IQCD Alert – A Significant Miss in 3Q2019 Driven by Petchems & Steel; Stay Market Perform

- **IQCD posts a 56.2% YoY & a 26.6% QoQ decrease in 3Q2019 net profit missing our estimate –** Industries Qatar's (IQCD) 3Q2019 net profit of QR576.9mn missed our street-low estimate (per Bloomberg) of QR801.0mn by 28.0%. As far as we can tell, the majority of the miss came from lower-than-expected JV income (likely because of the petchem segment) and another leg down in steel margins after 2Q2019's respite. JV income declined 53.5% YoY and 15.1% QoQ to QR499.1mn (25.6% shy of our modeled figure of QR670.8mn) primarily driven by weakness in petchems. On the steel front, cash gross margins dipped again to 8.1% after having climbed to 13.8% in 2Q2019 (15.3% in 3Q2018); we were expecting a steel gross margin of 11.0%. As a result of the decline in steel margins, IQCD's operating income (only includes steel) dipped into the red for the first time, on a quarterly basis, in at least a decade (our model extends back to 1Q2008). Steel revenue did surprise on the upside, coming in at QR1.4bn (-8.4% YoY, 33.6% QoQ), which was 12.9% ahead of our estimate of QR1.2bn. Considering group (steel + petchems + fertilizers) net income, according to the company, of the QR1.8bn in YTD group net income decline, pricing declines of 11% wiped out QR1.1bn in net income, while a 6% fall in sales volume took off another QR1bn.
- **We will have to lower our 2019 earnings estimates post IQCD's investor conference call to be held on Thursday (Oct. 31, 2019).** Our 2019 net income of QR3.3bn is clearly not achievable given QR2.0bn posted thus far for 9M2019. *We envisage a 15-20% cut to our 2019 earnings estimate to QR2.6-2.8bn.*
- **Steel gross margins take another dip to 8.1%.** In its press release, IQCD attributed the 8% YTD steel segment sales volume decline to continued soft domestic demand given the completion of a majority of large infrastructure projects; the company did state that near-to-medium-term prospects remained encouraging. Moreover, international competition remains strong from lower-cost EM producers. In our earnings preview, we had stated, "while 2Q2019 GMs likely benefited from better pricing, reduced sales of lower-margin products and/or utilization of lower-cost inventory, we do not expect this trend to continue to that extent." However, the extent of the GM decline was more than we expected, potentially pointing to a price decline, along with an increased sales mix of lower-margin billets (not sold in 2Q2019) and/or higher-cost inventory.
- **JV income takes a big fall likely driven by petchems:** As mentioned above, JV income was also below our modeled estimates. An overall group revenue figure of QR3.6bn (up 12% QoQ) implies petchems & fertilizer top-line of QR2.2bn for 3Q2019, only moderately below our forecast of QR2.3bn; however, the extent of the JV income miss implies further margin pressure with most of the revenue shortfall hitting the bottom-line. IQCD does not disclose segment details except in FY-end/half year, so we cannot ascertain which segment caused this miss. However, we suspect the miss mostly has to do with the petchems segment – in its trading statement, the company stated that petchem revenue fell 26% YTD due to demand-driven pricing declines along with periodic maintenance-related shutdowns. The company also mentioned that fertilizer prices remained stable YTD 2019 (and in 3Q2019) and sales volumes were down just marginally by 1% over the same period. According to IQCD, fertilizer pricing stability was driven by regulation-led export restrictions in major producing countries but demand was subdued because of cyclicality. *For more details on this and our estimates, please refer to page 2 for actual vs. estimate comparisons.*
- **Balance sheet continues to remain solid with QR9.0bn in cash/bank balances with new guidance of QR7.4bn in capex planned over 5 years (2019-2023).** The majority of this capex is maintenance-related but QR2.5bn is slated a 400K MTPA-ammonia line (Ammonia 7) with QR1.3bn to be financed by new borrowing. We expect much of this ammonia increase will be to offset older, less efficient production lines with net impact to urea volumes to be not that significant. Net-net, given IQCD's strong balance sheet, we continue to expect some newsflow related to potential acquisitions in the future.
- **Retain Market Perform rating with QR10.50 price target.**

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Income Statement (QR million)	3Q2018	2Q2019	3Q2019	3Q2019e	A Vs. E	YoY	QoQ
Revenue	**1,533.821**	**1,051.290**	**1,404.394**	**1,243.809**	**12.9%**	**-8.4%**	**33.6%**
Cost of Sales (Ex. Depreciation & Amortization)	(1,298.485)	(906.647)	(1,291.014)	(1,106.990)	16.6%	-0.6%	42.4%
Gross Profit	**235.336**	**144.643**	**113.380**	**90.714**	**25.0%**	**-51.8%**	**-21.6%**
General and Administrative Expenses	(33.357)	(36.033)	(38.328)	(36.070)	6.3%	14.9%	6.4%
Selling Expenses	(21.721)	(13.551)	(24.059)	(16.170)	48.8%	10.8%	77.5%
EBITDA	**180.258**	**95.059**	**50.993**	**40.173**	**26.9%**	**-71.7%**	**-46.4%**
Depreciation & Amortization	(59.872)	(69.215)	(69.922)	(69.907)	0.0%	16.8%	1.0%
EBIT	**120.386**	**25.844**	**(18.929)**	**(26.827)**	**-29.4%**	**-115.7%**	**-173.2%**
Finance Costs	(0.110)	(3.388)	(2.836)	(2.900)	-2.2%	2478.2%	-16.3%
Share of Results from Associates	10.532	45.935	8.875	40.000	-77.8%	-15.7%	-80.7%
Share of Results of JVs	1,073.437	587.737	499.129	670.768	-25.6%	-53.5%	-15.1%
Other Income	112.044	129.427	90.653	120.000	-24.5%	-19.1%	-30.0%
Profit Before Tax	**1,316.289**	**785.555**	**576.892**	**801.042**	**-28.0%**	**-56.2%**	**-26.6%**
Tax							
Profit After Tax	**1,316.289**	**785.555**	**576.892**	**801.042**	**-28.0%**	**-56.2%**	**-26.6%**
Minority Interest							
Profit for Equity Holders	**1,316.289**	**785.555**	**576.892**	**801.042**	**-28.0%**	**-56.2%**	**-26.6%**
Net Margin	*85.8%*	*74.7%*	*41.1%*	*64.4%*	-29.2%	-42.0%	-45.3%
EPS (in QR)	**0.22**	**0.13**	**0.10**	**0.13**	**-28.0%**	**-56.2%**	**-26.6%**
Cost of Sales	84.7%	86.2%	91.9%	89.0%			
Gross Margin %	15.3%	13.8%	8.1%	11.0%			
G&A % Sales	2.2%	3.4%	2.7%	2.9%			
Selling Expenses % Sales	1.4%	1.3%	1.7%	1.3%			
EBITDA %	11.8%	9.0%	3.6%	3.2%			
D&A % Sales	3.9%	6.6%	5.0%				
EBIT %	7.8%	2.5%	-1.3%				

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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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