

QATAR | BASIC MATERIALS

ST Rec.: Neutral
LT Rec.: Accumulate

Current Price*: QAR 177.2
LT Fair Value : QAR 190.2

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• Industries Qatar (IQ) is a holding company with controlling stakes in four of the largest non-gas industrial companies in Qatar namely QAPCO (petrochemicals), QAFCO (fertilizers), Qatar Steel (steel bars) and QAFAC (fuel additives).

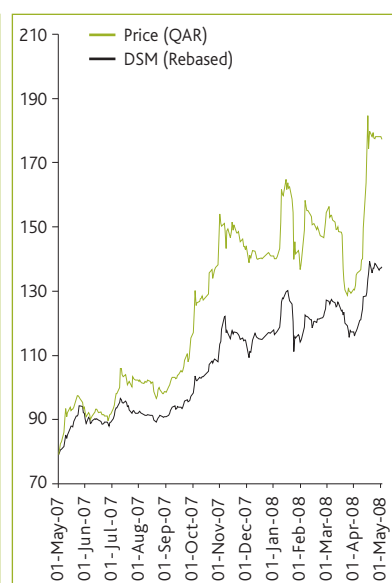
• The Government of Qatar is the largest shareholder in IQ and provides IQ group companies with significant benefits, the most significant in our view being access to competitively priced gas feedstock. This competitive feedstock cost provides QAPCO and QAFCO with an unmatched competitive advantage and production costs at a fraction of their global peers.

• Over the next few years, QAPCO and QAFCO will invest heavily in capacity additions to leverage this cost advantage, which will lead to strong market share gains. In the steel sector, significant investments are also being made to grow capacity with the driver there being the construction boom in Qatar and the greater GCC. Overall IQ group companies plan to spend over QAR20 billion on capacity expansions by 2012.

• While we expect that 2008 to be a peak earnings year for commodity prices for IQ and we expect EPS declines over the next few years, IQ is very well positioned versus most of its peers as volume growth should partially offset price declines. By 2011 when most of the capex program is complete, we expect the company to generate significant free cash flows.

• We estimate the fair value of IQ through a sum of the parts (SOP) approach based on DCF valuations of the principal operating units. Based on our analysis, we estimate the fair value of IQ at QAR190 per share, 7% above current levels. Because of the modest upside between the current stock price and our fair value, we set our ST recommendation at Neutral. We are positive on the company over the long term however as we expect the strong free cash flows post the completion of capacity expansions and resulting cash balance to lead to further growth opportunities; we set our LT recommendation at Accumulate.

December Year End	2007a	2008e	2009e	2010e
Revenue (mn)	9,326	15,177	14,033	13,206
Net Income (mn)	4,985	7,379	6,541	6,723
ROE	40.3%	45.8%	31.4%	23.4%
EPS	9.06	13.42	11.89	10.40
EPS Growth	38.0%	48.0%	-11.4%	-12.5%
PER	19.6	13.2	14.9	17.0
DPS	4.55	4.55	4.55	4.55
Dividend Yield	2.6%	2.6%	2.6%	2.6%
BVPS	24.87	33.74	42.00	46.95
P/BV	7.1	5.3	4.2	3.8
CFPS (Operating CF)	10.41	10.36	13.38	9.90
P/CF	17.0	17.1	13.2	17.9
EBITDA (mn)	4,875	7,469	6,680	5,816
EBITDA Margin	52.3%	49.2%	47.6%	44.0%
EV/EBITDA	20.2	13.2	14.8	17.0
Net Debt (Cash) (mn)	(2,730)	(1,677)	(2,725)	(2,055)
Net Debt (Cash)/ BV	-20%	-9%	-12%	-8%
Net Debt (Cash)/ Mkt Cap	-3%	-2%	-3%	-2%



Estimate Changes	2007a	2008e	2009e
(EGP mn)		Old New	Old New
Revenue	9,326	N/A 15,177	N/A 14,033
EBITDA	4,875	N/A 7,469	N/A 6,680
EBITDA Margin	52.3%	N/A 49.2%	N/A 47.6%
Net Income	4,985	N/A 7,379	N/A 6,541

Stock Data	
Last Ex-Div Date	N/A
Mkt. Val. (mn)	97,460
Shares (mn)	550
Av. Mthly Liqd. (mn)	QAR1,083
52-Week High / Low	189.0 / 78.09
Bloomberg / Reuters	IQCD QD / IQCD.QA
Est. Free Float	30%

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EXECUTIVE SUMMARY

Industries Qatar (IQ) is the largest listed company on the Doha Stock Exchange with a market capitalization of QAR91 billion (approximately USD25 billion). The company is essentially a publicly listed holding structure for the Government of Qatar's interests in four of the largest non-gas industrial companies in Qatar namely QAPCO (petrochemicals), QAFCO (fertilizers), Qatar Steel (steel bars) and QAFAC (fuel additives).

Not only does the Government of Qatar hold a 70% interest in IQ through Qatar Petroleum, the national oil company, it also holds 4.2% of the shares directly and is a joint venture partner in some of the projects of the IQ Group companies. This significant government ownership is important to keep in mind when analyzing IQ as it is ultimately through Government supplied competitively priced gas feedstock and other support that the IQ group companies derive their competitive advantage.

IQ TO PLAY AN IMPORTANT ROLE IN GOVERNMENT DIVERSIFICATION PROGRAM

This low cost gas is part of the Qatari Government's initiative to diversify its sources of income away from hydrocarbon revenues. This initiative is propelling the economy on a major capital expansion program where IQ companies are expected to play an important role. QAFCO, QAPCO and Qatar Steel are projected to spend a total of QAR20.5 billion (USD5.6 billion) on capital expenditure projects by 2012 which is expected to double and even triple the production capacity for some of their products.

VOLUME GROWTH SUPPORTED BY STRONG END MARKETS & CAPACITY EXPANSION

IQ's strong positioning in fast growing end markets such as petrochemicals, fertilizers and steel lead us to expect continued volume growth in key product areas such as LDPE (QAPCO), Urea (QAFCO) and Rebar (Qatar Steel). In addition, capacity expansion plans in these same divisions lead us to forecast significant market share gains in the medium-term, especially from 2011e onwards when the major expansion projects have been completed.

For example, we forecast Urea volumes to increase 30% to 2.9 million metric tons in 2011e from 2.2 million metric tons in 2008e, with the bulk of this increase coming in 2011e. Similarly, we forecast Rebar volumes to increase 33% to 2.4 million metric tons from 1.8 million metric tons during the same time period, again with all of the increase coming in the final year.

BUT PRICING ENVIRONMENT MAY HAVE PEAKED...

While we maintain a positive outlook for volumes for IQ's main divisions, we are more conservative on the outlook for pricing as we expect 2008e to be a peak year for prices for most of the commodities to which IQ has exposure. Our forecasts call for prices for key products such as Urea to fall 34% to USD285 per ton by 2011e from 2008e levels and for Rebar prices to fall 17% to QAR2,730 per ton by 2011e from 2008e levels.

...LEADING TO A MEDIUM TERM DECLINE IN REVENUE AND EARNINGS

Given our assumptions for pricing for IQ's key end products and with step changes in volumes not likely until the completion of the major expansion plans closer to 2011e, we forecast declining sales and earnings for the 2009e/2010e period before growth returns in 2011e. In fact, despite our expectations for a Y-o-Y rebound in revenue in 2011e of nearly 16%, we note that the absolute revenue level will only be slightly higher than our 2008e forecast of QAR15.2 billion due to expected declines in the interim period.

Earnings as well, we believe could be under pressure during this time due to the pressure on sales as well as expected margin pressure. On an EPS basis, we forecast 2008e to be the medium peak in earnings at QAR13.42 per share versus our 2011e forecast of QAR10.86 per share.

INVESTORS SHOULD FOCUS ON THE LONGER TERM CASH FLOW STORY

Given our above assumptions, we would not argue that earnings momentum is an area that investors should focus when analyzing IQ. Instead, we believe the longer-term cash flow outlook for IQ should be the key focus area for investors.

Once the major capacity expansion projects are completed around 2011, and with our expectations for continued strong end market demand for most of the company's commodity products, combined with our confidence on continued low cost feedstock supplies, we believe free cash flows will expand significantly. By 2011e, we expect free cash flow per share to reach near QAR8.00 per share from QAR2.78 per share in 2008e and QAR6.64 in 2007e.

VALUATION SUPPORTS LTFV OF QAR190 PER SHARE

We value IQ through a sum-of-the-parts approach based on DCF valuations of the principal operating units. This approach suggests a LTFV of QAR190 per share, 7.2% above IQ shares' current level. Our valuation is also supported by a comparable EV/EBIDA and P/E multiple analysis which results in an upper valuation range of QAR160 per share to QAR216 per share.

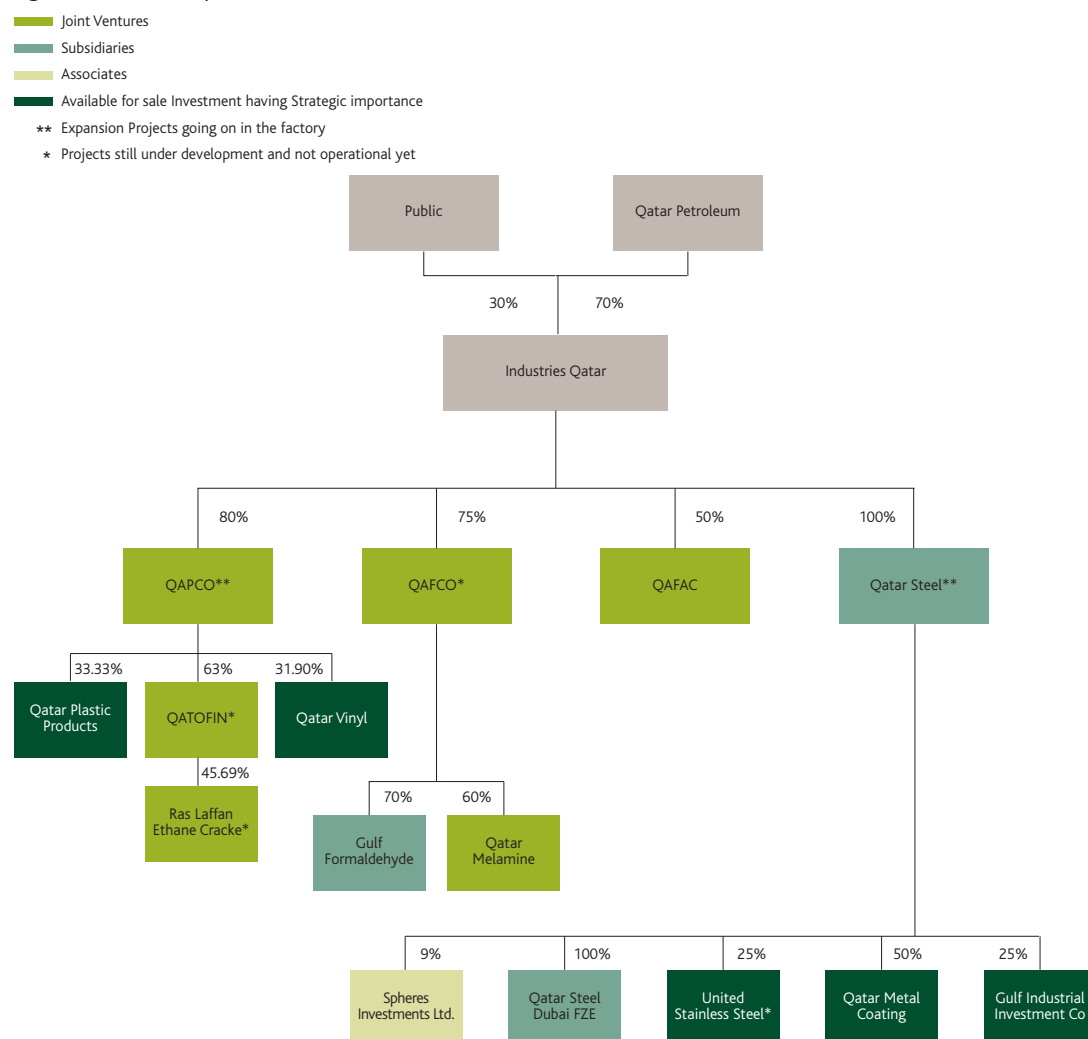
Risks to the IQ story include poor visibility in the cost structure of each group division and the risk of commodity price declines. This said, IQ is better positioned than the majority of its peers if commodity prices decline more precipitously than expected as a result of its substantial feedstock cost advantage, strong government support and solid financial position with no net debt. We initiate coverage of IQ with a ST Neutral / LT Accumulate recommendation.

I. COMPANY BACKGROUND

Industries Qatar (IQ) is the largest publicly listed company on the Doha Stock Exchange with a market cap of QAR91 billion (USD25 billion) representing about 32% of the value of the index. The Company is essentially a publicly traded holding structure representing the Government of Qatar's interest in some of the largest non-gas industrial sectors in the country. IQ's principal business consists of an interest in the following companies which it records on its financial statements on a proportional ownership basis:

1. IQ holds an 80% interest in Qatar Petrochemical Co (QAPCO), a manufacturer of ethylene and polyethylene which is a joint venture with Total Petrochemicals.
2. IQ holds a 75% interest in Qatar Fertilizer Co (QAFCO), a major producer of ammonia and urea which is a joint venture with Yara International, one of the world's largest fertilizer companies based in Norway.
3. IQ holds a 50% interest in Qatar Fuel Additives Co (QAFAC), a manufacturer of MTBE and methanol with three other joint venture partners.
4. IQ holds a 100% interest in Qatar Steel, a manufacturer of steel reinforced bars.

Figure 1.1: IQ Group Structure

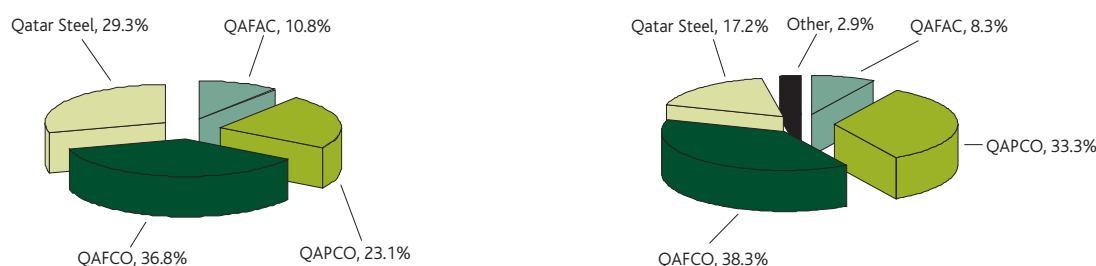


Source: Company Reports

INITIATION OF COVERAGE NOTE

Previously held by Qatar Petroleum, these four companies were transferred to a holding structure named Industries Qatar in early 2003 and in June of that year 30% of IQ was sold to the public through an IPO. The driver for the public share offering was not the need to raise capital but rather to fulfill the Emir of Qatar's objective to enhance the wealth of Qatari nationals by giving them a chance to directly participate in privatizations of some of its largest and most successful businesses. Non-Qatari nationals may also own shares of IQ but their level of participation is capped at 25% of the free float or 7% of IQ's total shares outstanding (25% of the 30% of shares not owned by Qatar Petroleum).

Figures 1.2: Sales and Net Profit by Group Company- 2007



Source: Company Reports

It is interesting to note that there are few, if any, synergies among the IQ group of companies. Nevertheless, there is a common thread among these companies in that their growth and success is conditional on the continued support of the Qatar Government which brings substantial financial and strategic benefits to the group companies. Chief amongst those benefits in our view is access to cheap gas feedstock with natural gas cost being the largest cost component in the production of fertilizers and petrochemicals manufactured by QAFCO and QAPCO which pay only a fraction of the international price for natural gas. Willingness to exploit this strong relative cost advantage over their peers is pushing a major capital expenditure program at QAPCO and QAFCO over the next three 3 years.

For Qatar Steel, the natural gas needed to process the iron ore pellets used as the raw material for steel production is only a small part of the total cost of production. The main driver for that business is the strong top line growth as a result of the massive construction boom in the Qatar and the Middle East region driving up demand for steel reinforced bars, Qatar steel's primary product. In that effort, Qatar Steel is supported by the Government of Qatar through tariffication on imported steel. Qatar Steel is also in the midst of a large capital expenditure program aimed at increasing its production capacity as well as securing raw material sources.

These three group companies will consume QAR20billion for their capital expansion over the next three years as part of IQ's Vision 2010 program. While this capital expenditure program comes in a period of high uncertainty as a result of rising construction costs especially in the Middle East as well as record high commodity prices, IQ's very strong cash flow generation ability, bolstered by its debt free status and tax free status, should permit the company to finance its growth mainly through internal cash flows.

Table 1.3: IQ Group Companies Expansion Projects

Under Development (QAR mn)	Project Details	Total Cost	IQ share of Total Cost	% Completion to Date	Completion Date	Remaining
QAPCO	QATOFIN - LLDPE Plant	5,000	2,550	44%	Q2-2009	1,428
QAPCO	LDPE 3 Plant	1,500	1,200	2%	Q3-2011	1,176
QAFCO	QAFCO 5	11,600	8,700	0%	Q2-2011	8,700
QAFCO	Qatar Melamine	602	271	30%	Q3-2009	190
Qatar Steel	Guelb el Aouj Iron Ore	1,800	900	0%	Q4-2011	900
Group Company Total		20,502	13,621			12,394
IQ	IQ Tower	700	700	0%	Q3-2010	700
IQ Total		21,202	14,321			13,094

Source: Company Report

II. QATAR FERTILIZER COMPANY (QAFCO)

A. COMPANY AND INDUSTRY BACKGROUND

QAFCO's cost advantage

The Qatar Fertilizer Company (QAFCO) was established in 1969 as a joint venture between the Government of Qatar, Norsk Hydro Norway, Davy Power Gas, and Hambros Bank. The objective of the joint venture, then as now, was to utilize foreign expertise for the production of chemical fertilizers and leverage Qatar's abundant gas resources. Today, IQ owns 75% of QAFCO while Yara International of Norway (previously part of Norsk Hydro) holds the remaining 25% interest. The facilities are located on a single site near Qatar Petroleum's facilities in Mesaieed Industrial City, 40km North of Doha. QAFCO's expansion occurred over a period of almost 40 years in four distinct waves of capacity additions.

QAFCO-1: QAFCO's first ammonia and urea facility was completed in 1973 with a capacity of 900 MT (Metric Tons) of ammonia per day and 1,000 MT of urea per day.

QAFCO-2: The second facility was completed in 1979, also with a capacity of 900 MT of ammonia per day and 1,000 MT of urea per day.

QAFCO-3: Completed in 1997, 18 years after QAFCO-2, the facility's production capacity was much larger at 1,500 MT of ammonia per day and 2,000 MT of urea per day.

QAFCO-4: The latest facility was completed in 2004 and again represented a step up for the company in terms of size and scale with a theoretical production capacity of 2,000 MT of ammonia per day and 3,200 MT of urea per day.

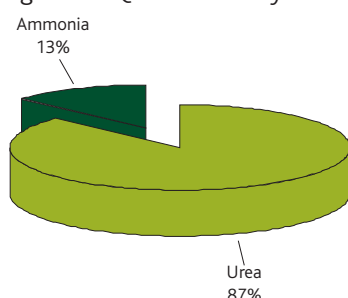
Table 2.1: Largest Global Urea Producers by Capacity, thousands of metric tons (2006)

Company	Country of Origin	Capacity (000 MT)	Market Share
IFFCO	India	4,208	2.8%
KALTIM	Indonesia	3,552	2.4%
National Fertilizers	India	3,208	2.2%
QAFCO	Qatar	2,932	2.0%
Agrium	Canada	2,639	1.8%
Sub-Total		16,539	11.1%
Other		131,881	88.9%
Total		148,420	

Source: Fertecon

Today QAFCO's operations have a total production capacity of 2.2 million MT of ammonia and 2.9 million MT of urea per annum. Urea is the main end product as the majority of the ammonia QAFCO produces is consumed in the production of urea. In 2007, QAFCO sold 2.8 million MT of urea for a total of QAR3.6 billion (USD1 billion). To put this in perspective, this makes QAFCO one of the five largest urea producers in the world and the largest producers of urea on a single site. However, as the urea market is still highly fragmented, the company has a very small share of total global capacity with a market share of 2.0%. In terms of IQ, QAFCO is the most important contributor to revenues and profitability accounting for 36.8% of IQ's revenues and 38.3% of net profit in 2007.

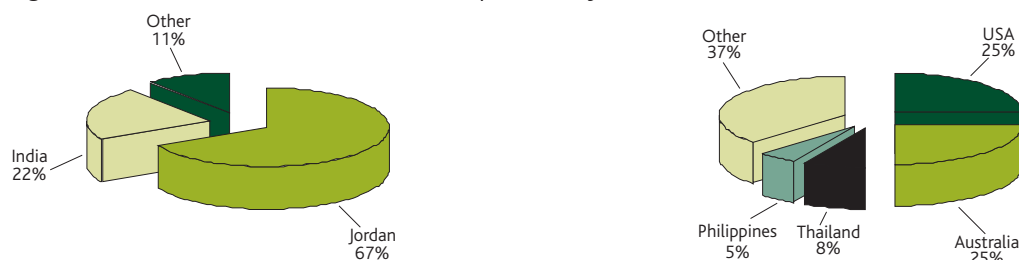
Figure 2.2: QAFCO Sales by End Product, 9M2007



Source: Company Reports

As demand for urea is seasonal and moves with crop cycles, the ability to generate sales year round is important. QAFCO is able to mitigate this seasonally effect trough an off take agreement with Yara International guaranteeing preset buying volumes. According to IQ, the offtake agreement with Yara amounted to a least 50% of QAFCO's total production last year which we believe gives the company a competitive advantage. Key markets for distribution are the US and Australia, each representing about 25% of sales last year.

Figures 2.3: QAFCO Ammonia and Urea Sales per Country, 2007



Source: Company

B. BACKGROUND ON UREA AND FERTILIZERS

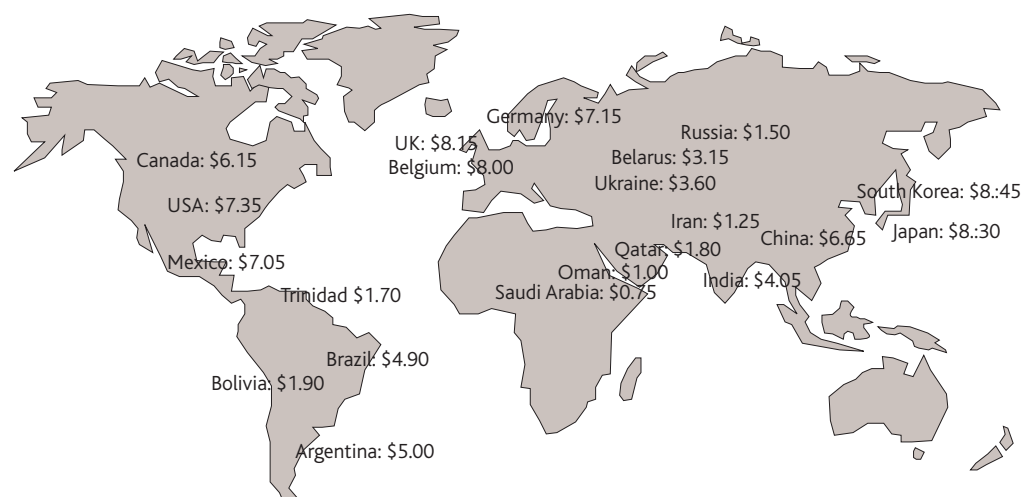
While we discuss the fertilizer industry in greater detail in Appendix 1, we believe it is necessary to provide a brief background on urea and fertilizers at this stage to understand the size of the opportunity for QAFCO and Middle Eastern urea producers who use natural gas as a feedstock.

Urea is the world's most widely used finished nitrogen fertilizer. It is traded globally with annual sales of about USD46 billion per year. About 90% of all urea is consumed as fertilizer, with the remaining 10% being used for technical applications.

The primary building block in the process of producing urea and other nitrogenous fertilizers is ammonia due to its high nitrogen content (82%). There are two primary methods to derive ammonia - either from natural gas or from naphtha, a petroleum-based chemical. However natural gas is the dominant method of ammonia production, accounting for about 80% of world capacity. For natural gas-based ammonia production, the natural gas cost represents 70%-90% of the total cash cost of production, most of the urea production in the world is located in countries with inexpensive sources of natural gas.

Figure 2.4: Global Natural Gas Costs by Country, USD per mmbtu, 2Q2007

Global Natural Gas Costs - 2nd Quarter 2007
(\$US per million BTUs)



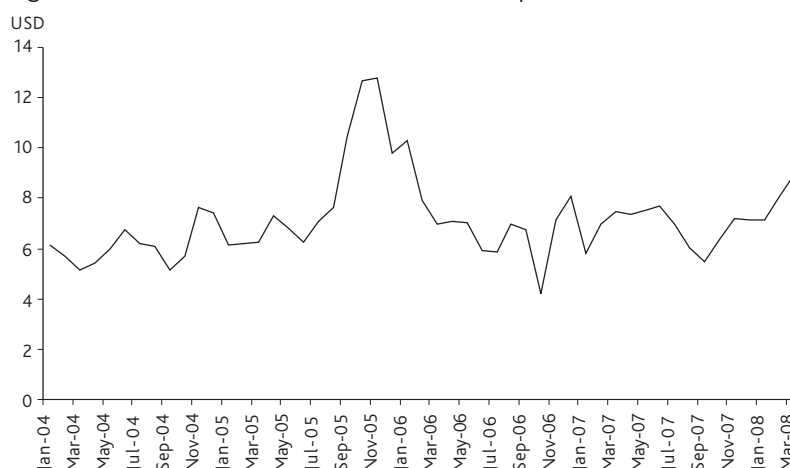
Source: American Chemistry Council

QAFCO Benefits From Advantageous Feedstock Pricing

In the case of QAFCO, all of its natural gas feedstock is supplied by the State of Qatar, through Qatar Petroleum, the national oil company. Although terms of the supply agreement are not public, we know QAFCO's agreement for the delivery of feedstock with Qatar Petroleum runs to 2019 with pricing terms expected to be very favorable.

Natural gas price in Qatar is among the lowest in the world, putting QAFCO in an extremely advantageous position versus its peers. Based on company documents, we estimate QAFCO paid an average of USD1.24 per mmbtu for feedstock from 2004-2006 and USD1.75 per mmbtu for feedstock in 2007. By comparison, natural gas prices currently run close to USD9.00 per mmbtu on the US Gulf Coast. On a cash cost per ton basis, this implies that a company like QAFCO incurred production costs for urea of about USD70 per ton in 2007 while the cash cost for US producers was USD225 per ton, with urea prices that year between USD320-USD380 per ton.

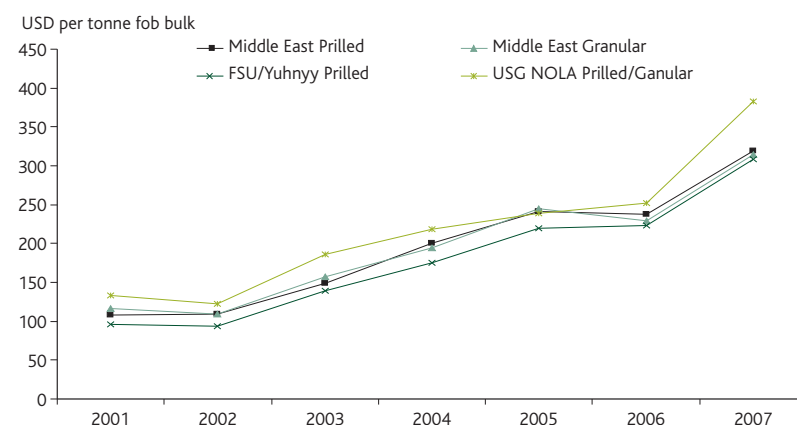
Figure 2.5: Natural Gas Price, US Gulf Coast, USD per mmbtu, 2004-Current



Source: CMAI

This significant cost advantage of Middle East producers with their low cost of supply over both other natural gas-based urea producers and naphtha-based producers is pushing Middle East producers to undertake a major phase of urea capacity expansion, as we discuss in the next section. Another important driver for Middle East urea capacity expansion is the spiraling price of urea. As can be seen on the following chart, prilled urea prices (the most common type) have surged more than threefold since 2002. For producers like QAFCO with relatively fixed feedstock costs, the majority of the urea price flows to the bottom line allowing the company to report gross margins in excess of 70%. We discuss the drivers for urea prices and fertilizer demand in general in detail in Appendix 1.

Figure 2.6: Monthly Prilled Urea Prices, USD per ton, 2000-current



Source: Fertecon

C. CAPACITY EXPANSION PLANS

QAFCO is in the process of significantly ramping up its urea capacity, like other Middle Eastern producers. It is estimated that the Middle East region will account for the majority of urea capacity additions in the world over the next 5 years and that the region is set to grow its share from about 10% of total world urea capacity to about 20% over that same period.

QAFCO-5 Will Significantly Increase QAFCO's Total Production Capacity

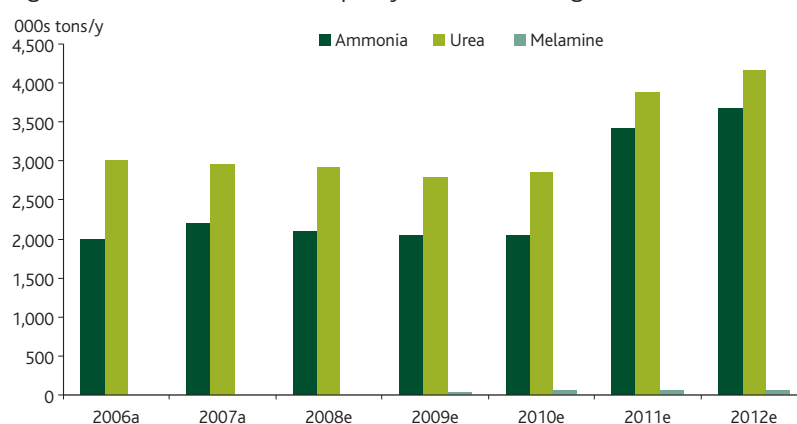
In the case of QAFCO, expansion will come in two forms: The first and by far the most significant expansion project is the construction of a fifth ammonia and urea facility, QAFCO-5. The QAFCO-5 facility will have two ammonia plants with a total daily production capacity of 4,600 tons, and a urea plant with a total daily production capacity of 3,850 tons. The completion of QAFCO-5, expected in 2011, will increase QAFCO's annual production of ammonia by 73% to 3.8 million tons and its production of urea by 43% to 4.3 million tons. The estimated total cost of the QAFCO-5 project is USD3.2 billion on which the company expects an IRR of more than 18%.

Melamine Product Line Expansion Due In 2009

The second form of expansion for QAFCO comes from product line expansion. QAFCO, through Qatar Melamine in which it owns a 60% interest, intends to further vertically integrate at the downstream level by producing melamine. Melamine is used in the production of molding powder to make dinner ware, coatings in cars, fan coils and appliances. Other uses include adhesive resins, which are used in the making of wood panels for the construction of kitchens, bathrooms, furniture and flooring.

The new melamine plant will have a production capacity of 60,000 tons per year. Construction commenced in the fourth quarter of 2006 and completion is expected in 1Q2009. The total cost of the project is estimated at USD250 million. The plant is expected to be the largest melamine plant in the Middle East and the second largest in the world. The plant will be in the Mesaieed industrial area within QAFCO's complex, where it will benefit from QAFCO's production of urea. QAFCO will handle both the administrative and operational aspects of the company. While we expect Qatar Melamine to generate very healthy margins, its overall contribution to IQ will be limited due to its small size relative to QAFCO's contribution from ammonia and urea.

Figure 2.7: QAFCO's Forecast Capacity Evolution Through to 2012e



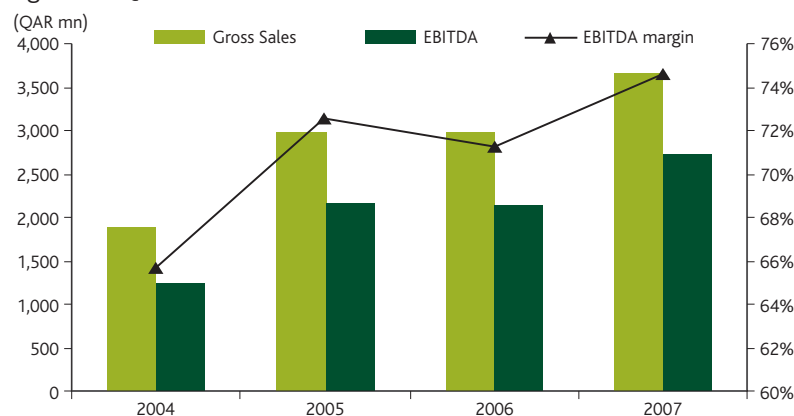
Source: Company Reports

D. QAFCO SALES AND PROFITABILITY

From 2004 to 2007, QAFCO recorded very strong results with compound annual growth of 24.8% in revenues and 30.2% in EBITDA. While the company has benefited from a strong appreciation in urea prices during this time, it is worth noting that its feedstock costs from Qatar Petroleum have also risen over this period as well, in tandem with urea prices. However, the impact of rising feedstock cost has been muted, with margins expanding fairly consistently over this four year period.

What we find most interesting about QAFCO's financial performance is how much of its revenues flow through to cash. From 2004 to 2007, the company's ratio of free cash flow to revenues averaged an impressive 57%. This is explained by the very low levels of working capital, and is despite the fact that QAFCO 1, 2 and 3 are fully depreciated. Looking forward, this bodes well for a resumption of strong free cash flow generation post the completion of QAFCO-5 in 2011.

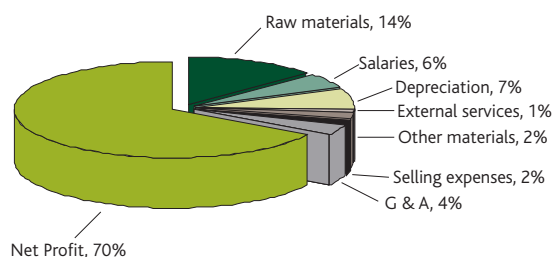
Figure 2.8: QAFCO Evolution of Sales and EBITDA



Source: Company, EFG-Hermes

As mentioned earlier in this note, QAFCO's cost structure is relatively fixed with raw material costs, largely natural gas to produce ammonia supplied by Qatar Petroleum, and salaries being the two main expense items. An impressive 70% of revenue flows to the bottom line and consequently, there is tremendous dependency in QAFCO's earnings on changes in urea prices which we believe are set to decline over the following years.

Figure 2.9: QAFCO Cost Structure, 2007

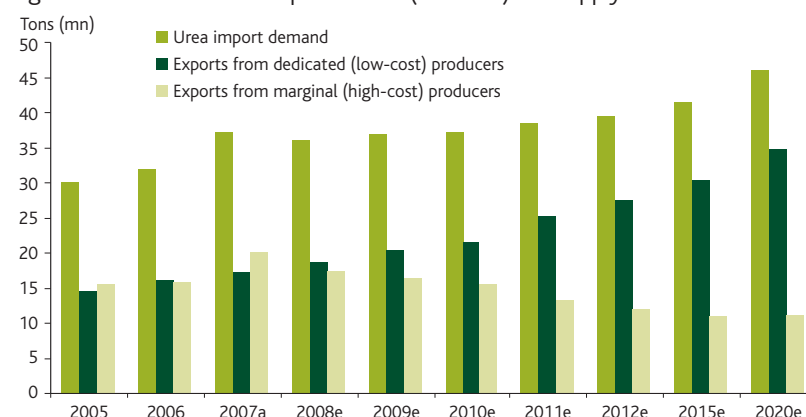


Source: Company Reports

Urea Prices Could Peak in 2008

According to fertilizer industry consultants Fertecon, urea prices are set to peak in 2008 and decline in 2009 and 2010 as additional low cost capacities come on-line, mostly from Middle Eastern producers. More specifically, almost 30 million tons of urea capacity is expected to be added from 2008-2011 of which 11.4 million tons is expected to be export capacity from low cost producers in Qatar, Saudi, Egypt, Algeria and Iran. We expect this additional low cost capacity to displace marginal high cost capacity and pressure urea prices over the next three years.

Figure 2.10: Global Urea Import Needs (Demand) Vs. Supply



Source: Fertecon

Our price forecasts imply a 22% decline in ammonia prices and a 34% decline in urea prices from 2008 to 2011. For QAFCO, we anticipate a decline in EBITDA margin of 1210 bps over the forecast period albeit from a very healthy level of 73.7% in 2008. Our forecasts assume natural gas feedstock costs of USD1.75 per mmbtu throughout the period, similar to the feedstock cost QAFCO incurred in 2007.

Table 2.11: QAFCO Forecasts

	2008e	2009e	2010e	2011e
Price - USD/Ton				
Ammonia	450	400	375	360
Urea	435	385	335	285
Melamine	0	1,873	1,630	1,387
Volume - 000's metric tons				
Ammonia	319	340	317	902
Urea	2,228	2,095	2,139	2,903
Melamine	0	14	27	27
Revenues - QAR mn	4,049	3,522	3,202	4,108
EBITDA - QAR mn	2,985	2,395	1,978	2,529
EBITDA Margin	73.7%	68.0%	61.8%	61.6%

Source: Fertecon, EFG-Hermes

While we believe a decline in profitability and profitability margin at QAFCO is inevitable given our view on urea pricing, QAFCO remains one of the lowest cost/highest margin urea producers in the world even more profitable than other Middle Eastern peers with a similar low-cost feedstock advantage. In a declining price environment, we believe its low cost position places it at an advantage to grow its share of urea market especially versus high-cost producers which may have to shut down capacity.

Table 2.12: QAFCO Profitability versus Peers

Country	Company	EBITDA Margin				Net Margin			
		2004	2005	2006	2007	2004	2005	2006	2007
	Fertilizers								
USA	Terra Industries Inc	14.5%	9.2%	7.4%	22.1%	4.5%	1.1%	0.2%	8.6%
Norway	Yara International ASA	11.6%	11.2%	9.9%	11.4%	8.7%	6.9%	8.9%	10.7%
Saudi	SAFCO	59.0%	64.6%	64.6%	70.3%	48.7%	60.3%	62.9%	62.8%
Canada	Agrium Inc	19.3%	19.4%	9.9%	16.0%	9.4%	8.6%	15.4%	8.4%
Israel	ICL-Israel Chemicals Ltd.	18.2%	23.6%	21.8%	N/A	9.2%	14.1%	11.5%	N/A
	Average Fertilizer Producers	24.5%	25.6%	22.7%	29.9%	16.1%	18.2%	19.8%	22.6%
Qatar	OAFCO	65.7%	72.6%	71.3%	74.6%	49.0%	58.6%	57.5%	66.0%

Source: Reuters, Company Reports

III. QATAR PETROCHEMICAL COMPANY (QAPCO)

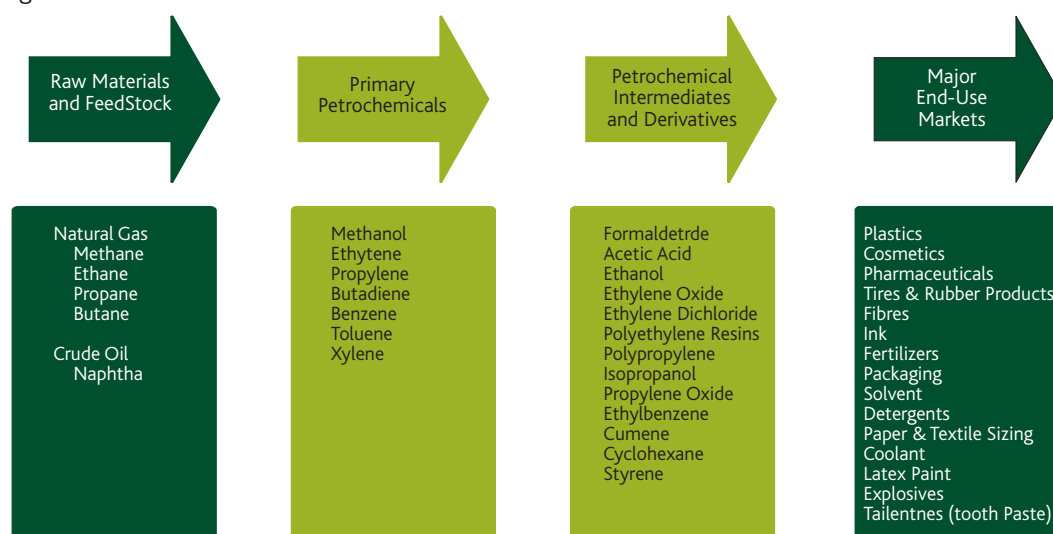
A. COMPANY AND INDUSTRY BACKGROUND

Growing market share in a key commodity market

QAPCO or the Qatar Petrochemical Company, is a joint venture between Industries Qatar (80% interest) and Total Petrochemicals (20% interest). Established in 1974, QAPCO is a world class producer of ethylene and LDPE (Low Density Polyethylene), using ethane feedstock supplied by Qatar Petroleum. Its manufacturing facilities consist of an Ethylene plant with a designed annual capacity of 525,000 MT, two LDPE plants with a total annual capacity of 360,000 MT and a Sulphur plant with an annual rated capacity of 70,000.

Ethylene is a commodity that lies at the very root of the petrochemicals industry. Global production of ethylene currently exceeds 80 million metric tons per annum making it the most highly produced organic compound in the world. The importance of ethylene is derived from the high weight of its principal derivatives in the industry, serving as a backbone for the thermoplastic industry as well as a diverse range of industries. Because ethylene is a high chemically-reactive gas that is difficult and expensive to transport, most of the international trade in ethylene takes place in the form of its derivative products such as polyethylene, PVC, ethylene glycol, styrene,...etc. Polyethylenes such as LDPE, LLDPE (Linear Low Density Polyethylene) and HDPE (High Density Polyethylene) make up 59% of end use for ethylene. These polymers are used in a broad range of applications, from automotive parts to carpet fibers, household & food containers, toys, stretch film/shrink film, diapers and trash bags.

Figure 3.1: Petrochemical Value Chain



Source: Zawya

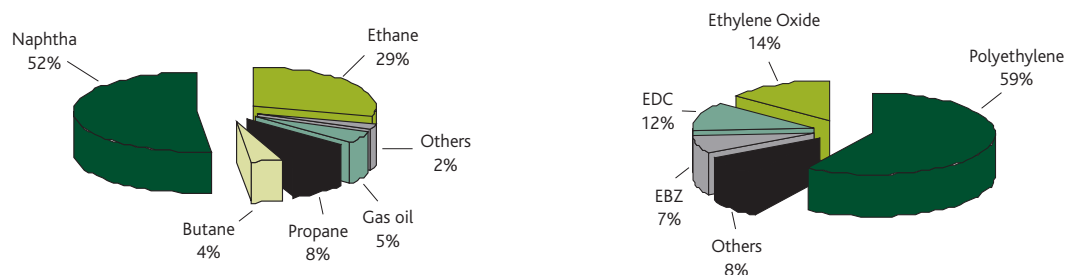
QAPCO is set to play a key role in the global commodity market for polyethylenes. Similar to QAFCO, the significant opportunity for QAPCO lies in its cost advantage versus its peers and the company is planning significant capacity additions to increase its volume of the world market. QAPCO exports worldwide to over 74 countries but its key focus is Asia which is the largest consumer market for polyethylenes.

While QAPCO is still a very small player in the world polyethylene market (USD740 in revenues in 2007), QAPCO is important as a share of IQ. Last year, QAPCO represented 23.1% of its IQ revenues and 33.3% of its net profit.

QAPCO Retains a Cost Advantage in Ethylene and Polyethylene Production

Similar to fertilizers, Ethylene production is based on two feedstocks, naphtha derived from oil and ethane, derived from natural gas which gives producers like QAPCO with access to low cost natural gas a distinct competitive advantage. One important difference with fertilizer production however, is that naphtha is the predominant feedstock used in ethylene production, accounting for 52% of world ethylene production, with only 41% of ethylene production being gas-based. This compares to 80% of world ammonia production which is gas-based.

Figures 3.2: World Ethylene Production by Feedstock and End Use, 2007

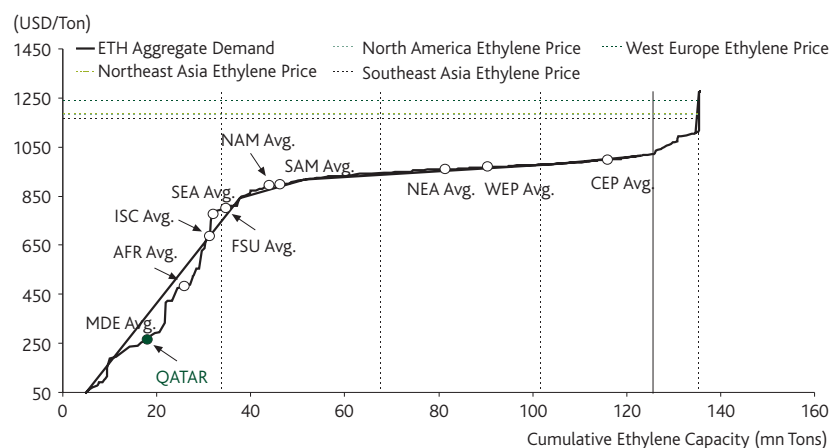


Source: CMAI

While the implication is that a decline in oil prices would have a negative impact on the relative competitive position of natural gas-based ethylene producers, given the low cost of feedstock in the Middle East, oil prices would have to decline to about USD20/bbl for naphtha based ethylene producers to compete with Middle Eastern gas-based producers.

The trend, of course, with oil prices in the last few years has been quite the opposite and has led to a consistent increase in the relative cost advantage of Middle Eastern producers. For example, versus Asian ethylene producers, which use naphtha as a feedstock and where 28% of world ethylene capacity lies, the cost advantage per ton of ethylene has grown from USD140-USD180 in 2003 to USD370-USD510 per ton in 2007 as the price of oil rose from USD29/bbl to USD66/bbl.

Figure 3.3: Global Ethylene Cash Cost per Site, USD per Ton, 2008

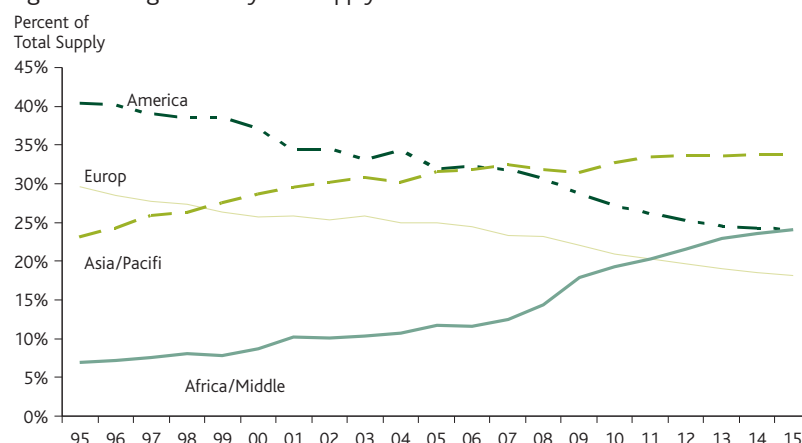


Source: CMAI

B. CAPACITY EXPANSION PLANS

An unprecedented wave of new ethylene capacity investment has been made in the Middle East and is expected to come on-stream through 2012. According to petrochemical industry consultant CMAI, Middle East ethylene capacity is expected to increase from 15 million tons in 2007 (12% of the global supply) to 28 million tons in 2010, and further increase to 40 million tons in 2015 (23% of the estimated global capacity in 2015), ranking the region ahead of current largest producers; North America and Western Europe.

Figure 3.4: Regional Ethylene Supply Market Share Trends to 2015e



Source: CMAI

Significant expansions in ethylene and polyethylene production planned

By 2012, QAPCO (including projects undertaken with its JV partners) plans to expand total (i.e. non-proportionate) polyethylene production capacity by 199% and ethylene capacity by more than 260%. IQ's share of the investment is estimated at QAR3.8 billion (USD1.0billion).

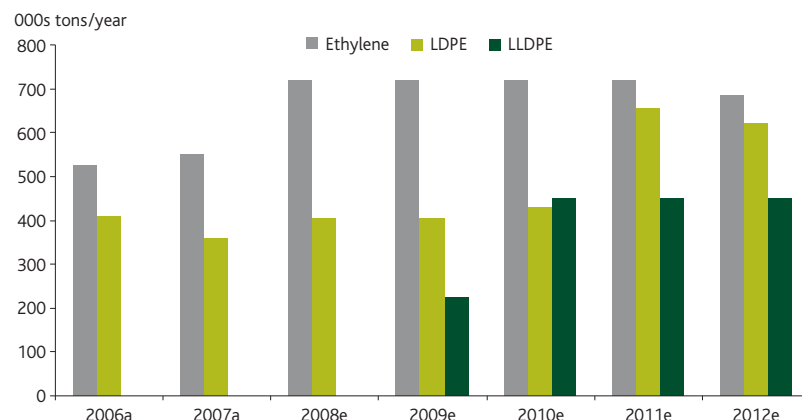
The expansion will come largely from two new projects: the addition of a third LDPE plant and the addition of new LLDPE capacity:

The new LDPE plant will have a capacity of 250,000 tons per year. Construction is expected to be completed in 3Q2011. Production will be absorbed by Qatar Vinyl Company and QPPC, two associate companies in which QAPCO has 31.9% and 33.3% stakes respectively to manufacture vinyl and flexible packaging.

The addition of new LLDPE capacity will be done through the QATOFIN joint venture between Total Petrochemicals and Qatar Petroleum in which QAPCO owns a 63% share. The new plant will be located in Mesaieed, adjacent to the existing QAPCO plant. The plant is expected to produce around 450,000 metric tons of polyethylene every year which will be mainly exported to Asia and Europe. LLDPE is used in almost all of the traditional markets for polyethylene. It is used for plastic bags and sheets (where it allows using a lower thickness than comparable LDPE), plastic wrap, stretch wrap, pouches, toys, lids, pipes, buckets and containers, covering of cables, geomembranes and flexible tubing. Construction is under way and completion is expected in 1Q2009.

Ethane feedstock for QAPCO's LDPE and LLDPE capacity expansion will be supplied by a new ethane cracker which will be located in Ras Laffan Industrial City. The proposed cracker will have the capacity to produce 1.3 million metric tons of ethylene and is expected to be one of the world's largest ethane cracker plants. Situated 80 kilometers North East of Doha, the ethylene from this cracker will be transported to QAPCO's plants in Mesaieed through the construction of a 120 kilometer pipeline in which QAPCO owns an interest.

Figure 3.5: QAPCO Expected Capacity Evolution through 2012e



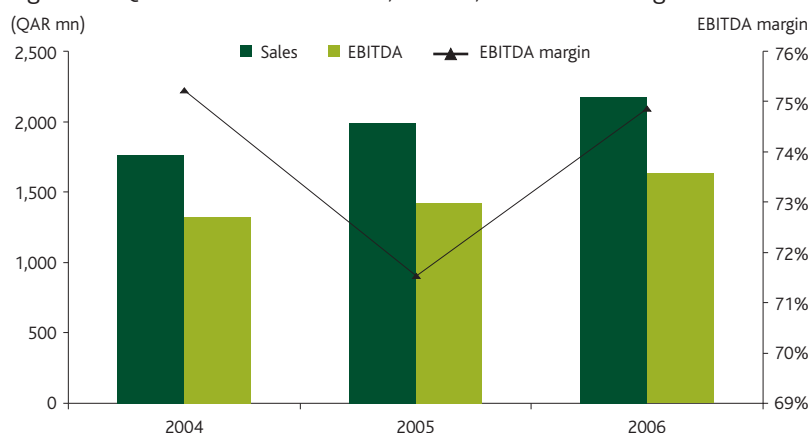
Source: Company Reports

C. QAPCO SALES AND PROFITABILITY

Strong volume growth ...

Between 2004 and 2006 (2007 stand-alone results for QAPCO have yet to be released), QAPCO recorded impressive growth with compound annual revenue and EBITDA growth of 15.2% and 19.2% respectively. Growth has almost entirely been driven by price gains in the price of ethylene and LDPE as capacity was constrained during this period and grew at a CAGR of only 5.1%.

Figure 3.6: QAPCO Evolution of Sales, EBITDA, and EBITDA Margin 2004-2007e



Source: Company Reports

...to be muted by expected price declines

The period from 2008e-2011e should see a very different scenario to that seen over the 2004-2007 period as substantial production growth should be offset by lower commodity prices. For QAPCO and its JV partners, we expect ethylene sales volumes (in MT) will grow 65% in 2008e, 30.5% in 2009e followed by more muted gains in 2010e and 2011e as a result of the commissioning of a second ethylene plant in Q4/07. LDPE volume growth should be fairly muted throughout the period growing 2.6% in 2008e, 1.3% in 2009e and 6.2% in 2010e. We expect LDPE sales volume to increase more than 50% in 2011e when the LDPE 3 capacity comes on line. LLDPE capacity through QAPCO's QATOFIN joint venture will kick in 2009e to 200,000 MT and almost from there double in 2010e.

We expect that global capacity additions during the 2008e-2011e period will lead to pricing weakness. We expect a 30% decline in ethylene prices and a 31% decline in LDPE prices during this period, in line with the forecasts of petrochemical industry consultant CMAI.

As a result, we expect QAPCO's EBITDA margin to decline 1,510 bps from 79.0% in 2008e to 63.9% in 2011e but nevertheless remain at very high levels, especially compared to global peers.

INITIATION OF COVERAGE NOTE

Table 3.7: QAPCO Forecasts 2008e-2011e

	2008e	2009e	2010e	2011e
Price - USD/ Ton				
Ethylene	1,218	1,104	897	855
LDPE	1,393	1,173	1,016	963
LLDPE	1,300	1,090	946	892
Volume - 000's of metric tons				
Ethylene	252	329	339	170
LDPE	320	324	344	524
LLDPE	0	101	192	192
Revenue - (QAR mn)	2,740	3,104	3,039	2,989
EBITDA - (QAR mn)	2,166	2,329	2,086	1,910
EBITDA Margin	79.0%	75.0%	68.6%	63.9%

Source: Company Reports, CMAI and EFG-Hermes

As we previously mentioned about 52% of world ethylene capacity is based on naphtha which gives ethane based producers a significant advantage when ethylene prices decline in a high oil price environment, increasing the likelihood of capacity shutting down.

With petrochemical industry EBITDA margins generally low, QAPCO's cost advantage would provide a strong buffer in a declining price environment as shown in the table below.

Table 3.8: QAPCO Margins vs. Petrochemical Peers

Country	Company	EBITDA Margin				Net Margin			
		2004	2005	2006	2007	2004	2005	2006	2007
	Petrochemicals								
Canada	Nova Chemicals	10.8%	8.2%	9.3%	13.1%	4.8%	-1.8%	-10.8%	5.2%
Taiwan	Asia Polymer Corp	16.6%	7.7%	5.3%		12.7%	7.2%	8.0%	
Taiwan	PTT chemical	27.0%	26.0%	65.7%	67.4%	23.1%	21.6%	24.8%	24.9%
Korea	Honam Petrochemical	N/A	18.6%	14.1%	13.9%	22.5%	9.6%	6.8%	7.5%
	Average	18.1%	15.1%	23.6%	31.5%	15.7%	9.1%	7.2%	12.5%
Qatar	QAPCO	72.8%	69.1%	72.6%	N/A	46.7%	44.9%	47.7%	N/A

Source: Reuters, Company Reports

IV. QATAR STEEL COMPANY

A. COMPANY AND INDUSTRY BACKGROUND

Well positioned in a strong demand environment

Founded in 1974, Qatar Steel was the first integrated steel manufacturing plant in the Arabian Gulf. While originally structured as a joint venture similar to the other IQ group companies, the Government of Qatar bought out its two partners, Kobe Steel and Tokyo Boeki in 1997 making Qatar Steel the only IQ group company to be wholly owned.

Qatar Steel is a manufacturer of steel billets, coils and rebars with rebars being the main product, representing 87% of sales in 2007. The company manufactures steel using the direct reduction (DRI) method of steel making which uses iron ore pellets as its key raw material and uses natural gas as a reducing agent (to remove the oxygen from the iron ore pellets and purify the steel), the most common method among Middle East steel plants.

Its facilities consist of 4 stations: two gas-based DRI modules, four electric arc furnaces, three continuous casting mills, a rolling mill and a high speed finishing bar mill. Annual steel making capacity was 830,000 tons per year at the end of 2007 which makes Qatar Steel the third largest producer of steel products in the GCC. Its revenue in 2007 was QAR2.7 billion (USD750 million) representing 29.3% of IQ's total revenues and 17.2% of net profits.

Table 4.1: GCC Rebar Supplier Market Share (2006)

Rebar Supplier	Market Share
Imports	27%
Hadeed, Saudi Arabia	25%
Al-Ittefaq, Saudi Arabia	14%
Qatar Steel	13%
Al-Rahji, Saudi Arabia	5%
ESI, UAE	5%
Uni Steel, Kuwait	5%
Other GCC	4%
Sharq Shora, Oman	2%

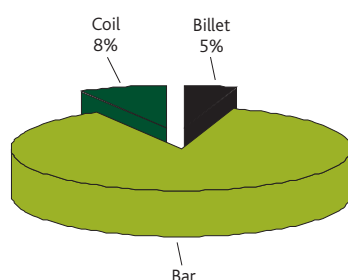
Source: Qatar Steel

Strong steel demand the key driver for Qatar Steel

Qatar Steel stands out from other IQ group companies in that energy costs as a percentage of manufacturing costs are low (around 10%) and as such, do not represent a big cost advantage for Qatar Steel versus its global peers. However, with the dynamics of the steel industry being more local than those of the fertilizer and petrochemical industries, Qatar Steel can benefit from the very strong demand for steel in Qatar and neighboring Gulf countries, which is the result of the boom in construction activity in the region, bolstering demand for rebars.

Reinforced bars (referred to as rebars) are used in the production of reinforced concrete and reinforced masonry structures and are an essential component in building construction. Reinforced bars represent the majority of steel consumed in the GCC. For Qatar Steel, reinforced bar made up 87% of revenues in 2007 (9-month data), steel billets (unprocessed steel bars) accounted for 5% of revenues and wire rod coils accounted for the remainder.

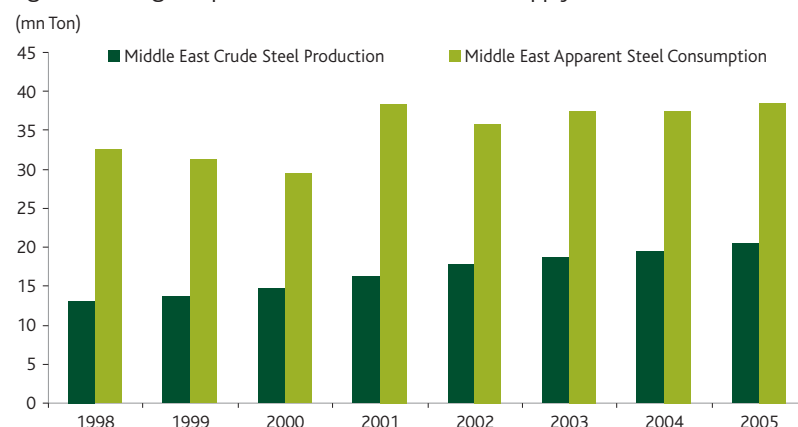
Figure 4.2: Steel Sales per Product Line, 9M 2007



Source: Company Reports

As we discuss in Appendix 3, the opportunity for Qatar Steel is that Qatari steel demand, much like in most of Middle Eastern countries, is substantially above local capacity and therefore steel buyers are very reliant on imports which are more expensive given transportation costs and import duties.

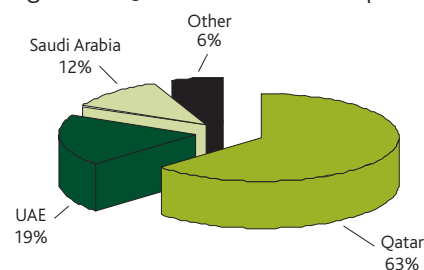
Figure 4.3: Large Gap between Middle East Steel Supply and Demand



Source: mesteel, OECD

By 2010, it is expected that steel consumption in the GCC will grow by 7.7% per annum, faster than any other region in the world. In Qatar, growth is expected to be a solid 5.4% but the fastest growing countries are expected to be Saudi Arabia and the UAE, steel markets that are approximately 4-5 times the size of Qatar. To take advantage of that growth, Qatar Steel acquired a steel production facility located in Dubai in 2003 and the UAE now represents almost 20% of its revenues.

Figure 4.4: Qatar Steel Rebar Sales per Country, 2007



Source: Company Reports

B. CAPACITY EXPANSION PLANS

Over the past two years Qatar Steel's plants in Qatar and Dubai have been operating at over 100% of their theoretical utilization rates. The company has even been supplementing its own production with imported steel from neighboring countries which it resells at a profit.

Phase I Expansion Completed in 2007

In late 2007, the company completed Phase 1 of its expansion plan. At a total cost QAR2.1billion, this expansion consisted of three major developments: 1) a major increase in DRI production capacity from 0.8 million to 2.3 million tons per annum through the addition of a new DRI/HBI combo plant, 2) an increase in billet capacity from 1.0 million to 1.6 million tons per annum and 3) the operation of a new bar mill unit raising capacity from 0.8 million to 1.5 million tons per annum.

Phase 2 Should Double Capacity by 2012

A second wave of capacity increase is planned for 2011-2012. Phase 2 includes the addition of a new furnace and billet plant with an annual capacity of 1.22 million tons and a rolling mill with a capacity of 800,000 tons, or another doubling of production capacity by 2012.

Figure 4.5: Qatar Steel Expected Capacity Evolution through 2012e



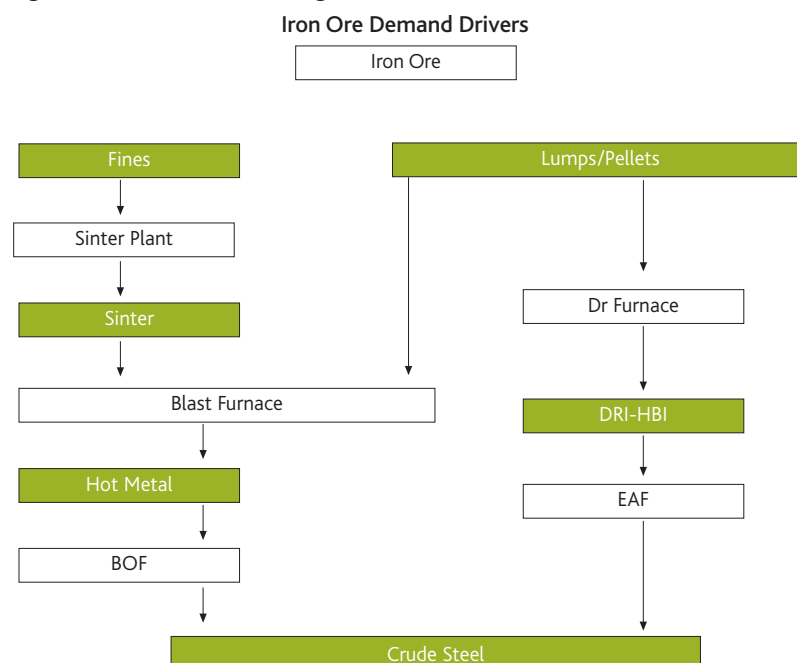
Source: Company Reports

Positive for Raw Material Sourcing

EXPANSION OF 25% OWNED GIIC

The second phase of Qatar Steel's expansion also includes a significant investment to expand raw material supply on the back of recent investments. In January 2007, Qatar Steel acquired a 25% stake in Bahrain based Gulf Industrial Investment Company (GIIC), a producer and supplier of iron oxide pellets to DRI plants across the globe and also Qatar Steel's main supplier of oxide pellets. GIIC is the only iron ore pelletization plant globally that is not directly affiliated with a steel production company.

Figure 4.6: Steel Manufacturing Processes



Source: Dofasco

GIIC currently owns and operates a pelletization plant which has a production capacity of 4.6 million MT per annum of DRI pellets. GIIC is in process of constructing a second pelletization plant at a cost of about USD500 million. This new plant will more than double GIIC's pellet capacity to about 11 million tons per annum. Construction of the second plant has already started and it is expected to start operations in July 2009. The expansion of GIIC's pellet capacity is a positive for Qatar Steel in that it will save on transportation costs as most of Qatar Steel's iron ore pellet needs are imported from Brazil and Sweden.

Extends vertical integration

ACQUISITION OF 49.9% STAKE IN GUEL EL AOJ IRON ORE PROJECT

In a further step towards vertical integration, in November 2007, Qatar Steel announced the purchase a 49.9% stake in the Guelb el Aouj iron ore project in Northern Mauritania for which it paid a total consideration of USD375 million.

The Guelb el Aouj project operates three adjacent iron ore mines, in central, eastern and western Mauritania, with present resources estimated to be in excess of 1 billion tons of iron ore. The project, which is expected to commence operations in 2010, will include mining works, the utilization of magnetic quartzite ore and the production of 7 million tons of direct reduction steel pellets annually for a period of over 30 years.

The other JV partners are Societe Nationale Industrielle et Miniere (SNIM), the state-owned Mauritanian iron ore company as well as Sphere Investments, a publicly listed company on the Australian stock exchange in which Qatar Steel owns an equity stake.

As we discuss in Appendix 1, access to iron ore is becoming an issue for steel companies given the strong worldwide demand for steel and spiraling iron ore costs.

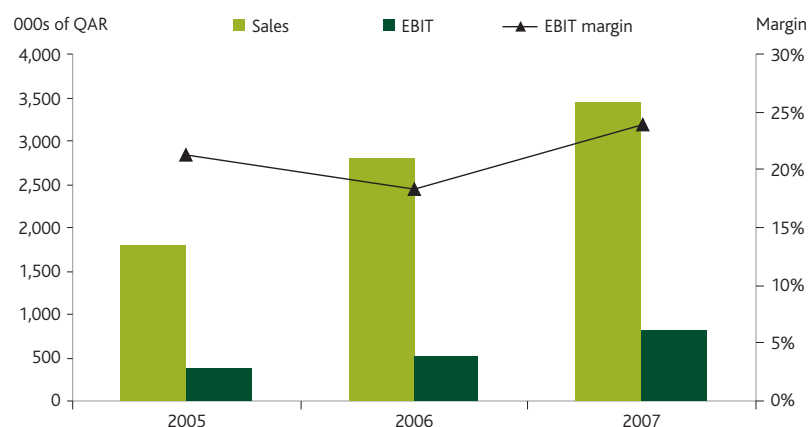
The development costs for the Guelb el Aouj project are expected to be QAR1.8 billion, of which IQ's portion is QAR0.9 billion. DR pellet production is expected to begin in 2010. Although no announcement has been made to this effect, we would expect the GLIC pelletization plant in Bahrain to become an off taker of the Mauritanian iron ore project.

C. QATAR STEEL SALES AND PROFITABILITY

Qatar Steel does not report standalone financial results but its revenues and its EBIT margin are provided in IQ's breakdown of performance per division.

With production capacity having been constant throughout the 2005-2007 period), sales growth reported during this period was entirely a function of imports as well as higher steel prices. In 2007, sales rose 23% on the back of a 20% increase in rebar prices.

Figure 4.7: Qatar Steel Sales, EBIT and EBIT Margin, 2005-2007



Source: Company Reports

We firmly believe that the outlook for Qatar Steel until 2012 is strong due to the resilience of the regional construction markets. We estimate that Qatar steel plants will operate at or near peak operating capacity throughout the period. The threat of competition within Qatar is mitigated by the 20% steel import duties which we expect to continue to be in effect over the forecast horizon.

On the profitability side, rising iron ore prices have not been a threat to Qatar Steel's profitability as the company has been able to consistently pass along higher steel costs to its customers, albeit with a slight lag. Profitability has remained strong throughout the last few years and we expect further vertical integration could lead to higher margins, above our forecast in the future.

INITIATION OF COVERAGE NOTE

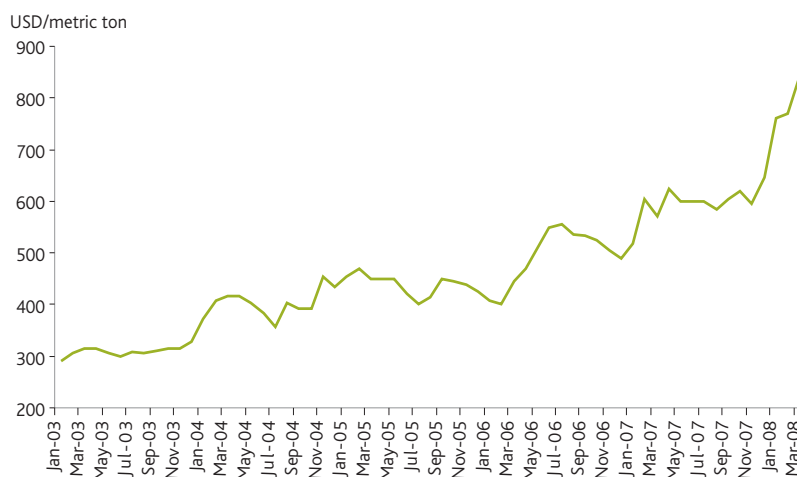
Table 4.8: Our Assumptions for Qatar's Steel's Revenue and profitability

	2008e	2009e	2010e	2011e
Price - QAR/Ton				
DRI	692	673	615	577
Bars	3,276	3,185	2,912	2,730
Coil	2,507	2,437	2,228	2,089
Volume - 000's metric tons				
DRI	813	534	617	0
Bars	1,798	1,650	1,700	2,390
Wire rod coil	216	250	300	300
Revenues - QAR mn	6,994	6,224	5,998	7,151
EBITDA - QAR mn	1,957	1,761	1,645	1,621
EBITDA Margin	28.0%	28.3%	27.4%	22.7%

Source: Company Reports, EFG-Hermes

We expect significant growth in rebar sales volume with 33.7% growth expected in 2008e, followed by a small decline of 8.2% and 3.0% in 2009 and 2010e with a 40.6% increase in rebar volume expected on completion of phase 2 of Qatar Steel's expansion.

Figure 4.9: Steel Rebar Prices CFR Dubai, USD per ton, 2003-Current



Source: mesteel

On steel pricing, we expect a significant increase in steel prices in 2008 on the back of a recently negotiated 86.7% increase in the price of direct reduction pellets by Brazilian supplier Vale and several Middle East steel makers including Qatar Steel. While we have little visibility on the price environment beyond the current year, we expect the current world steel shortage to continue over our forecast horizon. With the number and size of construction projects in the Middle East region, we expect imports to continue to play a key role in the market especially in the UAE. One key variable will be the impact of China which as the largest producer and consumer of steel has a large impact on availability of material for export. At the beginning of the year, China has imposed a large tax on steel exports effectively killing the export market however recent articles in trade papers suggest that Chinese steel has made its way back in the UAE over the last few weeks. We discuss the global steel environment in more detail in Appendix 3.

V. QAFAC

A. COMPANY AND INDUSTRY BACKGROUND

Gaining market share in a weak market

QAFAC is the newest of the companies in the IQ group, having been in operation since only 1999. QAFAC is a joint venture between IQ, OPIC Netherlands Antilles, LCY Investments Corporation and International Octane of Canada with each partner having a 50%, 20%, 15% and 15% stake respectively.

QAFAC manufactures two products, methanol and methyl tertiary butyl ether (MTBE) from its plant in Mesaieed Industrial City. The plant has a production capacity of 832,500 MT per annum of methanol and 610,000 MT per annum of MTBE which makes it one of the 10 largest methanol producers in the Middle East accounting for 7.7% of Middle Eastern capacity. QAFAC's annual revenues in 2007 were approx QAR2.0 billion (USD552 million), making it the smallest contributor to IQ representing 10.8% of total revenues and only 8.3% of net profit.

Methanol also known as methyl alcohol, is one of the most important commodity chemicals and is used in the production of a wide range of products such as glue, antifreeze, solvents and fuel additives such as MTBE. Natural gas is the most economical and widely used feedstock for methanol production. MTBE is manufactured by the chemical reaction of methanol and isobutylene. When fuel oxygenates, such as MTBE, are added to gasoline they help improve the combustion of gasoline thus reducing harmful smog and toxic air emissions. MTBE also enables refiners to reduce the use of other harmful gasoline compounds, such as benzene and other aromatics, while maintaining octane levels and fuel performance and reducing petrol consumption.

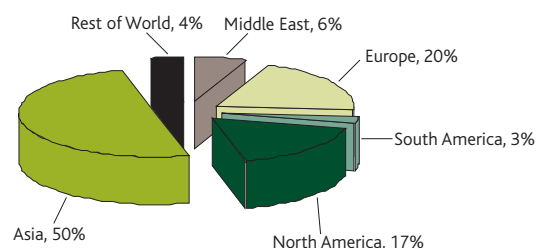
Similar to fertilizers and petrochemicals, the production of methanol allows QAFAC to leverage low cost ethane feedstock and allows QAFAC to be among the low cost MTBE producers. The issue with QAFAC is that contrary to fertilizers and petrochemicals, the outlook for this company is not positive as MTBE is a no-growth market. In fact, QAFAC is the only IQ group company with no plans for growth and no plans for capacity expansion in the 2008-2012 period.

MTBE MARKET STILL RECOVERING AFTER EFFECTIVE U.S. BAN IN 2002

The MTBE market is still struggling to adjust to the vacuum left behind by the disappearance in demand for MTBE in the U.S. in 2002, which at the time represented 60% of global MTBE demand, according to Jacobs Consultancy. Initially, the use of MTBE had grown significantly in the United States after the U.S. Congress passed the 1990 Clean Air Act Amendments (CAAA). Under the CAAA, Congress started the Reformulated Gasoline (RFG) program in January 1995 for those areas of the country that had the highest levels of air pollution. Refiners producing RFG were required to blend a minimum of 2% oxygen by weight and they quickly found that the oxygenate MTBE provided more environmental benefits and lower production costs than other oxygenates (i.e., ethanol). However in 2001 after MTBE was discovered to have seeped into parts of the US water supply and was increasingly believed to be an alleged carcinogen, it was effectively banned from being used as a fuel additive in the U.S. The loss of MTBE demand in the U.S. and other western markets caused roughly 25% of global MTBE capacity to shut down or be converted to another gasoline blend stock between 2001 and 2006.

The U.S. ban on MTBE in 2002 was a significant blow to methanol producers worldwide. However methanol continues to be used in other parts in the world. In Asia for example, with a growing population and concern over air pollution in urban areas from increased vehicle traffic, overall demand for MTBE is growing. Methanol demand growth in China for example was up 21% between 2002 and 2006. Also in Europe, the implementation of stricter gasoline quality requirements has recently increased the demand for alternative high octane blending components. While this should not have a large impact on European MTBE consumption which is expected to remain fairly stable over the next few years, it may provide producers like QAFAC the chance to grow its market share.

Figure 5.1: Methanol Demand by Region, 2007e

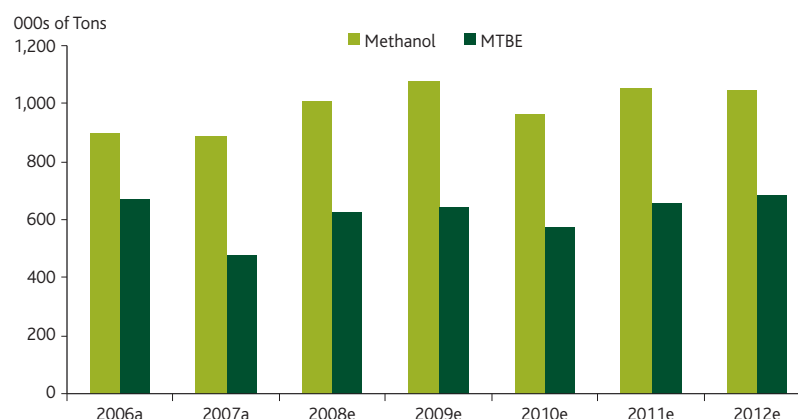


Source: MMSA

B. CAPACITY EXPANSION PLANS

QAFAC is the only one of the IQ group companies to have no capacity addition plans over the next few years. Interestingly, as recently as 2005, QAFAC management had spoken of building QAFAC-2, which at the time was aiming to be the world's largest methanol plant at a cost QAR1.5 billion, but those plans seem to have been shelved, at least for the 2008-2012 horizon.

Figure 5.2: QAFAC Expected Capacity Evolution Through 2012e



Source: Company Reports

C. QAFAC SALES AND PROFITABILITY

QAFAC does not report standalone financial statements. However, sales and net profit for the division are broken out. For 2007, QAFAC reported sales of QAR2 billion which is flat YoY, however the sales performance reflects lower MTBE volumes, down 28% YoY, resulting from scheduled maintenance in the first half of the year. Flat sales performance was achieved as a result of a 4.7% increase in methanol volumes but mostly by higher MTBE pricing YoY.

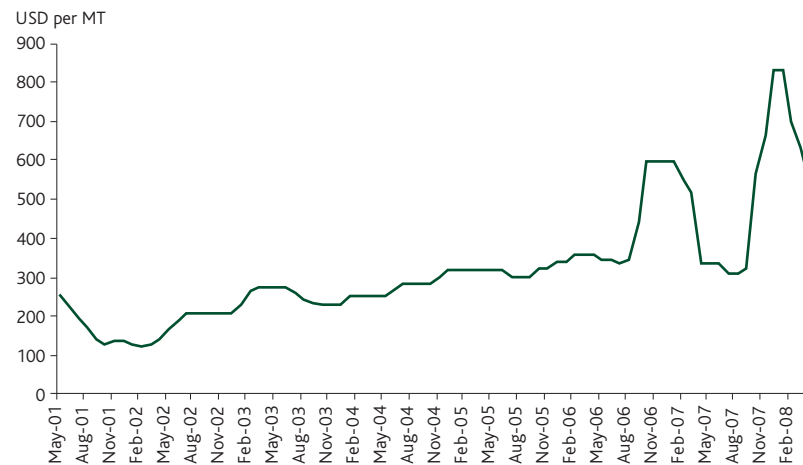
Figure 5.3: QAFAC Historic Sales and Net Margins, 2005-2007



Source: Company Reports

The net profit margin in 2007 improved by 270 bps to 41.2% of sales compared with 38.5% of sales the prior year. Butane prices which rose almost 70% on the year were offset by even stronger increases in methanol prices, as shown in figure 6.7. Tracking the cost of butane is important for QAFAC as it pays spot market prices for its butane, which is a cost component of MTBE, while the company obtains ethane feedstock from Qatar Petroleum at a fixed price.

Figure 5.4: Historic Methanol Pricing 2001 to Current



Source: Methanex

Looking forward, we expect a decline in EBITDA margins at QAFAC. While according to CMAI butane prices should be fairly muted and we expect ethane costs to be fixed, margins should decline as a result of lower methanol and MTBE prices which have a high correlation to ethylene prices.

Table 5.5: QAFAC Forecasts

	2008e	2009e	2010e	2011e
Price - USD/Ton				
Methanol	352	224	260	247
MTBE	789	715	581	554
Volume - 000's metric tons				
Methanol	391	423	378	408
MTBE	311	323	289	329
Revenues - QAR mn				
	1,393	1,183	967	1,030
EBITDA - QAR mn				
	513	343	258	261
EBITDA Margin				
	36.8%	29.0%	26.7%	25.3%

Source: EFG-Hermes, Company Reports

Over the 2008e-2011e forecast period, we expect IQ's revenues from QAFAC to drop from about QAR1.4 billion to QAR1.0billion as expected commodity price decline will not be offset by higher volumes. This decline in pricing will have a much larger impact and we forecast EBITDA margins at QAFAC to drop 1,150bps from 36.8% to 25.3%, further marginalizing the company as a contributor to IQ's sales and earnings.

VI. FINANCIAL FORECASTS

As we have previously stated, we expect 2008e to be a peak pricing year for most of the commodities sold by the IQ group of companies with the largest price declines expected in fertilizers and petrochemicals, which form the largest part of IQ's total revenues. While we believe this lower commodity pricing environment will lead to revenue and earnings declines for IQ in 2009e and 2010e, the lower revenues and earnings will mask the significant volume growth we expect throughout the period in steel, fertilizers and petrochemicals. By 2012e, once the capital expenditure programs are completed, Qatar Steel's rebar capacity will expand to 2.55 million tons compared to 832 thousand tons at the end of 2007, urea capacity will expand to 4.15 million tons from 2.96 million tons at the end of 2007 and LDPE capacity will grow to 622 thousand tons from 359 thousand tons at the end of 2007. Perhaps more importantly, once the capital expenditure program is completed, we expect IQ to not only be in a position to generate very strong cash flows but also to have accumulated a very large cash balance. We believe it is important to keep in mind the strong volume growth, future cash flow profile and balance sheet outlook throughout the earnings discussion as a focus on near term results alone will not do the company justice.

VOLUMES GROWING AS CAPACITY IS INCREASED

Our volume assumptions for 2008e-2011e are based on IQ estimates of projected capacity increases including the share of the JV partners in expansion projects. We adjust their estimates to reflect the proportional consolidation details for each division. With the exception of fuel additives, each division should add substantial capacity over the 2008e-2011e period as a result of the completion of key capex projects. The main drivers of volume growth over the period will be the addition of LLDPE capacity at QAPCO in 2009 as well as the completion of QAFCO-V and Phase II of Qatar Steel's expansion in 2011.

Table 6.1: Sales Volume Assumptions, 2008e-2011e, 000s of metric tons

	2008e	2009e	2010e	2011e
Petrochemicals - 000's metric tons				
Ethylene	252	329	339	170
Y-o-Y		30.5%	3.2%	-49.8%
LDPE	320	324	344	524
Y-o-Y		1.3%	6.2%	52.3%
LLDPE	0	101	192	192
Y-o-Y			90.0%	0.0%
Fertilizers - 000's metric tons				
Ammonia	319	340	317	902
Y-o-Y		6.6%	-6.6%	184.4%
Urea	2,228	2,095	2,139	2,903
Y-o-Y		-6.0%	2.1%	35.7%
Melamine	0	14	27	27
Y-o-Y			100.0%	0.0%
Steel - 000's metric tons				
DRI	813	534	617	0
Y-o-Y		-34.3%	15.5%	
Bars	1,798	1,650	1,700	2,390
Y-o-Y		-8.2%	3.0%	40.6%
Coil	216	250	300	300
Y-o-Y		15.7%	20.0%	0.0%
Fuel Additives - 000's metric tons				
Methanol	391	423	378	408
Y-o-Y		8.1%	-10.7%	7.9%
MTBE	311	323	289	329
Y-o-Y		3.9%	-10.5%	14.0%

*Reflects declines in sales volume as a result of increased internal consumption

Source: Company

PRICING MAY HAVE PEAKED FOR MANY COMMODITY PRODUCTS

We believe that 2008e will be the peak year for the prices of most of the commodities sold by IQs group companies as global supply increases begin to catch up to recent hikes in demand. For 2009e and 2010e, our declining commodity price assumptions more than offset the strong volume growth expected leading to revenue declines. By 2011e, with pricing beginning to stabilize and completion of capacity expansion projects leading to even stronger growth in volumes, we expect some return to growth for the company.

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Table 6.2: Commodity Price Assumptions, 2008e-2011e

	2008e	2009e	2010e	2011e
Petrochemicals - USD per ton				
Ethylene	1,218	1,104	897	855
Y-o-Y		-9.4%	-18.7%	-4.6%
LDPE	1,393	1,173	1,016	963
Y-o-Y		-15.8%	-13.4%	-5.2%
LLDPE	1,300	1,090	946	892
Y-o-Y		-16.1%	-13.2%	-5.7%
Fertilizers - USD per ton				
Ammonia	450	400	375	360
Y-o-Y		-11.1%	-6.3%	-4.0%
Urea	435	385	335	285
Y-o-Y		-11.5%	-13.0%	-14.9%
Melamine	0	1,873	1,630	1,387
Y-o-Y			-13.0%	-14.9%
Steel - QAR per ton				
DRI	692	673	615	577
Y-o-Y		-2.8%	-8.6%	-6.3%
Bars	3,276	3,185	2,912	2,730
Y-o-Y		-2.8%	-8.6%	-6.3%
Coil	2,507	2,437	2,228	2,089
Y-o-Y		-2.8%	-8.6%	-6.3%
Fuel Additives - USD per ton				
Methanol	352	224	260	247
Y-o-Y		-36.4%	16.1%	-5.0%
MTBE	789	715	581	554
Y-o-Y		-9.4%	-18.7%	-4.6%

Source: Fertecon, CMAI, EFG-Hermes

Our commodity price assumptions for 2008e-2011e are outlined in the table above. For fertilizers, our price forecasts are based on estimates from fertilizer industry consultants, Fertecon while our petrochemical forecasts are taken from industry consultant CMAI. It should be noted that both Fertecon and CMAI assume a WTI price of USD100 per barrel for 2008e and USD90 in 2009e and derive their commodity forecasts partly based on oil prices which in the current strong oil price environment could mean upward revisions to these numbers.

REVENUES PEAKING IN 2008e, DECLINES EXPECTED IN 2009e/2010e

We expect IQ to record significant revenue growth of 62.7% in 2008e to QAR15.2 billion. However given our declining price assumptions, and as the full impact of the capex program and capacity increases will only come in the later years of our forecast period, we expect 2009e and 2010e to show revenue declines of 7.5% and 5.9% to QAR14 billion and QAR132 billion respectively. For 2011e, we expect the completion of capacity expansion projects to lead to strong volume growth and a return to revenue to growth of 15.7% to QAR15.3 billion, just marginally above our 2008e revenue estimate.

Table 6.3: Revenue Growth by Sector, 2006a-2011e

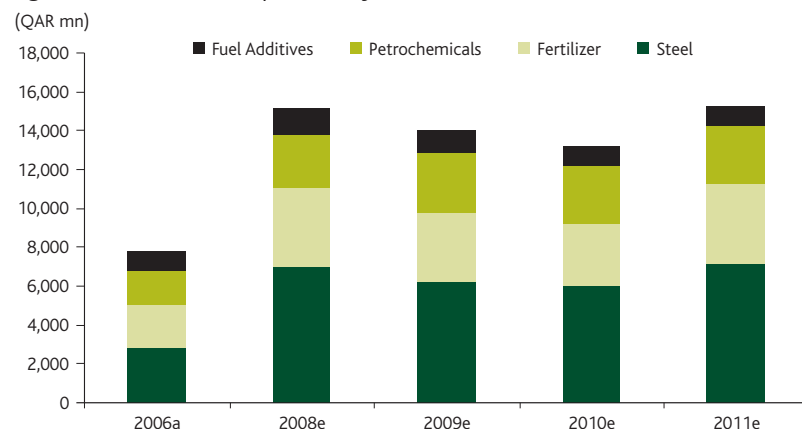
(QAR mn)	2006a	2007a	2008e	2009e	2010e	2011e
Petrochemicals	1,742	2,153	2,740	3,104	3,039	2,989
Y-o-Y		23.6%	27.3%	13.3%	10.9%	-1.7%
Fertilizers	2,239	3,435	4,049	3,522	3,202	4,108
Y-o-Y		53.4%	17.9%	-13.0%	-20.9%	28.3%
Fuel Additives	1,007	1,004	1,393	1,183	967	1,030
Y-o-Y		-0.3%	38.7%	-15.0%	-30.6%	6.5%
Steel	2,790	2,734	6,994	6,224	5,998	7,151
Y-o-Y		-2.0%	155.8%	-11.0%	-14.2%	19.2%
Total Sales	7,778	9,326	15,177	14,033	13,206	15,278
Y-o-Y		19.9%	62.7%	-7.5%	-13.0%	15.7%

Source: Company Reports, EFG-Hermes

Our revenue assumptions imply a significant shift in the company's revenue mix going forward with steel set to become the largest contributor to revenues. We expect steel's importance as a percentage of IQ revenues to rise from 29.3% in 2007a to 46.1% in 2008e and to stay in the 44%-47% range through 2011e.

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Figure 6.4: Revenue Composition by Sector, 2006a-2011e



Source: Company, EFG-Hermes

EBITDA MARGINS DECLINING BUT STILL STRONG OVERALL

For 2008e we expect IQ to post a peak EBITDA of QAR7.5 billion, a 53.4% increase YoY. However given our pricing and revenue assumptions, we expect lower EBITDA for the 2009e and 2010e period. We forecast IQ's EBITDA to decline to QAR6.68 billion in 2009e and hit a trough in 2010e of QAR5.82 billion implying EBITDA margins of 47.6% and 44.0% respectively. We expect a pickup in EBITDA in 2011e to QAR6.12 billion on the back of strong volume growth, however we expect further margin compression and for the EBITDA margin to reach 40.1% that year.

Table 6.5: EBITDA Growth by Sector, 2007e*-2011e

(QAR mn)	2007a	2008e	2009e	2010e	2011e
Petrochemicals	1,623	2,166	2,329	2,086	1,910
Y-o-Y		33%	8%	-10%	-8%
Fertilizers	1,867	2,834	2,248	1,828	2,330
Y-o-Y		52%	-21%	-19%	27%
Fuel Additives	405	513	343	258	261
Y-o-Y		27%	-33%	-25%	1%
Steel	838	1,957	1,761	1,645	1,621
Y-o-Y		133%	-10%	-7%	-1%
Total EBITDA	4,875	7,469	6,680	5,816	6,121
Y-o-Y		53%	-11%	-13%	5%
EBITDA Mix					
Petrochemicals	33.3%	29.0%	34.9%	35.9%	31.2%
Fertilizers	8.3%	37.9%	33.6%	31.4%	38.1%
Fuel Additives	8.3%	6.9%	5.1%	4.4%	4.3%
Steel	17.2%	26.2%	26.4%	28.3%	26.5%
EBITDA Margin	52.3%	49.2%	47.6%	44.0%	40.1%

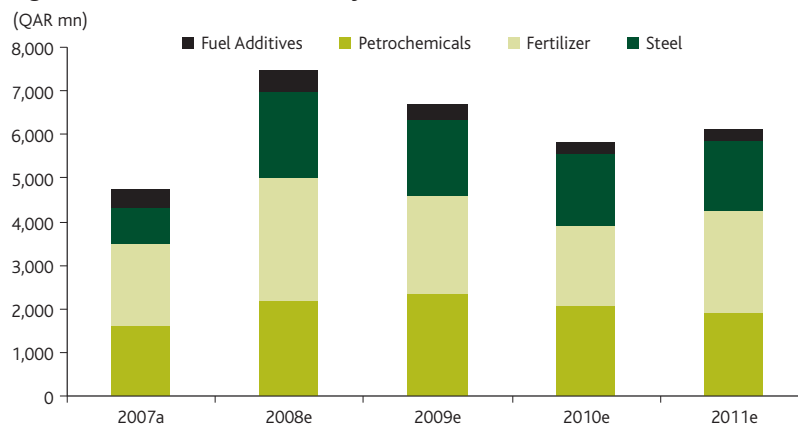
*EBITDA breakdown for 2007 is estimated

Source: Company, EFG-Hermes

On a margin basis, our 2008e forecasts imply an EBITDA margin of 49.2%, a 310 bps decline from 2007 levels. We expect IQ's EBITDA margin to fall steadily throughout our forecast horizon. By 2011e, we expect a consolidated EBITDA margin of 40.1%, a 1,200 bps decline from 2007a levels. This steep margin decline reflects both a decline in commodity prices as well as an unfavorable business mix. A large portion of this can be explained by the growth in importance of the steel sector within IQ's business mix where margins in the 20-30% range are significantly lower than the corporate average in the 40-50% range. Steel revenues are expected to grow to 46.8% of IQ's total revenues in 2011e from 29.2% in 2007a.

It should be noted that gross margin is the major determinant of EBITDA margin for IQ as SG&A expenses as a percentage of revenues for IQ are fairly small (around 5% in 2007).

Figure 6.6: EBITDA Contribution by Sector, 2007e*-2011e



*EBITDA breakdown for 2007 is estimated

Source: EFG-Hermes

SENSITIVITY OF FERTILIZER & PETROCHEMICALS EARNINGS TO PRICE CHANGES

With relatively fixed costs of production due to fixed feedstock costs, petrochemical and fertilizers gross margins are extremely sensitive to end price fluctuations. For example, on a USD per ton basis we estimate QAPCO's cash cost of production of LDPE at about USD270. In an environment where we expect LDPE to sell at an average of about USD1,393 per ton in 2008e, it is clear how even a small change in the price of LDPE is reflected in the gross profit. In our view, urea margins are even more sensitive to changes in prices with a 10% change in urea prices over our 2008e price assumption expected to have a 13.9% impact on gross profit. We highlight our estimate of the sensitivities for LDPE and urea in tables 6.7 and 6.8 below.

Table 6.7: Impact of 10% and 20% Increase in LDPE Price on Gross Profit and Margin

(USD/Ton)	2008 Price	10% Price Increase	Impact of 10% increase	20% Price Increase	Impact of 20% increase
LDPE Price - Net	1,393	1,533	10.0%	1,672	20.0%
LDPE Cash Cost	270	270	0.0%	270	0.0%
Gross Profit	1,123	1,263	12.4%	1,402	24.8%
Gross Profit Margin	80.6%	82.4%	1.8%	83.9%	3.2%
Impact on IQ's EPS (QAR)	13.42	13.71	0.30	14.01	0.59

Source: EFG-Hermes, CMAI

Table 6.8: Impact of 10% and 20% Increase in Urea Price on Gross Profit and Margin

(USD/Ton)	2008 Price	10% Price Increase	Impact of 10% increase	20% Price Increase	Impact of 20% increase
Urea Price	435	479	10.0%	522	20.0%
Urea Cash Cost	108	108	0.0%	108	0.0%
Gross Profit	327	370	13.9%	414	27.9%
Gross Profit Margin	71.8%	74.4%	2.6%	76.5%	4.7%
Impact on IQ's EPS (QAR)	13.42	13.98	0.56	14.55	1.13

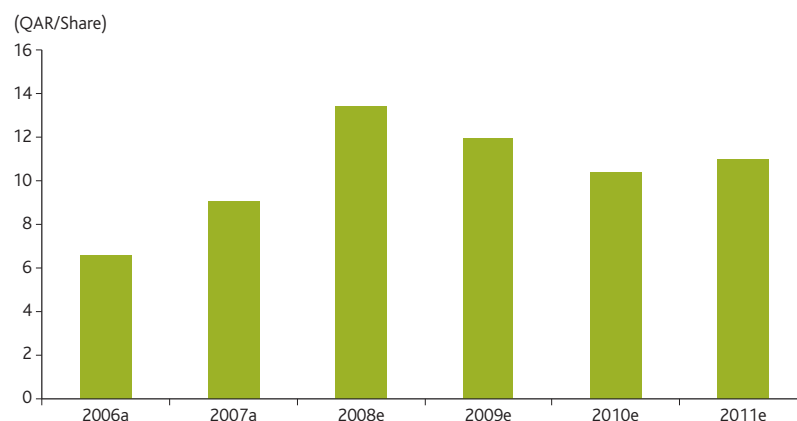
Source: EFG-Hermes, Fertecon

NET EARNINGS

We expect IQ to report strong results in 2008e with EPS of QAR13.42, a 48.0% increase in versus 2007a. However, we expect 2008 to be the peak year for IQ in EPS terms over our forecast horizon with earnings declines forecast in 2009e and 2010e to EPS of QAR11.89 and QAR10.40 respectively. We expect EPS growth to resume in 2011e on the back of strong volume growth after the completion of significant capacity additions that year. Our 2011e EPS estimate of QAR10.86 assumes a 5.7% increase over 2010e levels but a 19.1% decline from the 2008e peak.

Although the EPS outlook is for negative growth over the 2008e-2011e horizon, free cash flows during the same period are expected to increase significantly, up 278.1% based on our estimates, as capacity expansion projects come on line and capex drops off. We believe it is important to focus on IQ's cash generation profile as a focus on declining earnings only gives one part of the picture and can lead to an underestimation of the growth profile of IQ.

Figure 6.9: IQ Historical and Forecast EPS



Source: Company Reports, EFG-Hermes

CASH FLOWS

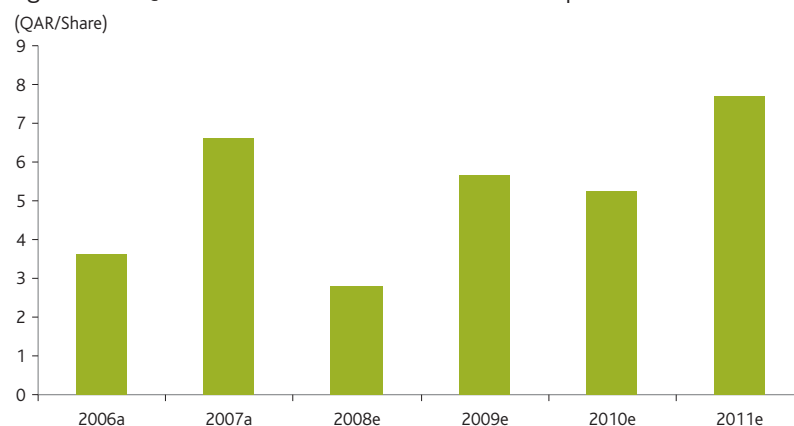
IQ has a consistent history of solid free cash flow generation which has helped it to build a strong financial position despite paying out a healthy portion of its earnings in dividends. As a percentage as revenues, free cash flow was 42.2% in 2005, 25.6% in 2006 and 39.3% in 2007. This has allowed the company to raise its dividend from QAR1.75 billion in 2005 to QAR2.5 billion in 2007 or QAR 4.96 per share which represents a yield of about 2.8% on the current stock price.

Despite its history of raising its dividend we assume IQ maintains its dividend going forward in light of the company's capital expenditure requirements.

As previously discussed, the IQ group companies will spend QAR21 billion in capex through 2012e, of which we expect IQ's share to be more than QAR12 billion. On a standalone basis, the company will spend a further QAR0.7 billion in capex to build a new corporate headquarter. Overall, these expenditures are expected to have a large impact on IQ's free cash flow going forward. We estimate that a large portion of the capex will occur in 2008e which will have a negative impact on free cash flow during the year. On a per share basis we forecast cash flow per share to decline to QAR2.78 from QAR6.64 in 2007.

Over our forecast horizon however, we expect FCF per share to pick up materially and by 2011e, when we estimate most of the CAPEX program will be completed, we estimate IQ should generate FCF close to QAR8.00 per share. It should be noted though that given the size of the capex program and the large impact of commodity prices on IQ's EBITDA, free cash flow per share in any given year is difficult to estimate but the trend for this company is clearly positive, we believe.

Figure 6.10: IQ Historical and Forecast Free Cash Flow per Share

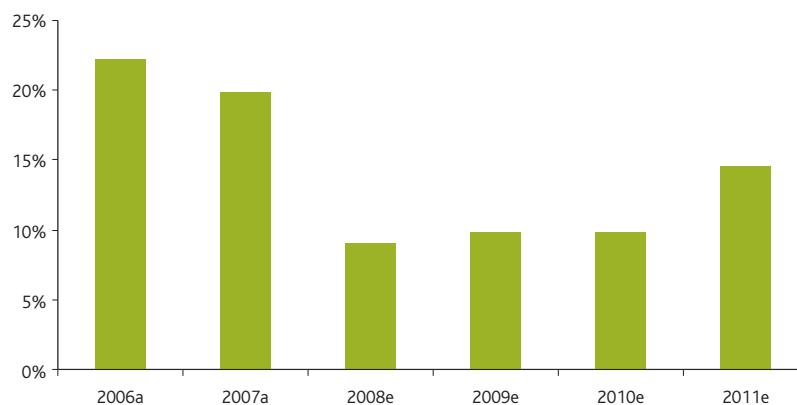


Source: Company Reports, EFG-Hermes

DEBT AND EQUITY

On the balance sheet front, IQ is in a very strong financial position with net cash of QAR967 million or QAR1.76 per share as of 1Q08. Our assumption is that financing the overall capital expenditure program will require some external borrowing. We expect about QAR2 billion of additional debt for IQ over the next two years although company management recently stated that it was not yet decided what the best way to finance the capital expenditure projects would be. That said, this level of borrowing is insignificant considering IQ's strong financial profile and its equity of QAR19 billion. If anything we would prefer to see the company increase its leverage given its low cost of debt with the effective interest rate on its term loans of about 5.6%.

Figure 6.11: Net Cash as a % of Equity



Source: Company Reports, EFG-Hermes

INITIATION OF COVERAGE NOTE

Table 6.12: Financial Statements (December Year End)

(QAR mn)	2006a	1Q07a	2007a	1Q08a	2008e	2009e	2010e	2011e
Balance Sheet								
Cash and Deposits	4,626	3,301	6,171	5,018	4,151	6,050	6,149	7,700
Accounts Receivable and Prepayments	1,150	1,470	1,267	2,007	2,244	2,075	1,952	2,259
Inventories	1,142	1,153	1,373	1,325	2,228	2,060	1,939	2,243
Other Current Assets	570	260	742	1,102	742	742	742	742
Total Current Assets	7,489	6,183	9,553	9,452	9,364	10,927	10,782	12,943
Net Fixed Assets	6,386	6,673	8,494	8,790	12,637	16,239	19,177	20,560
Other LT Assets	1,006	1,025	2,094	2,107	2,094	2,094	2,094	2,094
Total Assets	14,880	13,881	20,142	20,349	24,096	29,260	32,053	35,598
ST Debt	205	208	1,084	1,086	149	214	180	0
Suppliers	1,067	1,857	2,019	1,897	2,082	1,926	1,812	2,096
Other Current Liabilities	422	142	746	613	746	746	746	746
Total Current Liabilities	1,490	1,999	2,765	2,510	2,828	2,671	2,558	2,842
LT Debt	1,962	2,047	2,358	2,965	2,325	3,611	3,432	3,431
Other Liabilities	159	156	257	313	289	318	343	364
LT Liabilities	2,121	2,203	2,615	2,614	2,614	3,929	3,775	3,795
Total Liabilities	3,611	4,202	5,380	6,874	5,591	6,814	6,512	6,637
Net Worth	11,064	9,471	13,678	13,475	18,557	22,598	25,803	29,343
Income Statement								
Revenue	7,778	1,958	9,326	3,466	15,177	14,033	13,206	15,278
COGS	(4,092)	(1,004)	(4,395)	(1,496)	(7,167)	(6,713)	(6,630)	(8,256)
SG&A	(414)	(111)	(456)	(166)	(540)	(640)	(759)	(901)
EBITDA	3,272	N/A	4,875	N/A	7,469	6,680	5,816	6,121
Depreciation and Amortization	(524)	N/A	(399)	N/A	(399)	(437)	(480)	(523)
Net Operating Profit	2,748	907	4,475	1,952	7,070	6,243	5,336	5,598
Net Operating Margin	35.3%	46.3%	48.0%	56.3%	46.6%	44.5%	40.4%	36.6%
Income from Associates	20	(10)	52	24	52	100	110	121
Income from Investments	10	(3)	15	11	15	15	15	15
Other Income	364	0	522	113	326	255	322	325
Finance Charges	(44)	(14)	(80)	(29)	(84)	(72)	(78)	(20)
EBT	3,622	817	4,985	1,923	7,379	6,541	5,705	6,040
Taxes	0	0	0	0	0	0	0	0
Earnings before Minority Interest	3,619	893	4,983	1,923	7,378	6,540	5,704	6,038
Minority interest	3	0	1	0	1	1	1	1
Net Atributable Income to Shareholders	3,622	893	4,985	1,923	7,379	6,541	5,705	6,040
Cash Flow Statement								
Cash Operating Profit	4,094	N/A	5,303	N/A	7,842	6,979	6,178	6,482
Change in Working Capital	7	N/A	851	N/A	(1,769)	180	130	(326)
Cash Flow after Change in Working Capital	4,101	N/A	6,154	N/A	6,073	7,159	6,308	6,156
Capital Expenditure	(2,107)	N/A	(2,501)	N/A	(4,542)	(4,039)	(3,418)	(1,906)
Free Cash Flow	1,994	N/A	3,654	N/A	1,532	3,120	2,890	4,250
Non Operating Cash Flow	(304)	N/A	(1,048)	N/A	0	0	0	0
Net Financing	(1,243)	N/A	(1,307)	N/A	(3,552)	(1,221)	(2,791)	(2,699)
Change in Cash	447	N/A	537	N/A	(2,021)	1,899	99	1,551

Source: Company reports, EFG-Hermes

VII. VALUATION

We estimate the fair value of IQ through a sum of the parts (SOP) approach based on DCF valuations of the principal operating units. We believe that this approach is more appropriate than a DCF of the consolidated entity as it allows to discount those cash flows using cost of capital and terminal growth rates which we believe reflect the growth and risk profile of each business segment. As a complement to our analysis, we also derive a range of fair values for IQ using a comparable multiple approach, applying EV/EBIDA and P/E multiples of peers in the petrochemicals, fertilizers, steel and fuel additives segments to IQ's numbers for each segment.

A. DCF VALUATION

Assumptions

Because IQ has very little debt on its books, the majority of the cost of capital comes from the company's cost of equity and we believe it is worth highlighting our cost of equity assumptions per division and the reasoning behind the adjustment we make to the equity risk premium per segment.

As a starting base, our cost of equity assumptions use a risk free rate of 3.5% which is in line with the current yield of US 10-yr government bonds.

On a segment by segment basis, we use equity risk premiums per division ranging from 5.0% in the case of fertilizer and petrochemicals to 6.0% for steel and 7.0% for fuel additives. We believe that the relatively low equity risk premiums we assign to the fertilizer and petrochemical cash flow streams are justified by the fact that i) these companies have a large unmatched competitive advantage over their peers ii) this competitive advantage is sustainable given the Qatari Government owns more than 70% of the shares of IQ and participates directly as a JV partner in a number of the IQ group companies' projects iii) oil prices stay above the equivalent cost of the feedstock cost which in oil equivalent terms is about USD15-USD20 per barrel.

Table 7.1: Cost of Capital and Terminal Growth Rate Assumptions

	Cost of Capital Assumptions	Terminal Growth Rate Assumptions
Petrochemicals	8.0%	3.0%
Fertilizer	8.0%	3.0%
Fuel Additives	10.5%	-1.0%
Steel	9.5%	4.0%

Source: EFG-Hermes

Table 7.2: LT Price Assumption per Commodity

USD/Ton except rebar in QAR/Ton	
Ethylene	900
LDPE	1000
LLDPE	900
Ammonia	300
Urea	300
Melamine	1,630
Bars	2184
Methanol	325
MTBE	400
Natural gas cost - USD per mmbtu	1.75

Source: EFG-Hermes

We summarize our conclusions in table 7.3 below. Based on our analysis, we estimate IQ has a firm value of QAR103.6 billion, with 41% of that value coming from QAFCO, 34% from QAPCO, 22% from Qatar Steel and only 2% from QAFAC. Adding back IQ's net cash of QAR 967 million (as of Q1/08), we estimate the equity value of IQ at QAR104.6 billion or QAR190 per share, 7.2% above the current share price of QAR177.2.

INITIATION OF COVERAGE NOTE

Table 7.3: IQ Enterprise Value per Segment (QAR million, except per share amounts)

	EV
Petrochemicals	35,313
Fertilizer	43,012
Fuel Additives	2,330
Steel	22,961
Firm Value	103,616
Net Cash	967
Equity Value	104,583
Equity Value per Share	190.2

Source: EFG Hermes

Table 7.4: DCF of Fertilizer Cash Flows

(QAR mn)	2008e	2009e	2010e	2011e	2012e	Perpetuity
Fertilizers EBITDA	2,834	2,248	1,828	2,330	1,835	2,446
CAPEX	(2,709)	(2,685)	(2,618)	(1,418)	(206)	(206)
Changes in WC	(671)	229	(116)	(124)	42	42
FCF	(547)	(209)	(907)	788	1,671	2,281
WACC	8.5%					
Terminal growth rate assumption	3.0%					
EV	43,012					
Share of Net Debt	(242)					
Value of Equity	43,253					
Per Share	78.64					
S/O (mn)	550					

Source:

Table 7.5: Fertilizer Sensitivity Analysis

		WACC				
		7.5%	8.0%	8.5%	9.0%	9.5%
Terminal Growth	2.0%	77.5	71.1	65.6	60.9	56.9
	2.5%	85.6	77.9	71.4	65.9	61.2
	3.0%	95.5	86.0	78.2	71.7	66.2
	3.5%	107.9	96.0	86.4	78.5	72.0
	4.0%	123.9	108.4	96.4	86.8	78.9

Source: EFG-Hermes

Table 7.6: DCF of Petrochemicals Cash Flows

(QAR mn)	2008e	2009e	2010e	2011e	2012e	Perpetuity
Petrochemicals EBITDA	2,166	2,329	2,086	1,910	1,800	1,790
CAPEX	(1,454)	(978)	(486)	(360)	(202)	(202)
Changes in WC	(513)	237	(133)	(102)	41	41
FCF	199	1,588	1,467	1,448	1,639	1,629
WACC	8.5%					
Terminal growth rate assumption	3.0%					
EV	35,313					
Share of Net Debt	(242)					
Value of Equity	35,555					
Per Share	64.65					
S/O (mn)	550					

Source: EFG-Hermes

INITIATION OF COVERAGE NOTE

Table 7.7: Petrochemicals Sensitivity Analysis

		WACC				
		7.5%	8.0%	8.5%	9.0%	9.5%
Terminal Growth	2.0%	63.9	59.2	55.2	51.8	48.8
	2.5%	69.7	64.1	59.3	55.3	51.9
	3.0%	76.8	69.9	64.2	59.5	55.4
	3.5%	85.6	77.0	70.0	64.3	59.6
	4.0%	97.0	85.9	77.2	70.2	64.5

Source: EFG-Hermes

Table 7.8: DCF of Steel Cash Flows

(QAR mn)	2008e	2009e	2010e	2011e	2012e	Perpetuity
Steel EBITDA	1,957	1,761	1,645	1,621	1,516	1,161
CAPEX	(316)	(316)	(268)	(125)	(170)	(170)
Changes in WC	(463)	179	(105)	(86)	34	34
FCF	1,177	1,624	1,272	1,409	1,380	1,025
WACC	10.0%					
Terminal growth rate assumption	4.0%					
EV	22,961					
Share of Net Debt	(242)					
Value of Equity	23,203					
Per Share	42.19					
S/O (mn)	550					

Source: EFG-Hermes

Table 7.9: Steel Sensitivity Analysis

		WACC				
		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal Growth	3.0%	41.7	39.1	36.9	34.9	33.2
	3.5%	44.8	41.7	39.1	36.9	34.9
	4.0%	48.5	44.8	41.7	39.1	36.9
	4.5%	53.0	48.5	44.9	41.8	39.2
	5.0%	58.6	53.1	48.6	44.9	41.8

Source: EFG-Hermes

B. COMPARABLE VALUATION

Methodology

Given IQ's unique mix of businesses, it is difficult to find adequate comparables on a consolidated basis. Our preferred approach to comparable valuation is to impute a value for each of IQ's segments based on 2008 and 2009 earnings and EBIDA. We use EBIDA as opposed the more traditional EBITDA metric so as to take into account the tax advantage that IQ enjoys over its peers, as the company pays no corporate taxes.

With petrochemicals, fertilizers and fuel additives being globally traded basic materials, our peer group consists of a broad base of the largest global companies in these segments with a range of different feedstock costs and growth profiles. Our peer group for steel is composed predominantly of companies with a large exposure to emerging markets to reflect the higher growth rates afforded to these companies versus steel producers in mature markets.

Of the segments in which IQ competes, we believe the company is most competitive in the fertilizer and petrochemicals segments given the large feedstock advantage QAFCO and QAPCO enjoy over their peers. As we previously mentioned, QAPCO and QAFCO generate EBITDA margins that are multiple times greater than most of their publicly listed competitors as illustrated in table 7.10. In fact QAFCO and QAPCO, even earn higher margins than their Middle Eastern peers, such as SAFCO in Saudi Arabia and Sidi Kerir Petrochemicals in Egypt, which also benefit from a feedstock advantage.

INITIATION OF COVERAGE NOTE

Table 7.10: Fertilizers and Petrochemicals EBITDA Margins

Country	Company	EBITDA Margin		
	Fertilizer Companies	2005	2006	2007
Saudi	SAFCO	64.6%	64.6%	70.3%
USA	Terra Industries Inc	7.8%	7.4%	18.8%
Israel	ICL-Israel Chemicals Ltd.	23.6%	21.8%	22.2%
Canada	Agrium Inc	19.4%	9.9%	16.0%
Norway	Yara International ASA	11.1%	9.6%	11.1%
Russia	Uralkali	49.3%	29.3%	31.0%
	Average	22.2%	15.6%	19.8%
Qatar	QAFCO	72.6%	71.3%	74.6%
	Petrochemical Companies	2005	2006	2007
Egypt	Sidi Kerir Petrochemicals Co	58.4%	60.5%	63.5%
Taiwan	Asia Polymer Corp	7.7%	5.3%	na
Canada	Nova Chemicals	8.2%	9.3%	13.1%
Korea	Honam Petrochemical	18.6%	14.1%	13.9%
Taiwan	PTT chemical	26.0%	32.9%	33.1%
	Average	15.1%	15.4%	20.0%
Qatar	QAPCO	69.1%	72.6%	75.0%

Source: Company reports, EFG-Hermes estimates

Using the 2008e and 2009e EV/EBIDA and P/E multiples for the comparable companies, we can arrive at a range of fair values. We calculate, in table 7.11, for each of the main segments the minimum, average and maximum EV/EBIDA and P/E multiples. Then, using these multiples and applying them to our 2008e and 2009e EBIDA and earnings assumptions for each division, we can arrive at a range of values (minimum, average, maximum) which we then sum to arrive at implied total minimum, average and maximum values for IQ.

RESULTS AND CONCLUSION

As can be seen in Figure 7.11, the range is relatively large with a low end value of QAR77 per share and a high end value of QAR216 per share. We note that the values using 2009e figures tend to be lower than 2008e figures, which we attribute to our lower earnings figures for 2009e given our assumption that 2008e will be a medium term peak in earnings due mainly to pricing pressure and some margin compression.

This large implied valuation range is not helpful in guiding us in our valuation exercise for IQ so we have chosen to focus on the high end of the range. We believe this to be more appropriate for the company. Doing this suggest valuations between QAR160 per share to QAR216 per share. We believe that using the upper end of the range is justified by two factors:

- The multiple analysis using 2008e and 2009e estimates does not fully value the longer-term growth opportunities at IQ versus most of the peer group when considering the massive capacity expansion program the company is currently undertaking.
- The comparable analysis does not assign a premium for the extraordinary higher margins IQ enjoys versus essentially all of its peer group, which is mainly a result of its lower cost feedstock advantage.

Our comparable valuation range of QAR160 to 216 per share serves as a convenient cross-check for the fair value suggested by our SOP DCF of QAR190 per share.

INITIATION OF COVERAGE NOTE

Table 7.11: Comparable Valuation Table (Prices as at 2 May 2008)

Country	Company	Ticker	Price (local Curr.)	M.Cap (mn) (local Curr.)	M.Cap (mn) USD	EV (mn) (local Curr.)	EV/EBITDA 2008e	EV/EBITDA 2009e	P/E 2008e	P/E 2009e
Steel										
Egypt	Ezz Steel	ESRS:EY	95.05	17,336	3,224	22,619	5.3	4.9	11.8	11.2
India	JSW Steel Ltd	JSTL:IN	916.2	150,268	3,761	159,223	4.6	3.3	8.7	6.7
Sweden	SSAB Svenskt Stal AB	SSAB/A:PZ	203.0	65,759	11,192	108,875	9.5	9.4	9.6	9.1
China	Baoshan Iron & Steel Co Ltd	600019:CH	13.92	243,767	34,878	277,328	8.4	7.6	13.8	12.1
S.Korea	POSCO	005490:KS	493,500	43,026,785	43,027	42,288,785	7.8	7.5	10.2	10.0
	Minimum						4.6	3.3	8.7	6.7
	Average						7.1	6.5	10.8	9.8
	Maximum						9.5	9.4	13.8	12.1
Fertilizers										
USA	Terra Industries Inc	TRA:US	40.03	3,633	3,633	3,265	N/A	N/A	10.6	10.8
Israel	ICL-Israel Chemicals Ltd.	ISCHF:US	18.00	23,171	6,708	24,414	16.4	16.1	20.9	15.7
Saudi	SAFCO	SAFCO:AB	235.0	58,750	15,667	58,153	N/A	N/A	N/A	N/A
Canada	Agrium Inc	AGU:US	82.61	13,038	12,945	12,479	11.1	10.3	17.0	13.4
Norway	Yara International ASA	YAR:NO	372.0	108,466	21,791	116,345	8.8	8.8	13.5	13.2
Russia	Uralkali	URKA:RM	251.4	534,050	22,849	537,359	20.8	18.1	23.8	20.3
	Minimum						8.8	8.8	10.6	10.8
	Average						14.3	13.3	17.2	14.7
	Maximum						20.8	18.1	23.8	20.3
Petrochemicals										
Egypt	Sidi Kerir Petrochemicals Co	SKPC:EY	21.00	11,025	2,051	9,776	N/A	N/A	9.1	8.6
Taiwan	Asia Polymer Corp	1308:TT	28.35	7,397	245	6,158	N/A	N/A	8.8	N/A
Canada	Nova Chemicals	NCX:US	26.79	2,227	2,227	3,902	5.2	5.9	8.9	10.9
S.Korea	Honam Petrochemical	011170:KS	88,800	2,829,168	2,829	2,584,931	11.7	11.8	7.0	7.4
Thailand	PTT chemical	PTTCH:TB	107.0	160,151	5,091	154,553	6.0	6.0	8.4	8.8
	Minimum						5.2	5.9	7.0	7.4
	Average						7.7	7.9	8.4	8.9
	Maximum						11.7	11.8	9.1	10.9
Fuel Additives										
Canada	Methanex Corp	MEOH:US	24.67	2,384	2,384	2,493	6.3	6.7	9.5	10.6
IQ Implied Equity Value per Share (QAR)										
	Minimum						90.0	77.1	120.9	100.9
	Average						136.6	114.8	168.3	133.4
	Maximum						194.8	160.1	216.1	172.0

Source: Company reports, Bloomberg, Reuters and EFG-Hermes

C. VALUATION CONCLUSION

We use the value derived from our DCF analysis as a base to set our fair value for IQ at QAR190 per share. With only 7.2% upside to our fair value from the current stock price, we set our ST recommendation at Neutral. Over the LT however, we expect the strong free cash flows post the completion of capacity expansions and resulting cash balance to lead to further growth opportunities for IQ and we therefore set out LT recommendation to Accumulate.

In the sections below, we highlight what we see to be the upside and downside risks to our valuation. We believe that on balance, the upside risks outweigh the downside risks.

UPSIDE RISKS

Commodity Prices: In the current strong oil price environment, we believe our commodity price forecasts could prove too conservative which would understate earnings.

Further Value Accretive Projects: Given the strong free cash flow expected in future years, there is the possibility that those cash flows from higher commodity prices be utilized in a manner as to create value for shareholders not presently reflected in our forecasts.

Real Estate: We have assigned no value to IQ's new real estate JV.

DOWNSIDE RISKS

Gas Supply Terms: We currently have a lack of clarity on the gas supply terms with Qatar Petroleum and the possibility that gas prices will be revised upwards. While the Qatar Government, both directly and indirectly through Qatar Petroleum, owns more than 70% of IQ and should continue to support the company with competitively priced gas feedstock, we have little clarity on the price terms and duration of supply contracts between Qatar Petroleum and IQ group companies. The cost of natural gas is the most significant cost component (more than 80% of total cost) in the production of urea and ethylene.

Timing and Cost of Completion of Capex Projects: Due to the escalating costs of raw materials as well as labor and due to the large number of construction projects currently being undertaken in the Middle East, IQ has had to revise its estimated capital expenditure costs for new plants on more than one occasion. Delays in construction or higher than expected costs would have a negative impact on the company's earnings, all other things being equal.

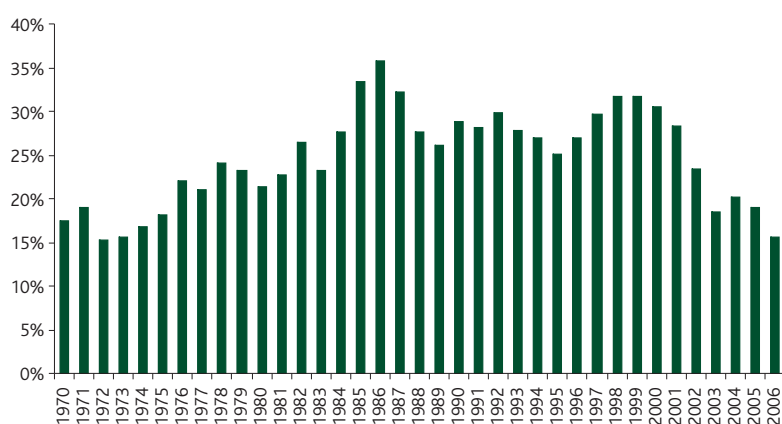
Potential Cost Controls: In the steel segment, where a significant portion of IQ's output is consumed domestically, IQ's steel unit – in common with similar units in other countries – may be subject to voluntary or involuntary price controls which would have an impact on margins as the unit would not be able to pass on the full impact raw material price increases. Recently, for example, Qatar Steel, agreed to a price freeze for steel until July 2008 to help stem the rate of inflation in Qatar.

APPENDIX A - MIDDLE EAST AND WORLD FERTILIZER INDUSTRY DYNAMICS

We see the mid-term outlook for world fertilizer demand as quite positive, benefiting from both cyclical and structural drivers relating not only to food consumption but energy consumption as well. We identify what we believe are the four main drivers for fertilizer demand as follows:

i) Severe Decline in Grains Inventory: According to the Food and Agriculture Organization (FAO), the ratio of the world grain stocks (inventory) to consumption has declined rapidly to 12% in 2007, down from 22% in 2003 and is now at a 30-year low. The FAO estimates this alarming level will continue over the next three years as current production levels are not sufficient to meet the world's demand for food, feed, and other usages. International trade in grains is also constrained by all time high, and volatile, fuel prices and a surge in freight rates. The shortage of grains for consumption increases the need to enhance the yield of current crops which is positive for fertilizer demand.

Figure A-1: Ending Grain Stocks Inventory to Grain Use Ratio 1970-Present

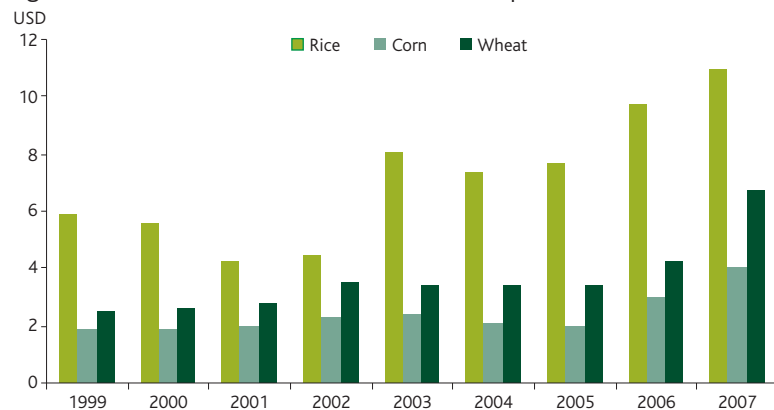


Source: USDA

ii) Expansion into Biofuels Applications: The significant rise in energy prices together with growing environmental concerns has led to the expansion in biofuels applications, mainly in the USA, Brazil and China, thereby creating another important source for demand for grains. Corn production, which is one of the largest consumers of nitrogenous fertilizers, has been used extensively in the US to produce Ethanol. In the last two years, US farmers have even been switching from soybean to corn as rising demand and prices for the product provide better economic rewards. On the other hand, the EU's Common Agriculture Policy (CAP) will dedicate more land for producing oil seeds to be converted into biodiesel. While the USA acts as a major exporter of corn, the expected decline in exports will also need to be met by increasing supply from other parts of the world, both of which will lead to healthy growth in demand for nitrogenous fertilizers.

iii) Surge in World Grain Prices: The above-mentioned developments have been reflected in the rising prices for wheat, corn and rice providing an economic incentive for farmers to increase crop yields using nitrogen fertilizers. It is estimated that fertilizer costs represent less than 15% of the total cash costs/ton of grains.

Figure A-2: US Wheat, Corn and Rice Prices-USD per Bushel

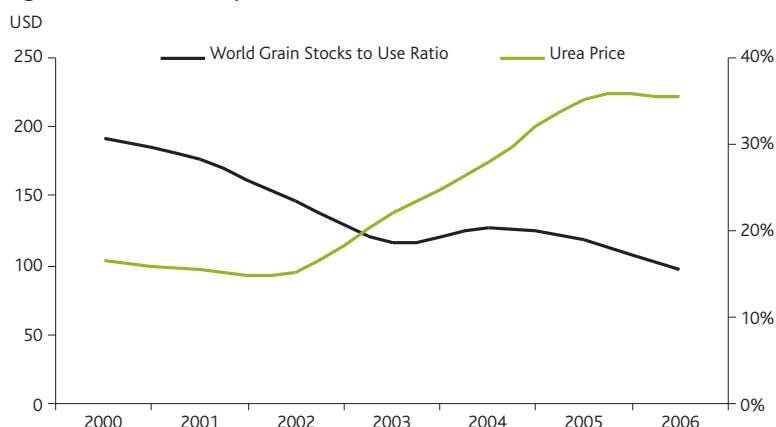


Source: USDA

iv) Environmental Issues: In 2005, the EU introduced tight measures for vehicles with diesel engines to restrict emissions of NO_x, which are toxic. This requires truck manufacturers to equip new vehicles with selective catalyst reduction (SCR), a process in which urea is used as the reducing agent. In the long term, demand for urea to limit NO_x is expected to gain momentum when the new diesel-engine vehicles are introduced to EU markets.

The above-mentioned developments, we believe, suggests that the current demand cycle could be extended for a longer period than generally accepted, with nitrogenous fertilizers, particularly urea, taking the lead due to developing economies trying to reach self-sufficiency in basic crops. However, we believe ammonia/urea producers are concerned more with the supply drivers rather than with the demand drivers since international trade, prices and margins are largely correlated to the costs of feedstock.

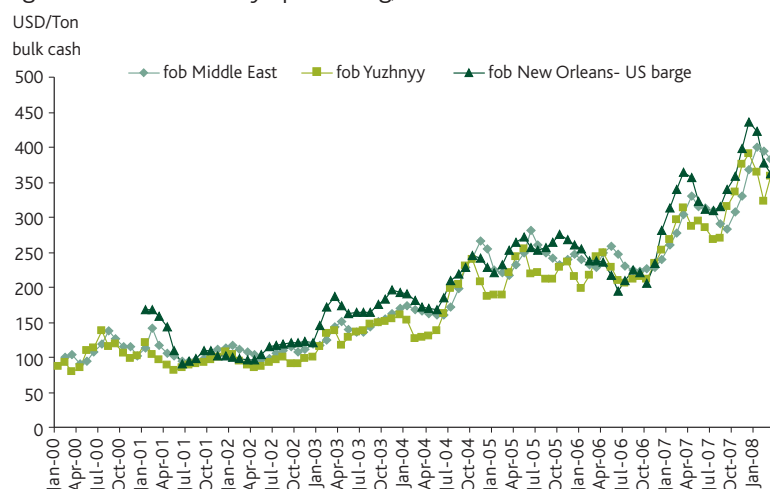
Figure A-3: Relationship Between Urea Price and Grain Inventories



Source: USDA

The convergence of these four factors have positive implications on the demand for fertilizers, especially nitrogenous fertilizers like urea which is the most widely used type to enhance crop yields. Urea pricing has soared and is at a multi-year high, reflection high food prices and low inventories, giving urea producers incentive to expand capacity.

Figure A-4: Urea Monthly Spot Pricing, USD/Ton

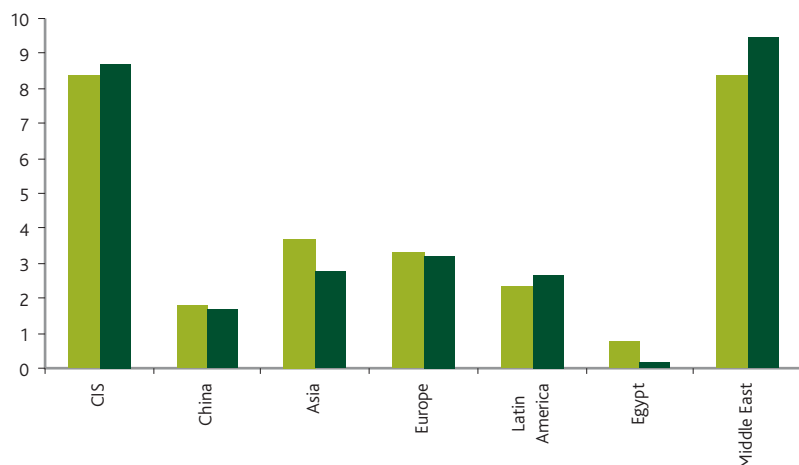


Source: Fertecon

OUTLOOK - MIDDLE EASTERN PRODUCERS SET TO GROW SHARE OF WORLD EXPORTS

It should come as no surprise then that fertilizer producers are increasing their capacity to meet the increase in demand and take advantage of the strong pricing environment. The Middle Eastern region in particular is the largest source of export capacity representing 27.4% of exports in 2007. More importantly, the Middle East region, as well as Asia to some degree, is expected to represent the bulk of urea capacity additions over the next few years.

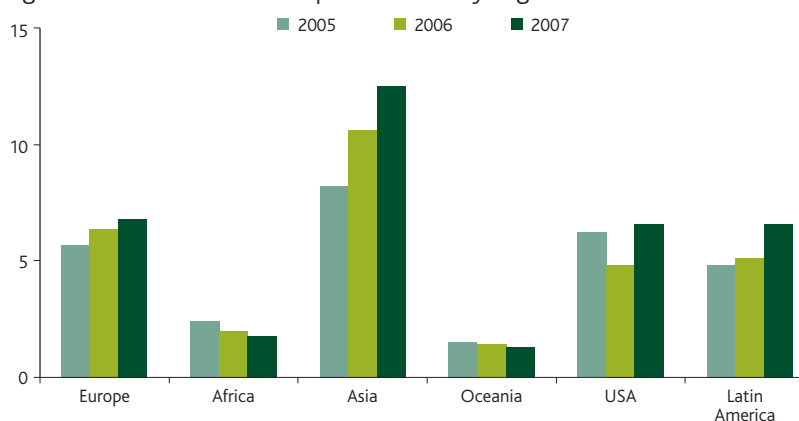
Figure A-5: Growth of Urea Export Volumes by Region



Source: Fertecon

While Middle Eastern production of urea grew 10.8% in 2006, it slowed to 8.7% in 2007 as plants approached near full capacity utilization at operating rates of 95%. Substantial planned capacity additions will see the Middle East's urea exports grow to represent over 40% of world exports by 2015 from 27.4% today with the bulk of the incremental capacity likely to supply rising demand in Asia.

Figure A-6: Growth of Urea Import Volumes by Region



Source: Fertecon

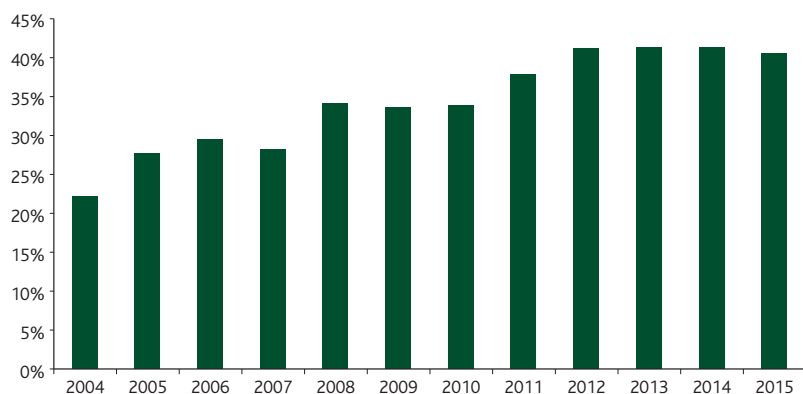
One of the key reasons why the Middle East will continue to be the main source of urea capacity additions is the region's low cost of production, which is lowest even amongst the global natural gas based producers. One of the major developments that cemented the Middle East's place among low cost gas suppliers was the adoption of a change in natural gas pricing formula in Russia, the world's largest natural gas producer. Russian gas prices are expected to increase 25% in 2008, 26% in 2009 and, 25% in 2010 with gas prices expected to be liberalized in 2011 according to a formula derived off Western European gas prices.. Russia has been the primary supplier of gas feedstock to both Russian and Ukrainian urea producers, which represented a very large source of world urea exports at 12.5% and 9.1% of total exports in 2007 respectively.

This shift has set the stage for Middle Eastern producers to become the low cost urea suppliers to the world. However, increasing urea production will require building new plants as current plant production capacity is nearly fully utilized.

On a country by country basis, Egypt is expected to triple its urea production to 6.1 million tons by 2011 as 5 fertilizer plants will be coming on stream, with the majority of this production destined for exports. Algeria, which currently exports no urea is building 2 new plants and is expected to export 1.2 million tons by 2012. Iran which also does not currently export urea plans to export 2 million tons by 2012.

These new investments are expected to bring Middle Eastern urea production to 23.9 million tons per year in 2015 from 14.9 million in 2007 and Middle Eastern producer's share of world urea exports from 27.3% in 2007 to 42.3% by 2015.

Figure A-7: Expected Growth in Middle East Producers Share of World Urea Exports



Source: Fertecon

APPENDIX B - WORLD STEEL INDUSTRY DYNAMICS

World steel production in millions of tons rose 7.5% in 2007 after having grown 9.0% in 2006 and at an annual growth rate of 6.1% between 2000 and 2005. BRIC countries (Brazil, Russia, India and China) have been the main driver of global steel demand in the last few years. BRIC steel consumption rose 13.1% in 2007 and is expected to grow another 11.1% in 2008e accounting for an astounding 50.8% of world consumption. China in particular is the 800-pound gorilla of the global steel industry accounting for over 37% of production and 33.2% of consumption.

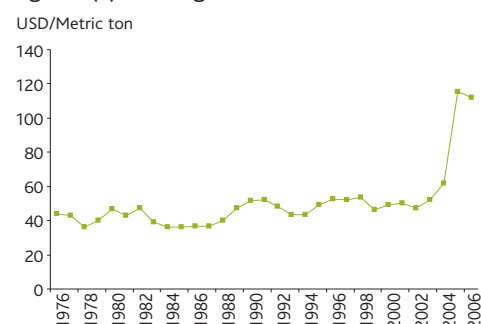
Table B-1: Steel Consumption Forecasts by Region

Regions	2007a	2008e	2009e	06/07	07/08	08/09
EU (27)	192.2	195.3	199.8	3.4%	1.6%	2.3%
Other Europe	31.2	33.1	35.3	9.4%	6%	6.7%
CIS	55.5	60.5	66.3	13.7%	8.9%	9.6%
NAFTA	141.5	144.2	145.6	-9.1%	1.9%	1%
Central and South America	41	44.6	47.7	13.7%	8.9%	7%
Africa	25.3	26.8	28.4	8.5%	5.9%	5.9%
Middle East	44.3	49.2	53.6	12.7%	11.1%	9%
Asia and Oceania	670.6	728.3	786.5	10%	8.6%	8%
World	1201.6	1282.1	1363.3	6.6%	6.7%	6.3%
BRIC	520.9	578.5	637.8	13.1%	11.1%	10.3%
World (excl. NAFTA)	1060.1	1137.9	1217.7	9.1%	7.3%	7%
World (excl. China)	793.3	827	862.7	3.6%	4.3%	4.3%
World (excl. BRIC)	680.7	703.5	725.4	2.2%	3.4%	3.1%

Source: IISI

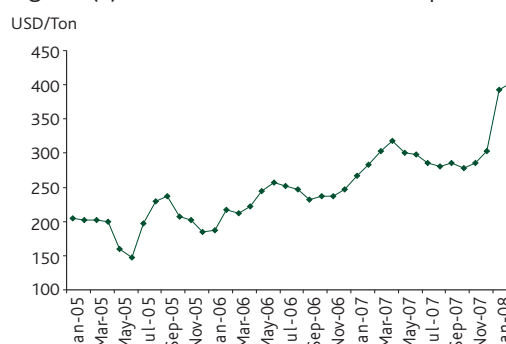
This rapid growth in steel demand has put pressure on steel prices and on prices of raw materials for steel production such as coking coal, iron ore and scrap prices. Iron ore in particular, is important for Middle East steel production as the majority of steel production in the region uses electric arc furnaces, which mainly use iron ore pellets as the key raw material in their production process.

Fig B-2 (a): Soaring Raw Material Costs



Source: Steelonthenet

Fig B-2 (b): Iron Ore Pellet and Steel Scrap Prices



MIDDLE EASTERN INDUSTRY DYNAMICS

The Middle East is a relatively small player in the global steel market representing 3.3% of consumption and only 1.4% of production. However, given rising local demand and favourable energy input pricing, the region is undertaking significant capacity expansion, at a faster pace than any other region globally. From a product perspective Middle East demand is concentrated on steel reinforcing bars for the driven by the growth in construction projects. Reinforced bars accounted for about 70% of total steel demand in the Middle East or 50 million metric tons per year and almost 20% of worldwide steel rebar consumption in 2006.

Table B-3: Global Crude Steel Production Growth Estimates (Million Ton)

Region	2007	2008e	Y-o-Y
Middle East	16.4	18.5	12.8%
Other Europe	30.5	33.4	9.5%
China	489.0	533.0	9.0%
South America	48.0	51.8	7.9%
Africa	18.9	20.1	6.3%
Former USSR	124.4	131.2	5.5%
Other Asia	144.9	152.7	5.4%
EU 25	210.0	215.5	2.6%
Oceania	8.8	9.0	2.3%
NAFTA	132.8	134.8	1.5%
Japan	119.8	120.0	0.2%

Source: Steelonthenet

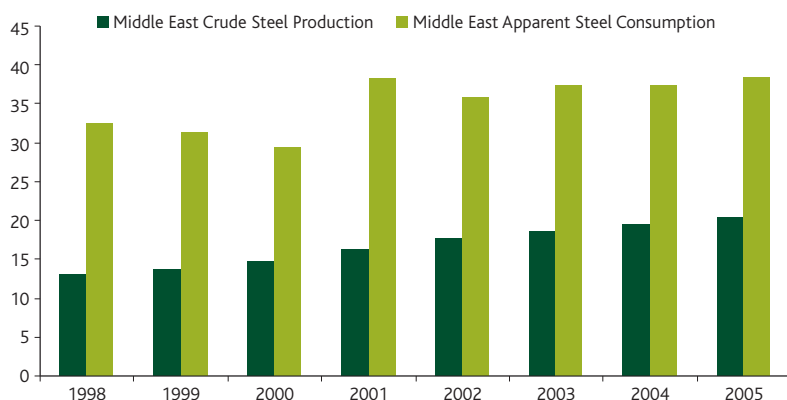
INITIATION OF COVERAGE NOTE

On the supply side, Middle East steel production is expected to grow 12.8% in 2008 and to increase nearly 70% by 2010. On a country by country basis, Saudi Arabia will have the most significant capacity expansion in the region. In November 2007, Saudi Iron & Steel Company (Hadeed) commissioned the world's largest direct reduction plant at Al-Jubail. The complex has production capacity of 1.7 million tons per year (t/y). A USD2.6 billion steel complex is also planned in the Kingdom's Jizan Economic City. The facility is expected to have capacity of 1 million tons per year.

Expanding steel capacity in Iran will contribute significantly to regional output. By 2012, the country expects its total steel production to reach 40.5 million tons per year. Among the projects being developed is Iran Alloy Steel Company's (Iasco) 650 thousand ton per year steel plant in Yazd. It will use feedstock from the direct-reduction and pellet manufacturing facility under construction at nearby Ardakan. And, in Egypt, prequalified companies are bidding for four licenses to build steel facilities in the country.

Expanding steel capacity in the region will somewhat help to alleviate the pressure of rising prices however, this will not be enough to satisfy local demand and imports should continue to play a key role in Middle Eastern steel supply over the next few years. Turkey is presently one of the largest steel suppliers to the region accounting for close to 70% of exports of rebar to the Gulf.

Figure B-4: Large Gap between Middle East Supply and Demand



Source: OECD

CHINA EXPORTS AND M&A MAIN UNCERTAINTIES FOR MID EAST STEEL SECTOR

While China has traditionally been an important steel supplier to the Middle East and the world, the outlook for Chinese exports is unclear at the moment and could contribute to unexpected shortages of steel which would lead to higher steel pricing.

In an effort to make sure that local Chinese factories have enough supply as well as to stem local steel price inflation, the Chinese Government announced in the beginning of 2008 that it was going to impose a tariff on steel exports of 10-15% on some steel products, reversing its previous policy of subsidizing steel exports. In 2007, China's steel exports to the world had risen 45.8% to 63 million tons. According to the China Iron and Steel Association, Chinese steel exports could drop by as much as 20 million tons in 2008 which could lead to another surge in steel pricing if demand growth remains strong.

Secondly, as it is the world's largest importer of iron ore, China plays a leading role in negotiating iron ore prices. The iron ore industry is highly concentrated with the top 3 companies accounting for 33% of total production. China asserted its importance in this market when Chinalco, a state run aluminium producer acquired a 12% stake in Rio Tinto, which has been an acquisition target of BHP Billiton, both major global natural resource producers. Beijing has objected strongly to the merger, which it fears would give BHP Billiton the upper hand in setting prices for iron ore and other commodities that China must import to sustain its economy. Iron ore prices are up 124% between 2003 and 2007 and we believe are set to increase by as much as 90% in 2008, depending on the region.

APPENDIX C – PETROCHEMICAL INDUSTRY DYNAMICS

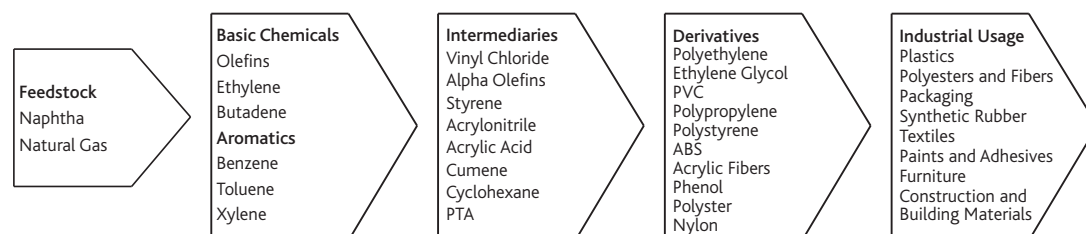
A. VALUE CHAIN ANALYSIS

Petrochemicals are derived from hydrocarbons (oil and natural gas) and form the basis of the chemical industry, with approximately USD2.1 trillion in annual sales. The industry's value chain is complicated due to the wide range of products, co-products, intermediaries and derivatives that varies from one producer/region to another according to the feedstock used, as well as a long list of final products used by a diverse range of industries such as plastics, fibers, rubbers, paints and adhesives, automotives, furniture, and construction and building materials.

Basically, raw materials (feedstock) are converted into end products first by the manufacture of basic chemicals (also called monomers), of which ethylene is the key building block, and then the conversion of basic chemicals into intermediaries and derivatives (also called polymers). Lastly, derivatives are processed, or further converted, into end products for industrial usages.

Basic chemicals can be broken down into; olefins, characterized by a chain of carbons as their backbone, and aromatics, containing a ring of carbon atoms as their molecules. The Olefin plant cracks the long chain of carbon molecules into small chains such as (C2), propylene (C3) and butadiene (C4). Aromatics, including benzene, toluene, and xylene, are also produced in olefin crackers as well as in the refinery units.

Figure C-1: The Petrochemical Basic Industry's Value Chain



Source: EFG-Hermes

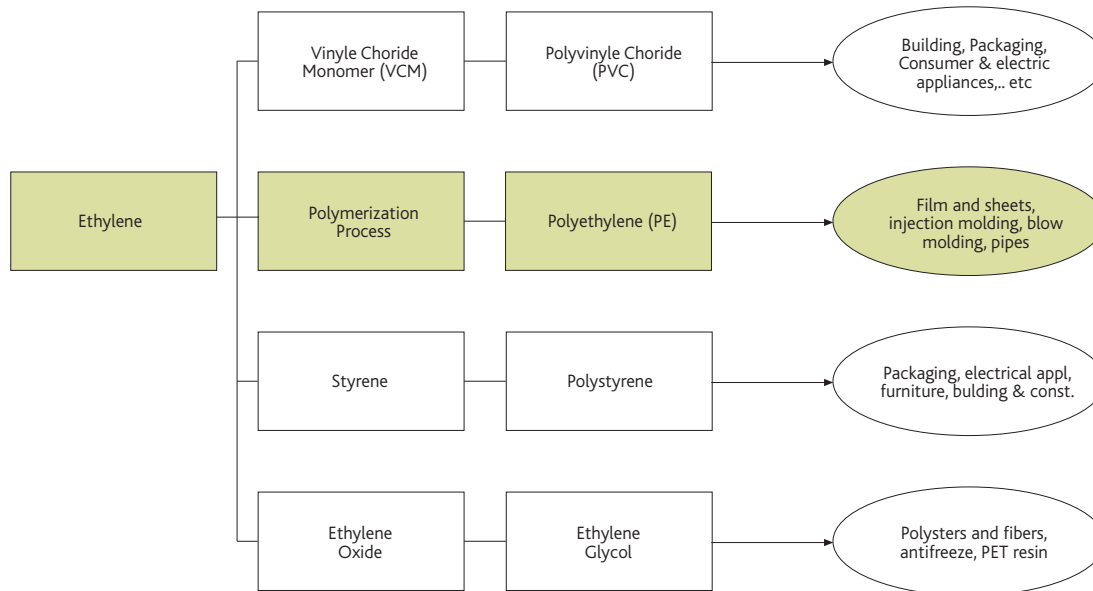
Ethylene is, by far, the most important basic chemical, accounting alone for approximately 40% of the world petrochemical volumes, followed by propylene. Ethylene and propylene are used mainly in the plastics industry. Through a polymerization process, where small carbon chains (monomers) are converted into long chains (polymers), ethylene and propylene are converted into polyethylene (PE) and polypropylene (PP), respectively, both represents more than 60% of the global commodity thermoplastic usages. Butadiene is another important basic chemical produced as a by-product in the olefin cracking process and is used mainly as an intermediate in the production of rubber, latexes and plastics. Aromatics can reduce the consumption of energy and therefore, are used as insulating foams in different industries. Aromatics are also used in gasoline blending for higher octane value, as well as in the manufacture of solvents, detergents and adhesives.

In this section, we focus on the analysis of ethylene, and its main derivative, polyethylene; both represent the core of IQ's petrochemical business segment. Due to its heavy weight in the industry, ethylene's production economics and market dynamics can also significantly impact the industry's profitability and margins trends.

THE ETHYLENE/POLYETHYLENE VALUE CHAIN

Ethylene is the key building block of the petrochemical industry. The importance of ethylene is derived from the high weight of its principal derivatives in the industry, serving as a backbone for the thermoplastic industry as well as a diverse range of other industries. Ethylene is a high chemically-reactive gas that is difficult and expensive to transport due to its physical characteristics. Therefore, international trade in ethylene mostly takes place in the form of its derivative products such as polyethylene, PVC, ethylene glycol, styrene, etc.

Figure C-2: Basic Value Chain of Ethylene and its Derivatives



Source: EFG-Hermes

Polyethylene is, by far, the largest and most important derivative of ethylene, accounting for almost 59% of its global end-use and 38% of the commodity thermoplastic usages worldwide. Polyethylene is mainly used in the production of film and sheet applications for different industrial usages such as food packaging, bags, milk bottles and shrink films, representing almost 50% of its end uses. Other usages include injection molding (13%), blow molding (12%) applications, as well as pipes, wire and cables and other applications. Other important ethylene derivatives include ethylene oxide (used in antifreeze, polyester and detergents), ethylene dichloride (used in PVC films, coatings and pipes), and ethyl benzene (used in polystyrene packaging and ABS resins)

Figures C-3 & C-4: Ethylene/Propylene Global Consumption by End Use



Source: CMAI

Polyethylene is produced in three forms depending on the physical characteristics and applications; high density polyethylene (HDPE), low density polyethylene (LDPE) and linear low density polyethylene (LLDPE). HDPE is a rigid plastic used mainly for the rigid packing items such as detergent or milk bottles. LDPE is a flexible plastic used for squeezable applications, carrier bags, and films. LLDPE is the fastest growing segment in the PE industry and combines both characteristics, mainly used in the manufacture of films for plastic bags, sheets, and applications that requires high resistance.

HDPE and LLDPE are often manufactured in the same plant with a producer having some flexibility to swing from the manufacture of one product to the other, while LDPE requires a dedicated plant. As most of the existing, and planned, PE capacity is integrated to ethylene production, there is a strong correlation between ethylene and PE prices and margins. Therefore, an analysis of the ethylene industry could also be applied to the PE industry.

Figure C-5 & C-6: Ethylene/Polyethylene Prices and Margins

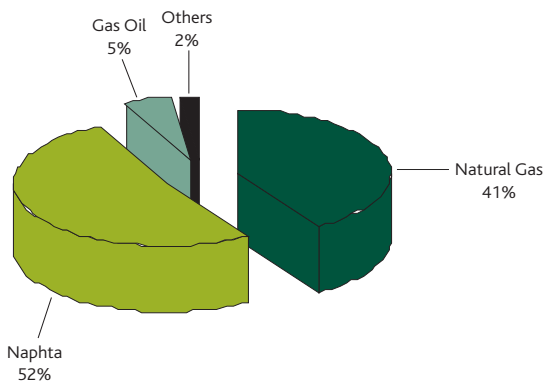


Source: EFG-Hermes

B. FEEDSTOCK

The competitiveness of an olefin producer is a function of several factors including energy costs, economies of scale, level of integration into upstream/downstream industries, location, and, most importantly, feedstock. Basically, the ethylene plant is the core of a petrochemical complex. Naphtha is the world's main feedstock used, accounting for 52% of the world ethylene production, due to its relatively easy and cheap transportation. Naphtha dominates ethylene production in Europe and Asia. On the other hand, natural gas feedstock (41% of the world ethylene production), particularly ethane (29%), is widely used in regions with associated gas production including North America and the Middle East.

Figure C-7: World Ethylene Production by Feedstock

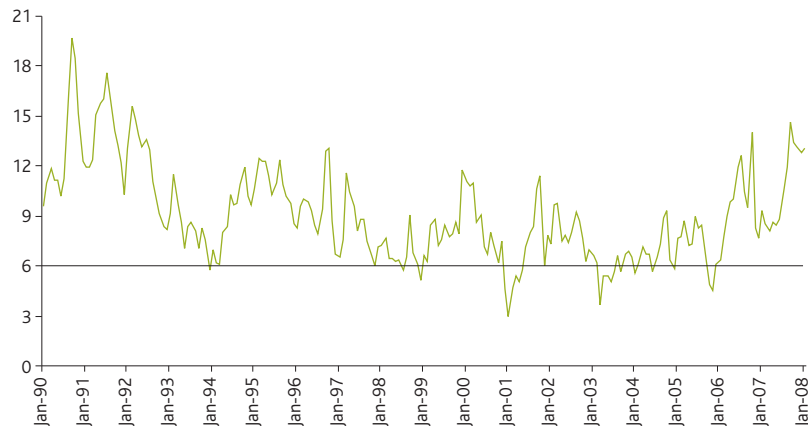


Source: CMAI

OIL VS. GAS COST ADVANTAGE

Hypothetically, the feedstock cost advantage is determined by the oil to gas thermal equivalent ratio. In terms of energy content, one barrel of oil is equivalent to six million British thermal units (mBtu). Thus, if oil price per barrel is more than six times the natural gas price per mBtu, the gas has a cost advantage over oil, while a ratio of less than six times implies oil advantage over gas. As shown in the below figure, natural gas has historically enjoyed a cost advantage over oil, though this advantage has decreased significantly after the US gas prices soared in 2001.

Figure C-8: Oil versus Gas Advantage in the US - North America Average Spot vs. North America Burner (USD/mBtu)



Source: CMAI, EFG-Hermes

INITIATION OF COVERAGE NOTE

In practice, however, determining competitive advantage for a feedstock is not that straightforward. The proportion of basic chemicals in the ethylene cracker varies significantly according to the type of feedstock employed. Therefore, the feedstock is not only a major determinant of producer's cost structure, but also a key factor in determining the type and scale of co-products, derivatives, and thus, the end markets for its production final products. Natural gas (ethane, propane, and normal butane) produces more ethylene at the expense of its co-products (propylene, butadiene and various gasoline and fuel gases), while naphtha (derived from crude oil), produces less ethylene and more of its co-products.

Thus, the choice of feedstock is constrained not only by availability, but also by producers' business strategy and required return on investment. For instance, naphtha is an economical feedstock for a vertically integrated ethylene producer with high exposure to the polypropylene or packaging business due to the higher co-product credits it produces. In this case, a shift towards ethane feeds, due to a higher than proportionate increase of naphtha prices, would limit its production of propylene and aromatics, thereby affecting its utilization rates and supply obligations. The table below illustrates the proportion of basic petrochemicals produced using each type of feedstock.

Figure C-9: Percentage of Basic Chemicals by Feedstock

% of monomers by feedstock	Ethane	Propane	Butane	Naphta	Gas Oil
Ethylene	80	44	41	25	18
Propylene	2	21	15	13	14
Butadiene	3	4	4	5	4
Aromatics	1	5	5	11	11
Others	14	26	35	46	53

Source: Industry

The selection of feedstock, assuming availability, is generally a tradeoff between lower production cost and higher return on investments. While the feedstock costs per ton for a naphtha-based cracker is higher than an ethane-based cracker, the incremental production cash costs per ton is lower, due mainly to the significantly higher amount of by-product credits that are produced by heavier feeds, allowing for higher operating margins. On the other hand, the investment cost for an ethane-based crackers is lower than that of naphtha, allowing for higher return on investments.

In a global industry context, operating cash margin is determined by the producers' revenue less total production cost, after adding back the net value of co-product credits. The table below illustrates the average cash margin of an ethane based cracker in the US versus a naphtha-based cracker in Western Europe, based on 2007 figures. While the total costs for an ethane cracker is lower, due mainly to the feedstock cost advantage, the net cash margin of the naphtha-based cracker is significantly higher due to the substantial value of by-product credits that are not produced to the same scale when using ethane.

Table C-10: 2007 Cash Margins by Feedstock - US Ethane Cracker vs. Western Europe Naphtha Cracker

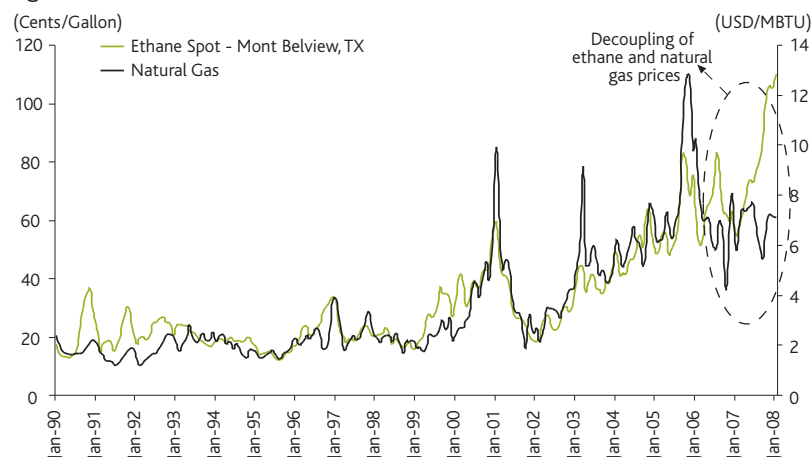
Cash Margin by Feedstock	US Ethane-Based Cracker	W. Europe Naphta-Based Cracker
Ethylene Price	1,007	1,219
Less: Freight	22	22
Revenue	985	1,197
Energy and Utilities	171	220
Feedstock Costs	756	2,114
Gross Variable Cost	927	2,334
Coproduct Credits		
Propylene	32	579
Butadiene	29	216
Pygas	16	558
Hydrogen	74	57
Fuel	41	266
Coproduct Credits	192	1,676
Net Variable Costs - adjusted for byproduct credits	735	658
Fixed Costs	81	81
Production Cash Costs	816	739
Cash Margin	169	458

Source: CMAI

THE DECOUPLING OF ETHANE AND NATURAL GAS: A NEW PRICE REGIME?

Furthermore, the sustainability of feedstock cost advantages for the ethane-based producers (mainly in the US) is now questioned as the price of ethane has recently shown a decoupling from natural gas prices where both were historically correlated. Instead, ethane has recently shown a stronger correlation to the price of naphtha, thereby increasing the volatility of feedstock costs and thus operating margins. The main reason lies in the different consumption patterns for both feedstocks, we believe. The price of naphtha is mainly correlated to the demand for fuel, with only 7% of its production used by the chemical industry, making olefin producers highly vulnerable to global fuel market dynamics.

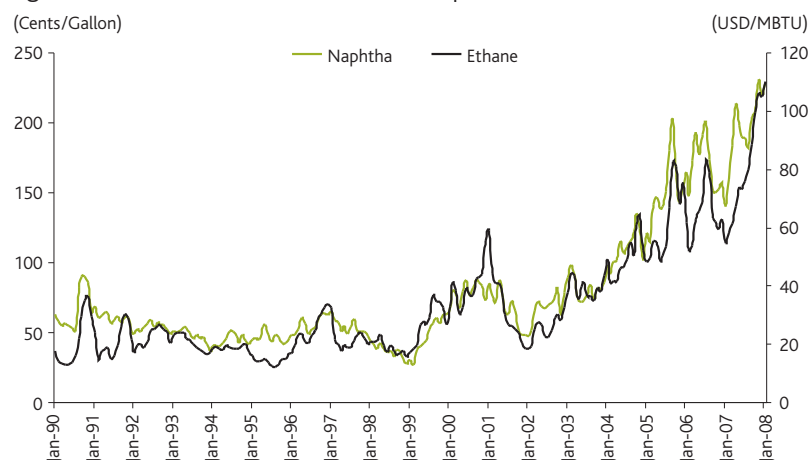
Figure C-11: Historical Prices: Ethane vs. Natural Gas



Source: EFG-Hermes, CMAI

On the other hand, the natural gas price is linked to the demand for energy in developed economies. Although a natural gas derivative, the main consumption of ethane is in the production of ethylene (29% of ethylene production worldwide). Thus, despite the fact that natural gas prices have eased down during 2006 and 2007, ethane prices continued to surge, showing a strong correlation to naphtha prices, driven by the strong demand for ethylene that allowed plants to continue enjoying high operating rates. This suggests that the cost competitiveness of the ethane-based crackers over naphtha crackers is shrinking and the oil to gas thermal equivalent ratio is no longer a practical methodology to estimate feedstock cost advantage. Likewise in all commodity sectors, a marginal producer is the one who sets the price floor, based primarily on its variable cash costs, below which it will not be able to continue operations; i.e. the cost of shutdown will be lower. The decoupling of ethane and natural gas suggests that feedstock costs will be solely determined by the movements in crude oil prices, which could lead to a new price regime for ethylene and its derivatives and co-products.

Figure C-12: Historical Prices: Ethane vs. Naphtha



Source: EFG-Hermes, CMAI

THE MIDDLE EAST ABSOLUTE COST ADVANTAGE

In the current high energy price environment, the cost competitiveness of the Middle Eastern ethylene producers is unmatched, we believe, due mainly to the cheap, and relatively fixed cost of feedstock (primarily ethane) that makes the region, by far, less vulnerable to the cyclical nature of this industry.

Ethylene producers in the Middle East are privileged by long-term supply contracts for natural gas in the range of USD0.75/mBtu – USD1.25/mBtu, significantly lower than the average gas price in the world's main production hubs (Henry Hub average price for natural gas has averaged above USD10/mBtu since the beginning of 2008, despite the end of the winter season). Moreover, the sustainability of this cost advantage is unquestionable as the equivalent oil price has to drop to the range of USD15-USD25 per barrel in order for a global producer to match the cost structure in the Middle East, a scenario that is highly unlikely to occur, we believe. This justifies the wide variation in the cash cost per ton of ethylene in different regions, while the Middle East has the lowest cash cost and the highest cash margin.

As an example, for a Middle Eastern producer with access to natural gas priced at USD1.25/mBtu, the average cash cost per ton of ethylene (adjusted by net value of co-product credits) in 2007 was USD100/ton, compared to USD739/ton in Western Europe and USD816/ton in the USA.

The sustained high energy price environment has left very little economic incentive for further investment in new ethylene capacities in the US and Europe, with most of the world's new capacity coming on stream in the Middle East (building on absolute cost advantage) and Asia, particularly China, (aiming to reach self-sufficiency). Both regions will accommodate almost 80% of the new ethylene capacity coming on stream in the next five years. That said, the share of the Middle East of world ethylene capacity is expected to increase significantly from 12% in 2007 to 23% in 2015.

C. MARKET DYNAMICS

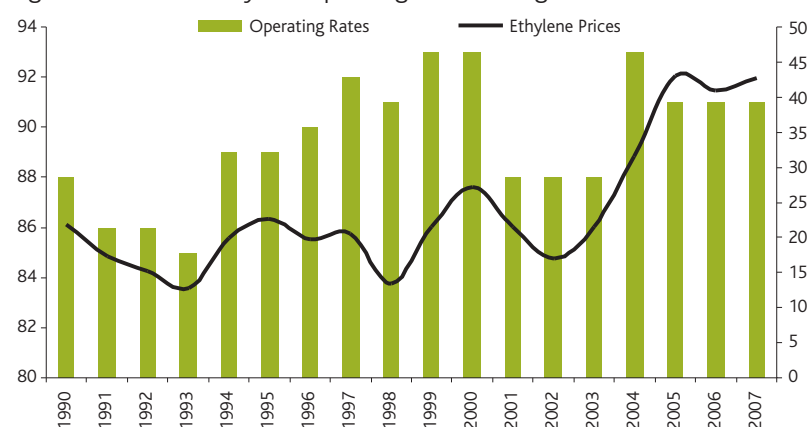
Cyclicality

Understanding historical trends is a key in estimating the future market directions. Ethylene's consumption pattern follows world growth and has grown historically at approximately 1.5x GDP, though this multiple has recently declined due to the shift of ethylene derivatives towards more durable goods and as the world economy has become more reliant on the service sector. The cyclical pattern of the ethylene industry is also applicable to PE, yet with a time lag.

The upward leg of a cycle usually starts on the back of a macroeconomic recovery and its concurrent increase in industrial value-added. This often triggers a pro-cyclical wave of capacity additions that comes on stream near the peak of the cycle, given the relatively long lead time associated with the construction of ethylene plants. The result is often an excess in supply that leads to a decline in operating rates and margins. Moreover, the industry's structure is relatively fragmented with no single producer having influence on the pricing dynamics. Thus, as a price-taker, an ethylene producer is highly vulnerable to the rise in energy costs (feedstock) and drop in demand, which cause high volatility in operating margins.

The direction of ethylene and PE prices is historically correlated with the change in utilization rates as determined by the supply/demand balance. In the early 1990s, the economic recession in some of the main consumption spots, such as the US and Western Europe, magnified the impact of global oversupply leading to a significant decline in utilization rates and margins. In 1995, however, utilization and margins improved with strong ethylene demand bolstered by a global economic recovery that coincided with a decline in energy costs. In 2001, the cycle reversed with a 6% increase in global capacity, and a 3% slump in demand.

Figure C-13: World Ethylene Operating Rates vs. Avg. Prices



Source: CMAI

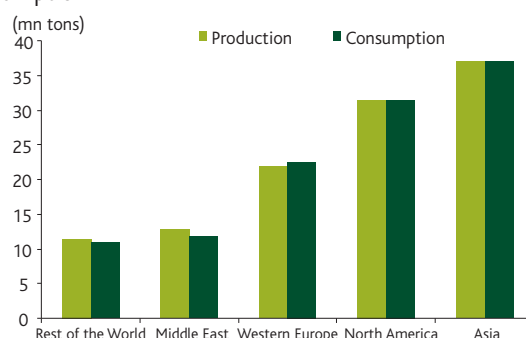
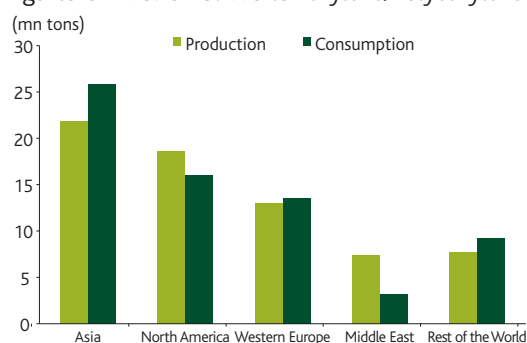
The current growth cycle started in 2004 on the back of the strong macroeconomic picture and a moderate step up in global ethylene capacity, as the rise in energy costs has hindered further investments in greenfields in Western Europe and the US. As a result, utilization rates have improved from 88% in 2001 to 93% in 2004 and an estimated 91% in 2007. The strong demand for ethylene and its derivatives has allowed producers to pass on the rise in energy costs to consumers. The magnitude of the current cycle and the performance of producers is mainly a function of the supply/demand balance as well as the outlook for oil and gas prices, we believe.

SUPPLY / DEMAND OUTLOOK

During 2004-07, demand for ethylene and PE has grown at a CAGR of 4% and 3.7%, to almost 114 and 68 million tons, respectively, while the capacity has grown at a CAGR of 2.9% and 3.3%, respectively, over the same period. The tight market conditions has allowed for healthy utilization rates and margins for global producers.

Unsurprisingly, the world's largest producers and consumers are located in Asia, due to the high economic growth, as well as North America and Western Europe, due to their solid economic base. While the US and Western Europe markets have shown signs of maturity, the growth was driven mainly by the emerging markets of Asia, mainly China, where the booming plastic industry accounting for almost 40% and 35% of the plastics imports in the US and the EU, respectively, has highly contributed to the global demand for ethylene and its derivatives. Assuming steady economic growth, demand for ethylene and PE is expected to grow at an average rate of 4% over the next five years.

Figures C-14 & C-15: World Ethylene/Polyethylene - 2007 Production and Consumption



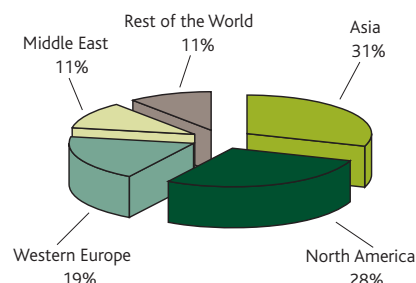
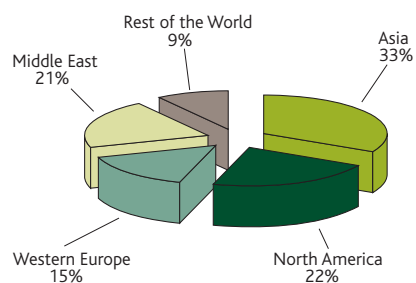
Source: CMAI

The Middle East Massive Capacity Buildup

On the supply side, however, a huge wave of capacity additions is coming on stream in the next five years. Global supply is expected to outpace the growth in demand, thereby adding pressure on utilization rates and prices. Global ethylene capacity is expected to reach 160 million tons in 2012, with most of the capacity additions coming on stream in Asia and the Middle East.

Building on its absolute feedstock advantage and key location near the high growth markets of Asia, the Middle East is currently undergoing massive capacity additions that will reshape the world trade dynamics for ethylene and its derivatives. Ethylene plants in the Middle East, most of which are export driven, primarily targeting China, will be the most competitive in the world. According to the CMAI, Middle East ethylene capacity is expected to increase from 15 million tons in 2007 (12% of the global supply) to 28 million tons in 2010, and further increase to 40 million tons in 2015 (23% of the estimated global capacity in 2015), ranking the region ahead of the current largest producers; North America and Western Europe.

Figures C-16 & C-17: Share of Global Capacity by Region: 2007 vs. 2012

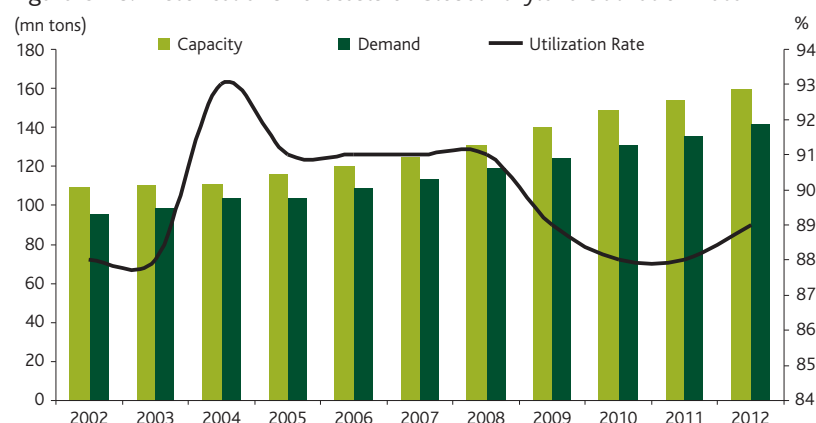


Source: CMAI

In addition, another 18 million tons of ethylene capacity is expected to come on stream in Asia by 2015, of which around 10 million tons will be added in China on the back of the high growth in demand for ethylene and its derivatives as well as the government's goal of reaching self-sufficiency in basic materials.

These aggressive capacity additions in the Middle East and Asia will not only pressure global utilization rates, but will also reshape the international trade outlook in ethylene and its derivatives, we believe. While the global demand for ethylene is expected to grow by 5-6 million tons per year during 2007-12, new capacity is forecasted at 34 million tons during that period, of which 19 million tons will be in the Middle East and 15 million tons in Asia. Thus, the global utilization rate is expected to decline starting in 2009 to 88% (the same level seen in the previous cycle of 2001), down from 91% in 2007, assuming no delays in the implementation of the planned projects in the Middle East. Indeed, such delays would keep the market tight for a longer period than estimated. However, the impact of the expected oversupply will not be homogenous on all producers, we believe. Several factors will determine the world's new competitiveness picture including: regional utilization rates, oil price outlook, the pace of capacity shutdowns for marginal producers and, most importantly, cost structures.

Figure C-18: Historical and Forecasts of Global Ethylene Utilization Rate



Source: CMAI, EFG-Hermes

WINNERS AND LOSERS

In a USD100/bbl oil environment, Middle East producers are undoubtedly the world's major beneficiaries due to their tremendous cost advantage over all other regions in the world. While the industry margins are expected to decline starting 2009, the impact on a Middle Eastern producer, with essentially a fixed price for feedstock, will be much less than that of a marginal producer with a high vulnerability to the changes in energy prices. Taking Qatar as an example, olefin producers enjoyed an outstanding USD716/ton cost advantage over the US producers, and USD639/ton advantage over Western Europe producers in 2007. That said, higher prices for energy suggests an upward movement on the floor price set by the world's marginal producers, with the difference feeding directly through to the margins of the Middle Eastern producers.

With a limited share of the global industrial value added, the Middle East is primarily building up capacity to export, capitalizing on its key location in proximity to the world's highest growth markets, particularly to China. However, with the ongoing/planned capacity additions in China and the Asia Pacific, the new capacity in the Middle East will also pressure other regions (North America and Europe), especially in the ethylene derivatives markets such as polyethylene and ethylene glycol. With the Middle East's high reliance on the Asian market, the question now is the impact of possible competition between Middle East exporters and Asian domestic producers. The chart below illustrates the global ethylene cost curve by region. It is clear that the Middle Eastern producers could supply ethylene and derivatives at a significant discount to the cost of production of the Asian producers, after adjusting for the cost of transportation and freight.

On the other hand, new investments in olefin plants in the US and Europe is unlikely to happen during our forecast horizon due the high energy prices that squeeze return on investments, especially with the significant rise in EPC costs, as well as the massive capacity buildup in Asia-Pacific that will gradually increase the region's self-sufficiency level. Thus, the share of North America in global trade is likely to be replaced by the new capacity in the Middle East.

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