IQCD Alert – 2Q2020 Earnings Grow QoQ & Exceed Estimates Ex. Items; Market Perform

- **IQCD posts QR333.6mn in 2Q2020 earnings, excluding one-offs, down 57.5% YoY but up 63.7% QoQ –** Normalized earnings were 8.8% higher than our estimate of QR306.7mn. Reported earnings of QR281.5mn included the impact of QR52.1mn in one-off non-cash expenses. These one-off expenses included: 1) an impairment charge of QR1.22bn related to mothballing of certain steel facilities (domestic rebar capacity lowered to 0.8MTPA from 1.5MTPA previously), which was partially offset by 2) QR1.17bn in fair value gain on revaluation of IQCD's 75% stake in QAFCO given QP's recent acquisition of Yara's 25% stake in QAFCO.
- **IQCD remains tax-exempt; the reporting of income taxes in IQCD's income statement do not reflect any economic change but rather a reporting (accounting) change –** Reported earnings included QR162.9mn in current and deferred income taxes. However, investors should note that IQCD remains tax-exempt with reported taxes on its share of earnings of JVs/subsidiaries being offset as other income in its income statement. This current accounting treatment for taxes formalizes the MOU between QP, the Ministry of Finance and the General Tax Authority. **The reporting change for income taxes does not have any economic impact on IQCD. Another accounting change introduced is that IQCD is now recognizing QAFCO as a subsidiary (vs. a 75%-owned JV previously) and is now consolidating all revenue/expenses for QAFCO and netting out QP's 25% stake as minority interest.** Given QP's recent purchase of Yara's 25% stake in QAFCO, IQCD believes it has a de-facto control over QAFCO, with effect from January 1, allowing IQCD to account for QAFCO as a subsidiary.
- **According to IQCD, ~5% lower ASPs YoY dented net income by roughly QR0.7bn in 1H2020.** Petchems made up ~QR0.5bn of this decline and fertilizers contributed ~QR0.2bn. Overall sales volumes declined by 29% vs. 1H2019 due to weaker demand, lower production given mothballing of steel facilities and periodic planned/unplanned maintenance. Fertilizer sales volume also declined as QAFCO cannot recognize sales from QAFCO 1-4 under the interim gas processing agreement until a permanent agreement is put in place. **Group revenue of QR4.9bn declined 26% YoY from QR6.7bn in 1H2019.** Besides the previously mentioned mothballing of steel facilities, there were no demand-driven stoppage of production with 1H2020 production volume coming in at 7MT, down 14% YoY. There was a planned shutdown of the MTBE facility for a short period in 2Q2020, which had immaterial impact on overall results. **Relative to 1Q2020, 2Q2020 overall revenue declined ~37% driven by lower prices and volumes.** 2Q2020 net income benefited QoQ due to reduced operating costs given lower production and costs optimization initiatives.

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- **Petrochemical margins improve despite weaker-than-expected revenue.** 2Q2020 segment revenue of ~QR709mn (down ~37% YoY) was below our model, while earnings were much higher than forecasted. Segment earnings of QR186.1mn fell 47.9% YoY but increased 51.3% QoQ. Net margin expanded from record lows of 12.9% in 1Q2020 to 26.3% in 2Q2020. Reversal of gas charges recorded last year helped boost margins for the quarter. Relative to 1H2019, realized prices fell ~24% YoY offsetting sales volume that increased roughly 3%. This lead to segment revenue decline of ~22% in 1H2020; 1H2020 segment earnings more than halved to QR309.2mn from QR667.0mn in 1H2019. Prices remained under pressure given dual macro headwinds of crude price weakness and economic malaise created by COVID-19. Production volumes were flattish in 1H2020 as slightly lower PE production was offset by higher fuel additives volumes.

- **Fertilizers revenue falls short of our expectations with modest margin improvement on a sequential basis; interim QAFCO 1-4 agreement remains in place serving to lower sales volume.** 2Q2020 revenue and net income of QR666.2mn and QR130.8mn, declined 36.2% and 43.3%, respectively, on a YoY basis. Profits were in-line with our forecast given QoQ margin improvement despite revenue coming in roughly 9% lower than our forecast. According to the company, selling prices declined ~13% YoY in 1H2020 due to lower input costs and weak seasonal demand further heightening the effects of gradual easing of supply-side curbs; sales volumes fell ~46% vs. 1H2019 primarily due to the interim agreement for QAFCO 1-4. As a result, overall fertilizer revenue fell ~32% YoY in 1H2020. We continue to expect QP and QAFCO to replace the interim agreement for QAFCO 1-4 with a permanent one in the future that should be in-line with the original agreement that expired back in end-2019. Fertilizer production, unlike sales volume, remained relatively robust, up approximately 8% YoY in 1H2020 with the segment experiencing minimal planned and unplanned maintenance shutdowns.

- **2Q2020 steel revenue comes in below our model with segment losses possibly prompted by a phased approach to mothballing capacity; we expect the segment to turn profitable in 2H.** Steel revenue of QR491.6mn (-53.2% YoY,-62.2% QoQ) was 21.3% lower than our estimate of QR624.9mn. Excluding the mothballing-related impairment charge and a loss posted by associates, the steel segment posted a loss of QR67.6mn in 2Q2020 vs. our expectation of a modest profit. We think activities related to the mothballing of facilities happened in a more gradual manner than we had anticipated thus dragging profitability for the quarter *(continued on next page)*.

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- *(continued from previous page)* We believe the company's strategy to avoid international markets and cater to domestic demand exclusively should help profitability going forward. During the quarter, as mentioned previously, IQCD recorded an impairment loss of ~QR1.2bn associated with its initiative to mothball steel capacity. According to its press release, the company took a prudent approach to impair the net book value of the facilities mothballed as it sees no possibility of restarting operations in these facilities in the immediate future. This decision is obviously subject to change if domestic/international demand improves appreciably. Overall selling prices fell 3% YoY vs. 1H2019 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). IQCD also witnessed higher costs given sales of expensive inventories in 1H2020.
- *For more details on the company's performance and our estimates, please refer to pages 4 and 5.*
- **Balance sheet continues to remain solid with QR11.3bn in cash/bank balances and zero debt.** The company generated operating cash flow of QR1.7bn and free cash flow of QR1.5bn in 1H2020, 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 Market Perform rating and QR10.0 price target.** With earnings under pressure in the medium-term, investors will seek answers about deployment of IQCD's cash pile and its strategy. The company remains optimistic about a 2H recovery pointing to a gradual easing of lockdown restrictions and stimulus measures undertaken by major governments, along with a recovery in oil prices from June 2020. Our QR1.4bn net income estimate for 2020 could however be a bit high and we will reassess our forecasts.

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Income Statement (QR million)	2Q2019	1Q2020	2Q2020	2Q2020e*	A Vs. E*	YoY*	QoQ*
Revenue	**1,051.290**	**1,302.053**	**2,420.493**	**624.935**		**130.2%**	**85.9%**
Cost of Sales (Ex. Depreciation & Amortization)	(913.886)	(1,312.047)	(1,323.933)	(547.249)		44.9%	0.9%
Gross Profit	137.404	(9.994)	1,096.560	77.685		698.1%	N/M
General and Administrative Expenses	(36.033)	(31.885)	(206.879)	(31.566)		**474.1%**	**548.8%**
Selling Expenses	(13.551)	(16.917)	(8.774)	(18.000)		-35.3%	-48.1%
EBITDA	87.820	(58.796)	880.907	28.119		903.1%	N/M
Depreciation & Amortization	(61.976)	(69.385)	(581.407)	(68.691)		838.1%	737.9%
EBIT	25.844	(128.181)	299.500	(40.572)		1058.9%	N/M
Finance Costs	(3.388)	(2.842)	(14.018)	(2.842)		313.8%	393.2%
Share of Results from Associates	45.935	15.190	(8.464)	15.000		N/M	N/M
Share of Results of JVs	587.737	270.864	38.306	244.945		-93.5%	-85.9%
Other Income	129.427	48.761	98.752	90.123		-23.7%	102.5%
Income from Investments & Other Income/Expenses	-		(52.142)				
Profit Before Tax	785.555	203.792	361.934	306.655		-53.9%	77.6%
Tax			(162.905)				
Profit After Tax	785.555	203.792	199.029	306.655		-74.7%	-2.3%
Minority Interest			82.435				
Profit for Equity Holders	785.555	203.792	281.464	306.655	-8.2%	-64.2%	38.1%
EPS (in QR)	0.13	0.03	0.05	0.05	-8.2%	-64.2%	38.1%
Cost of Sales	86.9%	100.8%	54.7%	87.6%			
Gross Margin %	13.1%	-0.8%	45.3%	12.4%			
G&A % Sales	3.4%	2.4%	8.5%	5.1%			
Selling Expenses % Sales	1.3%	1.3%	0.4%	2.9%			
EBITDA %	8.4%	-4.5%	36.4%	4.5%			
D&A % Sales	5.9%	5.3%	24.0%	11.0%			
EBIT %	2.5%	-9.8%	12.4%	-6.5%			
Net Margin %	74.7%	15.7%	11.6%	49.1%			

*Comparisons are not strictly meaningful, except Profit for Equity Holders, given change in accounting for QAFCO from JV to 75%-owned subsidiary

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In QR Millions

Steel	2Q2019	1Q2020	2Q2020	2Q2020e	A Vs. E
Revenue	1,051.290	1,302.053	491.606	624.935	*-21%*
Net Profit	85.122	(88.274)	(1,301.002)	31.690	*N/M*
NM %	*8.10%*	*-6.78%*	*-264.64%*	*5.07%*	
Revenue Q/Q	*-17%*	*-6%*	*-62%*	*-52%*	
Net Income Q/Q	*38%*	*-28%*	*1374%*	*-136%*	
Revenue Y/Y	*-36%*	*3%*	*-53%*	*-41%*	
Net Income Y/Y	*-52%*	*N/M*	*N/M*	*-63%*	
Petrochemicals	**2Q2019**	**1Q2020**	**2Q2020**	**2Q2020e**	**A Vs. E**
Revenue	1,126.204	951.000	708.676	837.111	*-15%*
Net Profit	357.073	123.023	186.147	113.010	*65%*
NM %	*31.71%*	*12.94%*	*26.27%*	*13.50%*	
Revenue Q/Q	*1%*	*-11%*	*-25%*	*-12%*	
Net Income Q/Q	*15%*	*-60%*	*51%*	*-8%*	
Revenue Y/Y	*-20%*	*-15%*	*-37%*	*-26%*	
Net Income Y/Y	*-51%*	*-60%*	*-48%*	*-68%*	
Fertilizers	**2Q2019**	**1Q2020**	**2Q2020**	**2Q2020e**	**A Vs. E**
Revenue	1,043.557	780.453	666.212	732.975	*-9%*
Net Profit	230.664	147.841	130.765	131.935	*-1%*
NM %	*22.10%*	*18.94%*	*19.63%*	*18.00%*	
Revenue Q/Q	*-5%*	*-29%*	*-15%*	*-6%*	
Net Income Q/Q	*11%*	*-45%*	*-12%*	*-11%*	
Revenue Y/Y	*0%*	*-29%*	*-36%*	*-30%*	
Net Income Y/Y	*-14%*	*-29%*	*-43%*	*-43%*	
Total Revenue	**3,221.051**	**3,033.506**	**1,866.494**	**2,195.021**	
YoY Growth	***-21%***	***-13%***	***-42%***	***-32%***	
QoQ Growth	***-7%***	***-15%***	***-38%***	***-28%***	
Steel	*33%*	*43%*	*26%*	*28%*	
Petrochemicals	*35%*	*31%*	*38%*	*38%*	
Fertilizers	*32%*	*26%*	*36%*	*33%*	
Total NI (Ex. Unallocated)	**672.859**	**182.590**	**(984.091)**	**276.635**	
Steel	*13%*	*-48%*	*132%*	*11%*	
Petrochemicals	*53%*	*67%*	*-19%*	*41%*	
Fertilizers	*34%*	*81%*	*-13%*	*48%*	

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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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