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- A Perfect Storm:** We update our views, forecasts and equity fair value estimates for the Saudi Basic Industries Corporation (SABIC) and Industries Qatar (IQ) to reflect the global financial crisis, which has led to a significant turnaround in feedstocks and commodities prices. The price of crude oil has plunged almost 65% from its peak in July, leading to a simultaneous steep decline in the price of major petrochemical feedstocks. The combination of diving feedstock costs and weak demand for commodities has driven down the price of SABIC's and IQ's main products by 45-65% over the last three months.
- Spot Demand Virtually Freezes:** Global demand along the ethylene value chain weakened significantly in the wake of the global financial crisis, with industrial indicators turning negative and sentiment in key demand sectors (such as construction and automotive) becoming extremely bearish. The rapid and sharp decline in feedstock costs coupled with severe tightness in credit has led traders and converters to de-stock their high-cost inventories and delay purchases in anticipation of weak prices ahead and to optimize their cash conversion cycle.
- Competition Intensifies in Export Markets...:** SABIC and IQ are highly dependent on demand from Asian emerging markets, particularly China, which in turn is highly dependent on consumption in the US and Western Europe. Therefore, the plastic processing industry in key export markets faces serious challenges, with October plastics export data showing a considerable retreat Y-o-Y. Competition among producers has risen, with spot demand weakening, inventories rising and operating rates declining.
- ...But Global Cost Advantage Favors SABIC and IQ:** According to our analysis, despite the severe correction in commodity prices globally, SABIC and IQ are currently enjoying cash margins of USD225 and USD350 per ton of ethylene (the main building block of the petrochemical industry) and USD160 and USD200 per ton of urea (the main fertilizers final product). These margins compare very favorably to those of any producer in any region of the world. Both SABIC and IQ are able to sell polymers at a major discount to the price of any domestic producer in their key export markets.
- A Gloomy Outlook on 4Q2008 Results:** Inevitably, the correction in global commodities prices has squeezed the margins of SABIC and IQ swiftly and massively over the last two months. We believe SABIC's and IQ's 4Q2008 earnings will suffer the steepest declines in their history. We also expect this sluggish demand and low price environment to continue through 2009. Going forward, prices of energy and commodities, we believe, will recover moderately as demand in emerging markets recovers, as consumers react positively to lower costs and as credit becomes more available, although profitability will remain significantly below its 2008 peak.
- Stay Cautious:** We believe investors should remain cautious about the performance of commodity stocks in the short to medium term as uncertainty grows over the impact of the financial crisis on energy prices and global demand. We have reduced our LT Fair Value for SABIC by 54% to SAR86.9 per share and for IQ by 41% to QAR111.8 per share. We assign a ST Neutral / LT Buy for SABIC and a ST Accumulate / LT Buy for IQ. We believe the impact of the severe price correction will be more severe on SABIC than on IQ due mainly to the higher weight of commodity petrochemicals in SABIC's portfolio and to SABIC's relative exposure to the weakened demand in Western Europe and the US. IQ's diversified financial profile will allow it to benefit from any upturn in a single product or market (such as urea and steel).

SECTOR NOTE

Companies Analysed in this Report

Companies	Price	ST / LT Rec	LTFV	P/E 08e	P/E09e	P/E10e	P/B08e	P/B09e	P/B10e
IQ (QAR)	73.0	Acc. / Buy	111.8	4.8	7.3	5.9	2.2	2.1	1.9
SABIC (SAR)	43.0	Neu. / Buy	86.9	5.6	9.3	6.3	1.2	1.2	1.0

Source: Industries Qatar, SABIC and EFG-Hermes

I. A PERFECT STORM IN GLOBAL COMMODITY MARKETS

GLOBAL FINANCIAL CRISIS SPREADS ACROSS THE ETHYLENE VALUE CHAIN

We update our views, forecasts and equity fair value estimates for the Saudi Basic Industries Corporation (SABIC) and Industries Qatar (IQ) in the wake of the global financial crisis that has pushed down world commodity prices sharply. We had previously anticipated that the petrochemicals growth cycle, which started its upswing in 2003, would peak in 2008 as prices reached historical highs, then reverse beginning in 2009 as massive new capacity came on stream in the Middle East and in Asia. The sudden outbreak of the global financial turmoil, however, and its domino effect on the global economy, has not only accelerated a downturn in global commodity markets but also exacerbated the impact of this downturn on global utilization rates, prices and margins.

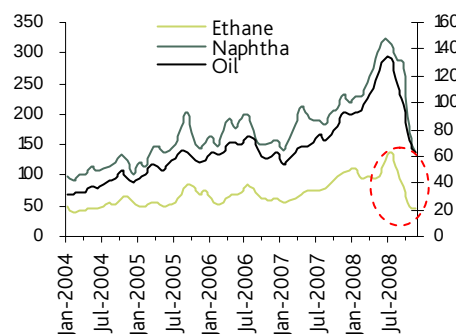
Over the last three months, the global petrochemical industry has been saddled by: i) a significant correction in oil and commodity prices as concerns grow that the credit crunch will trigger a deep and prolonged global economic recession, ii) sluggish demand in almost all of the world's regions due to the recessionary environment in the US and Europe, a consumption slowdown in Asia and an unprecedented rapid decline in feedstock costs that has led traders to de-stock and to delay purchases in anticipation of weaker prices ahead, and iii) severe tightness in credit lines for traders and producers. As a result, global utilization rates of ethylene (the main building block of the entire petrochemical industry) fell in almost all regions of the world, while the price of SABIC's and IQ's main products declined by a sharp 45-65% over the last three months.

UNPRECEDENTED OIL PRICE CORRECTION PUSHES COMMODITY FLOOR PRICES DOWNWARDS...

The price of crude oil has fallen by almost 65% from its peak in July, with the price of Brent crude falling to USD51 per barrel from USD122. The current oil price is significantly below the industry's consensus estimates for the next three years. Unsurprisingly, this rapid plunge in prices has led to a simultaneous steep decline in the price of major petrochemical feedstocks, with naphtha (the main feedstock used globally) now fetching USD380 per ton, almost 65% below its July peak of USD1,140. The combination of both a significant reduction in feedstock costs and weak demand for olefins and polymers has led to extremely bearish market sentiment and pushed ethylene prices down significantly. The current FOB Asia ethylene price is USD380 per ton, down from USD1,625 in July 2008.

Figure 1: Oil and Feedstock Price Trends (LHS)

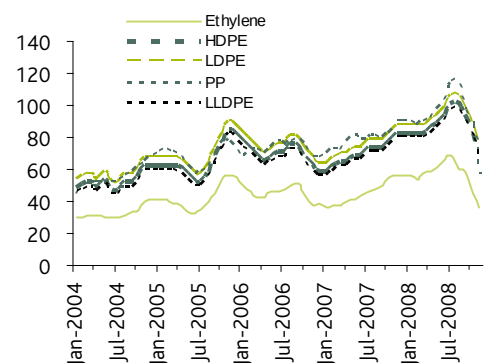
Cents per Gallon (LHS) and USD Per Barrel (RHS)



Source: Source CMAI

Figure 2: Ethylene And Its Main Derivatives (LHS)

Cents Per Pound



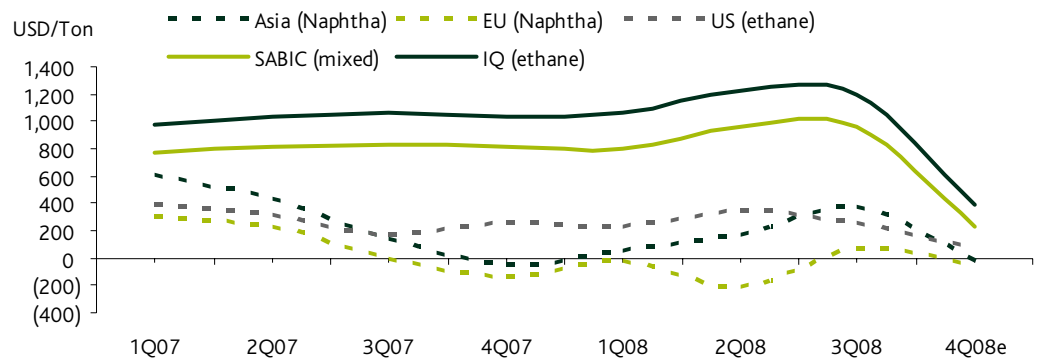
Source: CMAI

...AND WEAKENS THE GLOBAL COST ADVANTAGE OF SABIC AND IQ

One of the core investment drivers for SABIC and IQ in 1H2008 was the continued escalation of energy prices that boosted commodity prices, with the two companies being among the major beneficiaries due to their access to relatively fixed feedstock costs in Saudi Arabia and Qatar that are significantly cheaper than elsewhere. The recent dramatic fall in oil and naphtha prices has now eased the cost structure of the marginal producers and weakened the global cost advantage enjoyed by SABIC and IQ, though we believe their cost advantage will remain significantly greater than those of any other producers in the world. We estimate that the oil price would have to fall to around USD20-25 for a global naphtha-based producer to match the cost advantage of either SABIC or IQ, which have access to natural gas as cheap as 0.75 per mBtu in Saudi Arabia and USD1.5 per mBtu in Qatar. SABIC, however, uses other feedstocks such as propane and butane, which it buys in Saudi Arabia at a discount to the Saudi export price. It is also exposed to naphtha prices through its crackers in Western Europe.

Inevitably, the plummeting global commodities prices have caused the margins of both SABIC and IQ to contract swiftly and massively over the last two months. We estimate that SABIC's cost advantage against Asian naphtha-based producers has declined to around USD280 per ton of ethylene from USD450 in August 2008 and IQ's advantage to USD400 per ton from USD700.

Figure 3: Ethylene Cash Margins: SABIC and IQ vs Different Regions In The World



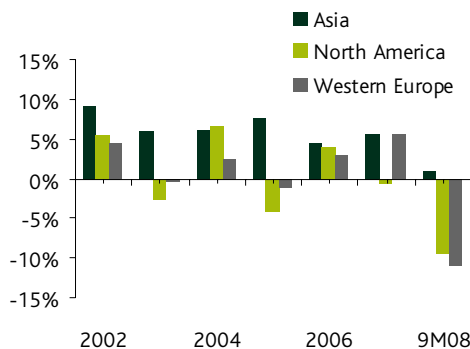
Source: CMAI

DEMAND DRIES UP IN KEY EXPORT MARKETS

Global demand along the ethylene value chain was relatively weak in 3Q2008 due to the escalation in raw material prices. Demand weakened significantly following the global financial crisis, with industrial indicators turning negative and sentiment in key demand sectors becoming extremely bearish. Recent industrial data has shown that the US and EU construction and automotive sectors have retreated considerably (together the two represent c25-30% of the demand for plastics). The rapid and sharp decline in feedstock costs coupled with severe tightness in credit has led traders and converters to de-stock their high-cost inventories and delay purchases in anticipation of weak prices ahead and to optimize their cash conversion cycle.

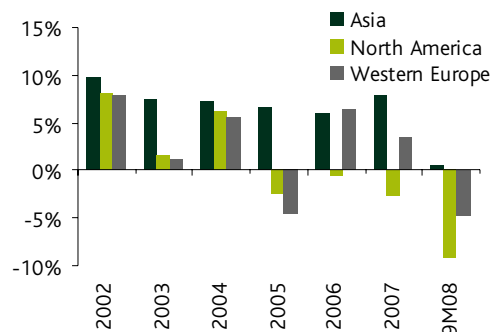
The Middle East's exporters, including SABIC and IQ, are highly dependent on demand from Asian emerging markets, particularly China, which in turn is highly dependent on consumption in the US (a major market for Chinese plastic products) and Western Europe. Therefore, the plastic processing industry in northeast Asia (particularly in China) is facing serious challenges, with October plastic exports data showing a considerable retreat Y-o-Y.

Figure 4: PE Demand Growth Y-o-Y by Region



Source: CMAI

Figure 5: PP Demand Growth Y-o-Y by Region

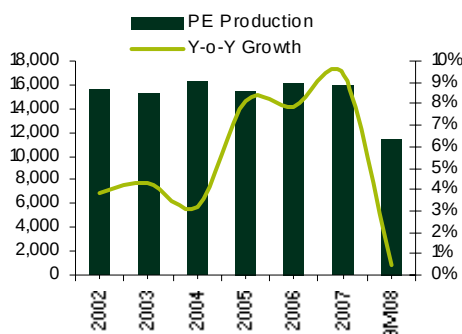


Source: CMAI

With spot demand having virtually disappeared, producer inventory has risen considerably, leading to a significant drop in global operating rates in October. However, the Middle East's utilization rates were relatively stable due to the absolute cost advantage of its producers over naphtha-based producers. According to Chemical Market Associates, Inc (CMAI), the current prices for ethylene and polymers lie below the production cash costs of most naphtha-based producers. Thus, producers in Asia face growing challenges in competing with low-cost base Middle East exporters, who are able to sell polymers at a major discount to the affordable price of any domestic producers.

Figure 6: North East Asia PE Production and Growth (Y-o-Y)

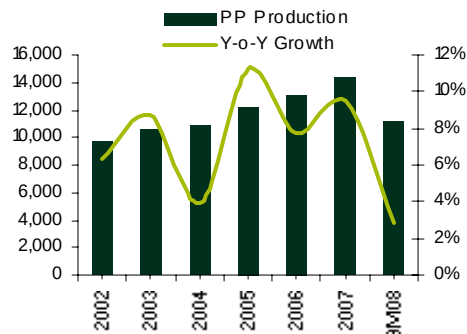
000s Tons (LHS)



Source: CMAI

Figure 7: North East Asia PP Production and Growth (Y-o-Y)

000s Tons (LHS)



Source: CMAI

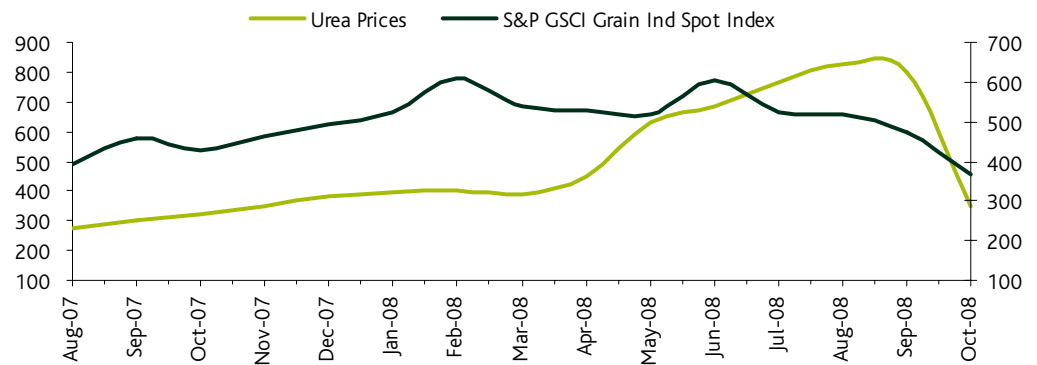
Global utilization rates will be pressured further by massive capacity increases in Asia and the Middle East, with almost 17 mtpa of new ethylene capacity expected to come on stream in 2009-11. We believe this will drive a major wave of capacity rationalization in the US, Western Europe and China as demand remains weak and competition rises among low cost producers. A wave of rationalization should lead commodity prices to rebound moderately in the medium term but remain significantly below their 3Q2008 peaks. We continue to believe that the current market structure will drive a serious need for consolidation, and we expect many mergers and acquisitions in the medium term, with the Middle East's low-cost producers playing an active role.

DESPITE STRONG FUNDAMENTALS, FERTILIZERS ARE NOT IMMUNE

While we see no historical correlation between GDP growth and demand for food, the financial crisis and the sharp drop in energy prices have both had a significant impact on the price of coarse grains and fertilizers. The price of urea (the main saleable fertilizer product of both SABIC and IQ) has fallen by

almost 70% from its peak in August, with the FOB Middle East price currently USD260 per ton, down from USD850 in August 2008. Buyers of fertilizers have been waiting on the sideline to force prices down further, helped by normal demand seasonality, with the Western hemisphere being a few days ahead of the application season, and by producers favoring lower selling prices than lower utilization rates.

Figure 8: Urea Price vs. Grain Spot Price Index



Source: USDA, Fertecon and Bloomberg

Indeed, the correction in grain prices has squeezed the profitability of farmers significantly over the last three months. This, coupled with the tighter credit, has increased the risk of a slowdown in demand in 2009. However, unlike our outlook for other commodities, we continue to believe that the fundamentals of fertilizers in the current cycle are strong despite the severe price corrections. The global grains inventory, while improved, is still alarmingly low (17% of annual consumption). The fact that the amount of arable land in the world is relatively limited has made an increase in agriculture yields imperative to world food security. This, in addition to the fact that farmer profitability remains above breakeven levels even after the sharp decline in food prices, suggests that lower-than-expected demand in 2009 should allow for a positive demand surprise in 2010 and onwards. We also expect to see prompt government intervention to support access to credit, particularly for agriculture-related activities. These strong fundamentals, we believe, provide a strong potential for a grains and fertilizers price recovery in the medium term.

II. IMPACT ON COMPANIES UNDER COVERAGE

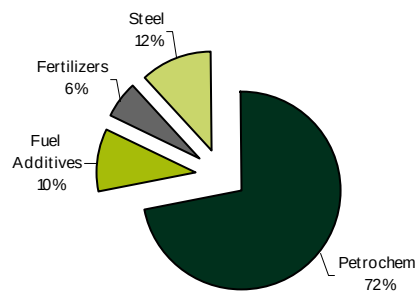
SABIC VERSUS INDUSTRIES QATAR (IQ)

Both SABIC and IQ share relatively similar business models and financial profiles, with both companies being highly exposed to the cyclicity of basic petrochemical commodities (mainly olefins/polyolefins), nitrogen-based fertilizers (mainly ammonia/urea) and steel. In addition, SABIC and IQ are amongst the world's most profitable petrochemical producers due to their access to significantly cheaper feedstock, making their cost of production a fraction of that of their global and regional peers. According to our analysis, despite the severe correction in commodity prices globally, SABIC and IQ still enjoy cash margins of USD225 and USD350 per ton of ethylene (the main building block of the petrochemical industry) and USD160 and USD 200 per ton of urea (the main fertilizers final product), respectively. These margins compare very favorably to those of any other producer in any region of the world. Furthermore, both companies are engaged in aggressive capacity expansion in petrochemicals, fertilizers and steel. While we believe their anticipated volumes growth will marginally offset the impact of the strong price corrections, we also believe their highly competitive, low-cost capacity will be a major contributor to their cash flow generation in the long term, once commodity prices start to recover.

The main difference between SABIC and IQ, however, lies in their different production scales, their varying degree of exposure to specific sectors and sub-sectors and the diversity of their products. SABIC, a global petrochemicals heavy weight, has a complex operating structure due to its widely spread operations and the variety of feedstock used by its ethylene crackers in Saudi Arabia (a mix of ethane, propane and butane) and in Europe (mainly naphtha). SABIC is the world's second largest producer of ethylene, third largest producer of polyethylene and second largest producer of methanol. It also integrates vertically along the supply chain by producing specialty plastics (mainly ABS and polycarbonates), which were fully consolidated into its global operations after August 2007, when it acquired GE Plastics, which it renamed SABIC Innovative Plastics (SIIP).

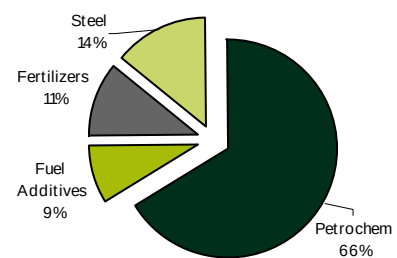
SABIC's exposure to basic petrochemicals commodities is higher than IQ's. According to our analysis, Petrochemicals and fuel additives (olefins/polyolefins, ethylene glycol, methanol and MTBE) represent c82% of its consolidated turnover and almost 75% of its consolidated EBITDA. Even though SABIC is one of the world's largest fertilizer producers and the Middle East's largest producer of steel, the contribution of fertilizers and steel together expected to make up only about 18% of its consolidated revenue and 25% of its EBITDA in 2008e.

Figure 9: SABIC's Revenue Breakdown in 2008e



Source: Source EFG-Hermes Estimates

Figure 10: SABIC's EBITDA Breakdown

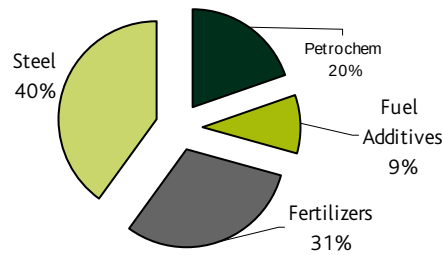


Source: EFG-Hermes Estimates

IQ's global weight, production scale and products portfolio is smaller than SABIC's, and its business structure is much simpler. IQ operates mainly in Qatar with natural gas as its main feedstock, used by its ethylene crackers. IQ's financial profile is more diversified, with a greater range of products contributing to turnover and earnings: Petrochemicals are expected to contribute c29% to turnover, fertilizers c31% and steel c40% in 2008e. Fertilizers is the main contributor to EBITDA (45% in 2008e), followed by petrochemicals (33%) and steel (22%).

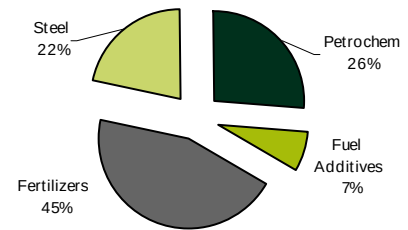
While we expect that the earnings of both companies will be hit badly in 4Q2008 and through 2009 following the recent and significant price corrections in almost every product in their portfolios, we believe IQ's product diversity will allow it to benefit from any upturn in a single commodity or market, such as urea and steel (71% of its 2008e turnover).

Figure 11: IQ's Breakdown of Revenues in 2008



Source: EFG-Hermes Estimates

Figure 12: IQ's Breakdown of EBITDA in 2008e



Source: EFG-Hermes Estimates

REVISED FORECASTS

Although the price of oil started its steep decline in August 2008, the impact on SABIC and IQ's 3Q2008 results was not significant due to the fact that changes in commodity prices always lag changes in feedstock costs. In September, however, commodity prices began tracking the downward trend in force, with the current Asian spot ethylene price plunging to USD380 per ton, down 70% from the average price in 3Q2008. The correction in oil prices coupled with weak global demand depressed the prices of olefins, polymers and fuel additives by as much as 50% from their 3Q2008 averages. That said, we believe SABIC's and IQ's 4Q2008 earnings will suffer the steepest drops in their history. We also expect this sluggish demand and low price environment to continue through 2009, when we believe the current cyclical downturn will bottom out. After that, our economists expect that prices of energy and commodities will recover moderately as demand in emerging markets recovers, as consumers react positively to lower costs and as credit becomes more available, although profitability will remain significantly below its 2008 peak.

We expect that fertilizers demand and prices will recover faster than those of other commodities due to their strong fundamentals and that this will benefit IQ's margins more than SABIC's due to its higher exposure to fertilizers. We expect that SABIC's margins will suffer from the heavy weighting of petrochemicals commodities in its business portfolio and from its exposure to developed markets (EU and US). The significant retreat in US demand will certainly dampen the performance of SABIC's newly acquired plastics subsidiary SIIP and put further pressure on its already low margins, thereby squeezing consolidated margins. The table below highlights our revised price forecasts for the main product baskets of SABIC and IQ as well as our new forecasts for turnover, profitability and margins.

Figure 13: Revised Forecast of SABIC's and IQ's Prices, Revenues and Earnings

Revised Forecasts	4Q07	1Q08	2Q08	3Q08	4Q08e	Change Q-o-Q	Change Y-o-Y	2007	2008e	2009e
Prices (Asia FOB - USD/Ton)										
Basic Petrochemicals										
Ethylene	1,179	1,240	1,398	1,370	573	-58%	-51%	1,189	1,145	708
Propylene	1,433	1,303	1,542	1,599	578	-64%	-60%	1,155	1,256	714
High Density Poly Ethylene (HDPE)	1,480	1,625	1,677	1,700	907	-47%	-39%	1,363	1,477	919
Low Density Poly Ethylene (LDPE)	1,592	1,710	1,783	1,788	992	-45%	-38%	1,444	1,568	1,026
Linear Low Density Poly Ethylene (LLDPE)	1,437	1,608	1,692	1,692	901	-47%	-37%	1,336	1,473	926
Ethylene Glycol	1,060	1,126	1,270	1,245	521	-58%	-51%	1,081	1,041	644
Polypropylene	1,433	1,515	1,748	1,737	837	-52%	-42%	1,362	1,459	935
Polystyrene	1,472	1,452	1,599	1,667	990	-41%	-33%	1,444	1,427	994
Fuel Additives										
Methanol	510	410	500	500	380	-24%	-25%	550	500	350
MTBE	720	855	966	1,005	550	-45%	-24%	630	844	550
Fertilizers										
Ammonia	310	450	750	850	350	-59%	13%	262	613	400
Urea	350	420	550	750	300	-60%	-14%	315	350	350
Steel										
Average Price (GCC)	701	856	1,176	1,238	679	-45%	-3%	2,287	700	730
New Financial Forecasts										
SABIC										
Revenue	40,223	39,980	43,365	44,381	22,987	-48%	-43%	126,204	150,713	122,133
EBIT	11,109	10,890	12,141	12,541	1,962	-84%	-82%	41,047	37,535	21,009
Net Income	6,866	6,924	7,548	7,240	1,243	-83%	-82%	27,022	22,955	13,865
EPS	2.29	2.31	2.52	2.41	0.41	-83%	-82%	9.01	7.65	4.62
IQ										
Revenue	2,546	3,466	4,210	5,074	2,844	-44%	12%	9,326	15,595	12,116
EBIT	2,452	1,804	2,427	2,180	1,319	-40%	-46%	4,475	7,730	4,925
Net Income	2,718	1,923	2,672	2,588	1,224	-53%	-55%	4,983	8,407	5,466
EPS	4.94	3.50	4.86	4.70	2.23	-53%	-55%	9.06	15.29	9.94

Source: CMAI, EFG-Hermes estimates

III. VALUATION AND RECOMMENDATION

DISCOUNTED CASH FLOW VALUATION

We maintain our discounted free cash flow (DCF) valuation approach to arrive at our long-term equity value estimates for SABIC and IQ. We reduced our LT Fair Value for SABIC by 54% to SAR86.9 per share and for IQ by 41% to QAR111.8 per share. This aggressive reduction is attributable mainly to: i) a correction in commodity prices that was much higher than estimated, ii) a lower-than-estimated energy price (and thus a lower perpetual floor price for SABIC's and IQ's main products) and an increase in our adopted discount rates and equity risk premiums across the board.

While both companies are highly leveraged to the current cyclical downturn in commodities, we believe the impact of the severe price correction will be more severe on SABIC than on IQ due mainly to SABIC's higher exposure to commodity petrochemicals (87% of turnover in 2008e). IQ's diversified financial profile will allow it to benefit from any upturn in a single product or market (such as urea and steel). Moreover, although both companies are increasing their petrochemicals and steel capacity, we believe the contribution of the new capacity to earnings and cash flow will be higher for IQ than for SABIC due to IQ's smaller production scale and operating model. We also regard favorably the better financial position of IQ, which has a net cash position of cUSD700 million, vs. SABIC's net debt of USD12 billion, and we expect a dividend yield in excess of 10% in 2008e and 2009e.

SABIC's relatively high exposure to the weakened demand in Western Europe and in the US increases its risk profile, we believe. We also see risks of delays or cancellations to SABIC's previously announced expansions in fertilizers and steel. Our adjusted model accounted only for SABIC's expansions in Saudi Arabia through its three greenfield projects: Yansab, Kayan and Sharq (we had previously assumed a long-term steel capacity of 10 mtpa). We believe investors should remain cautious about the performance of commodity stocks in the short to medium term as uncertainty grows over the impact of the financial crisis on energy prices and global demand.

WE ASSIGN A ST NEUTRAL / LT BUY FOR SABIC AND A ST ACCUMULATE / LT BUY FOR IQ.

Our long-term recommendation, however, is based predominantly on DCF exercises that estimate a normalized free cash flow for both companies based on average returns over a six-year period, including operating margins during the peak, mid-point and trough of a complete commodity cycle. We continue to believe in the strong long-term fundamentals of SABIC and IQ, as both companies are among the world's most efficient and profitable petrochemical producers. This global cost advantage will allow them to operate at above-average utilization rates and will certainly bring attractive value to shareholders should energy prices stabilize and consumers react to the current low-price environment, we believe. The table below highlights our assumptions for perpetual prices of SABIC's and IQ's basic commodities:

Figure 14: Long Term Average Price Assumptions of Basic Commodities

Commodity (USD/ton)	LT Price Assumptions
Ethylene	953
HDPE	1,200
LDPE	1,272
LLDPE	1,185
Methanol	350
MTBE	600
Ammonia	350
Urea	300
Steel	680

Source: EFG-Hermes estimates

SABIC

We have adjusted our discount rates upwards to account for risks and uncertainties in SABIC's performance during the current cyclical downturn. We used a risk free rate of 4.5% based on the current yield on 10-year US Treasury bonds, plus a subjective risk mark-up of 100 bps. In addition, we raised our equity risk premiums to 7% from 5% to account for the growing global risks and uncertainties in the wake of the financial turmoil. We use a WACC of 9.7%, which is based on our assumptions of a cost of equity of 11.5%, a cost of debt of 5% and a terminal growth rate of 2.5%. Because SABIC does not provide standalone divisional financial information or operational/financial breakdowns for its subsidiaries or business divisions, a sum-of-the-parts valuation is impractical. Instead, our DCF methodology is based on a five-year operational forecast at the consolidated level followed by a normalized free cash flow, on which we base SABIC's perpetual value.

Figure 15: Summary of SABIC DCF Findings

DCF VALUATION	2008	2009	2010	2011	2012	2013
Operating Income (EBIT)	37,535	21,009	30,553	39,346	44,264	47,967
Zakat Paid	(1,382)	(906)	(1,333)	(1,724)	(2,002)	(2,238)
Depreciation	9,950	10,684	10,970	10,815	10,456	9,886
Adjusted COPAT	46,102	30,787	40,190	48,437	52,718	55,616
Change in Working Capital	(3,592)	(5,752)	6,282	(5,557)	(1,708)	(1,074)
CAPEX	(28,000)	(20,000)	(15,000)	(8,624)	(5,410)	(1,853)
Free Cash Flow to Firm	14,511	16,963	19,486	34,250	45,598	52,688
Terminal Value						
Present Value of FCF	3,586	15,280	15,996	25,623	31,088	32,736
Enterprise Value	451,149					
Excess Cash and Equivalents	46,554					
Debt	89,814					
Net Debt	43,260					
Investments	5,691					
Equity Value	413,817					
Value for Minorities	153,112					
No of Shares	3,000					
LTFV	86.9					

Source: EFG-Hermes

IQ

We maintain our sum-of-the parts (SOTP) valuation approach, based predominantly on a discounted free cash flow (DCF) methodology, to account for the different risk profiles of the IQ's core operations and its different ownership stakes in each of its subsidiaries. We used a risk free rate of 4.5% based on the current yield on 10-year US Treasury bonds, plus a subjective risk mark-up of 100 bps. In addition, we raised our equity risk premiums to 7% from 5% to account for the growing global risks and uncertainties in the wake of the financial turmoil. The table below summarizes our WACC assumptions and DCF findings for IQ's various subsidiaries.

Figure 16: Summary of IQ's SoP DCF Findings

Valuation (QAR mn)	Valuation Method.	Risk Free Rate	Risk Premium	Terminal Growth	WACC	EV	Equity	IQ's stake	IQ's Equity	Value/ share
QAFCO	DCF	4.5%	7.0%	2.5%	11.1%	29,305	32,656	75%	24,492	44.5
QAPCO	DCF	4.5%	7.0%	2.5%	11.4%	33,720	35,278	80%	28,223	51.3
QAFAC	DCF	4.5%	7.0%	0.0%	11.3%	8,625	8,490	50%	4,245	7.7
QASCO	5x 2009 EBITDA	N/A	N/A	N/A	N/A	7,695	4,510	100%	4,510	8.2
Total Value						79,344	80,934		61,470	111.8

Source: EFG-Hermes estimates

Figure 17: Comparable Valuation

Country	Company	EV/EBITDA			EV/EBIDA			EV/Sales			PE			P/BV		
		2008e	2009e	2010e	2008e	2009e	2010e	2008e	2009e	2010e	2008e	2009e	2010e	2008e	2009e	2010e
USA	Dow Chemical Co	5.4	5.8	6.0	6.3	6.7	6.1	0.5	0.6	0.7	8.1	9.4	8.8	1.3	1.3	1.2
USA	Huntsman corp	7.6	6.5	5.6	8.3	6.8	4.8	0.6	0.6	0.6	28.7	15.4	19.8	1.1	1.1	1.5
USA	Nova Chemicals	3.9	4.4	5.9	4.5	4.7	6.2	0.4	0.4	0.4	4.7	7.3	15.5	1.0	0.8	0.8
USA	Westlake Chemical	5.2	6.6	8.9	6.2	7.6	9.8	0.4	0.4	0.4	10.3	18.4	35.1	0.7	0.7	0.7
India	Reliance	8.2	7.0	4.7	9.4	7.9	5.4	1.4	1.1	0.8	12.2	11.0	7.3	2.0	1.6	1.4
Taiwan	Formosa Plastic	4.9	6.3	6.2	5.3	7.2	6.7	0.8	0.9	0.9	8.0	9.9	10.7	1.3	1.3	1.3
Taiwan	Nan Ya Plastics	13.7	17.6	18.0	14.6	17.5	20.5	1.8	2.0	2.0	9.6	9.9	9.2	1.2	1.2	1.2
Taiwan	Formosa Chemical&Fiber	19.7	21.9	17.6	22.2	25.3	23.1	1.5	1.6	1.7	9.3	11.3	11.1	1.1	1.1	1.1
Turkey	Petkim Petrokimya Holding	8.0	5.9	5.4	8.1	6.0	5.7	0.4	0.4	0.4	NA	18.2	12.8	0.6	0.6	0.6
Japan	Sumitomo Chemicals	7.0	6.7	6.7	8.1	8.3	8.3	0.7	0.7	0.7	8.3	35.1	8.0	0.7	0.7	0.7
South Korea	Honam	4.9	5.4	5.4	7.9	10.0	9.5	0.5	0.5	0.5	4.4	4.8	5.5	0.5	0.4	0.4
Switzerland	CIBA Holding AG	7.8	7.4	7.4	8.2	8.2	8.3	0.9	0.9	0.9	NA	20.6	14.8	1.3	1.2	1.2
Belgium	Solvay	5.4	5.1	5.1	6.4	6.2	6.4	0.8	0.8	0.8	9.7	10.0	9.0	1.2	1.1	1.1
UK	Croda	6.3	5.9	5.9	7.9	7.6	7.9	1.0	1.0	1.0	9.9	9.1	8.3	0.3	0.2	0.2
Switzerland	Clariant	4.3	4.0	4.0	5.1	4.7	4.9	0.4	0.4	0.4	8.2	6.9	5.7	0.7	0.7	0.6
Germany	Linde	6.4	6.0	6.0	7.4	6.8	7.3	1.3	1.3	1.3	12.6	11.5	9.8	1.1	1.1	1.0
Germany	Bayer	6.0	5.7	5.7	6.0	6.4	6.7	1.3	1.2	1.2	9.1	9.4	8.6	1.8	1.6	1.5
Europe	Lonza Group	7.0	6.2	6.2	7.5	6.6	7.0	1.8	1.6	1.6	1.5	1.3	1.0	0.2	0.2	0.2
Netherland	DSM	4.1	3.9	3.9	5.1	4.6	4.4	0.6	0.6	0.6	4.9	6.0	5.5	0.6	0.6	0.6
Germany	BASF	3.7	3.5	3.5	5.9	5.4	4.9	0.6	0.6	0.6	6.2	7.8	7.1	1.2	1.2	1.1
Germany	Wacker Chemie	3.0	2.7	2.7	3.8	3.4	3.5	0.8	0.7	0.7	7.8	8.1	6.9	1.9	1.7	1.5
US	Rohm & Haas	11.2	9.8	9.8	7.8	7.1	6.6	1.7	1.6	1.6	21.2	21.4	16.5	4.9	5.1	5.3
US	Monsato	10.0	8.9	8.9	6.8	5.8	5.5	3.2	2.9	2.9	23.2	18.1	15.6	6.4	7.1	5.7
US	PPG Industries	5.1	4.7	4.7	3.6	3.4	3.4	0.7	0.7	0.7	8.6	8.6	7.8	1.6	1.4	1.4
US	Georgia Gulf	6.8	5.2	5.2	NA	10.0	14.2	0.5	0.4	0.4	NA	NA	2.7	0.4	1.6	1.1
US	Methanex	5.0	4.0	4.0	3.2	3.4	2.9	1.1	1.0	1.0	6.3	15.5	7.0	1.0	1.0	0.9
Canada	Agrium	3.6	3.8	3.8	4.5	4.8	4.6	0.8	0.8	0.8	4.1	3.8	4.7	1.3	1.0	0.8
Norway	Yara	3.1	3.3	3.3	4.0	4.6	4.2	0.5	0.5	0.5	2.7	3.9	3.7	1.1	0.9	0.8
US	Terra Industries	2.8	5.2	5.2	4.1	10.3	6.4	0.7	0.7	0.7	2.9	3.5	9.6	1.8	1.3	1.3
	Average	6.6	6.5	6.4	7.1	7.5	7.4	0.9	0.9	0.9	9.3	11.3	9.9	1.4	1.4	1.3
Saudi	SABIC	3.6	5.4	4.2	3.7	5.6	4.3	1.1	1.4	1.2	5.6	9.3	6.3	1.2	1.2	1.0
Qatar	Industries Qatar	4.6	6.8	5.4	4.6	6.8	5.4	2.4	3.1	2.6	4.8	7.3	5.9	2.2	2.1	1.9

Source: Reuters, EFG-Hermes estimates

Short-Term Rec.: Accumulate
Long-Term Rec.: Buy

Current Price*: QAR 73.5
LT Fair Value: QAR 111.8

▪ **An Unavoidable Squeeze in Margins:** According to our analysis, IQ will generate 40% of its 2008e turnover from steel, 31% from fertilizers (mainly urea), 20% from petrochemicals (mainly polyethylene) and 9% from fuel additives (methanol and MTBE). Fertilizers will contribute 45% of IQ's 2008e consolidated EBITDA, followed by petrochemicals (26%), steel (22%) and fuel additives (7%). Since August 2008, urea and polyethylene prices have fallen by c70% each, steel by 35%, methanol by 35% and MTBE by 45%. Inevitably, these sharp price corrections across IQ's business lines will squeeze its margins and its free cash flow generation during the current cyclical downturn.

▪ **A Relatively Low Concentration Risk:** While IQ's business model is skewed towards basic commodities, we believe the relatively diversified nature of its revenue streams and of the end markets for its product portfolio (agriculture, plastics, packaging, construction, fuel additives, etc) will allow the company to benefit from any upturn in a single market or a price recovery in a single product (such as urea and steel).

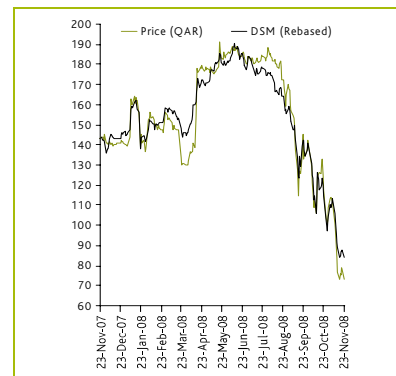
▪ **Absolute Cost Advantage Pays Off:** IQ operates its ethylene crackers on ethane feedstock (natural gas derivatives) at a significantly competitive price (USD1.5-2.0 per mBtu). Natural gas is also the feedstock in the production of ammonia, the backbone of urea and nitrogen-based fertilizers. This low gas price globally reduces IQ's production costs to a fraction of those of its global producers. We estimate IQ's direct cash costs at USD180 per ton of ethylene and USD80 per ton of urea. While the prices of urea and ethylene are currently equivalent to the cash costs of the world's marginal producers (with some of them producing at operating losses), we estimate that IQ is currently generating a cash margin of 70% on urea and 65% on ethylene. These margins compare very favorably to the margins of any producer elsewhere, we believe.

▪ **Volumes Growth Partially Offsets Price Corrections:** IQ plans to more than triple its steel capacity by 2012, adding 3.5 mtpa to its current capacity of approximately 2.1 mtpa. In petrochemicals, IQ will start operating its new linear low density polyethylene (LLDPE) line, with a capacity of 450,000 tpa, by 1Q2009 and will further increase its low density polyethylene capacity by 250,000 tpa by 2011. Moreover, IQ plans to increase its urea capacity to around 4.3 mtpa by 2011 from 2.9 mtpa now. We believe these highly competitive low-based capacity expansions will allow IQ to partially offset the impact of the current downturn in selling prices.

▪ **Cutting LTFV Estimate:** We have reduced our LT Fair Value for IQ by 41% to SAR111.8 per share on a higher-than-estimated correction in commodity prices, a lower-than-estimated oil price (and thus a lower perpetual floor price for IQ's products) and an increase in our adopted discount rates across the board. We assign a ST Accumulate / LT Buy for IQ. Our ST recommendation is based on the growing uncertainty over the price of oil and the impact of the financial crisis on global demand. Our LT recommendation, however, is based predominantly on our DCF valuation methodology.

December year end	2007a	2008e	2009e	2010e
Revenue	9,326	15,595	12,116	14,536
Operating Profit	4,475	7,730	4,925	6,182
EBITDA	4,875	8,018	5,494	6,844
Net Attrib. Income	4,985	8,470	5,466	6,813
EPS	9.06	15.29	9.94	12.39
DPS	4.55	8.80	8.00	8.00
Net Debt (Cash)	(2,730)	(1,369)	(835.6)	(59)
P/E (Attrib.)	8.1	4.8	7.3	5.9
EV / EBITDA	6.9	4.6	6.8	5.4
P / BVPS	2.9	2.2	2.1	1.9
P / CF	7.0	8.7	6.4	6.5
Dividend Yield	6.2%	12.1%	11.0%	11.0%
RoAE	40.3%	52.8%	29.2%	33.3%

Figures in QAR unless Otherwise Stated



	2007a	2008e	2009e	
(QAR mn)		Old	New	Old
Revenue	9,326	15,177	15,595	14,033
EBITDA	4,875	7,469	8,018	6,680
EBITDA Margin	52.3%	49.2%	51.4%	47.6%
Net Attrib. Income	4,985	7,379	8,407	6,541

Stock Data	
Mkt. Cap. / Shares (mn)	QAR40,150 / 550
Av. Monthly Liqd. (mn)	QAR1,345
52 Week High / Low	QAR193.0 / 69.9
Bloomberg / Reuters	IQCD QD / IQCD.QA
Est. Free Float	30%

Financial Statements (December year end)

Balance Sheet	9M2007	2007a	9M2008	2008e	2009e	2010e	2011e
Cash and Time Deposits	4,613	6,171	7,892	6,227	6,015	6,440	6,176
Receivables	2,237	2,009	3,837	3,336	2,690	3,393	3,704
Inventory	1,273	1,373	3,196	3,607	3,399	3,905	3,909
Total Current Assets	8,123	9,553	14,926	13,171	12,105	13,738	13,789
Net Fixed Assets	7,291	8,639	9,254	10,353	12,536	14,791	17,477
Other LT Assets	2,223	1,950	3,053	2,958	3,164	3,400	3,672
Total Assets	17,637	20,142	27,233	26,481	27,805	31,929	34,937
ST Debt	1,188	1,084	1,111	1,098	218	227	235
Payables	1,412	2,765	2,458	3,003	2,938	3,446	4,155
Other Current Liabilities	370	154	874	154	154	154	154
Total Current Liabilities	2,970	4,003	4,442	4,256	3,309	3,826	4,544
LT Debt	2,316	2,358	3,762	3,759	4,962	6,155	5,510
Other Liabilities	189	114	304	292	293	294	295
Net Worth	12,162	13,667	18,724	18,174	19,240	21,654	24,588
Income Statement							
Revenues	6,780	9,326	12,750	15,595	12,116	14,536	15,488
COGS	(3,259)	(4,395)	(5,560)	(7,129)	(6,611)	(7,623)	(7,889)
Gross Profit	3,521	4,931	7,190	8,466	5,505	6,913	7,599
SG&A	(362)	(410)	(551)	(735)	(581)	(731)	(801)
Depreciation and Amortization	-	(399)	-	(288)	(570)	(662)	(752)
EBITDA	N/A	4,875	N/A	8,018	5,494	6,844	7,550
EBITDA Margin		52.3%		51.4%	45.3%	47.1%	48.8%
Net Operating Profit	3,159	4,475	6,640	7,730	4,925	6,182	6,798
Net Operating Margin	46.6%	48.0%	52.1%	49.6%	40.6%	42.5%	43.9%
Net Interest Income (Expense)	120	150	93	109	130	148	2
Other Income (Expense)	123	359	450	569	412	484	535
Capital Gain/Loss	0	0	0	0	0	0	0
Earnings before Taxes	3,402	4,985	7,183	8,408	5,467	6,814	7,335
Zakat	0	0	0	0	0	0	0
NPAUI	3,401	4,983	7,182	8,407	5,466	6,813	7,334
Cash Flow Statement							
Cash Operating Profit After Tax	3,159	4,837	6,640	8,018	5,494	6,844	7,550
Change in Working Capital	(443)	1,329	(3,188)	(3,426)	789	(700)	394
Cash Flow after Change in WC	2,716	6,166	3,452	4,591	6,283	6,145	7,944
Capital Expenditure	(791)	(1,701)	(616)	(2,002)	(2,753)	(2,917)	(3,438)
Free Cash Flow	1,925	4,465	2,836	2,590	3,530	3,227	4,507
Non-Operating Cash Flow	(1,046)	558	(540)	(336)	206	247	263
Cash Flow before Financing	879	5,024	2,296	2,254	3,736	3,475	4,770
Net Financing	(892)	(3,466)	(575)	(2,198)	(3,947)	(3,050)	(5,034)
Change in Cash	(13)	1,558	1,721	55	(211)	425	(264)

Source: Industries Qatar, EFG-Hermes estimates

Short-Term Rec.: Neutral
Long-Term Rec.: Buy

Current Price*: SAR 43.0
LT Fair Value: SAR 86.9

▪ **Prices of Main Products in Freefall:** Among SABIC's huge portfolio of petrochemicals products and Fuel Additives (olefins/polyolefins, ethylene glycol, methanol and MTBE), represent 82% of SABIC's 2008e consolidated turnover and contribute almost 75% of its 2008e EBITDA, we estimate. The prices of products in this basket plummeted 45-65% in the last three months. This will indeed hurt SABIC's margins and free cash flow generation.

▪ **Cost Advantage Weakens:** One of the core investment drivers for SABIC in 1H2008 was the continued energy price escalation that boosted commodity prices, with the company a major beneficiary due to its access to relatively fixed feedstock costs in Saudi Arabia. The recent dramatic fall in oil and naphtha prices has now weakened the global cost advantage enjoyed by SABIC. At current oil and naphtha prices, SABIC's cost advantage against Asian naphtha-based producers has declined to around USD280 per ton of ethylene from USD450 in August, we estimate. We nonetheless continue to believe SABIC's cost advantage will remain significantly stronger than those of its global peers and strengthen further should the fluctuations in energy markets stabilize.

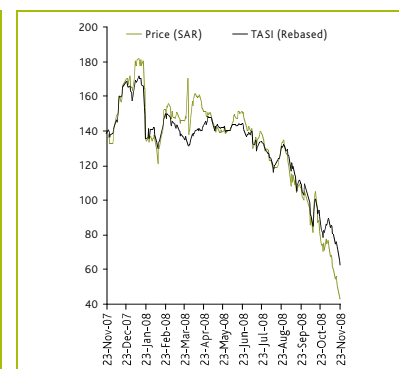
▪ **Global Volumes at Risk:** Besides the demand slowdown in SABIC's key export markets in Asia, we also see growing risks to its global volumes and operating rates due to its exposure to the recession in Western Europe (through SABIC Europe) and the US (through SIP).

▪ **A Significant Goodwill Impairment Seems Probable:** We see a possibility of a significant impairment of the goodwill reported after the acquisition of SIP (SAR14 billion) due to the significant drop in operating margins and a gloomy outlook on plastics demand that has led SABIC to shut down 20% of SIP's global capacity. SABIC does not provide financial details on SIP and, thus, we could not estimate a standalone fair value for the subsidiary.

▪ **Cutting LTFV Estimate:** We have reduced our LT Fair Value for SABIC by 54% to SAR86.9 per share due mainly to: i) a significantly higher-than-estimated correction in commodity prices and margins, ii) a lower-than-estimated perpetual floor price for SABIC's main products, a possible reduction in SABIC's global operating rates and an increase in our adopted discount rates and equity risk premiums across the board. Our adjusted LTFV implies a discount of around 55% to SABIC's estimated replacement value (based on 2008 prices). We believe the anticipated decline in replacement costs justifies this aggressive discount.

▪ **Recommendation:** We believe investors should remain cautious about the performance of commodity stocks in the short to medium term as uncertainty grows over the impact of the financial crisis on energy prices and global demand. We assign a ST Neutral / LT Buy for SABIC. Our long-term recommendation, however, is based on DCF exercises that estimate a normalized free cash flow based on average returns over six years, including the peak, mid-point and trough of a complete commodity cycle.

December year end	2007a	2008e	2009e	2010e
Revenue (bn)	126.2	150.7	122.1	147.5
Operating Profit (bn)	41.0	37.5	21.0	30.6
EBITDA (bn)	48.9	47.5	31.7	41.5
Net Attrib. Income (bn)	27.0	23.0	13.9	20.3
EPS	10.81	7.65	4.62	6.78
DPS	3.00	3.52	3.70	2.78
Net Debt (Cash)	34,053	30,483	33,027	27,454
P/E (Attrib.)	4.0	5.6	9.3	6.3
EV / EBITDA	3.3	3.4	5.1	3.8
P/BVPS	4.2	1.2	1.2	1.0
P/CF	2.3	3.0	3.5	3.7
Dividend Yield	7.0%	8.2%	8.6%	6.5%
RoAE	32.9%	23.0%	12.6%	17.3%
<i>Figures in SAR unless Otherwise Stated</i>				



	2007a	2008e	2009e	
(SAR bn)		Old	New	Old
Revenue	126.2	177.7	150.7	185.1
EBITDA	48.9	60.2	47.5	60.3
EBITDA Margin	38.7%	33.9%	31.5%	32.6%
Net Attrib. Income	27.0	29.4	23.0	28.4
				New
				122.1
				31.7
				25.9%
				13.9

Stock Data	
Mkt. Cap. / Shares (mn)	SAR129,000 / 3,000
Av. Monthly Liqd. (mn)	SAR14,669
52 Week High / Low	SAR184.6 / 42.3
Bloomberg / Reuters	SABIC AB / 2010.SE
Est. Free Float	30%

Financial Statements (December year end)

Balance Sheet	9M2007	2007	9M2008	2008e	2009e	2010e	2011e
Cash and Time Deposits	42,534	46,056	46,554	52,155	46,939	46,342	56,826
Receivables	25,273	29,198	28,968	30,372	24,579	29,724	34,791
Inventory	22,138	22,306	26,498	27,687	24,441	29,036	33,550
Other Debit Balances	7,313	1,928	9,256	2,275	2,248	2,705	3,209
Total Current Assets	97,258	99,488	111,275	112,489	98,207	107,806	128,377
Net Fixed Assets	116,516	123,114	137,295	141,164	150,480	154,510	152,319
Other LT Assets	31,787	33,646	32,773	31,982	35,892	38,993	41,805
Total Assets	245,562	256,247	281,344	285,634	284,579	301,309	322,501
ST Debt	5,844	4,671	6,444	3,632	6,880	7,766	14,031
Payables	15,398	14,965	18,196	17,561	15,537	18,395	21,202
Other Current Liabilities	12,369	12,071	14,234	11,999	10,935	12,334	13,752
Total Current Liabilities	33,611	31,708	38,874	33,192	33,352	38,494	48,986
LT Debt	78,447	75,438	83,370	83,006	77,086	69,321	55,290
Other Liabilities	49,211	57,948	56,485	60,892	62,825	70,185	79,541
Net Worth	84,293	91,154	102,614	108,545	111,315	123,309	138,685
Income Statement							
Revenues	86,524	126,204	127,726	150,713	122,133	147,499	172,485
Cash Costs	(47,682)	(70,648)	(75,756)	(91,318)	(80,792)	(95,651)	(110,250)
Depreciation and Amortization	(4,766)	(7,706)	(7,462)	(9,950)	(10,684)	(10,970)	(10,815)
Gross Profit	34,077	47,850	44,508	49,445	30,657	40,878	51,420
SG&A	(4,436)	(6,803)	(8,932)	(11,910)	(9,649)	(10,325)	(12,074)
EBITDA	34,406	48,753	43,038	47,484	31,693	41,523	50,161
EBITDA Margin	39.8%	38.6%	33.7%	31.5%	25.9%	28.2%	29.1%
Net Operating Profit	29,641	41,047	35,576	37,535	21,009	30,553	39,346
Net Operating Margin	34.3%	32.5%	27.9%	24.9%	17.2%	20.7%	22.8%
Net Interest Income (Expense)	355	(170)	(1,585)	(2,113)	(1,880)	(1,713)	(1,033)
Other Income (Expense)	1,176	1,531	1,862	2,486	3,797	4,781	4,792
Capital Gain/Loss	-	-	-	-	-	-	-
Earnings before Taxes	31,171	42,408	35,853	37,908	22,926	33,621	43,104
Zakat	(1,500)	(1,800)	(1,300)	(1,382)	(917)	(1,345)	(1,724)
Earnings before Minority Interest	29,671	40,608	34,553	36,526	22,009	32,276	41,380
Minority Interest	(9,510)	(13,585)	(12,841)	(13,571)	(8,143)	(11,942)	(15,311)
NPAUI	20,161	27,022	21,712	22,955	13,865	20,334	26,069
Cash Flow Statement							
Cash Operating Profit after Tax	32,906	46,953	41,738	46,102	30,776	40,178	48,436
Change in Working Capital	(13,069)	(11,550)	(6,751)	(3,592)	6,187	(5,692)	(5,563)
Cash Flow after Change in WC	19,838	35,403	34,986	42,511	36,963	34,486	42,874
Capital Expenditure	(59,005)	(68,719)	(23,720)	(28,000)	(20,000)	(15,000)	(8,624)
Free Cash Flow	(39,167)	(33,316)	11,266	14,511	16,963	19,486	34,250
Non-operating Cash Flow	3,419	(796)	7,436	3,977	(321)	1,432	1,681
Cash Flow before Financing	(35,748)	(34,113)	18,703	18,488	16,642	20,918	35,931
Net Financing	38,725	40,611	(18,204)	(12,389)	(21,857)	(21,516)	(25,446)
Change in Cash	2,977	6,499	498	6,099	(5,215)	(597)	10,485

Source: SABIC, EFG-Hermes estimates

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