

IQCD Alert – A Better-Than-Expected 2Q2019 but Headwinds Remain; Stay Market Perform

- **IQCD posts 36.7% YoY decrease but 16.5% QoQ increase in net profit in 2Q2019 beating our estimate** – Industries Qatar's (IQCD) 2Q2019 net profit of QR785.6mn beat our estimate of QR681.5mn by 15.3%. As far as we can tell, the majority of the beat came from the company's steel operations where cash gross margins increased to 13.8% vs. 9.2% in 1Q2019 and 21.5% in 2Q2018. We were assuming 7.0% gross margins in our model given indications that iron ore prices had increased high-single digits QoQ in 2Q2019. The QoQ increase in gross margins came despite the company's steel revenue falling 16.7% QoQ to QR1.1bn (-36.1% YoY). Given the QoQ fall in steel revenue, steel sales volume likely declined sequentially implying improvement in pricing and/or utilization of lower-cost inventory vs. 1Q2019. Other reported metrics remained in line with our estimates, including IQCD's JV income (fertilizers and petrochemicals), which came in at QR587.7mn (-40.9% YoY, 13.7% QoQ) vs. our estimate of QR580.3mn (variation of +1.3%). Other income also rose to QR129.4mn for 2Q2019 vs. our estimate of QR88.1mn explaining a portion of the 2Q2019 beat (other income was QR96.5mn in 2Q2018). IQCD stated that roughly QR0.6bn was wiped out in 1H2019 due to price declines (roughly 10% YoY), which implies lower YoY prices reduced 2Q2019 earnings by ~QR0.2bn (out of YoY decline of QR456.2mn). YTD sales volumes were also down ~9% driven by planned maintenance/unplanned shutdowns (in 1Q2019) and softer demand. The company attributed its sequential 2Q2019 earnings improvement on a gradual recovery in PE/steel prices. *We will maintain our 2019 net income estimate of QR3.3bn for now, which implies QR1.9bn in 2H earnings vs. QR1.5bn in 1H2019, a growth of 27%. We could adjust our estimate moderately downward depending on pricing trends in 3Q2019.*
- **Steel margins improve sequentially and we adopt a wait-and-see stance.** By segment, steel revenue was 18.9% below our forecast of QR1.3bn but cash gross margins surprisingly ticked up as discussed above. Our 2H2019 steel GMs work out to be 11.5% vs. 11.3% in 1H2019 and 13.8% in 2Q2019. According to the company, prices and sales volumes fell YoY. Sales volume fell moderately due to weak demand domestically and increasing international competition, which also hurt prices vs. 1H2018 levels. IQCD pointed to the completion of a majority of large infrastructure projects as a driver behind muted domestic demand. Regional demand continues to be hurt by the availability of low-priced steel from non-GCC producers, such as Turkey. Far East pricing remains under pressure due to low-cost Chinese steel. Steel prices improved QoQ.
- **JV income bang in-line with expectations:** As mentioned above, JV income was in-line with our modeled estimates. Petrochem revenue (which includes fuel additives) fell 24% YoY in 1H2019 with earnings declining 52%. Prices of petrochemical products were moderately down compared to the first half of 2018 but was up QoQ. 1H2019 prices were impacted by weak demand and marginal decline in crude prices; sales volume fell due to planned/unplanned shutdowns primarily in 1Q2019. Fertilizer top-line was modestly lower by 1% compared to 1H2018, while segment net profit was down 6%. 1H2019 fertilizer prices were up marginally driven by better demand metrics along with higher raw material costs and regulatory pressure on non-environment compliant producers in countries like China. Sales volumes, however were marginally down on last year on account of slightly lower production. *For more details on this and our estimates, please refer to page 2 for actual vs. estimate comparisons.*
- **Balance sheet continues to remain solid; we expect some newsflow related to potential acquisitions in the future.** IQ's balance sheet remains strong with group cash at QR10.7bn with minor debt of only QR10.9mn.
- **Retain Market Perform rating with QR10.50 price target.** Stock is trading around 20x our 2019 EPS estimate and 16x our 2020 EPS estimate.

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Income Statement (QR million)	2Q2018	1Q2019	2Q2019	2Q2019e	A Vs. E	YoY	QoQ
Revenue	1,645.371	1,261.848	1,051.290	1,295.918	-18.9%	-36.1%	-16.7%
Cost of Sales (Ex. Depreciation & Amortization)	(1,291.046)	(1,145.619)	(906.647)	(1,205.204)	-24.8%	-29.8%	-20.9%
Gross Profit	354.325	116.229	144.643	90.714	59.4%	-59.2%	24.4%
General and Administrative Expenses	(39.349)	(30.909)	(36.033)	(29.806)	20.9%	-8.4%	16.6%
Selling Expenses	(26.348)	(17.586)	(13.551)	(20.735)	-34.6%	-48.6%	-22.9%
EBITDA	288.628	67.734	95.059	40.173	136.6%	-67.1%	40.3%
Depreciation & Amortization	(59.066)	(66.646)	(69.215)	(67.000)	3.3%	17.2%	3.9%
EBIT	229.562	1.088	25.844	(26.827)	N/M	-88.7%	N/M
Finance Costs	(0.847)	(2.577)	(3.388)	-		300.0%	31.5%
Share of Results from Associates	(77.132)	36.561	45.935	40.000	14.8%	-159.6%	25.6%
Share of Results of JVs	993.646	517.076	587.737	580.251	1.3%	-40.9%	13.7%
Other Income	96.479	121.887	129.427	88.113	46.9%	34.2%	6.2%
Profit Before Tax	1,241.708	674.035	785.555	681.537	15.3%	-36.7%	16.5%
Tax							
Profit After Tax	1,241.708	674.035	785.555	681.537	15.3%	-36.7%	16.5%
Minority Interest							
Profit for Equity Holders	1,241.708	674.035	785.555	681.537	15.3%	-36.7%	16.5%
EPS (in QR)	0.21	0.11	0.13	0.11	15.3%	-36.7%	16.5%
Cost of Sales	78.5%	90.8%	86.2%	93.0%			
Gross Margin %	21.5%	9.2%	13.8%	7.0%			
G&A % Sales	2.4%	2.4%	3.4%	2.3%			
Selling Expenses % Sales	1.6%	1.4%	1.3%	1.6%			
EBITDA %	17.5%	5.4%	9.0%	3.1%			
D&A % Sales	3.6%	5.3%	6.6%	5.2%			
EBIT %	14.0%	0.1%	2.5%	-2.1%			

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In QR Millions		
Steel	1H2018	1H2019
Revenue	3,023.201	2,313.138
<i>Growth</i>		-23%
Net Profit	496.031	146.970
<i>Growth</i>		-70%
<i>Net Margin</i>	16.4%	6.4%

Petrochemicals	1H2018	1H2019
Revenue	2,962.578	2,245.028
<i>Growth</i>		-24%
Net Profit	1,384.685	666.960
<i>Growth</i>		-52%
<i>Net Margin</i>	46.7%	29.7%

Fertilizers	1H2018	1H2019
Revenue	2,163.221	2,141.834
<i>Growth</i>		-1%
Net Profit	467.627	437.853
<i>Growth</i>		-6%
<i>Net Margin</i>	21.6%	20.4%

Total Revenue	8,149.000	6,700.000
<i>Growth</i>		-18%
Total Segment Net Profit	2,348.343	1,251.783
<i>Growth</i>		-47%
<i>Net Margin</i>	28.8%	18.7%

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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