

## **IQCD Alert – 3Q2020 Adjusted Earnings Exceed Estimate; Stay Accumulate with QR11.5 PT**

- **IQCD net profit declined 19.2% YoY but on an adjusted basis rose 0.7% YoY, which exceeded our estimate** – Industries Qatar's (IQCD) net profit declined 19.2% YoY (but rose 65.6% on QoQ basis) to QR466.0mn in 3Q2020. However, adjusted net profit (excluding an impairment charge recorded for Qatar Melamine Co. or QMC) increased 0.7% YoY to QR580.8mn, which was 12.4% ahead of income expectations of QR516.7mn for 3Q2020. *We note our previously disclosed 3Q2020 earnings estimate of QR590.0mn assumed a 100% consolidation of QAFCO earnings. However, IQCD only recorded 75% of QAFCO earnings, under IFRS, during 9M2020. Thus, we have adjusted our previous earnings estimate for an apple-to-apples comparison.* The earnings beat, on an adjusted basis, was driven primarily by better-than-anticipated profitability in petchems and a modest upside in steel.
- **According to IQCD, ~10% lower blended ASPs YoY dented normalized net income by roughly QR0.9bn in 9M2020.** Petchems made up ~QR0.6bn of this decline and fertilizers contributed ~QR0.3bn. Overall sales volumes declined by roughly 20% vs. 9M2019 due to weaker demand, lower production given mothballing of steel facilities and periodic planned/unplanned maintenance. Fertilizer sales volume also declined as QAFCO could not recognize sales from QAFCO 1-4 under the interim gas processing agreement, which was in place until July 31, 2020. This temporary arrangement was replaced with a unified gas sales & purchase agreement (GSPA) covering QAFCO 1-6 and QMC from August 1, 2020. We remind investors that this new GSPA was part of a bundled deal along with IQCD's \$1bn purchase of the remaining 25% stake in QAFCO from QP.
- **Group revenue of QR8.0bn declined ~21% YoY from QR10.2bn in 9M2019.** Besides the previously mentioned mothballing of steel facilities, there were no demand-driven major stoppages of production with 9M2020 production volumes coming in at 12MT, down 6% YoY. As previously disclosed, there was a planned shutdown of the MTBE facility for a short period (57 days) in 2Q2020, which had an immaterial impact on overall results. Overall production volumes benefited from IQCD's acquisition of the remaining 25% stake in QAFCO, effective from January 1, 2020.
- **Relative to 2Q2020, overall revenue and normalized earnings increased ~22% and ~50%, respectively, QoQ.** 3Q2020 performance benefited from sequential improvement in product prices and lack of major shutdowns during the quarter. IQCD benefited from the gradual recovery in the global economy that began in the latter part of 2Q2020.

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- **Petrochemical margins improve boosting profitability despite in-line segment revenue.** 3Q2020 segment revenue of QR1.0bn (down ~5% YoY) was bang in-line with our model, while earnings were higher than forecasted. Segment earnings of QR315.1mn fell 6.1% YoY but increased 69.3% QoQ. Net margin expanded from record lows of 12.9% in 1Q2020 to 24.6% in 2Q2020 and 30.8% in 3Q2020. Relative to 9M2019, realized prices fell ~20% YoY offsetting sales volume that increased roughly 2%. This led to a segment revenue decline of ~18% in 9M2020; 9M2020 segment earnings declined 37.7% to QR624.3mn from QR1.0bn in 9M2019. Prices remained under pressure, down ~20% YoY, given the dual macro headwinds of crude price weakness and economic malaise created by COVID-19 (especially during 1H2020). Production volumes, closely matched sales volumes, up ~2% YoY as lower PE production was offset by higher fuel additives volumes.
- **Fertilizers revenue falls short of our expectations with modest adjusted margin improvement on a sequential basis.** 3Q2020 revenue and net income of QR1.1bn and QR82.0mn increased 0.9% but declined 49.8%, respectively, on a YoY basis. Sequentially, segment revenue increased 18.4% but earnings fell 53.0%. We note IQCD booked a QR153.0mn impairment loss at QMC as melamine prices remained under pressure and adjusting for this impairment charge, segment earnings would have come in at QR235.0mn, up 43.8% YoY/34.8% QoQ. Adjusted profits were lower than our forecast given moderately softer margins and revenue coming in 15.7% lower than our forecast. According to the company, selling prices declined ~11% YoY in 9M2020 due to weak seasonal demand; sales volumes fell ~19% vs. 9M2019 primarily due to the interim agreement for QAFCO 1-4, which was in place until July 31, 2020. This was partially offset by additional volumes recognized via the acquisition of the 25% stake in QAFCO from QP. As a result, overall fertilizer revenue fell 6.4% YoY in 9M2020. Fertilizer production, unlike sales volumes, remained relatively robust, up ~2% YoY (up roughly 36% including the acquisition) in 9M2020 with the segment experiencing minimal planned and unplanned maintenance shutdowns. We note this purchase added QR110.9mn to normalized income and QR313.5mn in FCF during 9M2020.
- **3Q2020 steel revenue comes in bang in-line with our model with the segment turning profitable as expected.** Steel revenue of QR538.5mn (-61.7% YoY, 9.5% QoQ) was comparable to our estimate of QR532.1mn. The steel segment posted a profit of QR26.1mn in 3Q2020 vs. our expectation of QR12.2mn (*continued on next page*).

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- *(continued from previous page)* Overall selling prices were flattish YoY vs. 9M2019. Sales volumes also retreated driven by muted construction demand, which was further exacerbated by the global pandemic. IQCD continued to point to soft domestic demand given the completion of a majority of large infrastructure projects. The company did state that near-to-medium-term domestic prospects remained encouraging. Sales volumes were also significantly impacted by the mothballing of certain steel facilities (domestic rebar capacity lowered to 0.8MTPA from 1.5MTPA previously). Production volumes declined ~50% YoY during 9M2020. IQCD also witnessed higher costs given sales of expensive inventories in 9M2020, which was offset by costs savings due to mothballing and optimization initiatives.
- *For more details on the company's performance and our estimates, please refer to page 4.*
- **Despite paying \$1bn (net of cash acquired) for the QAFCO deal, IQCD's balance sheet continues to remain solid with QR8.8bn in cash/bank balances and zero debt.** The company generated operating cash flow of QR2.5bn and free cash flow of QR2.1bn in 9M2020, which highlights its operational efficiency and ability to generate significant positive cash flows despite challenging conditions. Net-net, given IQCD's strong balance sheet, we expect the company to withstand difficult market conditions while retaining dry powder to take advantage of potential acquisition opportunities in the future.
- **We maintain our Accumulate rating on IQCD with a QR11.50 price target.** As we have noted previously, we see modest upside to our existing QR1.4bn earnings estimate for IQCD in 2020. Management has recently signaled stability in DPS going forward, which could imply flattish YoY DPS in 2020 despite significant EPS decline. Similar to the QAFCO deal, IQCD could look to acquire Total's 20% stake in QAPCO, which could also be perceived positively by investors.

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In QR Millions

Steel	3Q2019	2Q2020	3Q2020	3Q2020e	A Vs. E
Revenue	1,404.394	491.606	538.513	532.145	1%
Net Profit	10.672	(1,301.0)	26.084	12.203	114%
<i>NM %</i>	<i>0.76%</i>	<i>-264.64%</i>	<i>4.84%</i>	<i>2.29%</i>	
<i>Revenue Q/Q</i>	<i>34%</i>	<i>-62%</i>	<i>10%</i>	<i>8%</i>	
<i>Net Income Q/Q</i>	<i>-87%</i>	<i>1374%</i>	<i>N/M</i>	<i>N/M</i>	
<i>Revenue Y/Y</i>	<i>-8%</i>	<i>-53%</i>	<i>-62%</i>	<i>-62%</i>	
<i>Net Income Y/Y</i>	<i>-93%</i>	<i>N/M</i>	<i>144%</i>	<i>11%</i>	
Petrochemicals	3Q2019	2Q2020	3Q2020	3Q2020e	A Vs. E
Revenue	1,076.335	756.000	1,023.000	1,017.813	1%
Net Profit	335.727	186.147	315.084	261.578	20%
<i>NM %</i>	<i>31.19%</i>	<i>24.62%</i>	<i>30.80%</i>	<i>25.70%</i>	
<i>Revenue Q/Q</i>	<i>-4%</i>	<i>-21%</i>	<i>35%</i>	<i>44%</i>	
<i>Net Income Q/Q</i>	<i>-6%</i>	<i>51%</i>	<i>69%</i>	<i>41%</i>	
<i>Revenue Y/Y</i>	<i>-29%</i>	<i>-33%</i>	<i>-5%</i>	<i>-5%</i>	
<i>Net Income Y/Y</i>	<i>-49%</i>	<i>-48%</i>	<i>-6%</i>	<i>-22%</i>	
Fertilizers	3Q2019	2Q2020	3Q2020	3Q2020e	A Vs. E
Revenue	1,042.303	888.283	1,051.673	1,247.048	-16%
Net Profit	163.402	174.353	82.012	293.056	-72%
<i>NM %</i>	<i>15.68%</i>	<i>19.63%</i>	<i>7.80%</i>	<i>23.50%</i>	
<i>Revenue Q/Q</i>	<i>0%</i>	<i>-15%</i>	<i>18.4%</i>	<i>87%</i>	
<i>Net Income Q/Q</i>	<i>-29%</i>	<i>-12%</i>	<i>-53.0%</i>	<i>124%</i>	
<i>Revenue Y/Y</i>	<i>-5%</i>	<i>-15%</i>	<i>0.9%</i>	<i>23%</i>	
<i>Net Income Y/Y</i>	<i>-61%</i>	<i>-24%</i>	<i>-49.8%</i>	<i>79%</i>	
Total Revenue	3,523.032	2,135.889	2,613.186	2,797.006	-7%
YoY Growth	-15%	-34%	-26%	-20%	
QoQ Growth	9%	-35%	22%	50%	
Steel	40%	23%	21%	19%	
Petrochemicals	31%	35%	39%	36%	
Fertilizers	30%	42%	40%	45%	
Total NI (Ex. Unallocated)	509.801	(940.502)	423.180	566.837	-25%
Steel	2%	138%	6%	2%	
Petrochemicals	66%	-20%	74%	46%	
Fertilizers	32%	-19%	19%	52%	

### Recommendations

*Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*

**OUTPERFORM** Greater than +20%

**ACCUMULATE** Between +10% to +20%

**MARKET PERFORM** Between -10% to +10%

**REDUCE** Between -10% to -20%

**UNDERPERFORM** Lower than -20%

### Risk Ratings

*Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*

**R-1** Significantly lower than average

**R-2** Lower than average

**R-3** Medium / In-line with the average

**R-4** Above average

**R-5** Significantly above average

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