Industries Qatar (IQCD)

Recommendation	**ACCUMULATE**	**Risk Rating**	**R-3**
Share Price	**QR169.00**	**Target Price**	**QR190.55**
Implied Upside	**13%**		

Weak 4Q2012 Results Given Fertilizer Shutdowns; Changing Rating to Accumulate

4Q2012 results impacted by fertilizer shutdowns and losses/impairments in Bahraini steel associate; preliminary flattish net income guidance for 2013, while conservative could be concerning. IQCD reported a disappointing 4Q2012 with minor shutdowns (ammonia: 26 days, urea: 18 days) weighing on the top-line. While the company stated that these shutdowns were planned, we believe that they had not been fully communicated to investors previously. Losses and impairments at IQCD's Bahraini steel associate also crimped the bottom-line, in our view. ***The company also announced cash DPS of QR8.50 and a 10% stock dividend,*** which while in line with historical payouts was again somewhat subdued given IQCD's strong cash position (QR3.2bn in 2012 net cash vs. QR0.1bn in 2011) and lack of major announced expansions. ***IQCD also guided to flat 2013 earnings (vs. our estimate of +7%YoY), which while conservative could also concern investors.*** The company stated that its 2013 net income guidance is pegged on moderate incremental volume and minimal price inflation being offset by rising production costs. We believe that this guidance is conservative as: (1) low-single digit growth in petrochemical volume (LDPE-3 launched in 3Q2012 with 84% utilization by end-2012; a major maintenance shutdown has also been pushed into 1Q2014 from 1Q2013); (2) flattish steel volume (conservative as EF-1/2 will continue to operate until early 2015 vs. previous discontinuation in 1H2013, along with the commercial launch of EF-5 in 2Q2013) and (3) mid-double digit YoY increase in fertilizer volume (full year contributions from QAFCO 5/6, which exited 2012 at 86% and 82% urea utilization, respectively) should help boost 2013 net income. We maintain our estimates going forward in anticipation of IQCD's detailed 5-year (2013-2017) business plan (to be released in late-March 2013). Realized prices remain the major risk to our forecasts. ***Despite the 4Q2012 miss, we remain optimistic on IQCD longer term but change our rating to Accumulate.***

Financial Results and Key Takeaways

- **4Q2012 top-line of QR4.5bn (-13% QoQ/+11% YoY) was 7% below our estimate and consensus of QR4.8bn.** Revenue missed our estimate due to weaker-than-expected fertilizer and steel top-lines. By segment in 4Q2012: (1) Petrochemicals (QR1.8bn; 40% of revenue) beat our modeled estimate driven by better-than-expected price realizations; LDPE-3 ramped up during the quarter, closing 2012 at a utilization rate of 84%. Overall segment utilization improved 5.6 percentage points QoQ with negligible shutdown days. (2) Fertilizer (QR1.4bn; 30%) was a disappointment with shutdowns marring performance after a record 3Q2012. (3) Steel (QR1.3bn; 30%) revenue was impacted by moderately lower sales volume and price declines. For 2012, IQCD posted overall revenue of QR18,698mn (+13%) with growth primarily driven by QAFCO 5/6 volumes. *(Executive Summary continued on Page 2)*

Key Data

Current Market Price (QR)	169.00
Dividend Yield (%)	5.0
Bloomberg Ticker	IQCD QD
ADR/GDR Ticker	N/A
Reuters Ticker	IQCD.QA
ISIN	QA000A0KD6K3
Sector*	Industrials
52wk High/52wk Low (QR)	176.00/124.90
3-m Average Volume ('000)	215.4
Mkt. Cap. ($ bn/QR bn)	25.5/93.0
Shares Outstanding (mn)	550.0
FO Limit* (%)	12.3
Current FO* (%)	6.8
1-Year Total Return (%)	31.7
Fiscal Year End	December 31

Source: Bloomberg (as of February 21, 2013), *Qatar Exchange (as of February 21, 2013); Note: FO is foreign ownership

Broker Recommendations

Recommendation	Number
Buy	13
Hold	0
Sell	1

Source: Bloomberg

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4Q2012, Actual vs. Estimates

	4Q2012	QoQ	YoY	4Q2012e	A vs. E	Consensus	A vs. C
Revenue	4,473	-13%	11%	4,824	-7%	4,818	-7%
Petrochemicals	1,792	3%	8%	1,596	12%	N/A	N/A
Fertilizer	1,357	-29%	26%	1,781	-24%	N/A	N/A
Steel	1,324	-12%	4%	1,448	-9%	N/A	N/A
EBITDA	2,312	-21%	16%	2,601	-11%	2,554	-9%
Net Income	1,784	-32%	6%	2,308	-23%	2,441	-27%

Source: Company data, QNBFS estimates, Reuters, Bloomberg

- **December quarter net income of QR1.8bn (-32% QoQ/+6% YoY) was 23% below our estimate and 27% shy of consensus.** (1) EBITDA of QR2.3bn (-21% QoQ/+16% YoY) was some 11% below our estimate driven by the top-line miss, lowered profitability (GPM fell to 59.5% in 4Q2012 vs. 62.5% in 3Q2012 and our estimate of 60.5%) and higher-than-expected SG&A expenses. The EBITDA margin declined to 51.7% vs. 57.0% in 3Q2012 and our estimate of 53.9%. (2) Net income was further impacted by slightly greater-than-expected depreciation expenses as QAFCO-6/LPDE-3 were capitalized during the quarter and QR257mn in charges (including QR150mn in impairment losses) due to IQCD's Bahraini steel associate.
- **The company also announced cash DPS of QR8.50 and a 10% stock dividend.** This translates into a yield of 5.0% along with a payout of 55.4% in 2012, which is in line with the average payout during 2009-2011. According to the press release, IQCD's board has approved a revised dividend policy targeting a consistent growth rate in dividends over the upcoming five-year period. While we were not expecting a stock dividend, we believe that the company adopted a somewhat conservative stance on their cash dividends. Given IQCD's strong net cash position and lack of significant announced expansion projects, we believe that IQCD could have offered a better cash dividend component in 2012.
- **IFRS 11 adoption to shrink reported top-line and balance sheet but have no impact on net income and cash flow.** IQCD has to adopt International Accounting Standard Board's IFRS 11 rule from 2013. Under this accounting requirement, the company can no longer record proportional revenue and costs contribution from its JVs (QAPCO, QAFCO and QFAC) and instead has record them using the equity method. Thus going forward, IQCD's consolidated top-line will only consist of its wholly-owned steel subsidiary's revenue and the share of net income of these JVs will be reported as a separate line item in the income statement. Overall, total net income and shareholders' equity will not change but the balance sheet size will shrink with assets and liabilities associated with these JVs recorded as a single line item depicting investments in joint ventures. *We note that Qatar Electricity & Water (QEWS) will also have to adopt IFRS 11 going forward.*

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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