

IQCD Alert – Soft Fertilizer Margin Drives Weak 1Q2023 Results; Stay Outperform

- **IQCD reported QR1.17bn in 1Q2023 earnings (-56.9% YoY/-34.1% QoQ) – Industries Qatar's (IQCD) 1Q2023 earnings also fell shy of our QR1.36bn estimate by 14.4%. 1Q2023 fertilizer EBITDA margin fell from ~43% in 4Q2022 (~50% in 1Q2022) to ~35%, falling below our 40% forecast, and contributing to the majority of the earnings miss. IQCD's 1Q2023 urea realization of \$352/MT (down ~47% YoY and ~39% QoQ) was actually modestly ahead of our modeled forecast of \$340/MT leading to a slight beat on the fertilizer top-line. Thus, the margin deterioration is entirely due to higher fertilizer direct costs, which is surprising given the progressive fall in urea prices during 1Q2023. As fertilizer gas feedstock costs are based on YTD urea pricing, the miss in fertilizer EBITDA margin could point to higher-cost inventory and indeed the company points to unfavorable inventory movements linked to higher sales volumes in its press release. Finally, lower-than-expected earnings from steel-segment-associate Foulath, along with a slight miss by the wholly-owned steel operations combined to offset a modest beat in petchems and upside from interest income/other income. **Net-net, reported 1Q2023 earnings made up roughly 19% of our FY2023 net income estimate of QR6.1bn but we are unlikely to make significant revisions to our estimates until we have more visibility into pricing trends by mid-2023.****
- **Price realizations fell across the board YoY but improved sequentially for steel and petchems; sales volumes improved for steel and fertilizers but retreated for petchems. *For segment details, please see page 4.*** 1Q2023 overall sales volumes improved ~3% and ~10%, respectively, on a YoY and QoQ basis. Overall price realizations ratcheted down ~35% YoY and ~22% QoQ. Production volumes also increased ~11% YoY from 3.9 MTPA in 1Q2022 to 4.4 MTPA, while 1Q2023 production volumes also gained ~1% QoQ from 4.3 MTPA. Utilization rates climbed to 105% vs. 94% in 1Q2022 and 104% in 4Q2022.
- **Petchems, the only outperformer in 1Q2023, with segment top-line and profitability besting our forecasts given moderate upside in LDPE sales volumes along with slightly better-than-expected pricing.** 1Q2023 segment revenue of ~QR1.36bn (~26% YoY, ~-8% QoQ) was roughly 2% higher than our model on modestly better-than-expected volumes for LDPE, along with moderately higher-than-modeled price realizations across the board for PE & FA, except MTBE. Segment earnings of QR382.47mn fell 43.1% YoY and 1.5% QoQ, and was 14.0% ahead of our model. EBITDA margins came in ~40% for 1Q2023 vs. around 45% in 1Q2022 and 41% in 4Q2022. Product prices, while down significantly YoY across the board, firmed up sequentially as expected on the back of better fundamentals. Sales volumes were down ~4% YoY/~11% QoQ, with the roughly 8% increase in LDPE volumes shoring up the segment's YoY sales volumes. Production volumes gained roughly 7% YoY aided by higher availability of facilities but fell ~3% QoQ.
- **Fertilizer EBITDA margin disappointed, dropping back to 3Q2022's ~35% level, which was the lowest level seen in at least three years.** Revenue and income of QR2.24bn and QR511.09mn decreased 43.8% and 70.7%, YoY, respectively. Sequentially, segment revenue was down 34.6% and earnings declined 56.8%. Segment top-line was 3.7% above our model but earnings were short by 30.5%; to explain this decline in profitability, in its press release, IQCD pointed to higher operating costs because of unfavorable inventory movements linked to higher sales volumes. 1Q2023 EBITDA margin declined to ~35% vs. approximately 50% in 1Q2022 and 43% in 4Q2022. According to the company, urea prices decreased ~47% YoY and ~39% QoQ from \$661/MT in 1Q2022 and \$579/MT in 4Q2022 to \$352/MT in 1Q2023; realized urea prices were approximately 4% higher than our modeled estimate. Urea prices have come down from decade highs in 1H2022 given downward pressure on grain, energy, other commodity prices and overall inflation. IQCD also pointed to the restart-up of European production following shutdowns in 2022 amid the Russia-Ukraine crises. IQCD's production volumes were up ~11% YoY but flattish sequentially; sales volumes grew ~3% YoY and ~6% QoQ. *(continued on next page).*

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- *(continued from previous page)*
- **Steel segment revenue beat our forecast on a jump in volumes but profitability was below our estimates as income from associate (Foulath) weakened.** Steel revenue came in at QR1.23bn (-5.5% YoY, 64.2% QoQ), which was 30.5% ahead of our model. Segment income of QR133.99mn (-48.7% YoY, 16.4% QoQ) was, however, 37.0% shy of our forecast of QR212.79mn. We note that income from associates, primarily from Foulath that produces and sell iron oxide pellets, came in at QR64.13mn (12.0% YoY, -59.4% QoQ and 44.8% below our forecast of QR116.19mn). The segment also faced higher volume-related operating expenses and lower other income. EBITDA margins fell to ~15% in 1Q2023 vs. roughly 24% in 1Q2022 and 22% in 4Q2022. According to the company, steel realizations dipped by ~16% YoY but gained around 6% QoQ. IQCD pointed to constructive demand-supply dynamics, both in Qatar and internationally, in aiding the sequential growth in steel prices. We do note that steel prices were somewhat lower than our forecasts – the company reported rebar realizations of \$647/MT in 1Q2023 vs. \$724/MT in 1Q2022, \$623/MT in 4Q2022 and our expectation of \$716/MT. Sales volumes increased ~12% YoY and shot up ~55% sequentially; volumes were significantly stronger than our model, especially in billets, with domestic demand being helped by construction activities returning gradually to mid-2022 levels. Production volumes were up roughly up 17% YoY/7% QoQ. Production volumes, since the beginning of 2022 for DRI/HBI, were aided by the re-startup of the DR-2 facility in 1Q2022 that has 1,500 KTPA of capacity (as opposed to the 800 KTPA-DR-1 facility it replaced).
- *For more details on the company's performance and our estimates, please refer to page 3.*
- **Bullet-proof balance sheet with QR13.9bn in cash/bank balances & zero long-term debt.** We note that IQCD had sufficient cash in 1Q2023 (which already includes the impact of its QR6.7bn dividend payment) to fund its entire capex outlay of QR11.0bn over 2023-2027. The company, on a proportionate basis, generated operating cash flow of QR1.2bn and free cash flow of QR0.8bn in 1Q2023. Net-net, given IQCD's strong balance sheet, we expect the company to withstand difficult market conditions, when they arise, while retaining dry powder to take advantage of potential acquisition opportunities in the future. IQCD's strong FCF generating ability, along with its large cash balances, also provide investors with lower DPS volatility.
- **In terms of longer-term catalysts, the QR4.4bn Ammonia-7 project, which is also the world's largest Blue ammonia train, is expected to add 400 KTPA of sellable ammonia by 2026.** The Ammonia-7 project should also boost the company's ESG credentials. Also, in a smaller deal (roughly QR455mn net cost), IQCD expects to increase its direct stake in Qatar Vinyl Co. (QVC) to 44.8% from May 2026 from its current indirect stake (via QAPCO) of 25.52% by funding its share of the construction of a new Polyvinyl Chloride (PVC) plant. Moreover, similar to the QAFAC deal, IQCD could look to acquire Total's 20% stake in QAPCO, which could also be perceived positively by investors. The purchase of the remaining 50% of QAFAC could also be a possibility.
- **We continue to rate IQCD as an Outperform with a PT of QR17.00.** However, if overall recession expectations worsen, we could face a further downturn in commodity prices and IQCD's earnings expectations. From a valuation perspective, IQCD is trading at 13.0x its estimated 2023 EPS, which is below its historical median of ~17x, implying limited downside.
- **Risks:** Oil/urea prices influence IQCD's operations and investor sentiment. Geopolitical risks remain and cannot be modeled.

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Income Statement (QR Million)	1Q2022	4Q2022	1Q2023	1Q2023e	A Vs. E	YoY	QoQ
Revenue	5,280.579	4,169.832	3,467.196	3,099.963	11.8%	-34.3%	-16.9%
Cost of Sales (Ex. D &A)	(2,842.653)	(2,570.136)	(2,425.194)	(1,732.259)	40.0%	-14.7%	-5.6%
Gross Profit	2,437.926	1,599.696	1,042.002	1,367.704	-23.8%	-57.3%	-34.9%
General & Admin. Expenses	(175.822)	(193.952)	(166.532)	(154.998)	7.4%	-5.3%	-14.1%
Selling & Distribution Costs	(31.240)	(21.043)	(13.767)	(18.600)	-26.0%	-55.9%	-34.6%
EBITDA	2,230.864	1,384.701	861.703	1,194.106	-27.8%	-61.4%	-37.8%
Depreciation & Amortization	(375.042)	(374.668)	(329.378)	(377.478)	-12.7%	-12.2%	-12.1%
EBIT	1,855.822	1,010.033	532.325	816.628	-34.8%	-71.3%	-47.3%
Finance Costs	(5.494)	(6.800)	(7.253)	(7.208)	0.6%	32.0%	6.7%
Share of Results from Associates	57.249	157.782	64.128	116.192	-44.8%	12.0%	-59.4%
Share of Results of JVs	672.594	388.449	382.473	335.473	14.0%	-43.1%	-1.5%
Other Income	123.830	218.812	195.318	100.600	94.2%	57.7%	-10.7%
Profit Before Tax	2,704.001	1,768.276	1,166.991	1,361.685	-14.3%	-56.8%	-34.0%
Tax	(0.145)	(0.114)	(0.384)	(0.088)	337.4%	164.8%	236.8%
Profit After Tax	2,703.856	1,768.162	1,166.607	1,361.597	-14.3%	-56.9%	-34.0%
Minority Interest	(0.238)	0.453	(0.682)	(0.120)	469.0%	186.6%	-250.6%
Profit for Equity Holders	2,703.618	1,768.615	1,165.925	1,361.477	-14.4%	-56.9%	-34.1%
<i>Net Margin</i>	<i>51.2%</i>	<i>42.4%</i>	<i>33.6%</i>	<i>43.9%</i>			

EPS (in QR)	0.45	0.29	0.19	0.23	-14.4%	-56.9%	-34.1%
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Cost of Sales	53.8%	61.6%	69.9%	55.9%
Gross Margin %	46.2%	38.4%	30.1%	44.1%
G&A % Sales	3.3%	4.7%	4.8%	5.0%
Selling Expenses % Sales	0.6%	0.5%	0.4%	0.6%
EBITDA %	42.2%	33.2%	24.9%	38.5%
D&A % Sales	7.1%	9.0%	9.5%	12.2%
EBIT %	35.1%	24.2%	15.4%	26.3%
Net Margin %	51.2%	42.4%	33.6%	43.9%

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In QR Millions

Steel	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023	1Q2023e	A Vs. E
Revenue	1,300.068	1,159.139	1,054.591	748.040	1,228.299	941.567	30%
Profit Before Tax	261.211	359.527	152.943	115.105	133.986	212.794	-37%
NM %	20.09%	31.02%	14.50%	15.39%	10.91%	22.60%	
Revenue Q/Q	34%	-11%	-9%	-29%	64%	26%	
Profit Before Tax Q/Q	199%	38%	-57%	-25%	16%	85%	
Revenue Y/Y	6%	18%	50%	-23%	-6%	-28%	
Profit Before Tax Y/Y	1%	52%	15%	32%	-49%	-19%	
Petrochemicals	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023	1Q2023	A Vs. E
Revenue	1,835.000	2,017.000	1,639.000	1,483.000	1,362.000	1,335.481	2%
Profit Before Tax	672.594	831.054	568.336	388.449	382.473	335.473	14%
NM %	36.65%	41.20%	34.68%	26.19%	28.08%	25.12%	
Revenue Q/Q	42%	10%	-19%	-10%	-8%	-10%	
Profit Before Tax Q/Q	120%	24%	-32%	-32%	-2%	-14%	
Revenue Y/Y	33%	16%	5%	15%	-26%	-27%	
Profit Before Tax Y/Y	11%	-6%	-16%	27%	-43%	-50%	
Fertilizers	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023	1Q2023	A Vs. E
Revenue	3,980.511	3,972.022	3,157.431	3,421.792	2,238.897	2,158.396	4%
Profit Before Tax	1,745.172	1,561.848	858.375	1,183.317	511.093	734.934	-30%
NM %	43.84%	39.32%	27.19%	34.58%	22.83%	34.05%	
Revenue Q/Q	6%	0%	-21%	8%	-35%	-37%	
Profit Before Tax Q/Q	-24%	-11%	-45%	38%	-57%	-38%	
Revenue Y/Y	147%	78%	17%	-9%	-44%	-46%	
Profit Before Tax Y/Y	193%	65%	-33%	-48%	-71%	-58%	
Total Revenue	7,115.579	7,148.161	5,851.022	5,652.832	4,829.196	4,435.444	9%
YoY Growth	69%	44%	18%	-6%	-32%	-38%	
QoQ Growth	18%	0.5%	-18%	-3%	-15%	-22%	
Steel	18%	16%	18%	13%	25%	21%	
Petrochemicals	26%	28%	28%	26%	28%	30%	
Fertilizers	56%	56%	54%	61%	46%	49%	
Total Profit Before Tax (Ex. Unallocated)	2,678.977	2,752.429	1,579.654	1,686.871	1,027.552	1,283.201	-20%
Steel	10%	13%	10%	7%	13%	17%	
Petrochemicals	25%	30%	36%	23%	37%	26%	
Fertilizers	65%	57%	54%	70%	50%	57%	
Group Net Income	2,703.618	2,728.633	1,613.788	1,768.615	1,165.925	1,361.477	-14%
Segment Profit Before Tax/Group NI	99%	101%	98%	95%	88%	94%	
Unallocated Net Income	24.64	(23.80)	34.13	81.74	138.37	78.28	77%

Recommendations	
<i>Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price</i>	
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	
<i>Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals</i>	
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

Saugata Sarkar, CFA, CAIA
 Head of Research
 +974 4476 6534
 saugata.sarkar@qnbfs.com.qa

Shahan Keushgerian
 Senior Research Analyst
 +974 4476 6509
 shahan.keushgerian@qnbfs.com.qa

Phibion Makuwerere, CFA
 Senior Research Analyst
 +974 4476 6589
 phibion.makuwerere@qnbfs.com.qa

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