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%.

Key Highlights
- Potential monetization of AMAK Ownership
- Trecora Resources (TREC) plans to divest the 33.4% of Al Masane Al Kobra (AMAK). AMAK’s year-to-date EBITDA through the third quarter in 2018 was up $21 million from 2017 because of operations becoming more consistent, thus resulting in a higher generation of cash flow.
- Manufacturing Transformation Plan (MTP) focus on safe, high quality, and productive work
- 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 play in order to improve profitability and safety. A standard of simplified, efficient, and consistent work processes is being put into action in hopes of improving quality without compromising safety. The plan will slightly affect the workforce 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 single-cell business owned by mining newly found minerals in Saudi Arabia. When they had the opportunity to expand into the hydrocarbon field, they ran with it and became a leader in producing high purity light hydrocarbons. TREC also provides a variety of custom processing through their specialty wax 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 revenue in a positive way. The EIA predicts that Brent crude’s oil revenue will reach $113.56 based on the assumption that petroleum demand levels off, the growth rate goes to 0 annually, and annual energy consumption increases 4%. Life cycle waste management is an essential part of a company’s green strategy. The company’s goal is to reduce, reuse, and recover materials to extend their lifecycle. The company’s strategy is to reduce its waste generation and increase its recycling efforts.
  - 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 in 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 the demand for chemicals 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 breakpoint.

Business Description

Headquarters 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 35.4% 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 connects natural resources that you can touch.” The company has two segments of operation: Saudi Hampton Resources (SHR) that concentrates in petrochemical production and Trecora Chemical (TC) which focuses on specialty production.

Competitive Positioning

Market Leader in High Purity Paraffins
TREC has market share of about 60% in the high purity paraffin market with only one competitor, Phillips 66. High purity paraffins are used for ink solvents, chemical intermediates, and blowing agents for polypropylene. High-Purity Light Paraffins are used in a variety of uses for 82% of SHR’s revenues in 2017. SHR expects the petrochemical industry to continue its growth at the production facility. This led to the introduction of a new line that would be able to process a higher concentration.

Factory Improvements Increase Capacity to Meet Future Demand
When the Advanced Refiner at SHR is complete, the facility’s design capacity should increase by 4,000 barrels per day. The purpose of the Advanced Refiner is to convert the byproducts of petrochemicals into higher quality products that can be sold at higher prices. TREC

Porter’s Five Forces

Threat of Entry/Low
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 brand loyalty in this industry face.

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

Relative Power of Buyers/High
EatonMobil and its affiliates accounted for about 20% of TREC’s sales revenue in 2016 and 2017. If Eaton takes its business elsewhere, then this could cause a significant blow to the firm’s bottom line.

Relative Power of Suppliers/High
TREC uses one supplier for its 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 Rivals/High
This industry has many competitors. Companies in the chemical industry produce mostly undifferentiated products, making the industry relatively diverse.

Key Economic Drivers

Price Volatility of Commodities Drives Prices
TREC’s revenues are not only affected by the US economy but also the prices of commodities. In Appendix 1, we show the results of a regression that showed how TREC’s revenue is heavily determined by the industrial production index (IP), the NASDAQ index (NDQ), WTI oil prices, and Henry Hub natural gas prices. We can see that TREC uses oil prices as a benchmark for pricing products. The regression shows that as INDP and WTI oil prices increase, so do TREC’s revenues. However, when natural gas prices are high, TREC has to spend more time making their chemical products. The price of commodities are risks to TREC because there is uncertainty about which way their price will go.

Chinese Trade War Will Increase Export Prices
More than $100 billion in 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 onto the customer.

Terrorism Threats Could Affect Business in Saudi Arabia
In August 2018, the U.S. Department went out a travel advisory for Saudi Arabia because of terrorism and threats of missile attacks on civilian targets. The 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 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.

Financial Analysis

Operational Efficiency - TREC
Trecora Resources’ petrochemical and oil & gas divisions have not been very efficient in the past. They have normalized operating profit margin of 8.9% and will need to increase if they are going to maximize shareholder value. 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 complete.

New Management - AMAK
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 complete.

New Management - AMAK
In 2015, AMAK terminated their contract with the Chinese mining company who was in charge of maintaining mining operations for nearly two years. This contract was to provide the needed OPM to keep the mine operational. Currently, Crude Oils are low, but government regulation and market competition could cause oil prices to increase and affect TREC’s revenue in a positive way. The EIA predicts that Brent crude’s oil revenue will reach $113.56 based on the assumption that petroleum demand levels off, the growth rate goes to 0 annually, and annual energy consumption increases 4%.

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, it affects the price of crude oil and NG 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 is to improve its margins and operations to appear 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 also states that they will oversee by Dick Townend, TREC’s new Chief Manufacturing Officer, and it will focus on safety, sustainability, and consistency. The second part of TREC’s plan is to improve its operations and strategies that it has spent a large amount of money to invest towards its capital plan. Unfortunately, the company has been affected by the“Arabian” Unit and the Advanced Refomer Unit. TREC plans on these projects expanding its capacity, improving its operational reliability, and strengthening its margins. If TREC’s discounts AMAK at or even below its current price, shares should dramatically decrease. Decreasing leverage should improve TREC’s margins. TREC could potentially expand its business and cash flow from improving its operations. Overall, by decreasing its leverage, TREC should be in a better economic position if a recession begins.