Crude Oil Price**
  Currently, Crude Oils are low, but government regulation and market competition could cause oil prices to increase and affect TREC’s revenues in a positive way. The EIA predicts that Brent crude oil’s revenue will reach $113.56 based on the assumption that petroleum demand levels off, the economic growth at 2% annually, and annual consumption increases 4%

- **New Management**
  TREC has had a recent turnover of all their management besides the Chief Sustainability Officer. This could cause concern to shareholders because of the uncertainty in the direction the company will go and the fact that the majority of the new management has short tenures at previous jobs.

- **US Economic Outlook**
  TREC is a cyclical firm; change in economic growth can affect TREC’s demand. High economic growth will increase demand and therefore improve TREC’s revenues. TREC’s debt has greatly increased in the past few years, if a recession occurs TREC may not be able to meet its break-even point.

**Business Description**

Headquartered in Sugar Land, Texas, Trecora Resources (TREC) was established in 1967 as Arabian American Development Company. The company was originally a Saudi Arabian mining company which is now Al Masane Al Kobra (AMAK). TREC holds 33.4% of AMAK. In 2014, TREC entered the petrochemical industry and changed its name to Trecora Resources. The name Trecora comes from the incorporation of trust, ecology, and the core of the earth. The CEO at the time, Nick Carter emphasized, “Trecora Resources connotes natural production. The turning point for TREC was the creation of their market with the addition of AMAK, which is now the world’s largest producer of ethylene and propylene, and the 2nd largest producer of aromatics in the US. TREC has a history of investing in capital projects and has expanded its production capabilities.

**Competitive Positioning**

Market leader in high purity Pentanes

TREC's pentanes are high in purity and are used in various industries such as pharmaceuticals, chemicals, and fine chemicals. TREC's pentanes are also used in the production of various chemicals such as polyethylene and polystyrene.

**Porter's Five Forces**

**Threat of Entry/Low Profitability**

The chemical industry has many barriers of entry. Because of this, the threat of entry is low. Some of the barriers are the cost to construction and operating facilities, the cost of regulation (EPA, OSHA, etc.), and having to compete with existing companies in this industry face.

**Threat of Substitutes/Margin**

TREC’s customers are loyal even though there are many competitors in the industry. Although the chemical industry is competitive, the switching cost for suppliers is high.

**Buyer Power/High Profitability**

Commodities now make up the majority of TREC’s revenue, and the company has a large amount of money in investment towards capital projects and new plant expansions. This will cause a significant blow to the company’s bottom line.

**Supplier Power/High Profitability**

TREC uses one supplier for their wax segment. This supplier is expecting an outage in Q1 2019, and TREC is trying to find a new source of wax. TREC’s dependence on this supplier has put the company in a compromising situation.

**Threat of Generic/High Profitability**

This industry has many competitors. Companies in the chemical industry each produce mostly undifferentiated products, making the industry relatively uncompetitive.

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**Key Economic Drivers**

**Price Volatility of Commodities Demand**

TREC’s revenues are not only affected by the US economy but also the prices of commodities. In Appendix A, we show the results of a regression that showed how TREC’s revenue is heavily determined by the industrial production index (a measure of the US economy), WTI oil prices, and Henry Hub natural gas prices. In conclusion, TREC uses oil prices as a benchmark for pricing products. The regression shows that as WTI and Henry Hub oil prices increase, so do TREC’s revenues. However, when natural gas prices are high, TREC has to spend more time to make chemicals. The price of commodities affects TREC because there is uncertainty about which way their price will go.

**Chinese Trade War Will Increase Export Prices**

More than $100B of chemicals and plastics face tariffs now after the Chinese have placed retaliatory tariffs on many U.S. exports. The trade war mainly affects the American agriculture, automotive, and chemical industries. Companies must pay the tariff and can either absorb the cost or pass the cost on to the customer.

**Trouble Costs that Could Afflict Business in Saudi Arabia**

In August 2018, the U.S. State Department went out a travel advisory for Saudi Arabia because of terrorism and threats of missile attacks on civilian targets. The US State Department specifically restricted travel to the areas of the country that are within 50 miles of the border. AMAK’s mine is located near the town of Najran which is listed in the warning. A short-range missile or drone strike could be an imminent threat to the mine. This is one of two major concern for the mine. The other is that in October 2018, Saudi journalist Jamal Khashoggi was murdered while in the Saudi consulate in Istanbul. While at the moment this event has not directly affected AMAK, it has affected other industries of trade between the US and Saudi Arabia.

**Financial Analysis**

**Operational Efficiency - TREC**

Trecora Resources’ petrochemical and division has not been very efficient in the past. They have a normalized operating profit margin of 8.5% and will need to increase that if they are going to maximize shareholder value. The company has recently completed all of their big projects including their Advanced Refiner. This mass is used to convert lower quality by-products into higher quality products. As a result of their efficient capital expenditure projects, the company’s earnings have increased in the past few years, and they are expected to continue to increase by 1% to 2%.

**Operational Efficiency - AMAK**

In order to effectively and accurately value AMAK, we had to model our forecast with the assumption that management will focus predominantly on moving their negative OPM to a positive OPM. Currently, Crude Oils are low, but government regulation and market competition could cause oil prices to increase and affect TREC's returns. TREC’s debt has greatly increased in the past few years, if a recession occurs TREC may not be able to meet its break-even point.

**New Management - TREC**

Not only should Trecora's margins increase from improved operations, but also from a new management team. The company has recently made changes at CEO and Chief Manufacturing Officer. These two executives have been charged with the task of making their operations more reliable and efficient. They have promoted a new plan of "operational excellence". TREC's new executives should be able to improve margins with all of their big capital projects now completed.

**New Management - AMAK**

In 2015, AMAK terminated their contract with the Chinese mining company who was in charge of maintaining their mine. This increased the company’s costs of production and therefore decreased their margins. AMAK’s mine is located near the town of Najran which is listed in the warning. A short-range missile or drone strike could be an imminent threat to the mine. This is one of two major concerns for the mine. The other is that in October 2018, Saudi journalist Jamal Khashoggi was murdered while in the Saudi consulate in Istanbul. While at the moment this event has not directly affected AMAK, it has affected other industries of trade between the US and Saudi Arabia.

**Investment Summary**

TREC aims to provide the highest levels of quality and reliability for customers while operating efficiently and bringing their debt to normalized levels. Because TREC is a cyclical company that is affected by crude oil and NGL prices, as the economy expands, TREC’s customers demand more product, however if the economy contracts, TREC’s customers do not have as high of demand for TREC’s products. TREC’s strategy to improve its margins and operations appears to be two-fold. Each member of TREC’s new management team has significant experience in the chemical industry, and it appears that they have a plan to move the company forward toward its goal of “operational excellence”. This plan assumes that the company will succeed in increasing the company’s profit margin while keeping their debt to normalized levels. This will be overseen by Dick Townsend, TREC’s new Chief Manufacturing Officer, and it will focus on safety, sustainability, and consistency. The second part of TREC’s plan to improve its operations and margins is to reduce the company’s debt. The company has a large amount of money in investment towards capital projects and new plant expansions. This will cause a significant blow to the company’s bottom line.

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**Stock Price Target:** $14.38