

IQCD Alert – Weak 1Q2020 Earnings & Outlook Remains Challenging; Market Perform

- **IQCD posts a significantly weaker-than-expected 1Q2020; softness likely across segments going forward given dual macro headwinds of crude price meltdown and economic malaise created by the Coronavirus pandemic – IQCD reported 1Q2020 net income of QR204mn (-70% YoY, -62% QoQ), which was 55% lower than our Street-low estimate of QR450mn (Bloomberg consensus of QR467mn). According to IQCD, of the YoY QR470mn decline in earnings, average price decline of 2% wiped out QR262mn in net income. **Group revenue (which includes steel, petchems and fertilizers) came in at QR3.0bn, down ~13% both YoY and QoQ.** While production volume of 4 MT was up marginally YoY, group sales volume came in at a lower 1.9 MT, which was down 18% YoY. The fall in sales volume was attributed to changes in the sales & operating agreement for QAFCO trains 1-4, which did not allow IQCD to recognize sales volume from these trains on its books in 1Q2020 (more details below). On a sequential basis, realized prices gained 13% mostly because of better steel prices offsetting the overall price weakness due to the Coronavirus/oil price-related softness particularly felt in the fuel additives sub segment in petchems. QoQ sales volume fell 29% for the group mainly due to the aforementioned change in QAFCO 1-4's contract. Overall production volume was not impacted by COVID-19 & its 7% QoQ fall was due to maintenance shutdowns in steel/fuel additives.**
- **Petrochemical margins disappoint given challenging conditions.** 1Q2020 segment revenue of QR951mn (down 15% YoY) was in-line with our model, while earnings were 53% softer than forecasted. Segment earnings of QR123mn fell 60% YoY. Net margin of 13% was the weakest on record in our model, which goes back to 2012 on a quarterly segmental basis. Realized prices dipped 14% YoY driven by weak crude and soft demand in key markets, while sales volume was down 1% also impacted by planned maintenance in a PE facility. Overall production volume increased 4% as 1Q2019 had a higher number of planned and unplanned maintenance shutdowns.
- **Fertilizers revenue falls short of our expectations with margins consistent with 1Q2019; interim QAFCO 1-4 agreement serves to lower sales volume but is likely earnings neutral.** 1Q2020 revenue and net income of QR780mn and QR148mn, both declined 29% YoY and fell short of our forecasts by 28% and 45%, respectively. Net margin of 19% was in-line with 1Q2019 but below 4Q2019's 25%. YoY prices declined 15% due to more challenging market conditions relative to last year when prices were aided by supply side curbs. We note sales volume fell 40% because of the change in sales and operating agreement for QAFCO 1-4 mentioned previously. The prior gas sales and purchase agreement which sets the feedstock price for trains 1-4 expired in December 2019 and while a new agreement is in discussion with QP, it was delayed as Qatar Petroleum was occupied in negotiating and finalizing its purchase of Yara's 25% stake in QAFCO. As an interim measure, QP and QAFCO have entered into a sales and operating agreement for QAFCO 1-4 to ensure business continuity. This puts in place, on an interim basis, a gas processing agreement where QAFCO would receive the gas from QP and act as a producing agent to convert this gas to ammonia which would be used to produce urea. This urea would be then off-taken by QP in return for a processing fee plus a margin paid to QAFCO. Thus, QP would record the sales volume on its books and QAFCO would record the margin. Overall this interim agreement lowers IQCD fertilizer sales volume but is probably neutral to fertilizer earnings. QP and QAFCO expect to replace this interim agreement with a permanent one in the future that should be in-line with the original agreement that expired back in end-2019. Production volume, unlike sales volume, remained relatively stable, up 6% YoY, with fertilizers experiencing minimal planned and unplanned maintenance shutdowns in 1Q2020.

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- **Steel revenue surprises on the upside but higher priced inventory continue to squeeze margins, IQCD has temporarily resized Qatar rebar capacity by almost 50% in order to cater to only domestic demand.** Steel revenue of QR1.3bn (3% YoY, -6% QoQ) was 11% higher than our estimate of QR1.2bn and cash gross margins, while still being influenced by sales of expensive inventories, came in at -0.8% vs. -6.7% in 4Q2019 and our forecast of -6.0%. Net loss of QR88mn for 1Q2020 came in better than our estimate of a net loss of QR150mn and 4Q2019's net loss of QR122mn; IQCD reported net income of QR62mn for the steel segment in 1Q2019. Prices fell YoY by 3% due to several factors, including lower demand and higher competition. On the plus side, the steel segment was able to grow its volumes by 6% over 1Q2019. IQCD continued to point to soft domestic demand given the completion of a majority of large infrastructure projects. Moreover, the ongoing pandemic hurt construction activity; the company did state that near-to-medium-term domestic prospects remained encouraging. However, as has been the case, international competition remained strong from lower-cost EM producers despite the new challenges created by the Coronavirus. Given low levels of profitability in international markets, IQCD has decided to temporarily mothball part of its steel operations from 2Q2020 cutting its domestic rebar capacity to 0.8 MT (from 1.5 MT previously). The company's strategy is now to avoid international markets and cater to domestic demand exclusively.
- *For more details on the company's performance and our estimates, please refer to pages 3 and 4.*
- **Balance sheet continues to remain solid with QR10.9bn in cash/bank balances and zero debt.** The company generated operating cash flow of QR1.1bn and free cash flow of QR922mn in 1Q2020, 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 the dry powder to take advantage of potential acquisition opportunities in the future.
- **Retain Market Perform rating; will be lowering estimates and price target shortly.** Near-to-medium term market conditions remain challenging to say the least. In its press release, the company stated the full effects of the pandemic were not reflected in 1Q2020 results as the commodity markets only started to get impacted from February onward. Moreover, product prices also have not yet factored in completely the decline in oil prices and the weakness in crude seen so far in 2Q2020 should create additional headwinds. While the steel segment should benefit margin-wise given focus on domestic sales and fertilizers could possibly remain stable in the near-term, the dual pressure of lower oil prices and the Coronavirus create significant uncertainty. We retain our Market Perform rating but will likely revise our estimates/PT lower. With earnings under pressure in the medium-term, investors will seek answers regarding deployment of IQCD's cash pile and its strategy.

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Income Statement (QR million)	1Q2019	4Q2019	1Q2020	1Q2020e	A Vs. E	YoY	QoQ
Revenue	1,261.848	1,378.291	1,302.053	1,171.547	11.1%	3.2%	-5.5%
Cost of Sales (Ex. Depreciation & Amortization)	(1,138.380)	(1,471.018)	(1,312.047)	(1,241.840)	5.7%	15.3%	-10.8%
Gross Profit	123.468	(92.727)	(9.994)	(70.293)	-85.8%	N/M	-89.2%
General and Administrative Expenses	(30.909)	(34.473)	(31.885)	(32.000)	-0.4%	3.2%	-7.5%
Selling Expenses	(17.586)	(27.410)	(16.917)	(26.000)	-34.9%	-3.8%	-38.3%
EBITDA	74.973	(154.610)	(58.796)	(128.293)	-54.2%	N/M	-62.0%
Depreciation & Amortization	(73.885)	(71.490)	(69.385)	(72.000)	-3.6%	-6.1%	-2.9%
EBIT	1.088	(226.100)	(128.181)	(200.293)	-36.0%	N/M	-43.3%
Finance Costs	(2.577)	(2.696)	(2.842)	(2.500)	13.7%	10.3%	5.4%
Share of Results from Associates	36.561	(16.043)	15.190	36.927	-58.9%	-58.5%	N/M
Share of Results of JVs	517.076	576.813	270.864	530.192	-48.9%	-47.6%	-53.0%
Other Income	121.887	106.157	48.761	85.321	-42.8%	-60.0%	-54.1%
Income from Investments & Other Income/Expenses		100.000					
Profit Before Tax	674.035	538.131	203.792	449.647	-54.7%	-69.8%	-62.1%
Tax							
Profit After Tax	674.035	538.131	203.792	449.647	-54.7%	-69.8%	-62.1%
Minority Interest							
Profit for Equity Holders	674.035	538.131	203.792	449.647	-54.7%	-69.8%	-62.1%
<i>Net Margin</i>	53.4%	39.0%	15.7%	38.4%			
EPS (in QR)	0.11	0.09	0.03	0.07	-54.7%	-69.8%	-62.1%
Cost of Sales	90.2%	106.7%	100.8%	106.0%			
Gross Margin %	9.8%	-6.7%	-0.8%	-6.0%			
G&A % Sales	2.4%	2.5%	2.4%	2.7%			
Selling Expenses % Sales	1.4%	2.0%	1.3%	2.2%			
EBITDA %	5.9%	-11.2%	-4.5%	-11.0%			
D&A % Sales	5.9%	5.2%	5.3%	6.1%			
EBIT %	0.1%	-16.4%	-9.8%	-17.1%			

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In QR Millions

Steel	1Q2019	4Q2019	1Q2020	1Q2020e A	Vs. E
Revenue	1,261.848	1,378.291	1,302.053	1,171.547	11%
Net Profit	61.848	(121.818)	(88.274)	(150.297)	-41%
<i>NM %</i>	<i>4.90%</i>	<i>-8.84%</i>	<i>-6.78%</i>	<i>-12.83%</i>	
<i>Revenue Q/Q</i>	<i>2%</i>	<i>-2%</i>	<i>-6%</i>		
<i>Net Income Q/Q</i>	<i>-53%</i>	<i>-1212%</i>	<i>-28%</i>		
<i>Revenue Y/Y</i>	<i>-8%</i>	<i>12%</i>	<i>3%</i>		
<i>Net Income Y/Y</i>	<i>-81%</i>	<i>-193%</i>	<i>N/M</i>		
Petrochemicals	1Q2019	4Q2019	1Q2020	1Q2020e A	Vs. E
Revenue	1,118.824	1,072.216	951.000	964.995	-1%
Net Profit	309.887	305.737	123.023	260.549	-53%
<i>NM %</i>	<i>27.70%</i>	<i>28.51%</i>	<i>12.94%</i>	<i>27.00%</i>	
<i>Revenue Q/Q</i>	<i>-21%</i>	<i>0%</i>	<i>-11%</i>		
<i>Net Income Q/Q</i>	<i>-30%</i>	<i>-9%</i>	<i>-60%</i>		
<i>Revenue Y/Y</i>	<i>-28%</i>	<i>-24%</i>	<i>-15%</i>		
<i>Net Income Y/Y</i>	<i>-53%</i>	<i>-31%</i>	<i>-60%</i>		
Fertilizers	1Q2019	4Q2019	1Q2020	1Q2020e A	Vs. E
Revenue	1,098.277	1,100.587	780.453	1,078.576	-28%
Net Profit	207.189	271.076	147.841	269.644	-45%
<i>NM %</i>	<i>18.86%</i>	<i>24.63%</i>	<i>18.94%</i>	<i>25.00%</i>	
<i>Revenue Q/Q</i>	<i>-22%</i>	<i>8%</i>	<i>-29%</i>		
<i>Net Income Q/Q</i>	<i>-59%</i>	<i>66%</i>	<i>-45%</i>		
<i>Revenue Y/Y</i>	<i>-2%</i>	<i>-22%</i>	<i>-29%</i>		
<i>Net Income Y/Y</i>	<i>3%</i>	<i>-47%</i>	<i>-29%</i>		
Total Revenue	3,478.949	3,551.095	3,033.506	3,215.118	
<i>YoY Growth</i>	<i>-14%</i>	<i>-12%</i>	<i>-13%</i>		
<i>QoQ Growth</i>	<i>-14%</i>	<i>-1%</i>	<i>-15%</i>		
Steel	36%	39%	43%		
Petrochemicals	32%	30%	31%		
Fertilizers	32%	31%	26%		
Total NI (Ex. Unallocated)	578.924	454.995	182.590		
Steel	11%	-27%	-48%		
Petrochemicals	54%	67%	67%		
Fertilizers	36%	60%	81%		

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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