

13 October 2011



MENA Fertilisers

Fertile growth opportunities

We expect agricultural fundamentals to remain strong until 2013, which should benefit the MENA fertiliser producers. They are the largest exporters globally thanks to their advantageous cost position, and new capacities due over the next 12 months should give an additional boost to earnings.

Overview of recommendations

Stock	Country	Market cap (US\$bn)	Price	Target price	Upside
Industries Qatar	Qatar	18.0	124.60	164.00	32%
Orascom Construction Industries	Egypt	6.9	208.53	284	36%
SAFCO	Saudi Arabia	12.3	183.25	207.00	13%

Priced as of 11 October close.
Source: Company data, Rasmala forecasts

We initiate coverage with Buy recommendations on three fertiliser stocks

We initiate coverage on three fertiliser names in the MENA region: Industries Qatar (IQ), Orascom Construction Industries (OCI) and SAFCO. The latter is the only pure nitrogen fertiliser play, whereas IQ has petrochemicals and steel, and OCI has construction in addition to fertilisers. We are bullish on fertilisers in particular and believe that the market does not yet discount strong volume growth at IQ and OCI over the next 12 months. In addition, we believe that OCI's share has been discounted unjustifiably for political risk in Egypt.

New fertiliser capacity should benefit from strong agricultural fundamentals

Key to our investment case is that we believe agricultural prices are likely to remain elevated, demand for fertilisers will remain strong and industry operating rates will remain healthy during 2011-13. All three companies appear well positioned to benefit, as MENA producers are the lowest-cost producers globally. However, over the next 12 months, we expect IQ and OCI to receive an extra earnings boost from new capacities coming on stream, whereas SAFCO V is due to be fully operational only from 2014.

The main risk to our assumptions for petrochemicals is a global recession

The potential for further downgrades in US and European economic growth is real and would likely lead to a drop in petrochemicals demand, relevant to IQ only in this coverage universe. In our base case for ethylene, we assume demand growth in line with our forecast of 4% global GDP growth, driven by emerging markets. In our bear-case scenario, if global growth would stall and selling prices were to drop to troughs, we would likely have to cut our 2012 forecasts for IQ by up to 70%. However, if global GDP growth remains positive, our analysis suggests that petrochemical demand could remain relatively tight during 2012.

We see upside potential to our forecasts

We adopt a reasonably cautious stance on product prices, but nevertheless forecast average annual net income growth during 2010-13 of 22% for IQ and 21% for OCI, despite forecast declines in their petrochemicals and construction earnings, respectively. If the global economy does not deteriorate materially below our economists' current forecasts and the oil price – the key driver of petrochemicals prices – remains high, we could see significant upside to our forecasts, especially if the super-cycle for petrochemicals were to materialise.

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Important disclosures can be found in the Disclosures Appendix.

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Contents

Investment summary	3
Our base case assumes a healthy outlook for fertilisers, a reasonably balanced outlook for petrochemicals supported by high oil prices and a benign supply environment, and a promising outlook for construction and construction materials in Saudi Arabia and Qatar.	3
Stock recommendations	6
SAFCO's shares have clearly outperformed the local stock markets and its global fertiliser peers this year, but we see stronger catalysts for OCI and IQ to outperform over the next 12 months. We expect volume growth, not price growth, to be the main earnings driver.	6
What could go wrong?	9
We look some of the risks that could affect our forecasts negatively: a bear-case scenario of a substantial slowdown in global growth and a change in gas price regime.	9
Cheap gas is key competitive advantage	11
Cheap gas is the main driver to invest in petrochemicals and fertilisers, which have become key strategic industries for the region. We expect gas prices to rise, but remain in the US\$1-3/MMBtu range over the next five years – low enough to be competitive globally.	11
Expect healthy fertiliser demand	17
The nitrogen fertiliser market is likely to remain tight for the rest of 2011. We see some downside risk for prices as a less favourable spread between crop and fertiliser prices emerges, and capacity additions in 2011/12, but expect these to remain comfortably high.	17
Oil sets the floor for petrochemicals	24
A closer look at the supply side	26
Petrochemicals prices supported by oil	30
Construction: recovery in sight or not yet?	31
We expect strong GCC infrastructure spending, particularly Saudi Arabia, after two packages were announced earlier this year, as well as Qatar, especially as spending starts for the 2022 World Cup. Elsewhere, construction markets have declined steeply this year.	31
Key product price forecasts	34
We use a base-case scenario for the key product prices, for which we assume a drop in petrochemicals and fertiliser prices of 10-15% in 2012.	34
Company profiles	
The following are the latest reports published on these companies:	
Industries Qatar	36
Orascom Construction Ind	55
SAFCO	71

Investment summary

Our base case assumes a healthy outlook for fertilisers, a reasonably balanced outlook for petrochemicals supported by high oil prices and a benign supply environment, and a promising outlook for construction and construction materials in Saudi Arabia and Qatar.

We see volume growth as a key catalyst

We initiate coverage on three fertiliser names in the region. Our preferred stocks are Orascom Construction Industries (OCI) and Industries Qatar (IQ), on which we initiate coverage with a Buy recommendation. We expect volume growth to be the main catalyst for the two shares. We also initiate on SAFCO with a Buy recommendation, but with less upside potential than OCI and IQ.

Only SAFCO is a pure-play (nitrogen) fertiliser stock. IQ is a holding company with two other segments, petrochemicals and steel, whereas OCI has a construction business with focus on infrastructure work across the region. Key to our investment case is the combination of healthy demand for fertilisers, and IQ's and OCI's capacity expansions over the next 12 months, thus boosting strong volume growth.

Table 1 : Overview of recommendations

Stock	Country	Market cap (US\$bn)	Price	Target price	Upside
Industries Qatar	Qatar	18.0	124.60	164.00	32%
Orascom Construction Industries	Egypt	6.9	208.53	284.00	36%
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A healthy outlook for fertilisers until at least 2013

Farmer economics have been good this year

In the past 12 months, farm economics have been highly supportive of fertiliser demand and pricing: farmers' incomes are at record highs, global food stockpiles have declined to an almost historical low and grain prices have soared.

Expect tight supply/demand balance

The International Fertiliser Association estimates that urea capacity will grow by about 8% in 2012, higher than its forecast 5% demand growth. In contrast, our supply/demand analysis shows that some of these additions may occur a little later. We forecast supply will be broadly in line with demand and a relatively tight supply/demand balance will persist during the rest of 2011 and 2012. The good news is that the largest increases in exportable volumes are in the MENA region, in Qatar, Algeria and Saudi Arabia.

The key assumption for our positive outlook for fertilisers until at least 2013 is based on grain prices, currently about US\$6.5/bushel, that drive fertiliser demand. Urea inventory is low, as of the end of July down about 30% compared with end-July 2010, and prices have increased by on average almost 20% in 3Q11 compared with 2Q11 and 73% with 3Q10, which bodes well for 3Q and 4Q earnings. Prices are still high, in the US\$500-550/tonne range.

We think the MENA fertiliser producers – Industries Qatar, SAFCO and OCI – are well positioned to capture this growth: 1) they are the lowest-cost producers globally; 2) the region is the largest exporter of fertilisers; 3) Industries Qatar and OCI are starting up new facilities at the end of this year and next, and SAFCO in 2013, driving strong earnings growth; and 4) they have an advantageous geographical position.

Chemicals: the oil price will be the key driver for MENA petrochemicals

Petrochemical demand is closely correlated with GDP growth, hence the relevance of the fear of another recession, especially now that consensus is moving more towards a scenario of recession in the US and Europe in 2012. Whether a global recession will materialise is yet to be seen.

However, RBS economists in Asia, the main end market of Middle East petrochemicals, are still relatively optimistic and expect continued growth in Asia, even if lower than in previous years, to be able to offset weakness in Europe and the US. RBS economists forecast about 4% global GDP growth in 2011 and 2012 and, importantly, our China strategist Wendy Liu remains optimistic on China and expects Chinese GDP to grow 8-9% over the next five years.

Limited supply growth during 2011-15

During 2010, global ethylene capacity increased almost 7%, but we expect below-average capacity growth of on average 2-3% annually during 2011-15, below our economists' global growth forecast. Economic growth combined with the lack of new supply coming to the market for an extended period have resulted in much talk in the market about the super cycle for petrochemicals – in our view, the demand side will be the main determiner of whether this will occur, but for now, petrochemical earnings growth seems sustainable, especially if global uncertainty results in new capacities being cancelled or delayed. Based on current GDP forecasts of our economists and the supply outlook, we expect global ethylene operating rates to move up from about 82% in 2010 to 88% in 2015. Only in the worst-case scenario of 0% global growth in 2012 would we expect operating rates to drop materially.

In any case, we believe that operating rates for the MENA producers will remain high, as has been the case in the past during downturns, which then makes petrochemicals pricing the key variable, where the oil price is a key driver. Our oil team's forecasts (Brent US\$95/bbl for 2012) remain supportive of relatively high petrochemical prices.

Construction and steel

Construction in the region is a tale of mixed fortunes

The construction markets in the region have been a tale of mixed fortunes: the UAE markets, once the largest construction market in the region, has been depressed and many projects have been cancelled. In Egypt, some projects are going ahead, but overall, the uprising has caused delays or cancellation to many projects. On the other hand, Saudi Arabia and Iraq are emerging as some of the largest and fastest-growing markets and in both countries, both the number of projects planned or under way and, more importantly, the value of contracts awarded are up strongly. In Qatar, the project market has been lacklustre, albeit still high, but once the spending for the 2022 World Cup kicks off, it could become one of the more interesting markets in the region.

IQ and OCI are strong in the right markets

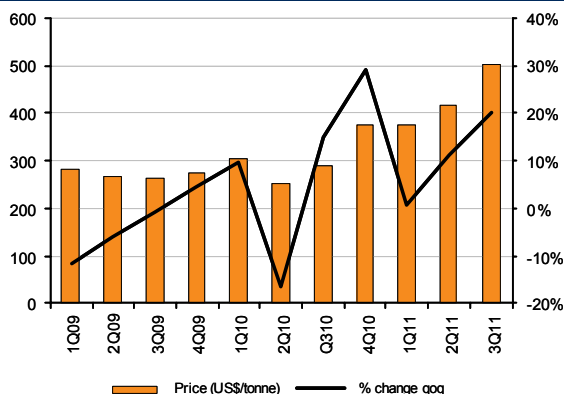
Industries Qatar is exposed to the construction market through its steel division, which sells predominantly to the local Qatar market. The rest of production goes to neighbouring countries. OCI has a construction business, active across the region. After two years of declining backlog, OCI managed to gain some important project wins in Saudi Arabia recently and this trend has continued into 3Q.

3Q results so far so good, 4Q looking good as well

SAFCO's 3Q headline results beat market expectations

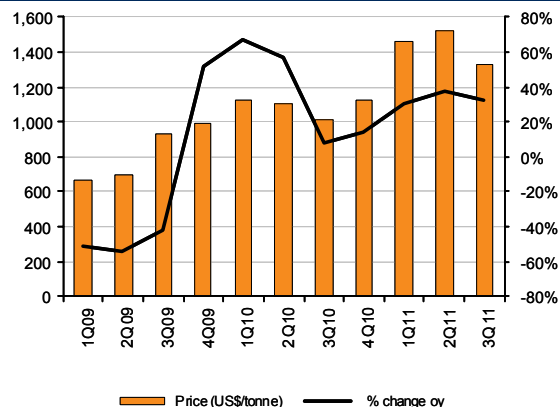
IQ and SAFCO have already released their 3Q results, without the details on volumes and prices as yet. OCI's 3Q results are due in November. Demand and prices seem to have remained high. For fertilisers, the average urea price has increased by 20% compared with 2Q and 73% compared with 3Q10. Ethylene prices have declined 13% in 3Q11 compared with 2Q11, but are still up by 18% on average compared with 3Q10. Steel prices are up 7% compared with 2Q11 and 18% versus 3Q10. In the construction segment, OCI reported the first pick-up in new contract awards in 2Q and this trend seems to have continued with some major project awards in Saudi Arabia during 3Q. Both SAFCO and IQ reported headline 3Q results that were above consensus: SAFCO's revenues increased 55%, and net income 100% compared with 3Q10; IQ reported a 44% increase in revenues and a 46% increase in net income.

Chart 1 : Average quarterly urea prices (US\$/t) and qoq % change



Source: Bloomberg

Chart 2 : Average quarterly NE Asia ethylene prices (US\$/t) and qoq % change



Source: Bloomberg

Risks to our investment case

Key risks include sensitivity to changes in prices

The single biggest risk to our investment case for each of the stocks is a decline in selling prices of key products, which could happen if the oil price falls below our expectations or demand growth stalls as a result of a slowdown in the global economy.

Supply/demand balance

Furthermore, our forecasts and model assumptions are functions of industry demand and supply. Short- and long-term competitive forces will likely emerge with the build-up of new capacities, which would represent downside risk to our forecasts.

Lower-than-expected GDP growth

Petrochemicals demand is closely correlated to GDP growth, hence a scenario of recession in the US and Europe will have a potentially material impact on our forecasts for volumes and prices in this sector. We look at this risk in more detail in our bear-case scenario for petrochemicals.

Political risk in Egypt in particular

Political risks remain a broader risk for the region, but within the region, the Gulf Cooperation Council (GCC) has been more stable than North Africa during the Arab uprisings. In Egypt, there is still much uncertainty regarding the economic outlook and the political direction the country may take, and popular measures by the government may result in a deteriorating environment for businesses operating in the country.

Changes in gas price policies

Changes in the gas price regime in the region pose a risk to our forecast earnings. The market has been widely expecting prices in Saudi Arabia moving from US\$0.75/MMBtu to US\$1.25/MMBtu. We do not assume that at this point because we believe current contracts are still in place. We also do not assume changes in policy in Qatar (where gas prices are linked to volumes and selling prices of the end products), and assume recognition of existing contracts in Egypt. However, it is not unlikely that Saudi Arabia will increase gas prices, especially in light of the recent increases from US\$1.50 to US\$2.25/MMBtu in Bahrain. For the longer term (from 2015), we assume an increase to US\$2.00/MMBtu. In Egypt, political pressure could result in a material change in gas prices there as well, which would affect our forecasts on OCI negatively.

Stock recommendations

SAFCO's shares have clearly outperformed the local stock markets and its global fertiliser peers this year, but we see stronger catalysts for OCI and IQ to outperform over the next 12 months. We expect volume growth, not price growth, to be the main earnings driver.

OCI and IQ are major beneficiaries of our outlook for fertilisers

In summary, we are positive on the outlook for fertilisers. We expect a supportive macroenvironment for petrochemicals, with some downside risks if global growth deteriorates sharply. For construction and steel, we are cautiously optimistic for the region and expect a gradual improvement in the market environment, driven by a boost in spending in Saudi Arabia in the short term and in Qatar in the longer term.

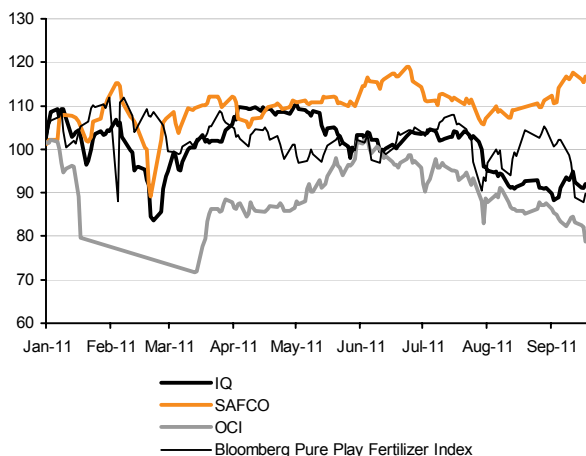
Only SAFCO's shares have outperformed its peers

SAFCO's share has done well so far this year

Share price performance for the three stocks has been mixed. Compared with its global fertiliser peers, only SAFCO has outperformed, and IQ has been more or less in line with the industry. OCI staged a strong comeback following the market closure between end-January and March, but has underperformed since June. We believe this was the result of OCI's higher exposure to the US and European markets than its peers and, more recently, a result of market concerns about the potential increase in gas prices in Egypt. Year-to-date, SAFCO's shares are up 19%, IQ down 7% and OCI down 22% compared to a 10% drop in the index.

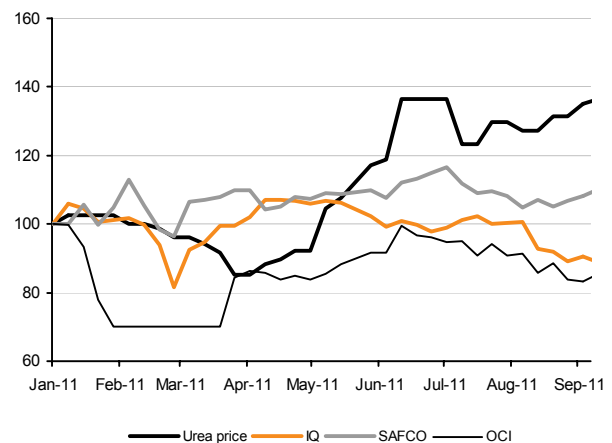
Compared with urea prices, all three shares have underperformed – even SAFCO – especially since the beginning of June, possibly indicating that the market doesn't believe the sustainability of prices staying higher than US\$500/tonne. This gives us comfort in our forecasts because we forecast a drop in prices, but still to a high level.

Chart 3 :Share price performance versus global peers



Source: Bloomberg

Chart 4 : Share price performance versus urea prices



Source: Bloomberg

OCI and IQ are major beneficiaries of our outlook for fertilisers

Industries Qatar – fertilisers are the main driver of volume growth

Key to our investment case for IQ is that we think agricultural prices are likely to remain elevated, demand for fertilisers will remain strong and industry operating rates remain healthy during 2011-13. IQ appears well positioned to benefit: it is one of the lowest-cost producers globally, but more important, we expect strong growth for the segment's gross profit of 34% in 2012, driven largely by new capacities coming on stream.

IQ's shares have performed relatively well in a global context, down only about 9% since the beginning of August. On a sum-of-the-parts valuation, we value IQ at QR164/share, suggesting 32% upside potential from the current levels. We see continued strong agricultural markets and news flow on the start-up of QAFCO V later this year as key catalysts for the stock.

Using a DCF analysis leads to multiples more or less in line with petrochemicals in Saudi Arabia, although the range is wide and multiples for start-ups are not relevant. The QAFCO multiples (EV/EBITDA of 9.5x for 2012) is well below SAFCO's 2012F multiple of 12.2x, but the latter discounts capacity start-ups beyond 2012, whereas QAFCO's multiples include these. SAFCO's historical multiples are about 10x EV/EBITDA.

Table 2 : Petrochemicals – regional comparables

	2011 EV/EBITDA	2012 EV/EBITDA
Advanced Petrochemical Company	6.8	6.7
Methanol Chemicals Company	9.9	8.1
National Industrialization Co	7.3	7.3
Saudi National Petrochemical Co	NM	7.2
Rabigh Refining and Petrochemical Co	12.5	9.3
Sahara Petrochemical Co.	19.7	13.4
Saudi Basic Industries Corp	6.3	6.0
Saudi Industrial Investment Group	NM	8.3
Saudi International Petrochemical Co	7.4	6.9
Saudi Kayan Petrochemical Company	NM	10.1
Yanbu National Petrochemical Company	8.8	8.3
Average	10.0	8.6

Source: Bloomberg consensus forecasts

OCI – share price fall overdone; near-term catalysts

Market is disregarding start-ups

OCI has four major capacity start-ups scheduled for the next 12 months, including Sorfert Algeria, still on track for start-up at the end of this year, as well as recently acquired Pandora Methanol, with a start-up date in mid-2012. Hence we expect strong earnings growth. At the same time, OCI's construction business has begun to show some positive momentum, with recent new project wins in Saudi Arabia.

The share has underperformed its peers in the region, we believe because of the political environment in Egypt, concerns that gas prices in Egypt will increase and a declining backlog in the construction segment. These arguments are valid; however, our analysis shows that the share price fall is overdone.

- We value OCI's operations using a cost of equity of 26.5% for EFC and EBIC leading to a WACC of about 18%.
- For the construction business, we use a blended (by backlog exposure) WACC, using similar discount rates as for the fertilisers for the Egyptian part of the backlog.
- For the construction backlog, we apply a modest recovery in 2012, but long term we assume normalised revenues below the current level and a lower EBITDA margin of 12%.
- An increase in gas prices is a risk for OCI's plants in Egypt (EFC and EBIC) if the government decides to break contracts unilaterally (which has been the case in other industries). However, the plants account for only about 19% of our equity valuation and if we increase the gas prices from US\$1.50 and US\$1.25 for EFC and EBIC, respectively, to US\$4/MMBtu, our target price would decrease from EGP284/share to EGP265/share, still 27% upside potential from current levels. Only a gas price of approximately US\$12/MMBtu would justify the current share price, if everything else remains the same.

SAFCO – no near-term catalysts, but supportive dividend yield

7% dividend yield should provide floor for the share

SAFCO is the only pure fertiliser play among the four stocks on which we initiate coverage. SAFCO is benefiting from the current market environment for fertilisers more than IQ and OCI – fertilisers account for 67% and 33% of their 1H EBITDA, respectively, and we are not as bullish on the petrochemicals and the construction as we are on fertilisers. We initiate on SAFCO with a Buy recommendation because we see some upside potential from current levels (+13%), but see the stock mainly as an attractive dividend yield play. Multiples look full (2012F EV/EBITDA 12.0x), but if we exclude our valuation for SAFCO IV, this multiple would drop to about 8.7x. However, over a 12-month period, we prefer OCI and IQ as SAFCO's expansion plans are further out (start-up 2013) and multiples of 2012F 12.0x EV/EBITDA already seem to reflect most of these expansions.

Table 3 : Current and implied valuation multiples

	Industries Qatar	OCI	SAFCO
Country	Qatar	Egypt	Saudi Arabia
Share price (local FX)	124.60	208.53	183.25
Target price (local FX)	164.00	284.00	207.00
Market cap US\$bn	18	6.9	12.3
PE 2011F	8.4	9.9	12.2
PE 2012F	7.8	7.8	12.7
EV/EBITDA 2011F	8.1	5.9	11.4
EV/EBITDA 2012F	7.0	4.6	12.0
Implied EV/EBITDA 2012			
Fertilisers	9.5	7.0	13
Petrochemicals	9.4	-	-
Steel	5.5	-	-
Construction	-	6.4	-

Priced as of 11 October close.
Source: Rasmala forecasts

Fertiliser peer multiples

We cross-check our valuations with peers outside the region, but note that MENA multiples tend to be higher, reflecting the higher EBITDA margins and lower tax rates than elsewhere. The peers include large fertiliser companies in Europe, the US and Asia.

Table 4 : Fertilisers – comparable multiples

		Market cap	EBITDA margin		EV/EBITDA		PE	
	Country	US\$m	2010	2011F	2011F	2012F	2011F	2012F
Potash Corp of Saskatchewan	Canada	42,332	42%	57%	9.1x	7.7x	12.9x	10.7x
Mosaic Co/The	US	25,581	25%	32%	5.7x	5.1x	10.1x	8.9x
Yara International ASA	Norway	12,523	15%	14%	7.4x	7.6x	6.8x	7.2x
Agrium Inc	Canada	11,860	15%	17%	5.2x	5.1x	8.0x	7.8x
CF Industries Holdings Inc	US	10,534	32%	50%	3.8x	3.9x	6.9x	7.2x
Weighted average			30%	40%	7.2x	6.4x	10.4x	9.3x

Priced as at close of 11 October 2011
Source: RBS forecasts for Yara and Bloomberg consensus forecasts for others

What could go wrong?

We look some of the risks that could affect our forecasts negatively: a bear-case scenario of a substantial slowdown in global growth and a change in gas price regime.

Bear-case scenario for petrochemicals – impact on IQ

A number of commentators are beginning to suggest that Europe and the US could tip into recession later this year and into next year. Against this background, there is a realistic possibility that the outlook for global GDP growth could be much worse than the nearly 4% 2012 consensus estimate recently published by the IMF. In our bear-case scenario, we assume 2% demand growth, but this is still sufficient to keep a tight balance between supply and demand – our analysis suggests only 2-3% annual supply growth during 2011-15, on average.

Table 5 : Ethylene demand scenarios under different GDP assumptions

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012E
Base case											
Global GDP growth	2.9%	3.6%	4.9%	4.6%	5.2%	5.4%	2.9%	-0.5%	5.0%	3.9%	4.0%
Global demand growth		4%	5%	0%	4%	5%	-6%	2%	4%	5%	5%
Multiplier effect		0.99	1.10	0.02	0.72	1.00	-1.92	-4.54	0.81	1.36	1.30
Global supply growth		1%	1%	4%	4%	4%	4%	2%	8%	2%	0%
Demand growth over supply growth		3%	4%	-4%	0%	1%	-10%	0%	-4%	3%	5%
Bear case											
Global GDP growth	2.9%	3.6%	4.9%	4.6%	5.2%	5.4%	2.9%	-0.5%	5.0%	2.5%	2.0%
Global demand growth		4%	5%	0%	4%	5%	-6%	2%	4%	3%	2%
Multiplier effect		0.99	1.10	0.02	0.72	1.00	-1.92	-4.54	0.81	1.20	0.75
Global supply growth		1%	1%	4%	4%	4%	4%	2%	8%	2%	0%
Demand growth over supply growth		3%	4%	-4%	0%	1%	-10%	0%	-4%	1%	2%
Worst case											
Global GDP growth	2.9%	3.6%	4.9%	4.6%	5.2%	5.4%	2.9%	-0.5%	5.0%	2.0%	0.0%
Global demand growth		4%	5%	0%	4%	5%	-6%	2%	4%	0%	-2%
Multiplier effect		0.99	1.10	0.02	0.72	1.00	-1.92	-4.54	0.81		
Global supply growth		1%	1%	4%	4%	4%	4%	2%	8%	2%	0%
Demand growth over supply growth		3%	4%	-4%	0%	1%	-10%	0%	-4%	-2%	-2%

Source: RBS economics team, Rasmala

Hence we look at a worst-case scenario, but rather than assuming a correlation with oil prices, which is likely to remain the case during a downturn, we assume key product prices drop to prices achieved during the last trough in 2009 (petrochemicals, fertilisers and steel). These prices are below what an oil price of, for example, US\$70/bbl would suggest.

Worst-case scenario could lead to a cut of 67% in IQ's 2012 net income

We keep volumes the same (high), as MENA producers, including IQ, have some of the lowest production costs globally and have shown in the past that they can keep utilisation rates at or even above 100% despite an industrywide drop in demand. Hence prices are the main variable. This scenario implies a cut in net income of 67% for 2012 net income for IQ and, applying our 2012 target multiples (10.5x for petrochemicals and 5.0x for fuel additives) implied by our base-case scenario, a valuation of QR132/share.

IQ is the most sensitive to a slowdown in GDP

Clearly, IQ is the most sensitive to changes in prices because it has operations in all three segments, whereas OCI has the construction business and SAFCO only fertilisers. We would likely have to cut net income by 10% for SAFCO and 37% for OCI compared with our current forecasts.

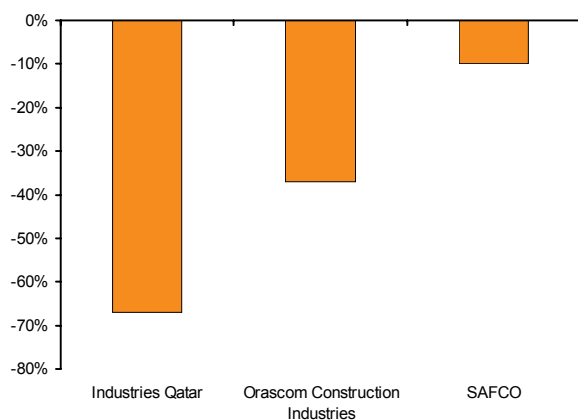
A scenario of higher gas prices for OCI and SAFCO

An impact of higher gas prices is not that material

The impact of a higher gas price would also lead to lower forecasts: for OCI, we expect a decline of 12% in 2012 net income compared with our current forecasts if we increase the gas cost from US\$1.25-1.50/MMBtu to US\$4.00/MMBtu in Egypt. For SAFCO, we expect a decline of 14% in a scenario of a US\$2.25/MMBtu gas price rather than the US\$0.75 we assume now. The impact on our valuations is relatively limited, a drop of 7% and 4% for OCI and SAFCO, respectively.

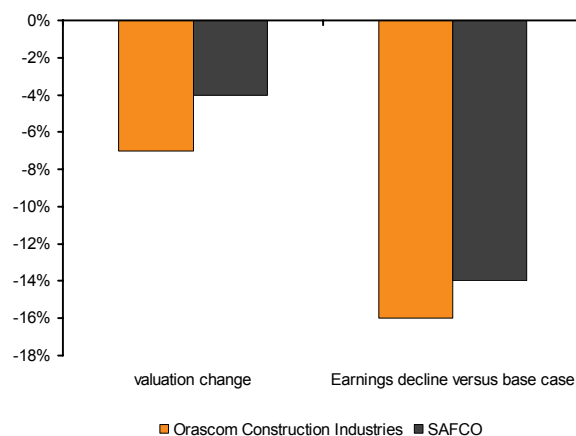
Industries Qatar currently enjoys a flexible pricing structure, in which end prices are linked to volumes and selling prices of the end product and hence we see no risk to the current prices.

Chart 5 : Impact of lower prices on 2012 net income



Source: Rasmala estimates

Chart 6 : Impact of higher gas price for OCI and SAFCO



Source: Rasmala estimates

Cheap gas is key competitive advantage

Cheap gas is the main driver to invest in petrochemicals and fertilisers, which have become key strategic industries for the region. We expect gas prices to rise, but remain in the US\$1-3/MMBtu range over the next five years – low enough to be competitive globally.

Using cheap gas to diversify economy

Petrochemicals and fertilisers – tool to diversify the economies

Several countries in the region see the petrochemicals and fertilisers sectors as key strategic industries. The rationale for investing in these sectors is clear: governments across the GCC are trying to diversify the economies away from oil and create jobs, and using available gas domestically for this purpose is an easy and relatively cheap way to do this.

Cost competitive globally

Petrochemicals and fertilisers are obvious industries to develop. They use either 100% natural gas as a feedstock (for example in Qatar), or a combination – in Saudi Arabia, natural gas accounts for about 70% of total feedstock requirement in the petrochemical sector. Nitrogen fertilisers are 100% gas based. The cheap gas means that these industries are cost competitive on a global basis and remain highly profitable even during downturns. Furthermore, global demand growth drives the need for continued investment in additional world-scale plants as the bulk of this growth comes from East and South Asia and, to a lesser extent for fertilisers, Latin America. The Middle East is geographically well positioned to serve these markets.

Historically, gas prices in the region made sense

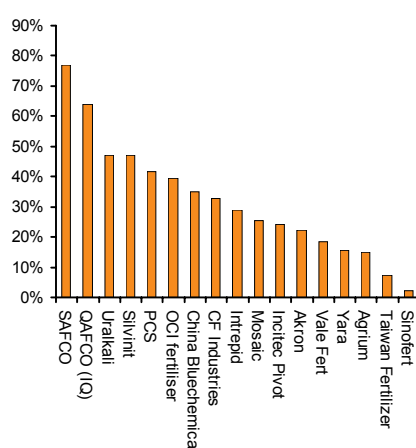
Current prices are undoubtedly low in a global perspective, ranging from about US\$0.75/MMBtu in Saudi Arabia to US\$0.95-2.35/MMBtu in other Gulf countries (GCC and Iran) and up to US\$3.0/MMBtu in North Africa. Russian gas prices come the closest (about US\$3.5/MMBtu in 1H11); in the US, market prices are linked to Henry Hub, recently around US\$4/MMBtu; and across most of Europe, producers pay gas prices linked to crude oil formulas, currently in excess of US\$10/MMBtu.

Historically, low prices made sense, as associated gas used to be flared and gas infrastructure did not exist. A common misconception is that these low prices are the result of heavy subsidies, but this is not the case and only in the past six years or so has the differential in global gas pricing widened. This has the added benefit that the cost curve for these industries is much steeper than before, with the MENA producers comfortably sitting on the very low end of the curve.

... translate into high EBITDA margins

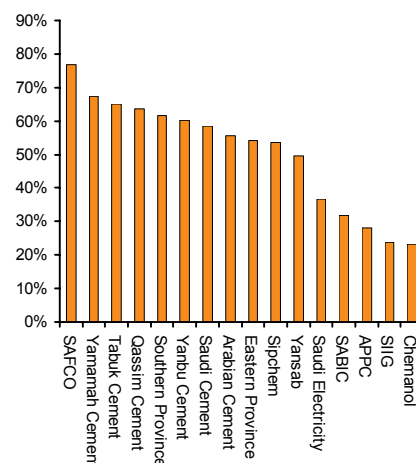
The cost advantage is evident in EBITDA margins in the region: gas-intensive industries such as fertilisers (OCI in Egypt/Algeria, SAFCO in Saudi Arabia, Industries Qatar) enjoy margins well above those in all other regions, in addition to which the geographical location on trade routes to Asia, Europe and the Americas makes it easy to export to all major end markets. In Saudi Arabia, all industries that use gas as a feedstock benefit from the fixed pricing environment: the average EBITDA margin in fertilisers (SAFCO) was 77% in 2010, cement 61% and petrochemicals 35%.

Chart 7 : MENA fertilisers – competitive cost position (EBITDA margins, 2010)



Source: Company reports, Bloomberg, Rasmala

Chart 8 : Saudi industrials – EBITDA margins, 2010



Source: Bloomberg, Rasmala

Moving downstream and expansion abroad next goal

Because of the high margins such industrials can achieve, even during downturns, the balance sheets are generally strong and can be used to expand capacity in the country, or use it for acquisitions elsewhere, with the added benefit of gaining access to technology to move even further downstream. Of the major players in the region, the two most acquisitive companies have been state-controlled SABIC (it acquired DSM's basic chemicals operations in 2002 and GE Plastics in 2007) and OCI in Egypt, whereas Qatar Petroleum has hardly ventured outside the country, except for a 10% stake in the Sonatrach/Total petrochemicals venture. Moving downstream from base chemicals into specialty chemicals may take a few years to accomplish, but strategically it makes sense to create higher value-added products and as a result also potentially attract some major customers to set up in the region, for example, car manufacturers.

Gas prices set to go up

However, the market is widely expecting an increase in gas prices in Saudi Arabia and possibly in Egypt as well. Gas prices in Qatar are already variable, linked to volumes and prices of the end product. The rise in gas prices is real: recently, Aluminium Bahrain announced that Bahrain Petroleum will raise gas prices from US\$1.50/MMBtu to US\$2.25/MMBtu from 1 January 2012. In the table below, we list our assumptions for future gas prices in the main markets.

Table 6 : Summary overview gas pricing in the region

Country	Gas market summary	2010 prices (US\$/MMBtu)	Assumed future prices (US\$/MMBtu)	Future pricing rationale
Saudi Arabia	All current and future gas supplies for domestic consumption Only less than 10% of gas reserves easy to develop Priority to add 50 Tcf non-associated reserves by 2016 Goal: 10% global market share in petrochemicals by 2015	0.75	0.75 - 3.00	Liquid pricing under review, but assume current gas price regime stays in place Assume a base price of US\$2/MMBtu from 2012 Higher cost of future gas production
Qatar	Third-largest gas reserves in the world after Russia and Iran Strategic priority to develop downstream industries Moratorium on developing the giant North Field means limited availability of gas for large petrochemical projects	0.95 - 2.35	1.00 - 2.75	Variable pricing seems sensible Steel will keep low pricing Fertilisers, petrochemicals dependent on selling prices and volumes of end product
Egypt	Country started to increase gas prices to industry in 2008 One-third of gas production earmarked for exports, Israel accounts for less than 3% of Egypt's production but political issue. Economic policy towards neighbours could result in upward price pressure	1.25 - 3.00	1.25 - 3.00	Pricing will be dominated by politics 1) Popular demand; 2) decrease subsidies to industry; 3) attract foreign upstream investors However, we assume that existing contracts for industrial will remain in place
UAE	Net importer of gas Qatar main supplier at low cost (about US\$1.30/mmBTU) Prices for Dubai utilities (DEWA) on cost-plus basis Prices up from US\$1.53 in 2007 to US\$2.26/MMBtu in 2010	1.10- 2.25	1.10 to > 2.00	Dependent on import prices Qatar will likely not increase gas supply Dispute with Iran regarding pricing Higher cost of future gas production
Algeria	Eighth-largest reserves in the world, second in Africa But production has been virtually flat over past decade; gas exports rising, Megaz pipeline to Spain started in 1Q11 Potential gas supply crunch in 2013-14, according to MEED	0.60 - 2.00	> 2.00	At least 51% government ownership Potential gas supply crunch puts upward pressure on prices

Source: Rasmala research, MEED, Zawya, Wood Mackenzie, company reports

Competitive cost position looks set to stay

Fertilisers and cement the most sensitive industries to changes

Companies with the biggest cost advantages, and thus the most operational sensitivity to changes in gas prices, are those which use ethane as the main feedstock and have all plants based in the country/region: fertilisers, methanol and cement fall in the former category, whereas both utilities and other petrochemicals use mixed feedstock and fall in the latter. Clearly, an increase in the gas price will diminish the cost advantage somewhat, but even so, they should remain high.

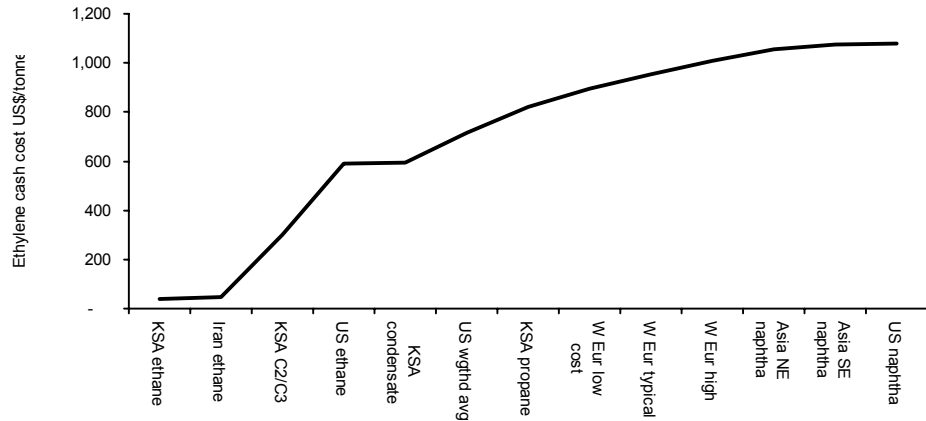
Gas prices in Saudi Arabia could go up, but for now we assume that it will remain at US\$0.75/MMBtu

The market has been widely expecting a price increase in Saudi Arabia, from US\$0.75/MMBtu to US\$1.25/MMBtu. This would imply an increase in ethylene cash cost (ethane feedstock) from US\$40-50 to US\$70-80/tonne, still well below costs in other regions. Taking freight costs into account of currently up to US\$200/tonne, delivered costs are in line with other regions if gas prices exceed US\$2-3/MMBtu, which we see as a ceiling to which prices could go in the future. Changes in heavier feedstock pricing, which are not fixed but linked to market prices, generate bigger swings in margins. Likewise, the urea cash cost would increase from about US\$85 to US\$100/tonne, still yielding very competitive cash margins in excess of 70%.

Petrochemicals: ethane-based production is the most competitive

MENA petrochemical producers are at the very low end of the global cash cost curve and the widening differential between global gas prices has strengthened their position in recent years. Gas prices are fixed in most countries in the GCC except Qatar, where they are variable but still well below global levels, resulting in high margins for IQ's petrochemicals segment.

Chart 9 : Current ethylene cash cost curve by region and feedstock



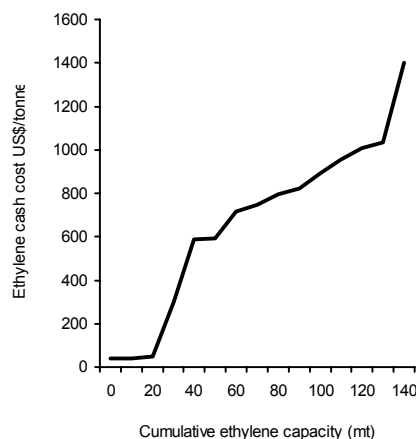
Source: CMAI, Rasmala

The mix has been changing for petrochemicals

But even within petrochemicals, cost advantages differ from product to product. Ethylene can be produced by a wide variety of hydrocarbon feedstocks, but the end products vary as a result: naphtha, gasoil and condensates, commonly used in Europe and Asia, yield more propylene, C4 olefins and aromatics as co-products; ethane and propane, the dominant feedstocks in North America and the Middle East, produce only ethylene and propylene. Because naphtha costs are more similar across regions than ethane, the polypropylene cost curve is flatter than for ethylene. In addition, plants that produce just ethylene and propylene are cheaper to construct and less complicated to operate. According to consultants CMAI, in 2010, 50% of global ethylene production was based on naphtha and 32% on ethane. In North America and the Middle East, the average use of ethane is 60-70% in ethylene production; in Europe, around 10%.

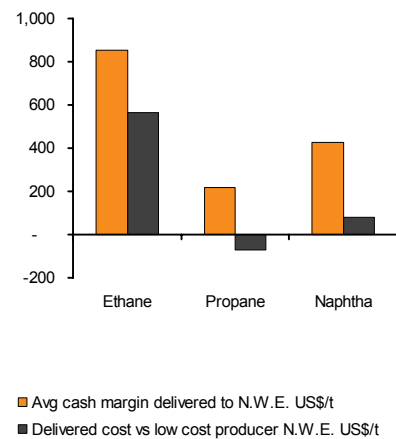
With a fixed gas price, the cost advantage is the highest during times that selling prices are high, and vice versa. The ethylene cost curve moves up and down with changes in crude oil and natural gas price swings, but also to the right, with additions of new low-cost additions in the Middle East.

Chart 10 : Ethylene cash cost curve for global capacity



Source: CMAI, Rasmala

Chart 11 : Ethane-based production in Mideast by far the most competitive (2010)



Source : CMAI, Bloomberg

The US has become more competitive with the advent of shale gas

With the advent of shale gas in the US, producers there have become much more cost competitive on a global basis and have moved to the left on the cost curve. As long as natural gas prices remain near the US\$4-5/MMBtu range, this advantage appears set to stay for US ethane-based producers. At those levels, production costs are in the US\$600-650/tonne range, well below marginal naphtha-based costs of US\$1,250-1,350/tonne and current prices of about US\$1,400/tonne. The regions falling behind on the cost curve are Europe and Asia, and we would expect inefficient plants to feel the pressure and possibly close down in the future.

Ethane feedstock costs could double

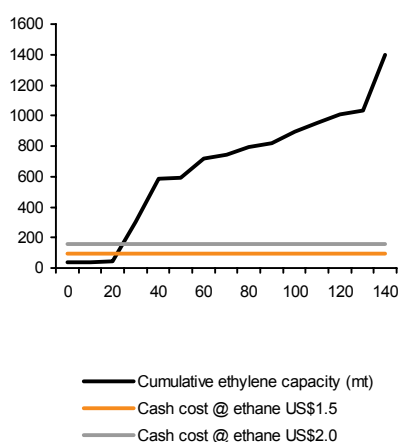
Average cash costs remain below US\$100/tonne

We estimate that for every US\$1/MMBtu increase in the natural gas price, the average ethylene cash cost will rise by cUS\$60/tonne, assuming no change in co-product credits, or other costs (utilities, catalysts and chemicals). Therefore, if the gas price in Saudi Arabia were to increase from US\$0.75 to US\$1.25, we estimate that the average cash cost for ethylene increases from US\$40-50 to US\$70-80/tonne, still well below costs in other regions, even taking into account freight costs US\$200/tonne higher currently.

But fluctuations in the oil price have a more profound impact on profitability

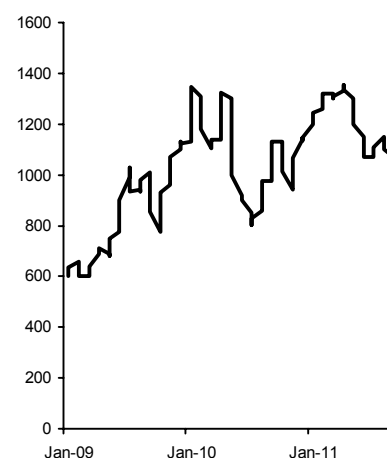
About half the new crackers in the Kingdom have ethane as a feedstock, the rest heavier feedstocks. Some recent capacity additions (Kayan etc) have already been based on a mixed-feedstock cracker and the latest projects under consideration are destined to be oil based or mixed feed, including the largest petrochemical project, the Aramco-Dow US\$15bn petrochemicals complex in Jubail, which was recently given the go-ahead. The shift away from gas to heavier feedstocks has a more profound impact on margins than an increase in natural gas prices, even if these are doubled or tripled. Liquid prices in Saudi Arabia are at a 30% discount to market prices, rather than being fixed like ethane. It takes about 3.3t of naphtha to produce 1t ethylene; hence the sensitivity to a change in oil prices is high and has a potentially large impact on cash costs. The good news is that the recent increase in oil production in Saudi Arabia of about 6% ytd also means that more gas becomes available.

Chart 12 : Cost advantage for ethane looks there to stay



Source: Rasmala

Chart 13 : High ethylene prices support strong cash margins (US\$/t)

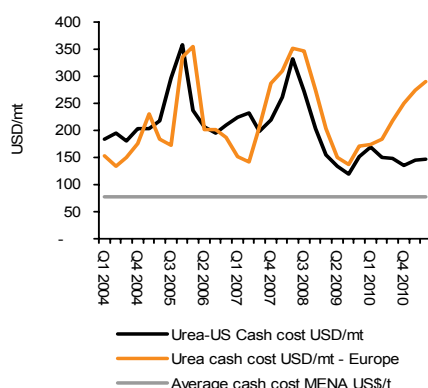


Source : CMAI, Rasmala forecasts

Fertilisers have higher sensitivity to changes

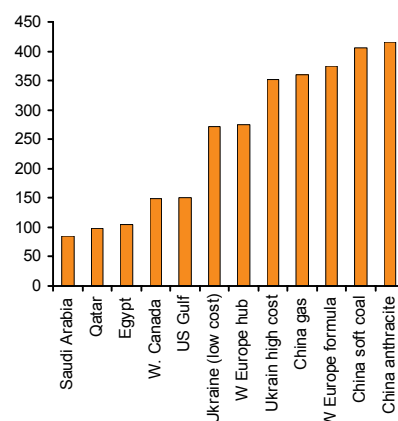
We estimate the urea cash cost in Qatar and Egypt around US\$100/tonne freight on board (FOB), in Saudi Arabia cUS\$85/tonne compared with a US Gulf producer currently about US\$150/tonne and a European producer around US\$275/tonne based on spot prices of US\$9-10/mmBtu, higher for the formula-driven plants. The cash costs compare with current urea prices over US\$500/tonne. Gas futures indicate that this advantage is there to stay in the near term. Chinese anthracite coal import prices are up 40-50% from 2010 and Ukraine gas prices range from US\$6 to US\$9/mmBtu.

Chart 14 : Urea cash cost MENA versus US and European producers



Source: Bloomberg, Rasmala

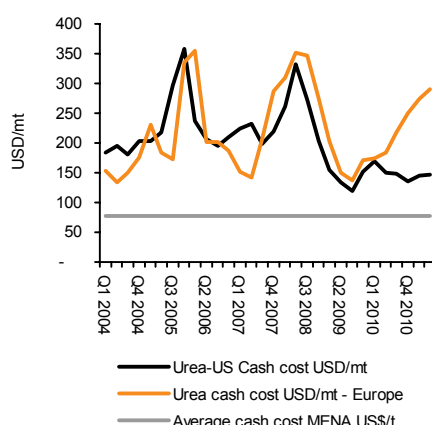
Chart 15 : MENA fertilisers enjoy the lowest cash cost globally (US\$/tonne)



Source : Company reports, Rasmala estimates

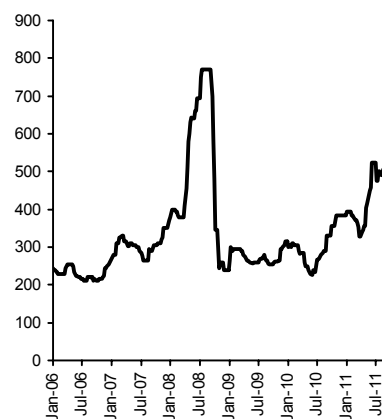
For fertilisers, the sensitivity to changes in gas prices is higher than for petrochemicals, but still not disastrous. Similar to ethylene, if the gas price in Saudi Arabia were to increase from US\$0.75 to US\$1.25, we estimate that the average cash cost for urea would increase from about US\$85 to just over US\$100/tonne. This is still well below cash costs in other regions, even taking into account freight costs of cUS\$30/tonne. It is clear, however, that prices should not rise too much to remain competitive. In a scenario of US\$2.50/MMBtu, we estimate that SAFCO's urea cash cost would be about US\$135/tonne, close to cash costs in the US of US\$140-150/tonne, by our estimates.

Chart 16 : Urea cash cost MENA versus US and European producers



Source: Bloomberg, Rasmala

Chart 17 : Urea prices (US\$/t)



Source : Bloomberg, Rasmala forecasts

We estimate that in a new pricing scenario, the cash margin impact for urea fertilisers in Saudi Arabia would have been 6-7ppt lower in 2010, when urea prices averaged around US\$300/tonne, still above 70%. At current prices over US\$500/tonne, margins are well above 80% in both pricing scenarios.

Table 7 : SAFCO's urea margins in different gas price scenarios

	2011E	2012E	2013E	2014E	2015E
Gas price (US\$/MMBtu)	0.75	1.25	1.25	1.25	1.25
Cash cost (US\$/t)	85	101	104	108	112
EBITDA margin	79%	73%	73%	73%	73%
Gas price (US\$/MMBtu)	0.75	2.00	2.00	2.00	2.00
Cash cost (US\$/t)	85	119	123	127	130
EBITDA margin	79%	68%	68%	68%	68%
Gas price (US\$/MMBtu)	0.75	2.50	2.50	2.50	2.50
Cash cost (US\$/t)	85	132	135	139	143
EBITDA margin	79%	65%	65%	65%	65%

Source: Rasmala estimates

Egypt – uncertainty rules

OCI has long-term contracts for gas prices in Egypt, but the recent gas price hike in Bahrain from US\$1.50 to US\$2.25/MMBtu as well as the revocation of licenses in the steel sector and the unwind of contracts in the property sector, and the popular demand to raise gas export prices to Israel and Jordan, have sparked doubts that OCI's contracts will remain valid.

EFC (urea) currently pays US\$1.50/MMBtu, which will increase to US\$2.00/MMBtu from 2018. Total duration of the EFC contract is 25 years. EBIC (ammonia) pays US\$1.25/MMBtu on a 20-year contract. Hence cash costs are about US\$80/tonne for EBIC's ammonia production and US\$105-110/tonne for EFC's urea production.

We do not assume a price increase in Egypt

In our forecasts and scenario for gas pricing in the region, we do not assume that Egypt will renege on its contracts, especially not since it recently increased the corporate tax rate from 20% to 25% and as OCI started paying taxes from 2008 despite being located in a free zone. Nevertheless, if the gas price were to increase from the current level to US\$3.00/MMBtu or even US\$4.00/MMBtu, prices more or less in line with US prices, but well above regional ones, then we estimate that EFC's urea cash cost would go up to about US\$140/tonne for US\$3.00/MMBtu and about US\$170/tonne for US\$4.00/MMBtu, which would make exports to the US much less competitive.

Table 8 : OCI – EFC cash cost under different gas price assumptions

	2011E	2012E	2013E	2014E	2015E
EFC gas price (US\$/MMBtu) – base case	1.50	1.50	1.50	1.50	1.50
Cash cost (US\$/t)	103	104	106	109	111
EBITDA margin	74%	69%	70%	70%	70%
EFC gas price (US\$/MMBtu)	1.50	3.00	3.00	3.00	3.00
Cash cost (US\$/t)	103	142	144	146	148
EBITDA margin	74%	58%	59%	60%	60%
EFC gas price (US\$/MMBtu)	1.50	4.00	4.00	4.00	4.00
Cash cost (US\$/t)	103	167	169	171	173
EBITDA margin	74%	51%	52%	53%	53%

Source: Company data, Rasmala forecasts

EBIC will account for about 35.5% of OCI's global ammonia production capacity and EFC 56% of urea capacity (both OCI's share of capacity) in 2012 when all facilities are up and running, so are relevant, but the overall impact on EBITDA is diluted by the fact that OCI's operations in Algeria, the US and the Netherlands will be starting up over the next 12 months. We estimate that we would have to cut net income by about 9% and 15% for 2012 under a scenario of a gas price of US\$3/MMBtu and 4.0/MMBtu, respectively.

Expect healthy fertiliser demand

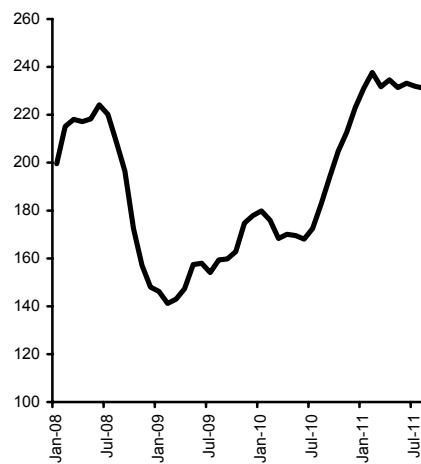
The nitrogen fertiliser market is likely to remain tight for the rest of 2011. We see some downside risk for prices as a less favourable spread between crop and fertiliser prices emerges, and capacity additions in 2011/12, but expect these to remain comfortably high.

Farm economics are supportive for fertiliser demand

Farmer economics have been good this year

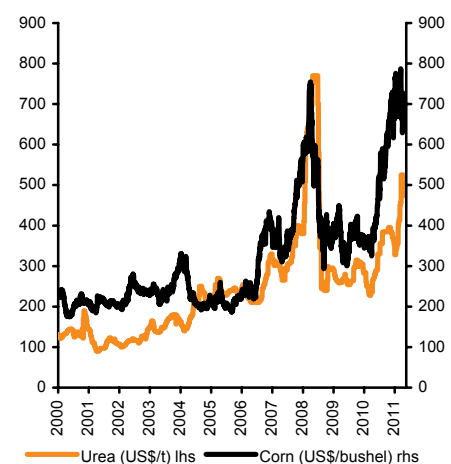
In the past 12 months, farmer economics have been highly supportive for fertiliser demand: farmer incomes are at record highs, stock-to-use levels for corn have dropped historically low and grain prices have soared – the FAO food index has increased almost 70% since its low reached in early 2009 and corn prices more than 100% since the low in 2010. These improving farm economics have resulted in higher planted acreage, as farmers endeavour to benefit from the high grain prices and maximise yields, thus boosting demand for fertilisers. Nitrogen fertiliser prices have risen considerably on strong demand boosted by high grain prices and a tight supply/demand balance following the drop in exports from China, further supported by high feedstock costs in Europe and China.

Chart 18 : FAO Food Price Index



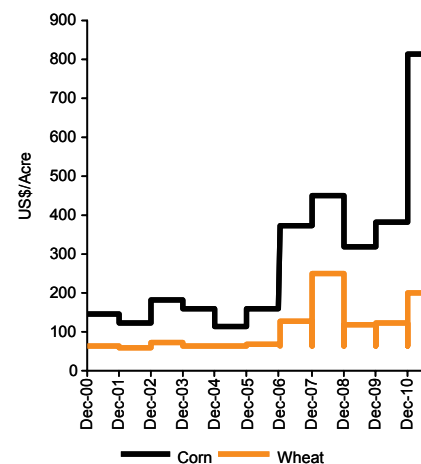
Source: Bloomberg

Chart 19 : Urea and corn prices



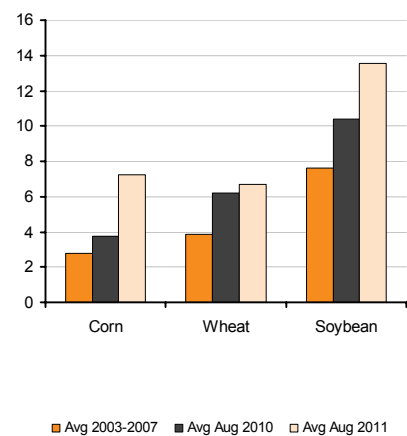
Source: Bloomberg

Chart 20 : US crop cash margin



Source: Bloomberg

Chart 21 : Cash crop prices US\$/bushel



Source : Bloomberg, Agrium, Rasmala

Where do we go from here?

Population growth and per capita income drive demand for more and higher-quality food and more protein. The latter requires higher production of meat and subsequently an increase in grain production for feed purposes. Farmers use fertilisers to increase the crop yield per acre, but the actual usage can fluctuate in any given year depending on farm economics (grain prices have to be high enough to justify the use of fertilisers), weather and demand for other uses than food or feed production, in particular the use of corn for biofuels. Grain prices in their turn depend on end-user demand and are negatively correlated with inventory levels, measured by the US Department of Agriculture (USDA). The USDA publishes the World Agricultural Supply and Demand Estimates (WASDE) report on a monthly basis in which it estimates crop production, inventories and prices for the next year.

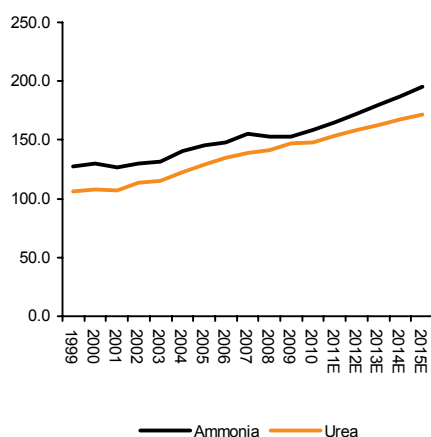
The demand picture started to recover in 2010 and is looking positive

In 2008/09, at the height of the financial crisis, global fertiliser demand dropped about 8%: -2% for nitrogen (nitrogen fertiliser demand was flat, industrial demand for nitrogen down c8%), -13% for phosphates and -19% for potash, also the result of limited credit availability to farmers, but recovered by about 5% in 2009/10. The International Fertiliser Industry Association (IFA) estimates global fertiliser consumption growth of 5% in 2010/11, after which it expects it to revert to a more modest 2.5% in 2011/12 and 2.6% growth pa until 2015/16.

Looking at MENA producers in particular, the demand side is important, but as they tend to maintain high utilisation rates (in excess of 100%) even during downturns, the demand side, together with new fertiliser supply, is particularly important for fertiliser pricing rather than for forecasting volumes produced.

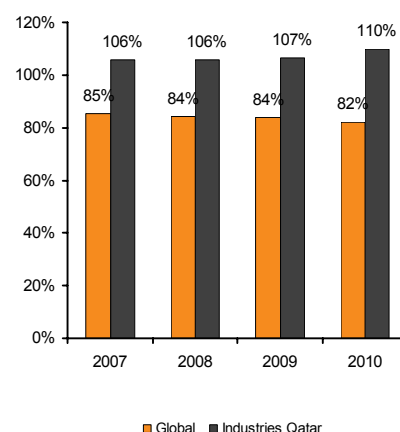
A strong rebound in fertiliser demand in 2010 and 2011

Chart 22 : Demand outlook for nitrogen fertilizers – continued growth



Source: IFA

Chart 23 : Global operating rates 2007-2010 versus QAFCO fertiliser operating rates



Source : IFA, Company reports

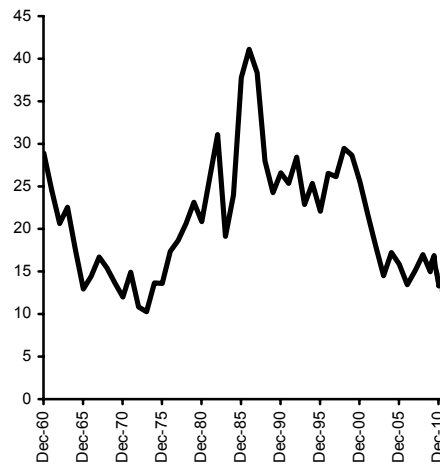
Crop production and prices remain supportive

The latest USDA report assumes higher grain prices

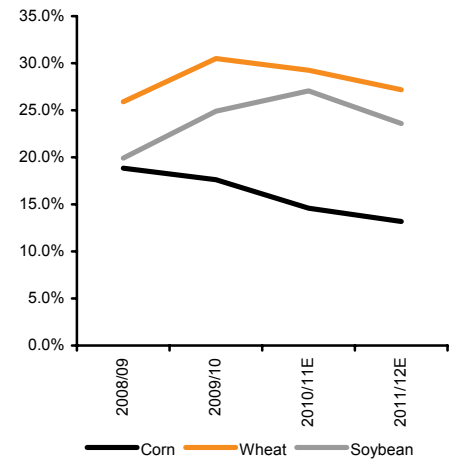
The latest report, released on 12 September, remains supportive of this positive outlook for fertiliser demand, which should benefit from the combination of a tight market, lower crop yields, higher planted areas and high crop prices.

For pricing, the USDA expects crop prices to remain high – the season-average farm price is projected to be in the range of US\$6.50-7.50 and US\$7.35-8.35 per bushel for corn and wheat, respectively.

The USDA expects a US stock-to-use ratio for corn of 6.9% for the current crop year and even lower at 5.3% for 2011/12, dangerously close to the record low of 5.0% in 1995. Lower production and yields are the main cause of these declining stocks, as once again, the USDA lowered its forecast for US average corn yield as a result of deteriorating crop conditions (extremely hot weather throughout the corn belt) and now expects an average corn yield of about 148 bushels/acre, down almost 17 bushels/acre from the record year of 2009/10. Even so, this crop year, the USDA expects corn production to be the third highest ever in the US, with the second highest planted area since 1944. Globally, the USDA also expects stocks to decline by about 8% during 2011/12.

Chart 24 : Corn – stock-to-use ratio (%)

Source: Bloomberg

Chart 25 : Stock-to-use ratio actuals and forecasts for major crops (%)

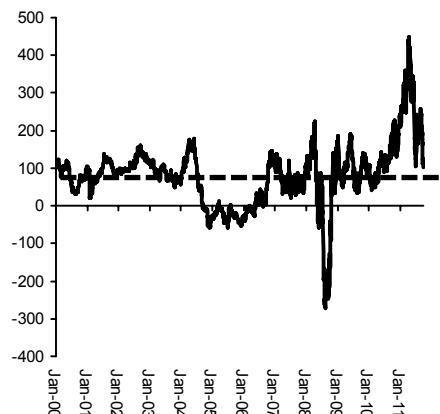
Source: USDA, Rasmala forecasts

This means that US corn acreage will have to increase and stay above 90m acres until at least 2012/13 just to maintain stock levels. The USDA forecasts an increase in planted areas in the US for both corn (+5%) and wheat (+3%) for 2011/12 compared with 2010/11.

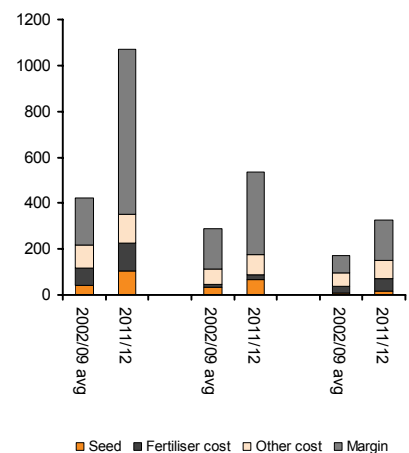
The USDA did lower its projected corn use for ethanol by 100m bushels due to higher expected corn prices and continued weakening in the outlook for US gasoline consumption as forecast by the Energy Information Administration. Biofuels are an important factor, accounting for almost 40% of total corn use, and demand has grown on average 28% from 2004/05 to 2009/10. However, growth is now less; the USDA expects growth in 2010/11 of about 9% and a flat market in 2011/12.

Crop cash margins likely to stay high

Fertiliser demand is also affected by the margin farmers can make on crops, with fertilisers amounting to about one-third of crop cash costs and lower grain prices generally leading to less fertiliser usage. As a result of the steep increase in grain prices, the corn/urea spread has been high, despite the increase in fertiliser prices. The spread reached its maximum in April this year, but since then has tightened. In 3Q to date, urea prices are up about 23% compared with 2Q, but corn prices down 7% on average. Whereas the spreads are still attractive and guarantee a positive yield per acre, the drop has been steep and any further falls could lead to reduced fertiliser buying and pressure on prices. However, crop futures are still high and with current fertiliser prices, crop cash margins are likely to stay high.

Chart 26 : Corn – urea spread

Source : Bloomberg, Rasmala

Chart 27 : US crop margins (US\$/acre)

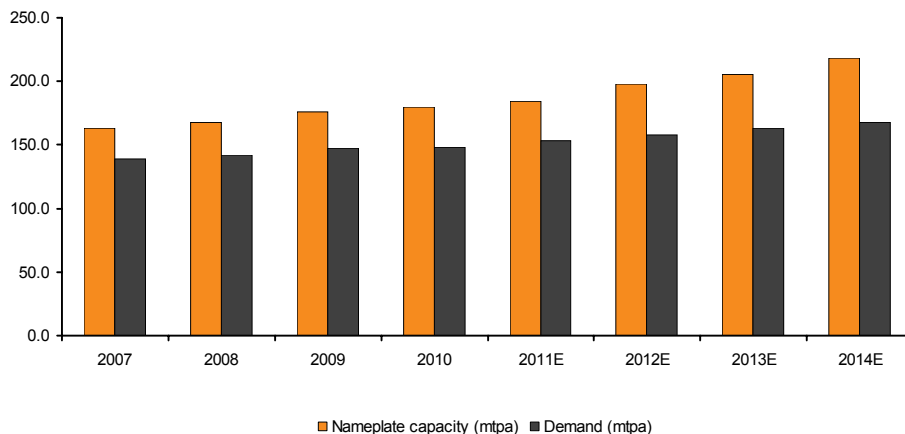
Source : USDA, Agrium, Rasmala

Will the increase in capacity in 2012 materialise?

Fertiliser capacity additions in Qatar, Algeria and China

The IFA is expecting a large increase in nameplate capacity in 2012 – for nitrogen about 5% and urea, almost 8%. For urea, over 2010-15, the IFA estimates that 58 new plants will come on stream, growing capacity by on average 4.5% pa. With a forecast demand growth of on average 3.2% pa over that same period, the gap between demand and supply should widen. The supply surplus will be limited in 2011-13 (less than 5% of global capacity), but should become more significant in 2014-15 at 8-10% of global capacity.

Chart 28 : Global urea supply and demand (mtpa) – the gap could be widening



Source: IFA, Rasmala

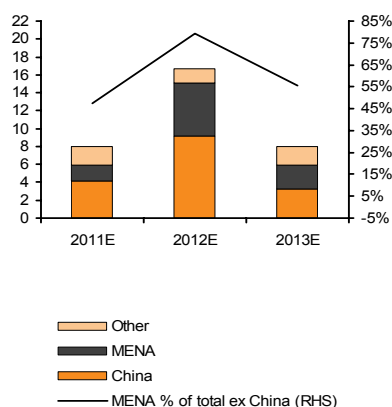
The Middle East accounts for the majority of global nitrogen fertiliser capacity increases outside China

However, in our forecasts, we assume a more benign supply environment. History has shown that such large-scale projects are prone to delays, which has also been the case for OCI's plant in Algeria and IQ's new plants.

The MENA region is the largest exporter globally, accounting for about 40% of total urea exports in 2009, whereas China is the second-largest exporter of urea globally. For the MENA region, we believe that not all Algerian capacity will be available throughout the year: Sorfert Algeria will be starting up at end-2011/early 2012 and Suhail Bahwan (2.3 mtpa urea) in 2Q12, if not delayed towards the end of 2012.

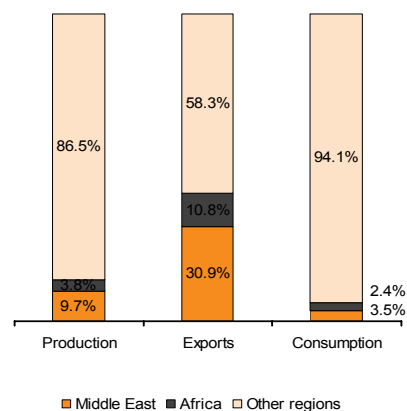
One-third of the planned capacities are in China – we don't expect all new volume to find its way to international markets. Exports are down ytd already and we expect a further decline for the rest of the year given a new tax regime discussed below.

Chart 29 : Global fertilisers – urea capacity additions 2011-2013 (mtpa)



Source: IFA, Zawya Projects, Rasmala

Chart 30 : MENA accounts for more than 40% of global exports (2009)



Source : IFA

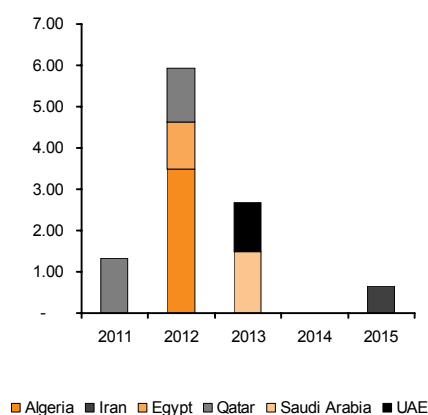
The MENA region is important in a global perspective

As one of the main exporters of nitrogen fertilisers in the world, capacity additions in the region are relevant from a global perspective. Currently, many projects are ongoing across the region, with a total value of around US\$24bn for all types of fertilisers, according to MEED projects data. Of this, we estimate around US\$16bn in nitrogen fertilisers. We estimate that around 10mtpa of new urea production capacity will come on stream in the region from 2011 to 2013, and 8mtpa ammonia capacity, well over 50% of global additions outside of China, especially from the end of 2011 and into 2012. Generally, we see any capacity additions as value accretive to the companies concerned, boosting growth and profits for the respective companies. From a volume perspective, the supply surplus is largely irrelevant for MENA producers because utilisation rates tend to stay high throughout the cycle.

All three listed major nitrogen players in the region (Industries Qatar, SAFCO in Saudi Arabia and Orascom Construction Industries in Egypt) are adding capacity, due to come on stream between the end of this year and 2013/2014, which would double their combined capacity for ammonia and urea. Even though all three are major players in nitrogen fertilisers, strategies of the three are materially different.

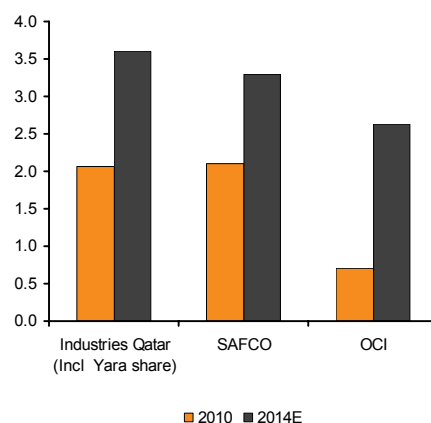
- Industries Qatar has all production located in Qatar, but has an off-take and distribution agreement with joint venture partner Yara. Its main end markets are in Asia.
- SAFCO has all production located in Saudi Arabia and co-operates with its largest shareholder, SABIC, for the distribution. Like QAFCO, its main end markets are in Asia.
- OCI, on the other hand, is a relative newcomer in the fertiliser space (since 2007) through the acquisition of EFC in Egypt, following the disposal of the cement operations to Lafarge. The company has been acquisitive (a 16% stake in US-based distributor Gavilon, DSM Agro & Melamine in 2010, and recently an ammonia/methanol plant in Texas) and has almost completed a large plant in Algeria. In addition to the latter, OCI has production plants in Egypt and The Netherlands. After completion of the plant in Algeria and revamps in Egypt, OCI will reach a total capacity of just over 7 mtpa, taking the company into the top three of nitrogen producers.

Chart 31 : MENA fertilisers – urea capacity additions, 2011-15 (mtpa)



Source: Zawya Projects, Company reports, Rasmala

Chart 32 : MENA fertilisers – urea capacity 2010 and 2014E (mtpa)



Source : Company reports

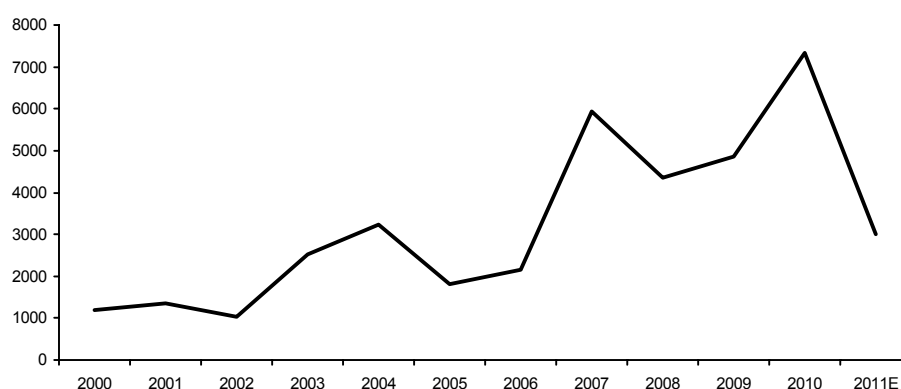
These three are the main drivers behind the expansion in nitrogen fertilisers in the region, but several privately owned companies and government entities are also expanding capacity, in particular Abu Dhabi National Oil Company (ADNOC) and privately owned Omani conglomerate Suhail Bahwan Group, which has plants in Oman and Algeria.

China exporting less in 2011

China is an important factor in the global supply demand balance: it has in excess of 40% of global installed capacity and has been the largest urea exporter globally, acting as a major swing exporter. New capacity additions are large – 3.2 mtpa of new capacity was started up in 2010, to be followed by 3.6 mtpa (all coal-based) in 2011, according to *China Fertilizer Market Week*. But the government is also phasing out inefficient small facilities, making the actual increase in capacity much lower. Furthermore, two factors are likely to limit Chinese urea exports: the high cost compared with other regions and the latest tax regime for exporters.

China – high cost swing exporter

Chart 33 : China urea exports (kt) 2000-11E



Source: China Fertilizer Market Week

New tax regime will limit Chinese exports

Recently, following concerns regarding the large volumes of urea exported in 2010, the Chinese government has modified the export tax system in which it has set a minimum urea price of US\$440 FOB. This price has not only a 7% low season (1 July-31 October) export tariff applied to it, but also an additional sliding scale duty that starts at 34% and rises as the landed price of urea exceeds the US\$440 minimum price. The old tax regime of a 7% export tax made exports attractive when international market prices were strong.

Effectively, the new tax regime means that exports are attractive only when international prices are above the domestic price of Rmb2,300 per tonne, or US\$500 at current exchange rates. Chinese urea exports are down 70% ytd and *China Fertiliser Market Week* estimates that urea exports will total about 3.0mt this year, down from about 7mt in 2010, which should be beneficial for urea prices.

Table 9 : Urea FOB price and tax rate in China

FOB (US\$/t)	Rmb/t	Tax rate	Tax (Rmb/t)	Net export price (Rmb/t)
324	2,087	7%	137	1,950
448	2,885	34%	732	2,153
463	2,982	36%	789	2,193
478	3,078	39%	864	2,214
494	3,181	41%	925	2,256
509	3,278	43%	986	2,292

Source: China Fertilizer Market Week

Pricing – China sets a floor

Pricing is the main variable for MENA producers

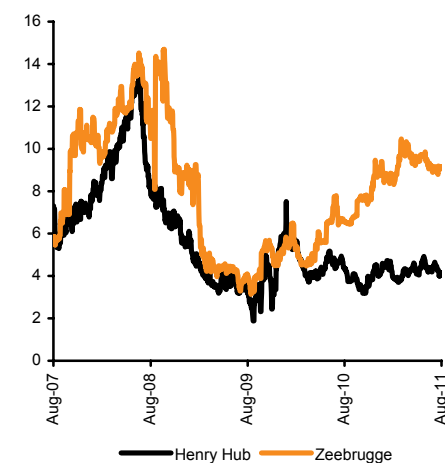
Pricing remains the main variable for MENA operators, determined on a global basis and by the marginal high-cost producers. A supply surplus could put a ceiling on any future price increases, as could a drop in grain prices, but fundamentals are currently not pointing that way. Urea and ammonia prices have been up strongly over the past 12 months, with urea prices around US\$500-550/tonne compared with the low US\$200s at the end of 2009.

High-cost producers provide a floor for nitrogen prices

High cash costs also play an important role in fertiliser pricing. China, and to a somewhat lesser degree, Ukraine, are important swing exporters when urea markets are strong. However, these countries are also high-cost producers: currently Chinese plants that use coal as a feedstock (70-80% of the total) suffer from high coal prices, which result in cash cost of currently cUS\$400/tonne. During weak urea markets, when prices fall below the cash costs, exports don't make sense and the high-cost producers effectively create a price floor by tightening available global supplies.

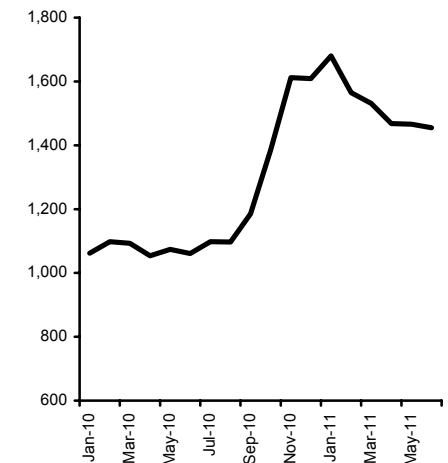
The supply/demand balance is tight and we expect this to remain so. We are currently in a demand-driven environment and urea prices are well above marginal production costs.

Chart 34 : Natural gas price US and Europe (US\$/mmBtu)



Source: Bloomberg, Rasmala

Chart 35 : Chinese coal price (Rmb/tonne)



Source : Bloomberg, Rasmala forecasts

Maintain high level of pricing but below current levels

For our price forecasts, we take into account the supply/demand balance and the cash costs. The winter wheat season starting in the US and Europe in September and the main urea application season in Brazil in September probably means that prices can keep up relatively well, but beyond 2011, we adopt a slightly more cautious approach because: 1) fears of a double-dip recession could lead to a wait-and-see approach by farmers; 2) recently, urea prices in relation to grain prices have become less favourable for farmers; 3) new capacities coming on stream in China, Qatar and Algeria in 2012 could lead to lower global utilisation rates; and 4) potentially lower oil, coal and gas prices will make producers outside the region more cost competitive versus the Middle East producers.

Oil sets the floor for petrochemicals

The petrochemical and fertiliser supply/demand balance has been tight so far this year; prices have risen strongly. We see downside price risk from continued talk on the strength of the economy, lower oil prices and a less favourable spread of crop and fertiliser prices.

Petrochemicals – will the super cycle materialise?

Demand side could be volatile

In the past year, the chemicals sector has enjoyed strong upward momentum, benefiting from tight markets and strongly increased selling prices. The economic recovery and lack of new supply coming to the market in the near future have resulted in much talk in the market about the super cycle for petrochemicals, in which economic growth combined with limited new capacity drive strong petrochemical earnings for an extended period, at least until 2015.

However, there are still uncertainties about this occurring, especially on the demand side, especially if the fear of a double-dip recession materialises. Petrochemical demand is closely correlated with GDP growth, and we expect demand for ethylene, the largest petrochemical product and as such a proxy for the wider petrochemicals industry, to grow at a similar rate or above. Hence the relevance of the fear of another recession, which would have a direct negative impact on industrial production and consequently demand for chemicals.

Corporates are cautious

Company managements are erring on the side of caution, with SABIC recently stating that 2Q record earnings may be difficult to sustain. Similarly, in Europe, companies have been relatively cautious in their outlook, quoting the prospect of a weakening macro backdrop. Indeed, we understand that cracker operating rates have already dropped in the past few months as a result of lower demand for basic materials.

But we do not expect much growth in supply in 2011-15

Much of the excitement for a super cycle stems from the outlook for new chemical plants, or the lack thereof. After substantial capacity increases over the past two years (almost a 7% increase in 2010 alone), we expect the next few years to be relatively quiet and estimate that capacity will grow on average by 3% annually during 2011-15, and even lower (about 2%) in 2011 and 2012. With supply limited, the demand side will be the main determinant for the super cycle to materialise.

RBS economists expect 4% GDP growth in 2011-12

Whether a global recession will materialise is yet to be seen, but the RBS economists in Asia (the main end market of Middle East petrochemicals) are still relatively optimistic and expect continued growth in Asia to offset weakness in Europe and the US. For global growth, RBS economists still forecast about 4% GDP growth in 2011 and 2012, and, importantly, our China strategist Wendy Liu remains optimistic on China and expects Chinese GDP to grow 9% in 2012 and 8-9% over the next five years. This bodes well for operating rates for the petrochemicals and thus, for now, petrochemical earnings growth seems sustainable, especially if global uncertainty will result in new capacities cancelled or delayed.

Table 10 : Global GDP forecasts

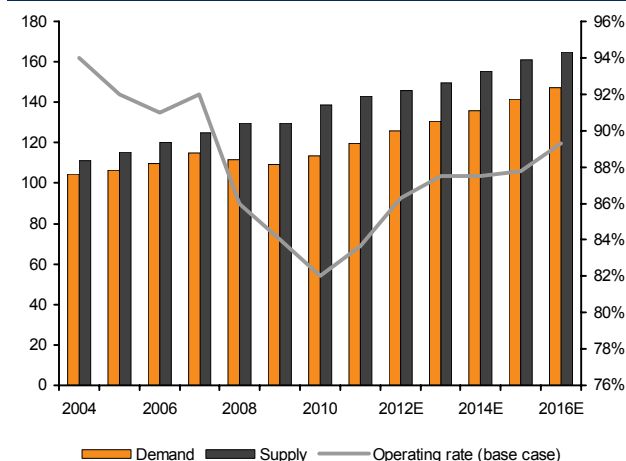
	GDP growth (%)			
	2009	2010	2011F	2012F
US	-3.5	3.0	1.7	2.1
Euro area	-4.3	1.7	1.6	1.1
UK	-4.9	1.4	1.6	1.2
Japan	-6.3	4.0	-0.5	2.3
G-4	-4.2	2.6	1.3	1.8
Asia (ex-Japan)	6.4	9.6	8.1	7.7
- China	9.1	10.3	9.6	9.0
- India	6.8	10.1	7.6	7.6
Emerging Europe and SA	0.5	4.7	4.4	3.7
Latin America				
- Brazil	-0.6	7.5	4.0	4.0
- Argentina	-0.9	9.1	6.6	3.1
RBS- World	-1.0	5.0	3.9	4.0

Source: RBS forecasts

Historically, ethylene demand has grown by on average 1.0-1.5x GDP, but can be higher when the economy slows rapidly or comes out of recession. In our base case, we use a multiplier of around 1.3x, in line with the RBS view on petrochemicals in Asia (see *Petrochemicals Journal*, 'Fear overtaking fundamentals', published 16 September 2011 by Avin Sony).

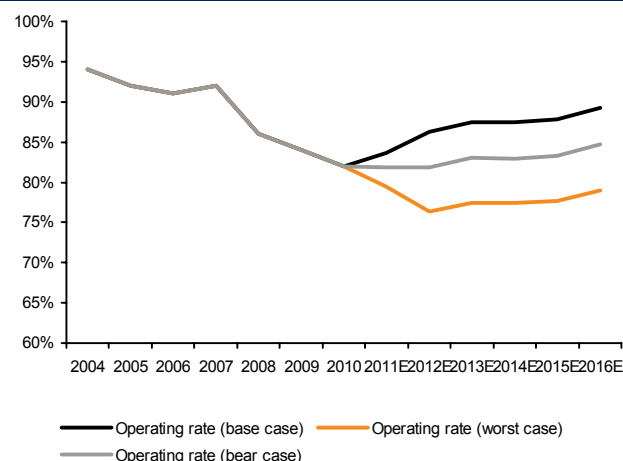
In this scenario of petrochemical demand growth of about 5% during 2011-12, operating rates should move up steadily from the low to mid 80% area achieved in 2008-10 to about 88% by 2013, sufficient enough to ensure strongly improved margins for the global chemical industry. However, in a bear-case scenario of only 2-3% growth, in line with supply growth, operating rates are more likely to stay at current levels during 2011-13, whereas we expect operating rates to fall under a worst-case scenario of no global growth in 2012, resulting in a drop in petrochemicals demand of about 2% that year.

Chart 36 : Ethylene global supply/demand balance and operating rates



Source: CMAI, ICIS, Rasmala

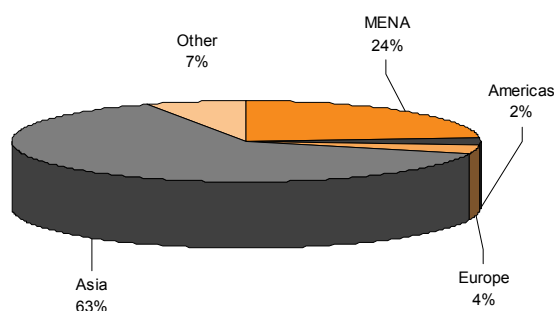
Chart 37 : Global ethylene operating rates under different scenarios (%)



Source: CMAI, ICIS, Rasmala

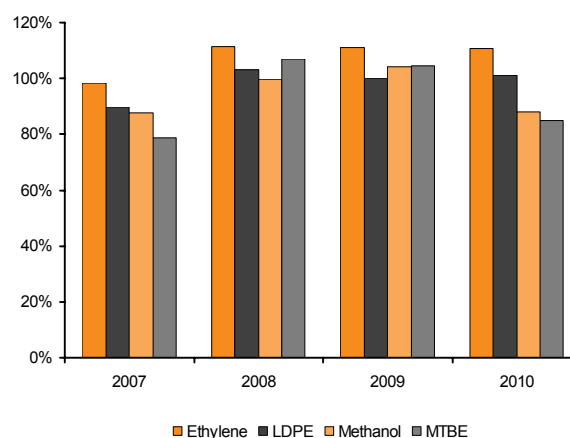
Having said that, operating rates for MENA petrochemicals tend to remain high throughout the cycle, in particular those that have all production in the region, benefiting from low-cost gas as a feedstock. For the Gulf producers, Asia is also by far the main export market, accounting for up to 70-80% of revenues for Gulf producers. For Industries Qatar, it was about two-thirds in 1H11. The price is the main variable for earnings for the Gulf producers.

Chart 38 : Industries Qatar: 1H11 petrochemicals revenues by geography



Source: Company reports

Chart 39 : Industries Qatar: petrochemical utilisation rates



Source: Company reports

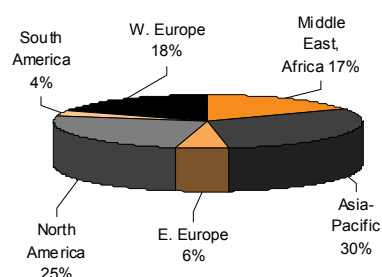
A closer look at the supply side

We expect global capacity to grow about 3% pa on average in 2010-15

Petrochemicals – 2011-15: a quiet period for new capacity

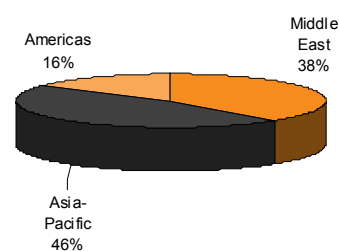
Around 9mt of new ethylene capacity came on stream globally during 2010, of which about 46% was in the Middle East and 55% in Asia-Pacific, according to the *Oil & Gas Journal*. Globally, capacity additions are concentrated in Asia-Pacific, particularly China, the Middle East and Latin America, which account for 46%, 38% and 16% of additions between 2010 and 2015, respectively. On average, we forecast global capacity growth of 3.1% pa between 2010 and 2015, with ethylene capacity going from 138mt at the end of 2010 to 161mt at the end of 2015.

Chart 40 : Share of global ethylene capacity by region, 2010



Source: Rasmala, ICIS, Zawya Projects

Chart 41 : New capacity additions share by region, 2011-15

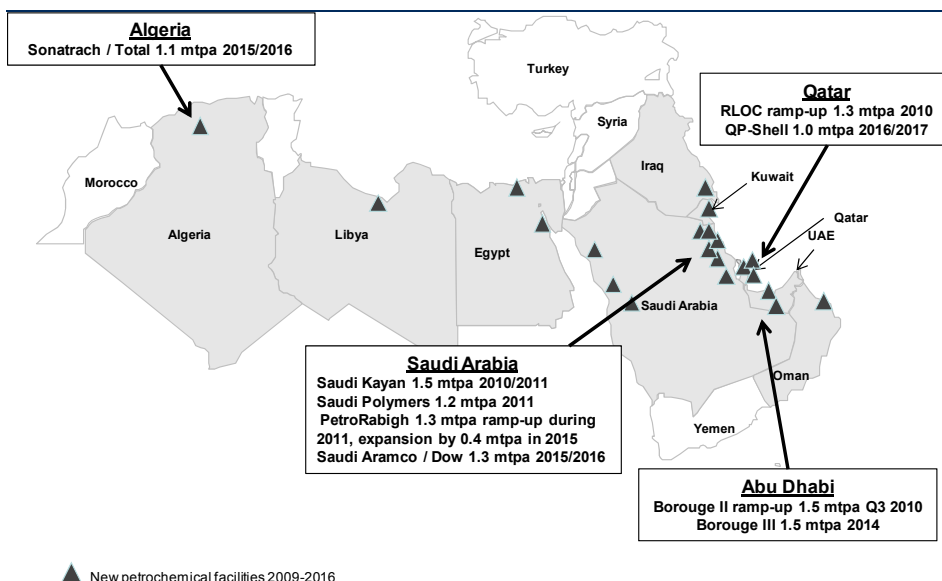


Source: Rasmala, ICIS, Zawya Projects, GPCA

Middle East supply – ramp-up of projects rather than new plants in 2011

Projects are currently under development or being planned across the region, concentrated in Saudi Arabia, Qatar, Iran and the UAE for basic chemicals, and in Algeria, Qatar, Saudi Arabia and Egypt in the case of fertilisers. Outside the region, most new capacities are in Asia, mainly in China, including Kuwait Petroleum/Sinopec's 1mtpa ethylene plant due to start in 2015.

Figure 1 : Major petrochemical projects and ethylene capacities starting up



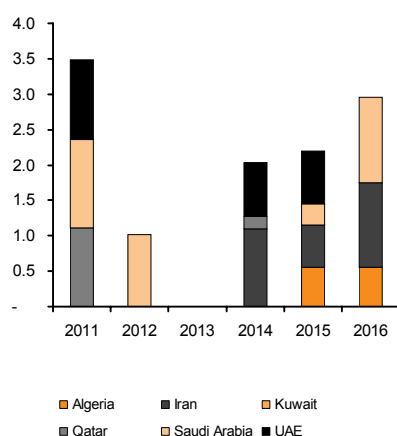
Source: Rasmala, Zawya Projects, MEED Projects

We see capacity expansions in the Middle East, but relatively quiet in 2011-15

We estimate 11mt will be added in MENA during 2011-16, but some projects are still uncertain or have already been delayed, such as the Aramco-Dow and Sonatrach-Total plants that are still in the early stages of planning. These will likely be extended beyond 2015, as the construction cycle for such large-scale projects takes four to five years. Furthermore, Iran accounts for about one-

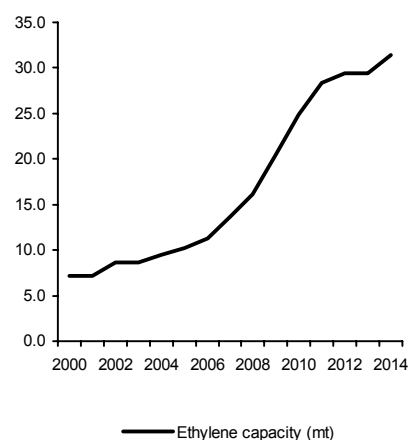
third of the total additions in the region, where projects tend to have a high probability of being postponed or cancelled. Excluding these projects, total capacity additions in the region amount to around 8mtpa over the next five years.

Chart 42 : Ethylene capacity additions in the Middle East & North Africa (mtpa)



Source: Rasmala, ICIS, Zawya Projects

Chart 43 : Installed ethylene capacity in the MENA region (mtpa)



Source : Rasmala, ICIS, Zawya Projects, GPCA

2011 – mainly ramp-ups of projects started in 2010

In 2011, we see the start-up of only one new cracker (Saudi Polymers), as well as the ramp-up of three others that started up in 2010 (the massive Saudi Kayan complex, RLOC in Qatar and Borouge II in Abu Dhabi), but then it should be relatively quiet until 2014-15. In 2014, Borouge III in the UAE is the single largest project due to come on stream.

Table 11 : New ethylene capacity, 2011-16

Country	Project	Capacity (mtpa)	Start-up	2010	2011	2012	2013	2014	2015	2016
Algeria	Arzew	1.10	2015-2016						0.55	0.55
Iran	Assaluyeh	0.60	2016-2020							
	Chovar, Llam	0.50	Q4 2014					0.50		
	Assaluyeh, Kavvan	2.40	2014-2016					0.60	0.60	1.20
	Gachsaran	1.00	2016-2020							
Kuwait	Al Zour	1.40	2016-2020							
Oman	Sohar	0.85	On hold							
Qatar	RLOC	1.30	2010	0.19	1.11					
	QAPCO	0.18	2014					0.18		
	QP- Shell	1.00	2016-2017							
Saudi Arabia	Saudi Kayan	1.48	2010	0.37	1.11					
	Saudi Polymers	1.17	Q4 2011		0.15	1.02				
	PetroRabigh	0.30	Q1 2015						0.30	
	Saudi Aramco – Dow	1.20	2015-2016							1.20
UAE	Borouge II	1.50	H2 2010	0.38	1.13					
	Borouge III	1.50	2014					0.75	0.75	
	Taweelah	1.45	Delayed							
Total				0.94	3.49	1.02	-	2.03	2.20	2.95
Total excl Iran				0.94	3.49	1.02	-	0.93	1.60	1.75

Source: Rasmala, Zawya Projects, companies, ICIS, CMAI, MEED

Saudi Arabia leads the pack...

Saudi Arabia second to none in the region – but not much extra demand for gas

Saudi Arabia is a leader in terms of installed ethylene nameplate capacity in the region – about 12mt out of total GCC capacity of about 16.7mtpa (8.6% global market share for ethylene capacity) is located there compared with 2.5mtpa in Qatar, the second-largest ethylene producer in the GCC. However, it is getting quieter in terms of new olefins expansions – in addition to the ramp-up of the massive Kayan project, only three major olefin projects are in the pipeline in the Kingdom.

- Saudi Kayan (SABIC/Al Kayan Petrochemicals) started up units at its 5mtpa complex in Jubail in 2010, which will have capacity to produce 1.48mtpa of ethylene and 0.7mtpa of PE, as well as benzene and other products. SABIC has revealed plans to add 0.3mtpa of HDPE.

- Saudi Polymers (a 35/65 joint venture between Arabian Chevron Phillips Petrochemicals and the Saudi Industrial Investment Group) will start up an ethane/propane steam cracker in Jubail towards the end of the year. The cracker will produce 1.165mtpa of ethylene and 0.445mtpa of propylene, and will include downstream units for polyethylene, polypropylene and polystyrene.
- A 30% expansion and widening of product offering of PetroRabigh's cracker (a joint venture between Saudi Aramco and Sumitomo Chemical), which should increase ethylene production by 0.3mtpa from the existing 1.3mtpa, due to be completed by 2015. The company started up its refinery and petrochemicals complex in Rabigh last year.
- But the largest project currently planned in Saudi Arabia is the delayed (from the original 2015 planned start-up date) US\$15bn-18bn petrochemicals complex of Saudi Aramco-Dow Chemical in Jubail. The joint venture gave the green light for the project in July this year. According to MEED, the US\$1.5bn cracker will use mixed-feed ethane and naphtha to produce 1.2mtpa of ethylene and 400,000tpa propylene. In addition, there will be several downstream products, including TDI and MDI.

... and is moving further downstream

Looking beyond ethylene, Saudi Arabia also still accounts for the lion's share of new projects under development, but the country is, in addition to building up basic chemicals capacity, moving ahead with projects further downstream, as illustrated by the recent announcement that SABIC will build a US\$2bn elastomer plant in a joint venture with ExxonMobil Elastomers (using the latter's technology), producing products that are destined for the automotive industry (carbon black, rubber and thermoplastics). This strategic direction in the Kingdom, also helped by the acquisition of GE Plastics (and its technology) by SABIC is aimed at serving end-customers and ultimately with the goal of attracting those to the country.

Qatar – some hiccoughs in expanding the offering

Qatar – QP looking to revive petrochemical projects now; LNG up and running

In Qatar, several projects in the petrochemicals and fertilisers space are ongoing, but the moratorium on the development of the giant North Field means that there is limited potential for new large-scale petrochemical projects, unless based on other feedstock sources. According to press articles, several large-scale petrochemical complexes that had been planned during 2005-07 were put on hold due to a lack of feedstock availability, in particular a US\$6bn complex in Ras Laffan that ExxonMobil cancelled in 2010. However, at the same time, other projects are going ahead. Projects in the petrochemicals are driven by Qatar Petroleum directly or through Industries Qatar, but generally in co-operation with major international players.

- Ras Laffan Olefins Co (RLOC), a joint venture of Qatofin (owned by IQ 63%, Total Petrochemicals 36% and QP 1%) and Q-Chem II (owned by QP 51% and Chevron Phillips Chemicals 49%), started up its 1.3mtpa cracker in 2010. We expect the plant to run at full capacity this year, an additional 1.1mtpa. RLOC is considering expanding its cracker to about 1.45-1.60mtpa.
- Shell announced in December 2010 that it will study a large-scale petrochemicals complex in Ras Laffan in co-operation with QP and possibly to be integrated with the Pearl GTL plant for a substantial part of the ethane feed. According to industry consultants ICIS, the project would be based on a mixed-feed 1mtpa cracker and include a monoethylene glycol (MEG) plant with a capacity of up to 1.5m tonnes/year. However, start-up will not be until 2016-2017.
- Total Petrochemicals has also been in talks with Qatar Petroleum about a project in Ras Laffan, but is yet to sign an agreement. Qatar Petrochemical Co (the 80/20 joint venture between IQ and Total Petrochemicals) plans to expand its 720,000 tpa cracker in Mesaieed to 900,000 tpa by 2014. At the same time, the JV will increase linear low density polyethylene (LLDPE) capacity from 450,000 to 600,000 tpa.

UAE – Abu Dhabi emerging as a major player

Outside Saudi, the UAE is calling the shots

In Abu Dhabi, around US\$13bn worth of petrochemical projects are under way, according to MEED, including Borouge III where contracts have already been awarded.

- Borouge, a joint venture between Abu Dhabi National Oil Company (ADNOC) and Borealis, brought its second cracker Borouge II in Ruwais on stream last year, raising ethylene capacity by 1.4mtpa to 2.1mtpa.
- The expansion of Borouge is under way to expand total petrochemical output by 2.5 to 4.5mtpa by mid-2014. The project, Borouge III, includes construction of a third ethane cracker, with a 1.5mtpa capacity. Downstream products include around 1mtpa each of PE and PP as well as LDPE.

- ChemaWEyaat (Abu Dhabi National Chemicals Company, owned by IPIC, ADNOC and ADIC) has delayed its olefins and aromatics project from the original start-up date of 2014, but may go ahead for start-up after 2015. The project will be based on a 1.5mtpa naphtha cracker.

Not much going on elsewhere except in Algeria

Algeria - Total faces delays

In Algeria, only one major olefins project is currently in the pipeline – the Sonatrach/Total Petrochemicals/QP project, with 1.1mtpa of ethylene and with downstream units (MEG, HDPE and LLDPE) in Arzew. The project is now due in 2014, delayed from a previous start-up in 2013 – although we believe that the project is not going to be operational until 2015-16 at the earliest, given that it is still in the early stages of planning. Originally, this was a Total Petrochemicals/Sonatrach JV, but in 2010, Qatar Petroleum bought a 10% stake (following new regulations that foreign investors cannot hold a majority stake), which reduced Total's stake from 51% to 41%. Sonatrach now has the largest stake at 49%.

Kuwait – not much in the pipeline

In Kuwait, only one major project is in the pipeline for start-up after 2015, a 1.4mtpa mixed-feed (ethane/naphtha) cracker, planned by Kuwait Petrochemical Industries (PIC) and Equate (a JV of PIC, Dow Chemicals and Kuwaiti investors). The Olefins III project, which is expected to include plants for polyethylene and polypropylene, would be located at Al Zour, alongside a fourth refinery being planned by Kuwait Petroleum Corp. (KPC).

The wildcard, Iran

With 4.7mtpa installed ethylene capacity at end-2010, Iran is a heavyweight in the region (the second-largest ethylene producer after Saudi Arabia), but Iran is notorious for project delays and petrochemicals are no exception, despite highly ambitious plans to reach ethylene capacity of 11.5mtpa by 2015. International sanctions against the country make it more difficult to export the product and to finance large-scale projects, thus delaying them, whilst feedstock availability (at a cost of US\$1.25/MMBtu for ethane) has also been an issue. We do not pencil in any projects coming on stream in 2011-13, but the first phase of the Busheyr (Kavian Petrochemical) 1.2mtpa of ethylene project, which was due to start up in 2011/12, could occur in 2014-16, according to CMAI.

Petrochemicals prices supported by oil

Oil prices are a key driver

As is the case with fertilisers, pricing remains the main variable for MENA operators, determined on a global basis and by the marginal producer. As the high-cost producers are using naphtha as their main feedstock, rather than ethane, petrochemical prices show a high correlation with oil prices. The higher the oil price, the more favourable it is for chemicals prices.

We use the RBS oil price forecast as a base, which assumes an average Brent price of US\$107/bbl for 2011 and a downward trend in prices from 2012 onwards, to reach US\$84/bbl in 2015, which serves as the long-term real oil price forecast (inflated at 2.5% pa). Despite recent weakness in response to global economic growth concerns, Brent oil prices are still up on the year.

Table 12 : Oil price forecasts(US\$/bbl)

	2010	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Brent US\$/bbl	80	107	95	90	86	84	86	88	90	93	95

Source: RBS Oil Team

The oil price assumption is the main driver for the slight decline we forecast for petrochemicals prices from current levels, but they remain relatively high. However, we note that any expectation of lower chemical prices could result in a wait-and-see approach by customers and lead to destocking and a short-term impact on volumes.

Nevertheless, we expect cash margins to remain high for the MENA producers. However, we note that: 1) the lower oil price would also mean that the marginal producer becomes more competitive; and 2) share prices of the pure petrochemical producers (mainly in Saudi Arabia) are also correlated with oil prices. In the case of Industries Qatar, we see the diversification of the operations as a stabilising factor for the share price.

Construction: recovery in sight or not yet?

We expect strong GCC infrastructure spending, particularly Saudi Arabia, after two packages were announced earlier this year, as well as Qatar, especially as spending starts for the 2022 World Cup. Elsewhere, construction markets have declined steeply this year.

Construction markets in the region are important for both IQ and OCI. The former has steel production plants in Qatar, which predominantly sells to the local (Qatar) market, as well as in other countries in the Gulf. OCI has a construction business that is active across the region.

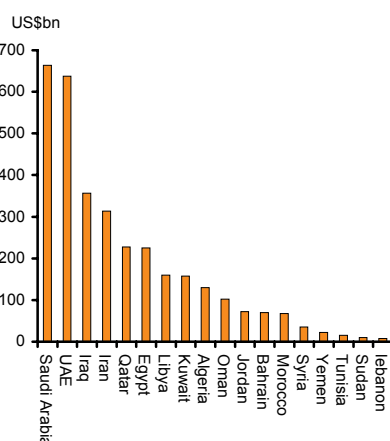
What do the construction markets look like across the region?

In the GCC, government spending has been a key driver pushing economic growth back on track in 2010. Whereas construction (real estate) spending was down sharply, investments in the industrial, metal, gas production, petrochemicals, power and water sectors were all stable or up over the previous year.

Saudi Arabia is now the largest construction market in the region

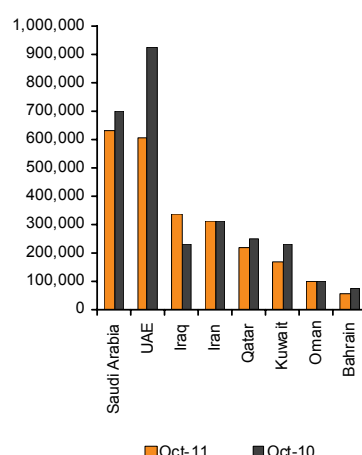
Looking at the size of the construction markets first, Saudi Arabia is now the largest market for projects planned or underway in the GCC (about US\$625bn in September 2011, according to MEED Projects) and announcements earlier this year on further spending will likely lift these figures. The UAE is still a large market (US\$609bn), whereas Qatar follows in third place at US\$221bn. Outside the GCC, the strongest growth in projects planned or under way has been in Iraq, +50% from US\$231bn in September 2010 to US\$346bn in September 2011. OCI is bidding for several projects in Iraq.

Chart 44 : Projects planned or under way in the MENA region



Source: MEED Projects

Chart 45 : Projects planned or under way in the MENA region (US\$bn)



Source: MEED Projects

Saudi Arabia spending spree

Boost in public spending to appease the population

In response to the spreading of unrest across the MENA region, the Saudi government announced a socio-economic benefit package of SAR140bn (US\$37bn) in February, followed by another of SAR350bn in March. Overall, the two packages together amount to about 30% of 2010 GDP.

The first (SAR140bn) package will be used mainly to help lower- and middle-income earners by providing them with affordable housing, unemployment benefits and pay rises to offset inflation. The package also includes an extra allocation of SAR40bn (US\$10.7bn) to the Saudi development fund to finance low-income housing and provide other loans. The second package comprises 21 royal orders, including spending SAR250bn (US\$66.7bn) for the construction of 500,000 housing units.

Qatar could become more interesting in the longer term

The recently announced Qatar National Development Strategy 2011-2016 document highlights many aspects of Qatar's planned development. One of the features that attracted most media attention was Qatar's spending plan of QAR820bn (US\$225bn) for 2011-16, half of which might

come from the non-hydrocarbon sector. The report estimates that of the QAR820bn, public investment accounts for about QAR347bn. However, the substantial government expenditures that the press has highlighted are already mostly included in projects planned, whereas the economic impact of investments for the FIFA World Cup 2022 is likely to be modest during 2011-16.

Egypt can still be a significant market in the future

Egypt is also significant in terms of projects planned or under way, but some of these may be delayed by the recent developments in the country. However, we believe Egypt will ramp up infrastructure spending as a means of giving something to the people. In addition, internationally funded projects are still going ahead, such as the new museum, and more help has been offered by a number of countries.

Projects to help Egypt plug the gaps

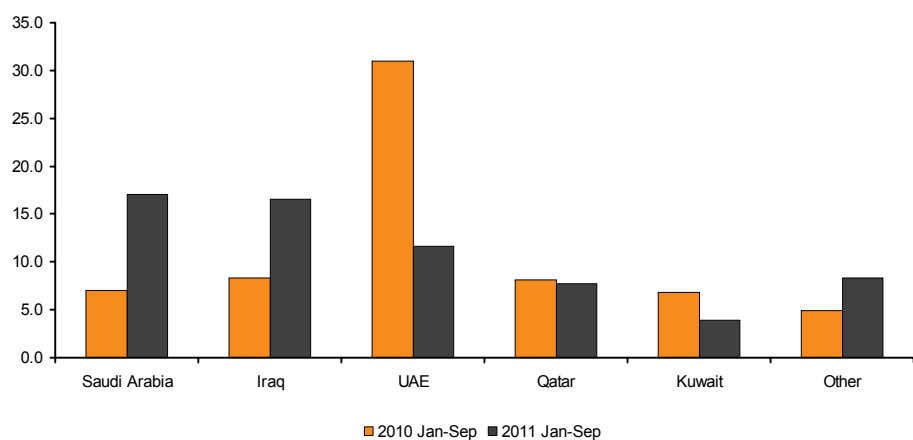
Given Egypt's importance to the region, offers have come in from abroad that could help Egypt with its funding gap of US\$10bn-12bn. An agreement from the Islamic Development Bank for US\$2.5bn worth of funding over three years focuses on development projects and trade, including a power plant and an educational centre. Qatar has pledged US\$10bn for investment projects in tourism, property, transport, education and agriculture and the UAE US\$3bn for SMEs and housing.

But how is the construction market doing?

According to MEED Projects data, the value of new contract awards has been a tale of mixed fortunes for the first three quarters of this year. Overall for the MENA region, the value has been flat. Saudi Arabia and Iraq have recorded strong growth this year, but there has been a slowdown in new construction awards in the UAE, we believe caused by a delay in spending in Abu Dhabi in particular.

- In Saudi Arabia new contract awards increased 143% from January to September and 201% in 3Q. Saudi Arabia is now the largest market for projects planned or under way in the GCC (about US\$625bn in September 2011, according to MEED Projects) and announcements earlier this year on further spending will likely lift these figures.
- UAE was not until recently the most significant construction market in the region, but new contract awards are down 62% during the first three quarters of 2011 and even down 82% in 3Q. In 2010, these were still held up by Abu Dhabi when construction came to a standstill in Dubai. This year, it seems Abu Dhabi is pulling the construction markets down.
- Iraq new contract awards ytd rose 99%, clearly becoming a more important market. The country has witnessed the strongest growth in projects planned or under way in the region, up 50% from US\$231bn in September 2010 to US\$346bn in September 2011.

Chart 46 : New construction awards (US\$bn)



Source: MEED, Rasmala

In the GCC, Saudi Arabia has been the most active construction market and about US\$17bn of new contracts have been awarded ytd, followed by the UAE with about US\$12bn and Qatar about US\$8bn. The big increase in Saudi Arabia follows the announcements earlier this year that the government will increase spending on infrastructure. One of the latest project awards in Saudi

Arabia went to Besix, 50% owned by OCL, a US\$533m contract to build the 60,000-seat stadium at the King Abdullah Sports City development near Jeddah.

Table 13 : New contract awards (US\$bn)

	2008	2009	2010	2010 Jan-Sep	2011 Jan-Sep	% change	3Q10	3Q11	% change
Saudi Arabia	16.2	46.7	15.2	7.0	17.0	143%	1.9	5.7	201%
Iraq	5.5	18.1	8.6	8.3	16.6	99%	0.0	5.6	NM
UAE	48.6	84.2	33.1	31.0	11.7	-62%	14.8	2.6	-83%
Qatar	13.6	5.6	9.0	8.2	7.8	-5%	1.9	0.9	-51%
Kuwait	16.3	7.7	10.1	6.9	3.9	-43%	4.8	0.7	-85%
Other	33.2	36.0	9.1	4.9	8.3	69%	1.1	1.8	69%
Total	145.0	138.0	85.0	66.3	65.3	2%	24.4	17.3	41%

Source: MEED, Rasmala

Project markets are now predominantly government driven (85% or more of new project awards are public sector), which is good in the sense that the governments have healthy balance sheets in general, but it also means that decision making is very slow. The project markets have also become increasingly competitive – many projects have been retendered to get lower prices, and where there used to be one contractor tendering, now it is more likely eight for each project. This has been one of the main concerns investors highlight because normally, that would lead to a pressure on margins, which are high in the case of OCL.

Key product price forecasts

We use a base-case scenario for the key product prices, for which we assume a drop in petrochemicals and fertiliser prices of 10-15% in 2012.

Table 14 : Key price actuals and forecasts (US\$/tonne)

	2010	1Q11	2Q11	3Q11F	4Q11F	2011F	2012F	2013F
Petrochemicals								
Ethylene	842	946	1,068	924	850	947	834	845
LDPE	1,492	1,705	1,741	1,617	1,488	1,638	1,459	1,479
LLDPE	1,193	1,378	1,412	1,294	1,190	1,318	1,167	1,183
Methanol (Industries Qatar)	246	288	284	266	260	274	295	300
MTBE	784	972	1,153	1,050	1,000	1,044	885	900
Fertilisers								
Ammonia (fob Yuzhnyy)	346	434	493	492	500	480	425	450
Ammonia (fob Middle East)	339	421	480	475	490	467	415	435
Urea prilled (fob Yuzhnyy)	280	367	344	478	469	414	385	385
Urea (fob Middle East)	301	373	378	480	470	425	375	381
Urea (fob Egypt)	313	357	361	422	425	359	380	391
CAN (cif Germany)	247	257	331	368	371	294	319	332
UAN		222	272	318	320	247	270	283
Melamine	1559	1877	1709	1650	1550	1793	1745	1696
Steel								
Steel bar	629	732	747	771	760	752	775	798
DRI/HBI	367	395	442	450	425	428	387	399
Energy								
Crude – Brent US\$/bbl	80	105	117	104	102	107	95	90
Naphtha (US\$/t)	692	911	1,004	903	888	927	784	745
Natural gas (US\$/mmBtu)								
Hub gas Henry	4.40	4.20	4.40	4.20	4.70	4.50	5.30	5.50
Hub gas Zeebrugge	7.50	8.60	9.50	9.30	11.00	9.60	10.90	11.30
Qatar								
Petrochemical	1.75	2.21	2.21	2.21	2.21	2.21	2.33	2.48
Fertiliser	2.35	2.30	2.30	2.30	2.30	2.30	2.10	1.92
Steel	0.98	2.30	2.30	2.30	2.30	1.21	1.23	1.27
Saudi Arabia								
	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Egypt								
EFC	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
EBIC	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Algeria						0.57	0.60	0.63

Source: Company data, Rasmala forecasts

Company profiles

The following are the latest reports published on these companies:

COMPANY PROFILES

Industries Qatar	36
Orascom Construction Ind	55
SAFCO	71

13 October 2011

Initiation of coverage

Buy

Target price

QR164.00

Price

QR124.60

Short term (0-60 days)

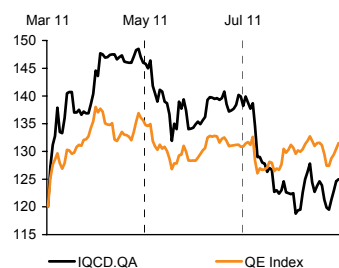
n/a

Market view

No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (QR)	122.5	139.6	n/a
Absolute (%)	1.7	-10.7	n/a
Rel market (%)	0.2	-10.7	n/a
Rel sector (%)	n/a	n/a	n/a

**Market capitalisation**

QR68.53bn (€13.77bn)

Average (12M) daily turnover

QR40.65m (€7.93m)

Sector: European-DS Tot Mkt
 RIC: IQCD.QA, IQCD QD
 Priced QR124.60 at close 11 Oct 2011.
 Source: Bloomberg

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Industries Qatar

Fertilisers key to earnings growth

We initiate coverage of Industries Qatar with a Buy recommendation and target price of QR164. We believe the stock offers strong growth prospects at reasonable valuations. Our positive view on robust agricultural fundamentals combined with new capacities in the segment are key to our investment view.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (QRm)	9,857	12,331	16,570	18,301	21,591
EBITDA (QRm)	3,919	5,793	8,690	9,741	11,185
Reported net profit (QRm)	3,793	5,575	8,150	8,736	10,209
Normalised net profit (QRm)	3,793	5,575	8,150	8,736	10,209
Normalised EPS (QR)	6.90	10.14	14.82	15.88	18.56
Dividend per share (QR)	5.00	5.50	7.41	7.94	9.28
Dividend yield (%)	4.01	4.41	5.95	6.37	7.45
Normalised PE (x)	18.10	12.30	8.41	7.84	6.71
EV/EBITDA (x)	17.50	12.20	8.05	6.98	5.79
EV/invested capital (x)	3.56	2.95	2.47	2.19	1.93
ROIC - WACC (%)	11.60	15.60	22.00	18.40	20.00

Accounting standard: IFRS

Source: Company data, Rasmala forecasts

year to Dec, fully diluted

New fertiliser capacity should benefit from strong agricultural fundamentals

Key to our investment case for Industries Qatar (IQ) is that we believe agricultural prices are likely to remain elevated, demand for fertilisers will remain strong and industry operating rates will remain healthy during 2011-13. IQ appears well positioned to benefit: it is one of the lowest-cost producers globally, but, more important, we expect strong growth for the segment's gross profit of 34% in 2012, driven largely by new capacities coming on stream.

Petrochemicals

With fears of a global recession, chemicals may not be the obvious area for investors to consider; however, we believe most chemical stocks now discount a bear-case scenario. Our supply side analysis suggests very limited supply growth during 2011-15 – 2-3% on average pa – and large-scale plants under consideration may even be delayed by fear of another recession. We expect relatively healthy growth in 2012 for this segment, but below 10% for both revenues and earnings.

Steel – one of the few routes in Qatar to gain exposure to infrastructure

We view the decision to postpone large capacity expansions in the steel segment as positive, given the segment's lower profitability and higher earnings volatility than petrochemicals and fertilisers. However, it is a main beneficiary of major infrastructure spending in Qatar and Saudi Arabia – particularly in the former when spending for the 2022 World Cup materialises.

A cheap stock, in our view

IQ's shares have performed relatively well in a global context and are down only about 7% ytd. In a sum-of-the-parts valuation, we value IQ at QR164/share, suggesting 32% upside potential from current levels. We see continued strong agricultural markets and news flow on the start-up of new fertiliser capacity later this year as key catalysts for the stock.

Important disclosures can be found in the Disclosures Appendix.

Distributed outside MENA by The Royal Bank of Scotland N.V. and its affiliates under a strategic alliance with Rasmala Investment Bank Ltd.

The basics

Versus consensus

EPS (QR)	Ours	Cons	% diff
2011F	14.82	15.11	-1.9%
2012F	15.88	15.35	3.5%
2013F	18.56	17.35	7.0%

Source: Bloomberg, Rasmala forecasts

Catalysts for share price performance

We see two main catalysts for the share. First, IQ's earnings are sensitive to any changes in prices for petrochemicals, fertilisers and steel; hence these would be the main catalyst for share price performance. Grain futures and oil prices are two key drivers of fertiliser prices and petrochemical prices, respectively; the next key catalyst for grain futures will be the release of the World Agricultural Supply and Demand estimates (WASDE) report, scheduled to be published 9 November. Second, the successful start-up of new fertiliser plants towards the end of the year is one of the main drivers of our forecast earnings growth in 2012.

Earnings momentum

One of the main drivers for earnings growth for Industries Qatar is volume growth. Historical capacity utilisation has been in the range of 95-105%, and we expect to remain within this range. Hence volume growth is mainly based on IQ's growth strategy for new major capital expenditure programmes, particularly for fertilisers. Another main driver is price movements of the major product groups of petrochemicals, steel and fertilisers. We forecast average annual net income growth of 22% during 2010-13.

Valuation and target price

We derive our target price by using a sum-of-the parts valuation of each of the three business segments – petrochemicals, fertilisers and steel. For this purpose, we use a DCF valuation to capture the planned capacity expansions, which are not completely reflected in the 2011 and 2012 multiples. This results in a valuation of QR164 per share. We check our valuation with peer multiples in each of the segments.

How we differ from consensus

We are in line with consensus with our Buy recommendation: Bloomberg lists nine Buys, one Hold and zero Sell recommendations, with an average target price of QR161/share. We are slightly below consensus for 2011F and above for 2012F earnings.

Risks to central scenario

The key risks to our investment thesis are as follows. 1) Our forecasts and valuation are highly sensitive to commodity price movements. On the one hand, lower-than-expected prices would have a negative impact. On the other hand, higher-than-expected prices would likely result in upside risk to our estimates. Such price movements are dependent upon the supply-demand balance of the products, so substantial new capacity build-up by competitors inside or outside the region could result in lower-than-expected prices than currently anticipated. 2) Delays in planned capacity expansions could negatively affect our earnings forecasts. 3) All of IQ's businesses are cyclical in nature, and, in particular, the petrochemicals segment is dependent upon the global economy and global industrial production. A change in global GDP forecasts would likely have a direct impact on global demand for such products. 4) Political risks remain a broader risk for the region, but, within the region, Qatar and the UAE have been the most stable countries.

Forced ranking*

Company	Rec	Upside/downside
Yara	Buy	+41%
OCI	Buy	+36%
Industries Qatar	Buy	+32%
SAFCO	Buy	+13%

*by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: RBS and Rasmala forecasts

Key events

Date	Event
Oct 2011	3Q results
9 Nov 2011	WASDE report

Source: Company

Key assumptions and sensitivities

IQ's revenues and earnings are most sensitive to changes in product prices. A 10% drop in key product prices for each segment compared with our forecasts results in a drop in net income of up to 7%.

Table 1 : Key price assumptions

('000 tonnes)	2010	1Q011	2Q11	3Q11F	4Q11F	2011F	2012F	2013F
Ethylene	842	946	1,068	924	850	947	834	845
LDPE	1,492	1,705	1,741	1,617	1,488	1,638	1,459	1,479
LLDPE	1,193	1,378	1,412	1,294	1,190	1,318	1,167	1,183
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Ammonia	339	421	480	475	490	467	415	435
Urea	301	373	378	480	470	425	375	381
Melamine	0	1,651	1,493	1,500	1,500	1,536	1,500	1,400
Steel bar	629	732	747	771	760	752	775	798
DRI/HBI	367	395	442	450	425	428	387	399
Crude – Brent US\$/bbl	80	105	117	104	102	107	95	90
Naphtha (US\$/t)	692	911	1,004	903	888	927	784	745
Natural gas (US\$/mmBtu)								
Petrochemical	1.75	2.21	2.21	2.21	2.21	2.21	2.33	2.48
Fertiliser	2.35	2.30	2.30	2.30	2.30	2.30	2.10	1.92
Steel	0.98	2.30	2.30	2.30	2.30	1.21	1.23	1.27
Group	1.91	1.95	1.95	1.95	1.95	1.95	1.98	2.02

Source: Company data, Rasmala forecasts

Table 2 : Sensitivities to our 2012 forecasts for a 10% decrease per tonne in pricing

	Revenues	EBITDA	Net income
Petrochemical prices (ethylene, LDPE and LLDPE)	-3%	-5%	-5%
Fuel additives (methanol and MTBE)	-1%	-1%	-1%
Fertiliser pricing (urea, ammonia and melamine)	-3%	-5%	-6%
Steel (bar and DRI/HBI)	-3%	-7%	-7%

Source: Company data, Rasmala forecasts

Executive summary

We initiate coverage of Industries Qatar, the largest publicly listed company in Qatar and second-largest listed industrial company in the MENA region after SABIC by market cap, with a Buy and QR164 TP, suggesting 32% upside potential.

A healthy outlook for fertilisers until at least 2013

Farmer economics have been good this year

In the past 12 months, farm economics have been highly supportive for fertiliser demand and pricing: farmer incomes are at record highs, global food stockpiles have declined to an almost historical low and grain prices have soared. This crop year, the USDA expects corn production to be the third highest ever in the US, with the second highest planted area since 1944, and for 2011/12 expects an increase in production of about 4% but a drop in ending inventories.

Expect tight supply/demand balance

The International Fertiliser Association estimates that urea capacity will grow by about 8% in 2012, higher than its forecast of 5% demand growth. In contrast, our supply/demand analysis shows that some of these additions may occur a little later. We forecast supply will be broadly in line with demand and a relatively tight supply/demand balance will persist during the rest of 2011 and 2012. The good news is that the largest increases in exportable volumes are in the Mena region, in Qatar, Algeria and Saudi Arabia.

We have a positive view on the outlook for fertiliser until at least 2013 and we think IQ is well positioned to capture this growth: the company is one of the lowest-cost producers globally and is planning to start up significant new production facilities at the end of this year and next. Hence, we forecast an increase of 64% in urea volume produced from 2011 to 2012.

Chemicals: the oil price will be the key driver for Mena petrochemicals

Petrochemical demand is closely correlated with GDP growth, hence the relevance of the fear of a double-dip recession. Whether a global recession will materialise is yet to be seen, but RBS economists in Asia, the main end market of Middle East petrochemicals, are still relatively optimistic and expect continued growth in Asia, even if lower than in previous years to be able to offset weakness in Europe and the US. For global growth, RBS economists still forecast about 4% GDP growth in 2011 and 2012. Importantly, our China strategist Wendy Liu remains optimistic on China and expects Chinese GDP to grow 8-9% over the next five years.

Limited supply growth during 2011-15

During 2010, global ethylene capacity increased almost 7%, but we expect below-average capacity growth of on average 2-3% annually during 2011-15, below our economists' global growth forecast. Economic growth combined with the lack of new supply coming to market for an extended period has resulted in much talk in the market about the super cycle for petrochemicals. In our view, the demand side will be the main determiner of whether this will occur, but for now, petrochemical earnings growth seems sustainable, especially if global uncertainty would result in new capacities cancelled or delayed. Based on current GDP forecasts and the supply outlook, we expect global ethylene operating rates to move up from about 82% in 2010 to 88% in 2015. Only in the worst-case scenario of 0% global growth in 2012 would we expect operating rates to drop materially.

We believe that operating rates for the Mena producers will remain high, as in past downturns, which then makes petrochemicals pricing the key variable for which the oil price is a key driver. Our oil team's forecast (Brent US\$95/bbl for 2012) remains supportive of relatively high petrochemical prices.

Steel – IQ benefits from continued infrastructure spending in GCC

The steel business is IQ's least profitable (EBITDA margin 26% in 2010 versus 55% for both chemicals and fertilisers), but is largely domestic (Qatar 49% of revenues in 1H11, GCC 44%). It is a more volatile business and prone to fluctuations in iron ore prices, as IQ imports this raw material. Hence we are slightly more cautious in our outlook and valuation for this segment. However, the segment can also benefit from infrastructure spending in the region, especially in Qatar and Saudi Arabia, two countries where we expect healthy growth in the construction market.

Four reasons to buy Industries Qatar now

This may not be the best time to revisit cyclical industries such as chemicals and steel; however, we believe that IQ's share is not yet factoring in the company's strong growth potential, particularly in fertilisers. Within the region, IQ has become one of the more transparent companies when it comes to quarterly disclosure of details on product prices and volumes, as well as its growth strategy for the next five years. Our investment case is based on four key points.

- Capacity growth is a key driver for a re-rating, in our view. We expect attractive capacity growth during 2010-13 for the most profitable segments – petrochemicals and fertilisers – offering investors 8% and 23% average capacity growth, respectively, over that period.
- The postponement of the steel expansion is positive in our view. The segment has lower margins than the other two and is more prone to volatility as a result of iron ore imports. Strong growth in fertilisers and petrochemicals should result in a boost to profitability margin. We expect IQ's gross margin to improve from 48% in 2010 to 52% in 2012.
- It is a direct play on Qatar's large gas reserves, and one of the very few in the country. All segments benefit from a low-cost feedstock environment, making IQ one of the most profitable companies globally in the petrochemicals and fertiliser segments.
- It is also a direct play on Qatar's thriving economy (the IMF forecasts GDP growth of 18.7% for 2011, 6% for 2012) through the steel segment. We would prefer to see a pure-play chemical company separate from its steel activities because we believe the stock would attract higher valuations, but the steel segment is the only one of the three business lines that is largely a domestic play.

Valuation

Our valuation is based on a sum of the parts, cross-checked with comparable multiples. We see the implied multiples as still relatively conservative in a regional perspective, with a target 2012F EV/EBITDA of 9.5x for fertilisers, 10.5x for petrochemicals, 5.0x for fuel additives and 5.5x for steel.

Key risks to our investment case

The key risks to our investment thesis are as follows. 1) Our forecasts and valuation are highly sensitive to commodity price movements. On the one hand, lower-than-expected prices would have a negative impact. On the other hand, higher-than-expected prices would likely result in upside risk to our estimates. Such price movements are dependent upon the supply-demand balance of the products, so substantial new capacity build-up by competitors inside or outside the region could result in lower-than-expected prices than currently anticipated. 2) Delays in planned capacity expansions could negatively affect our earnings forecasts. 3) All of IQ's businesses are cyclical in nature, and, in particular, the petrochemicals segment is dependent upon the global economy and global industrial production. A change in global GDP forecasts would likely have a direct impact on global demand for such products. 4) Political risks remain a broader risk for the region, but, within the region, Qatar and the UAE have been the most stable countries.

Valuation

We value Industries Qatar using a sum-of-the-parts valuation, which yields a target price of QR164 per share. At the current share price, this implies upside potential of 32% on a 12-month basis.

Sum-of-the-parts valuation

We derive our target price via a sum-of-the-parts analysis, for which we use a DCF analysis for QAFCO and QAPCO and target multiples for QASCO and QAFAC. This yields a value of QR164/share. Our key assumptions are as follows.

- Forecast cash flows to 2020 and a terminal value. We derive terminal value as a perpetuity of free cash flows growing at 1.5% pa for QAFCO and 2.5% for QAPCO.
- A WACC of 10.4%. This assumption is based on a risk-free rate of 1.9%, market risk premium of 8%, beta of 1.2, cost of debt of 5%, tax rate of 0% and target gearing of 10%.
- Target multiples are based on comparable companies for QASCO and QAFAC. We use a target multiple 2012F EV/EBITDA of 5.5x for Qatar Steel and 5.0x for Qatar Fuel Additives.

Table 3 : Sum-of-the-parts valuation

	Methodology	Valuation QARm	Valuation US\$m	IQ share	EV to IQ QARm	EV to IQ US\$m	% of total
Petrochemicals	DCF	44,814	12,312	80%	35,851	9,849	40%
Fuel additives	Multiples	5,218	1,433	50%	2,609	717	3%
Fertilisers	DCF	55,715	15,306	75%	41,787	11,480	46%
Steel	Multiples	10,101	2,775	100%	10,101	2,775	11%
Total EV					90,347	24,821	100%
Investments					2,068	568	
Net cash (debt) 2010					-2,252	-619	
Equity value					90,164	24,770	
Number of shares					550		
Equity value per share					164		

Source: Rasmala forecasts

Peer multiples

The analysis leads to target multiples of 9.5x 2012F EV/EBITDA for fertilisers and 10.5x for petrochemicals. We cross-check these with multiples on which regional and international peers trade.

Table 4 : Current and implied multiples

	2011F	2012F	2013F
Implied EV/EBITDA by segment			
Fertilisers	12.6	9.5	9.2
Petrochemicals	10.6	10.5	9.4
Fuel additives	5.0	5.0	5.4
Steel	5.5	5.5	3.6
Group	10.2	9.2	8.0
Group – current EV/EBITDA	7.9	6.9	5.7
Industries Qatar PE			
Target PE	10.9	10.3	8.8
Current PE	8.4	7.8	6.7

Source: Rasmala forecasts

In petrochemicals, the main regional listed comparables are in Saudi Arabia.

- Saudi Basic Industries Corporation (SABIC) is one of the largest petrochemical companies in the world in terms of revenues and the largest listed stock in the MENA region by market capitalisation. It is active in petrochemicals (base chemicals, intermediates, polymers and high performance plastics products), nitrogenous fertilisers and metals (steel products and investments in aluminium production). In particular, SABIC has exposure to the same segments as IQ, but has a stronger focus on petrochemicals rather than fertilisers – thus it provides a less direct comparable.
- Other, mostly one-product, petrochemical companies listed in Saudi Arabia.

In fertilisers, the main regional nitrogen fertiliser comparables are as follows.

- Saudi Arabian Fertilizer Company (SAFCO) is the largest nitrogen fertiliser company in Saudi Arabia by market capitalisation, headquartered in Jeddah. It produces nitrogen-based fertilisers. SABIC, with a 43% stake, is its largest shareholder.
- Orascom Construction Industries (OCI), headquartered in Cairo, Egypt, has only recently ventured into nitrogen-based fertilisers and in addition is active in construction across the MENA region. However, OCI's construction business is too large to make this company a direct comparable, hence we believe SAFCO is the best comparable for QAFCO.

Using a DCF analysis leads to multiples that are more or less in line with petrochemicals in Saudi Arabia, although the range is wide and multiples for start-ups are not relevant. The QAFCO target multiple (EV/EBITDA of 9.5x for 2012F) is well below SAFCO's 2012F multiple of 12.0x, on our forecasts, but the latter is discounting capacity start-ups beyond 2012, whereas QAFCO's multiples include these. SAFCO's historical multiples are about 10x EV/EBITDA.

An industrial conglomerate

Industries Qatar is a holding company with four main lines of operation: petrochemicals, fuel additives, nitrogen fertilisers and steel. The company has full support from the State of Qatar, which is, through Qatar Petroleum, its largest shareholder.

Petrochemicals, fertilisers and steel

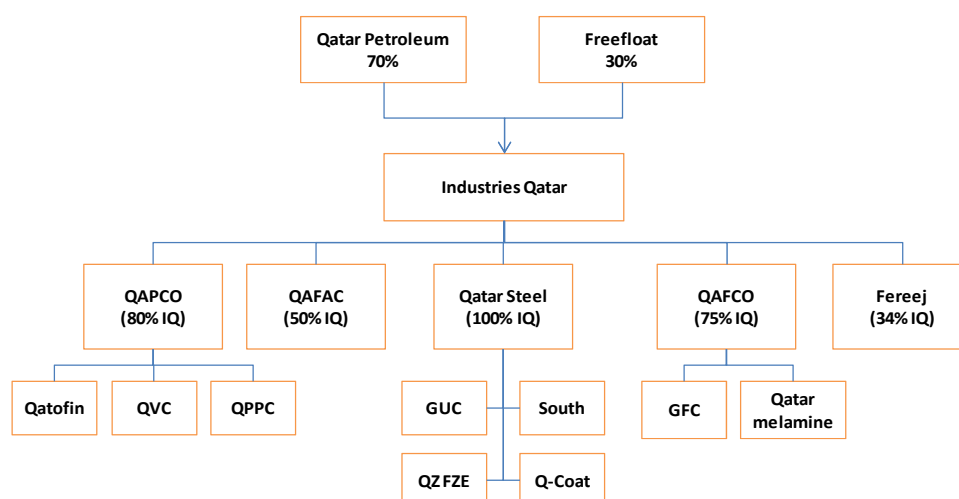
IQ is effectively a holding company

Foreign investors can buy up to 7.5% of outstanding shares open

IQ was incorporated as a Qatari joint stock company on 19 April 2003. IQ operates as a holding company with direct shareholdings in a number of subsidiary and joint venture companies, which are independently managed by their respective boards of directors and management teams.

State-owned Qatar Petroleum is IQ's largest shareholder (70%) and as a parent company provides all head office functions for IQ. Foreign investors can currently own up to 7.5% (25% of the freefloat) of share capital.

Figure 1 : Industries Qatar organisation chart



Source: Company, Rasmala

Qatar Petrochemical Company (QAPCO)

Incorporated in 1974, QAPCO is 80% owned by IQ and 20% by Total Petrochemicals. QAPCO has two joint ventures, Qatofin Company Limited and Ras Laffan Olefins Cracker Company (RLOC), and two associated companies, Qatar Vinyl Company (QVC) and Qatar Plastic Products Company. QAPCO was established with the aim of utilising associated and non-associated ethane gas from petroleum production in Qatar and produces ethylene, low-density polyethylene (LDPE), linear low-density polyethylene (LLDPE) and sulphur. A substantial part of the ethylene produced is used in the LDPE production process, with the remainder being supplied to QAPCO's associate, QVC, to meet its feed requirements. QAPCO markets LDPE in over 75 countries, with the main markets being the Middle East, Far East, Africa and the Indian subcontinent. LLDPE is a relatively new addition to the product portfolio (2009).

Qatar Fuel Additives Company (QAFAC)

QAFAC, incorporated in 1991, is a joint venture between IQ (50%), OPIC Middle East Corporation (20%), International Octane Limited (15%) and LCY Middle East Corporation (15%). It produces and exports methanol and methyl-tertiary-butyl-ether (MTBE) and its primary markets are the Far East, Europe and the Gulf region.

Qatar Fertiliser Company (QAFCO)

QAFCO (incorporated in 1969) is a joint venture owned by IQ (75%), Fertiliser Holdings AS (10%) and Yara Netherlands BV (15%). QAFCO produces and sells ammonia and urea. Asia and in particular India are the most important export markets for QAFCO.

Qatar Steel Company (QS)

QS (incorporated in 1974) was the first integrated steel producer in the GCC and is Qatar's sole steel producer. When the State of Qatar established QS in 1974, it went into a joint venture with Kobe Steel and Tokyo Boeki, but IQ acquired 100% of the company in 2003. QS manufactures and sells steel bars, billets and reinforcing bars. End markets are primarily in Qatar (49% of revenues in 1H2011) and other GCC countries.

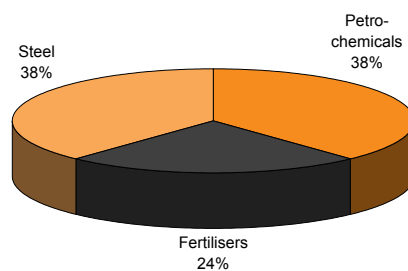
Fereej Real Estate Company (incorporated 2008)

Fereej is a joint venture owned by IQ (34%), Qatar Real Estate Investment Company (33%) and Al-Koot Insurance and Re-Insurance Company (33%). It invests in residential and commercial buildings, and provides facilities management and construction project management services.

Petrochemicals is most important segment for IQ

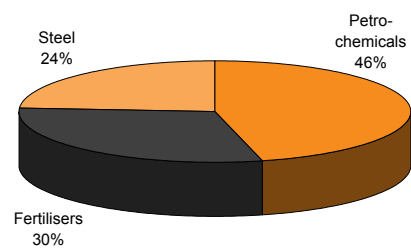
The petrochemicals segment (ethylene and derivatives, fuel additives) is the largest segment for Industries Qatar, accounting for 38% of total revenues in 2010, followed by steel (38%) and fertilisers (24%). As the petrochemicals and fertilisers segments have the advantage of low-cost feedstock, the contribution to profits of these two segments is higher than for steel: in 2010, petrochemicals accounted for 46% of EBITDA, fertilisers 30% and steel 24%.

Chart 1 : Revenues by segment ,2010



Source: Company data

Chart 2 : EBITDA by segment, 2010



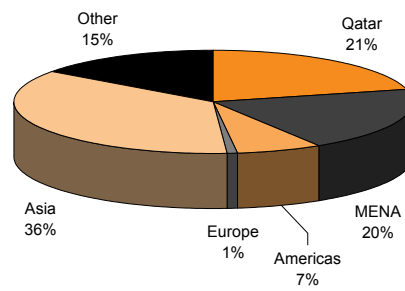
Source :Company data

Asia is an important export segment

Steel for the domestic market

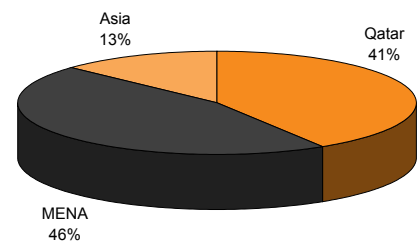
For petrochemicals and fertilisers, Asia is the most important export market, representing 60% and 44% of 2010 revenues, respectively. Steel is predominantly sold to the regional market, with 41% of revenues distributed domestically in 2010 (49% in 1H11) and 46% in the rest of the Mena region, mostly Saudi Arabia and the UAE.

Chart 3 : Revenues by geography, 2010



Source: Company data

Chart 4 : Steel revenues split, 2010



Source :Company data

Growth strategy

IQ is in the middle of significant capacity expansions, with petrochemical and fertiliser plants starting up in 2011-12. Steel expansion has been postponed, however, because no gas has been allocated yet.

Capacity expansions drive revenue growth

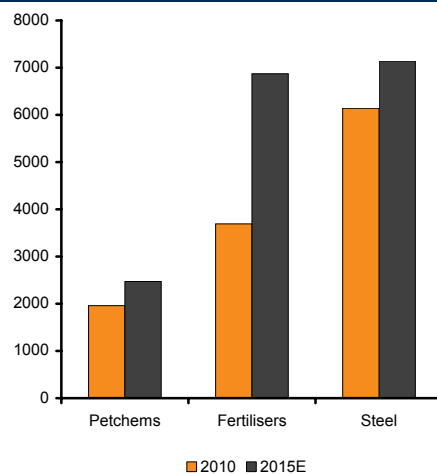
Bulk of new capacity starting up within the next 12 months, and in the most profitable segments

In April 2011, IQ gave an update of its growth strategy, outlining its capital expenditure plans for 2011-15. Unlike its Saudi rival SABIC, which has acquired operations in Europe and the US and has built up capacity in Asia, IQ focuses on organic growth in Qatar rather than acquisitions, by building new, complementary plants and by investing in existing facilities. This leaves IQ in a comfortable balance sheet position, but it also means that the company will likely continue to focus on its current upstream portfolio of products, rather than move downstream in chemicals or fertilisers. Based on IQ's plans, we expect strong capacity growth in the most profitable segments, petrochemicals and fertilisers, growing by on average 8% and 23%, respectively, annually during 2010-13.

Qatar Steel Phases 2 and 3 on hold – positive

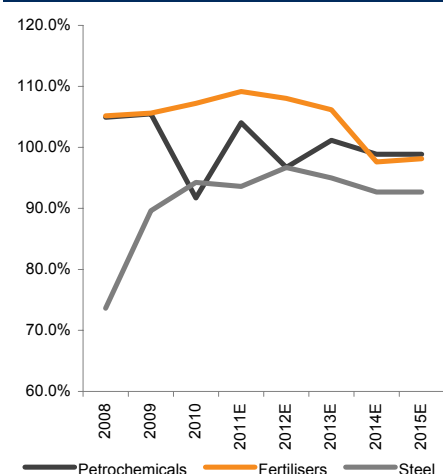
All three business segments are core to the company and expansions had been planned across the board. In steel, IQ announced aggressive expansion plans last year with the intention to double steel capacity from 6.1mtpa in 2010 to 12.4mtpa by 2015. Recently, however (August 2011), following discussions with Qatar Petroleum, IQ decided to put the Qatar Steel Phase 2 and 3 projects on hold due to restrictions on natural gas allocations. IQ intends to revisit the projects when sufficient natural gas allocations have been secured. Given that IQ imports iron ore, this segment does not have the same cost-competitive position as the other segments (reported net margin of 26% in 2010 compared with 55% in both fertilisers and petrochemicals); hence we see this as a positive development.

Chart 5 : Capacity expansions (mt)



Source: Company data, Rasmala

Chart 6 : Utilisation rates 2007-13E



Source: Company data, Rasmala estimates

Cheap gas drives the capacity expansions

Natural gas cost advantage is IQ's key competitive differentiator

The driver behind the capacity expansions is IQ's access to cheap gas, the key competitive differentiator for the company on a global basis. For steel, the rationale is less evident, but the product is predominantly used for the domestic market.

Qatar Petroleum supplies IQ with natural gas on long-term contracts: feedstock prices vary by plant and are formula driven, linked to selling prices and volumes of the products IQ sells. In 2010, Industries Qatar's feedstock costs were about US\$0.95/MMBtu for steel, US\$1.75 for petrochemicals and US\$2.35 for fertilisers, and the average price for the group US\$1.91/MMBtu. For 2008, when commodity prices reached record levels, we estimate that IQ paid slightly less than US\$3 for fertiliser feedstock. We expect no changes to this pricing structure: costs for all projects/plants are decided on a case-by-case basis and are subject to availability of gas.

For 2011-15, IQ expects natural gas price inflation of 1.4% for the group, but higher for petrochemicals and steel (+8.7%) and a decline of 3.7% for fertilisers. These natural gas prices ensure high EBITDA margins for each of the businesses, but are much higher than competitors pay in the rest of the Gulf, especially in Saudi Arabia, where prices are US\$0.75/MMBtu currently.

In addition, IQ purchases butane as a feedstock for MTBE and LLDPE, at market prices. For the steel segment, IQ sources iron ore from four suppliers in Brazil (Companhia Vale do Rio Doce and Samarco Mineracao), Sweden (Luossavaara-Kiirunavaara Aktiebolag) and Bahrain (Gulf Industrial Investment Co.).

But gas is not always available and IQ competes with other industrial projects

As is evident from the postponement of the steel projects, natural gas may be abundant in Qatar, but is not readily available and many other industries compete for natural gas: LNG, GTL, aluminium and cement, in addition to gas exports by pipeline.

In fact, in petrochemicals, IQ is not the only company expanding in Qatar: its parent company QP also plans to expand petrochemical capacity, without IQ, albeit some projects, a US\$6bn project with ExxonMobil in Ras Laffan and a US\$2.6bn project in Mesaieed with Honam Petrochemicals of South Korea (1.3mt ethylene, 0.7mt PP), have been put on hold/cancelled.

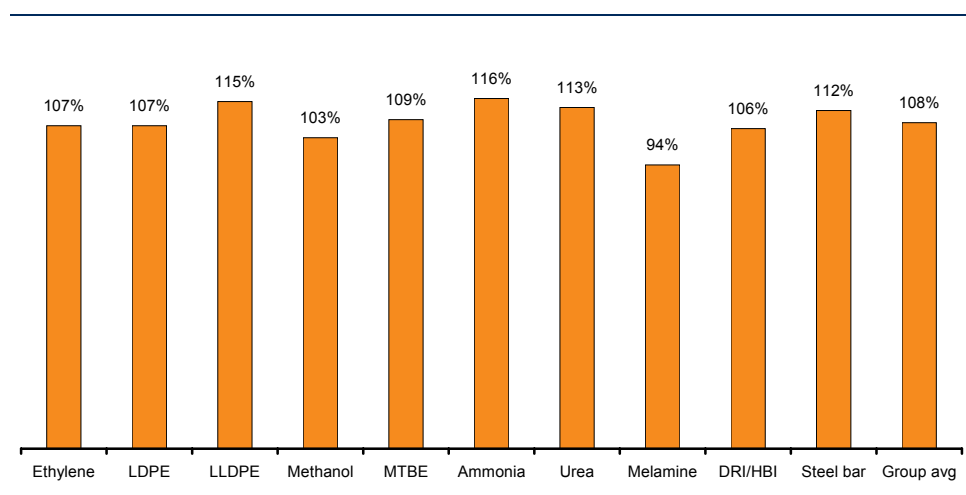
High utilisation rates

The cost advantage also makes it possible to keep utilisation rates high in petrochemicals and fertilisers, as has been the case in the past even during downturns, hence making pricing the key variable for revenues. In its most recent results for 1H11, IQ reported an average 108% utilisation rate, with only melamine below 100% because this plant was only started up in 1Q11.

Rates are also held high as a result of off-take agreements with joint venture partners Yara and Total Petrochemicals, which set a floor for minimum volumes. The off-take agreements are for volumes of up to 70%, but in 2008 and 2009, the off-take accounted was less at about 50% of total production.

Historically, utilisation has been high for the petrochemicals and fertilisers segment, but steel has been a more volatile segment than the other two, with utilisation dipping to about 74% in 2008. In our forecasts, we assume that capacity utilisation stays between 90% and 110% of nameplate capacity over our forecast period, with available capacity adjusted for scheduled maintenance stops.

Chart 7 : Industries Qatar utilisation rates in 1H11 by plant



Source: Company reports

IQ is not the sole producer of petrochemicals in Qatar

Cost advantage and off-take agreements support high utilisation rates

Steel expansion on hold, but petrochemicals and fertilisers should ensure strong growth

In the following table, we outline our assumptions for capacity growth between 2010 and 2015. Outside steel, start-ups are imminent and we believe they should be positive catalysts for the share.

- In petrochemicals, the commercial launch of the LDPE-3 unit in is due in 1Q12. The LLDPE plant started up in 2Q10 and is now fully ramped up, running above 100% capacity.

In fertilisers, melamine started up in 1Q11 and achieved 94% utilisation in 2Q, the first full quarter of operation. QAFCO 5 and 6 have been delayed and are now due to start up in 3Q11 and 4Q12 respectively. In our model, we assume some more minor delays and expect the first contribution from QAFCO 5 at the end of 4Q11.

Table 5 : Capacity outlook (mtpa)

Product	Plant	Launch	2010	2011F	2012F	2013F	2014F	2015F	CAGR 2010-13F
Petrochemical segment									
Ethylene	Ethylene - 1	Pre-2009	420	420	420	420	420	420	
Ethylene	Ethylene - 1	Pre-2009	156	156	156	156	156	156	
Ethylene	RLOC	2010	152	302	302	302	302	302	
Ethylene – total			728	878	878	878	878	878	6%
LDPE	LDPE - 1	Pre-2009	168	168	168	168	168	168	
LDPE	LDPE - 2	Pre-2009	152	152	152	152	152	152	
LDPE	LDPE - 3	Q1 2012	0	0	180	240	240	240	
LDPE – total	Total		320	320	500	560	560	560	21%
LLDPE	Qatofin	2010	107	227	227	227	227	227	28%
Methanol	QAFAC 1	Pre-2009	500	500	500	500	500	500	0%
MTBE	QAFAC 2	Pre-2009	305	305	305	305	305	305	0%
QAPCO			1,155	1,425	1,605	1,665	1,665	1,665	13%
QAFAC			805	805	805	805	805	805	0%
Petrochemical segment			1,960	2,230	2,410	2,470	2,470	2,470	8%
Fertiliser segment									
Ammonia	QAFCO 1	Pre-2009	296	296	296	296	296	296	
Ammonia	QAFCO 2	Pre-2009	295	295	295	295	295	295	
Ammonia	QAFCO 3	Pre-2009	444	444	444	444	444	444	
Ammonia	QAFCO 4	Pre-2009	516	516	516	516	516	516	
Ammonia	QAFCO 5	Q3 2011	0	116	1,155	1,155	1,155	1,155	
Ammonia – total			1,550	1,666	2,705	2,705	2,705	2,705	20%
Urea	QAFCO 1	Pre-2009	320	320	320	320	320	320	
Urea	QAFCO 2	Pre-2009	374	374	374	374	374	374	
Urea	QAFCO 3	Pre-2009	609	609	609	609	609	609	
Urea	QAFCO 4	Pre-2009	840	840	840	840	840	840	
Urea	QAFCO 5	Q3 2011	0	100	998	998	998	998	
Urea	QAFCO 6	Q3 2012	0	0	748	998	998	998	
Urea – total			2,143	2,242	3,888	4,138	4,138	4,138	25%
Melamine	Melamine	2010		27	27	27	27	27	
Fertiliser segment			3,693	4,151	6,621	6,870	6,870	6,870	23%
Steel segment									
Steel bar	QS Phase 1	Pre-2009	1,500	1,500	1,500	1,500	1,500	1,500	
Steel bar	QS Dubai	Pre-2009	300	300	300	300	300	300	
Steel bar	QS EF1R	Q1 2013	0	0	0	1,000	1,000	1,000	
Steel bar – total			1,800	1,800	1,800	2,800	2,800	2,800	16%
DRI/HBI	QS Phase 1	Pre-2009	2,300	2,300	2,300	2,300	2,300	2,300	0%
Billets	QS Phase 1	Pre-2009	1,800	1,800	1,800	1,800	1,800	1,800	0%
Coils	QS Dubai	Pre-2009	240	240	240	240	240	240	0%
Steel segment			6,140	6,140	6,140	7,140	7,140	7,140	5%
Billets	QS Phase 2	On hold	0	0	0	700	700	700	
Steel bar	QS Phase 2	On hold	0	0	0	700	700	700	
DRI/HBI	QS Phase 2	On hold	0	0	0	1,800	1,800	1,800	
Wires	QS Phase 2	On hold	0	0	0	100	100	100	
DRI/HBI	QS Phase 3	On hold	0	0	0	0	0	1,800	
Coils	QS Phase 3	On hold	0	0	0	0	0	1,200	
Steel segment	Including phase 2 & 3		6,140	6,140	6,140	10,440	10,440	13,440	19%

Source: Company data, Rasmala forecasts

Key forecasts

We expect fertilisers to be 31% of total revenue by 2013. With lower steel growth in 2011 and 2012, this should benefit margins. Despite substantial investment in new plants, the balance sheet looks comfortable. IQ has not indicated it plans to use cash for acquisitions.

Revenues – capacity expansions drive growth

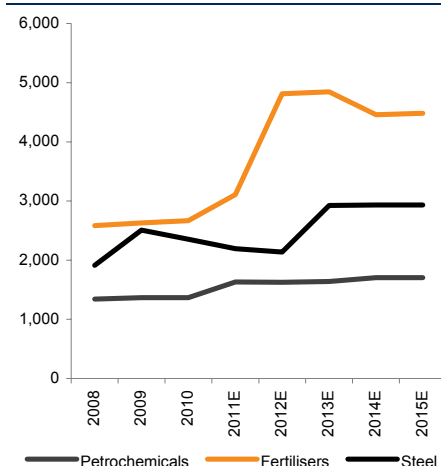
We derive our revenue forecasts on the basis of our assumptions for capacity expansions and price forecasts, which yields strong group revenue CAGR of 21% over the 2010-13E period due to new capacity starting up.

The fertiliser segment is the main contributor to this growth, with a CAGR of 33%. The bulk of this growth will come in 2011 and 2012, when QAFCO 5 is being ramped up. We expect a CAGR of 12% for the petrochemical segment, with most of this growth in 2011. In 1H11, the segment recorded a 68% increase in sales as a result of new capacities and strongly improved selling prices. For the steel segment, we also expect strong growth, but mostly in 2013. As a result, we expect fertilisers to become more prominent in the revenue mix, moving from 24% of group revenues in 2010 to 31% in 2013, which is also beneficial for margins.

Double-digit growth in IQ's installed capacity between 2010 and 2015E

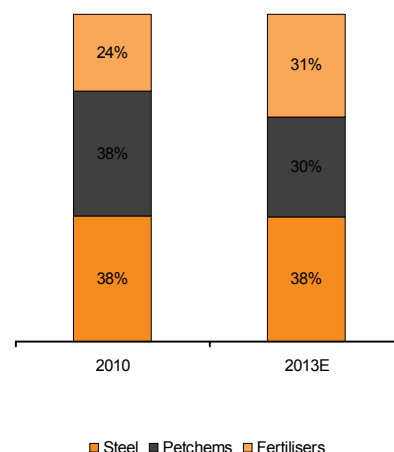
Fertilisers become more prominent in the portfolio

Chart 8 : Sales volumes (mtpa)



Source: Company data, Rasmala estimates

Chart 9 : Segment split as % of revenues

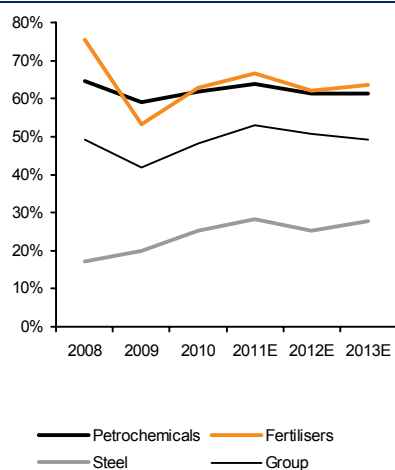


Source :Company data, Rasmala estimates

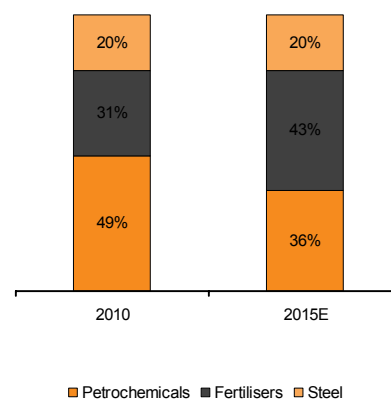
High margins driven by low natural gas costs

Profitability at IQ is driven by low natural gas costs for all segments, somewhat offset by the steel segment, which buys raw materials at market prices, particularly iron ore. Higher depreciation as a result of the large capital expenditure programmes and higher financing costs result in net income growing at a lower rate than EBITDA during 2010-15, but we forecast strong average growth for 2010-15.

- **Gross profit:** we expect petrochemicals to decline in importance, from 49% of gross profit in 2010 to 36% in 2015, the difference being made up by fertilisers. Steel should keep the same level of 20% of total gross profit in both years.
- **EBITDA:** we expect a 2010-15 CAGR of 12% and the EBITDA margin to stay roughly the same at 48% in 2015 compared with 47% in 2010. However, as fertiliser and petrochemical capacities are ramped up, we expect the margin to peak at 53% in 2012, then fall from 2013 onwards when new steel capacity is ramped up.
- **Net profit:** we expect a 2010-15 CAGR of 11%, slightly lower than at the EBITDA level due to increased depreciation and higher finance costs.

Chart 10 : Gross margins by segment


Source: Company data, Rasmala estimates

Chart 11 : Gross profit contribution to total by segment


Source :Company data, Rasmala estimates

Table 6 : Revenues by product

	2003	2004	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Revenues (QRm)											
Ethylene	213	282	234	325	478	990	741	1,026	1,249	748	727
LDPE	777	1,113	1,348	1,409	1,651	1,856	1,339	1,725	1,924	2,519	3,162
LLDPE	0	0	0	0	0	0	0	512	1,163	1,010	941
Other							23	385	440	440	440
QAPCO	991	1,394	1,582	1,734	2,128	2,846	2,104	3,647	4,777	4,717	5,270
Methanol	193	241	256	326	394	428	234	302	379	388	337
MTBE	323	445	723	680	609	973	787	735	1,227	981	947
QAFAC	516	686	979	1,006	1,003	1,401	1,021	1,038	1,606	1,370	1,284
Petrochemicals	1,506	2,081	2,561	2,741	3,132	4,247	3,125	4,685	6,383	6,087	6,555
Ammonia	203	306	322	393	366	557	338	507	757	894	696
Urea	760	1,070	1,886	1,849	2,490	3,881	2,192	2,471	3,777	5,698	6,043
Melamine								0	148	133	124
Other								3	-67	-67	-67
Fertilisers	962	1,376	2,208	2,242	2,855	4,438	2,529	2,980	4,615	6,657	6,796
Steel bar	878	1,279	1,441	2,412	3,037	5,139	3,066	4,055	4,826	4,842	7,720
DRI/HBI	0	0	0	0	0	350	625	472	319	268	55
Other					398	281	289	197	424	442	462
Steel	878	1,279	1,441	2,412	3,435	5,770	3,980	4,725	5,569	5,553	8,237
Other					0	0	2	4	4	4	4
Group revenues	3,347	4,736	6,210	7,394	9,422	14,454	9,636	12,393	16,570	18,300	21,591

Source: Company data, Rasmala forecasts

Table 7 : Sales volumes by product

ktpa	2003	2004	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Ethylene	140	127	96	112	153	308	317	335	363	247	237
LDPE	320	289	324	318	312	327	322	318	323	475	588
LLDPE								118	243	238	219
Methanol	282	319	334	330	345	387	403	338	380	362	309
MTBE	292	309	355	337	244	321	324	258	323	305	290
Ammonia	319	348	349	414	370	338	382	411	446	593	440
Urea	1,421	1,599	2,226	2,240	2,223	2,247	2,249	2,257	2,443	4,179	4,367
Melamine									44	41	41
Steel bar	762	820	877	1,278	1,345	1,632	1,600	1,773	1,764	1,718	2,660
DRI/HBI						180	682	354	205	190	38
Coil & wire					118	102	228	228	228	228	228
Petrochemicals	1,034	1,044	1,109	1,097	1,054	1,343	1,366	1,367	1,632	1,627	1,642
Fertilisers	1,740	1,947	2,575	2,654	2,593	2,585	2,631	2,668	2,933	4,812	4,847
Steel bar	762	820	877	1,278	1,463	1,914	2,510	2,355	2,197	2,137	2,926
Total	3,536	3,811	4,561	5,029	5,110	5,842	6,507	6,390	6,762	8,575	9,415

Source: Company data, Rasmala forecasts

Income statement

QRm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	9857	12331	16570	18301	21591
Cost of sales	-5235	-5815	-7075	-7639	-9457
Operating costs	-702.5	-723.4	-805.0	-920.0	-950.0
EBITDA	3919	5793	8690	9741	11185
DDA & Impairment (ex gw)	-548.9	-636.3	-750.0	-1398	-1518
EBITA	3370	5157	7940	8343	9667
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	3370	5157	7940	8343	9667
Net interest	-118.1	-146.6	-169.2	-186.3	-207.9
Associates (pre-tax)	-42.0	116.7	110.0	120.0	185.0
Other pre-tax items	1751	451.0	272.9	463.3	569.2
Reported PTP	4961	5578	8154	8740	10213
Taxation	0.00	0.00	0.00	0.00	0.00
Minority interests	-2.47	-2.36	-3.45	-3.70	-4.32
Other post-tax items	-1166	0.00	0.00	0.00	0.00
Reported net profit	3793	5575	8150	8736	10209
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	3919	5793	8690	9741	11185
Normalised PTP	4961	5578	8154	8740	10213
Normalised net profit	3793	5575	8150	8736	10209

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

QRm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	5990	5290	6405	9620	13555
Other current assets	3609	4749	5673	6251	7466
Tangible fixed assets	16047	19543	23383	25501	27252
Intang assets (incl gw)	130.2	128.2	128.2	128.2	128.2
Oth non-curr assets	1654	2197	2307	2422	2543
Total assets	27431	31908	37895	43923	50944
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	2052	3405	3934	4004	4446
Long term debt (3)	5868	6118	6416	7676	8376
Oth non-current liab	442.9	623.9	655.0	687.8	722.2
Total liabilities	8363	10146	11004	12367	13544
Total equity (incl min)	19069	21762	26891	31556	37400
Total liab & sh equity	27432	31908	37895	43923	50944
Net debt	225.8	2252	1435	-520.5	-3755

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

QRm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	3919	5793	8690	9741	11185
Change in working capital	322.1	-818.6	-394.1	-508.5	-772.6
Net interest (pd) / rec	-118.1	-146.6	-169.2	-186.3	-207.9
Taxes paid	0.00	0.00	0.00	0.00	0.00
Other oper cash items	876.8	-259.8	340.8	463.3	569.2
Cash flow from ops (1)	5000	4568	8468	9510	10773
Capex (2)	-4879	-4141	-4547	-3396	-3084
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-21637	-542.7	-109.8	-115.3	-121.1
Cash flow from invest (3)	-26516	-4684	-4657	-3512	-3205
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	179.0	1326	297.9	1260	700.0
Ordinary dividend paid	-4400	-2750	-3025	-4075	-4368
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	921.6	181.0	31.2	32.8	34.4
Cash flow from fin (5)	-3299	-1243	-2696	-2782	-3634
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Incl/(decr) cash (1+3+5+6)	-24816	-1359	1115	3216	3934
Equity FCF (1+2+4)	120.5	427.0	3920	6113	7689

Source: Company data, Rasmala forecasts

year to Dec

Standard ratios	Industries Qatar					Yara			OCI		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	-33.1	25.1	34.4	10.4	18.0	24.2	-3.01	2.32	15.8	10.7	7.43
EBITDA growth (%)	-45.6	47.8	50.0	12.1	14.8	10.2	-7.91	0.30	43.2	16.0	7.22
EBIT growth (%)	-50.0	53.0	54.0	5.08	15.9	11.2	-13.0	-0.15	50.5	16.8	8.84
Normalised EPS growth (%)	-47.9	47.0	46.2	7.19	16.9	44.2	-10.2	0.09	30.0	27.1	15.7
EBITDA margin (%)	39.8	47.0	52.4	53.2	51.8	15.3	14.5	14.2	27.2	28.5	28.4
EBIT margin (%)	34.2	41.8	47.9	45.6	44.8	12.0	10.8	10.5	22.0	23.2	23.5
Net profit margin (%)	38.5	45.2	49.2	47.7	47.3	12.5	11.5	11.3	13.6	15.6	16.8
Return on avg assets (%)	14.3	19.3	23.8	21.8	22.0	14.8	12.0	11.0	10.8	12.7	13.2
Return on avg equity (%)	20.3	27.3	33.5	29.9	29.6	25.5	19.2	16.7	22.6	24.8	24.8
ROIC (%)	22.7	26.7	33.1	29.5	31.1	13.3	11.1	10.7	22.3	26.8	31.0
ROIC - WACC (%)	11.6	15.6	22.0	18.4	20.0	5.58	3.34	2.98	7.00	12.9	17.0
	year to Dec					year to Dec			year to Dec		
Valuation	FY09A	FY10A	FY11F	FY12F	FY13F	FY09A	FY10A	FY11F	FY12F	FY13F	FY13F
EV/sales (x)	6.98	5.74	4.22	3.72	3.00	1.18	1.14	1.06	1.61	1.31	1.07
EV/EBITDA (x)	17.5	12.2	8.05	6.98	5.79	7.69	7.87	7.47	5.92	4.60	3.77
EV/EBITDA @ tgt price (x)	23.1	16.0	10.5	9.21	7.73	9.66	10.0	9.60	7.72	6.14	5.21
EV/EBIT (x)	20.4	13.7	8.81	8.15	6.70	9.79	10.6	10.1	7.31	5.63	4.55
EV/invested capital (x)	3.56	2.95	2.47	2.19	1.93	1.73	1.58	1.43	1.68	1.60	1.51
Price/book value (x)	3.60	3.15	2.55	2.17	1.83	1.66	1.43	1.25	2.08	1.79	1.55
Equity FCF yield (%)	0.18	0.62	5.72	8.92	11.2	4.69	10.1	8.81	20.2	23.4	25.1
Normalised PE (x)	18.1	12.3	8.41	7.84	6.71	7.18	7.99	7.98	9.88	7.78	6.72
Norm PE @ tgt price (x)	23.8	16.2	11.1	10.3	8.84	9.59	10.7	10.7	13.5	10.6	9.16
Dividend yield (%)	4.01	4.41	5.95	6.37	7.45	2.63	2.83	3.04	5.40	6.43	7.44
	year to Dec					year to Dec			year to Dec		
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	550.0	550.0	550.0	550.0	550.0	Net debt to equity (%)	1.18	10.3	5.34	-1.65	-10.0
Reported EPS (QAR)	6.90	10.1	14.8	15.9	18.6	Net debt to tot ass (%)	0.82	7.06	3.79	-1.19	-7.37
Normalised EPS (QAR)	6.90	10.14	14.82	15.88	18.56	Net debt to EBITDA	0.06	0.39	0.17	-0.05	-0.34
Dividend per share (QAR)	5.00	5.50	7.41	7.94	9.28	Current ratio (x)	4.68	2.95	3.07	3.96	4.73
Equity FCF per share (QAR)	0.22	0.78	7.13	11.1	14.0	Operating CF int cov (x)	43.3	32.2	51.0	52.0	52.8
Book value per sh (QAR)	34.6	39.5	48.9	57.3	68.0	Dividend cover (x)	0.86	2.03	2.69	2.14	2.34
	year to Dec						year to Dec				

Priced as follows: IQCD.QA - QR124.60; YAR.OL - NKr235.60
Source: Company data, Rasmala forecasts

Valuation methodology

We derive our target price via a sum-of-the-parts analysis, in which we use a DCF analysis for QAFCO and QAPCO and target multiples for QASCO and QAFAC. This yields a value of QR164/share. Our key assumptions are as follows.

Table 8 : Valuation methodology

	Methodology	Valuation QAR m	Valuation US\$m	IQ share	EV to IQ QAR m	EV to IQ US\$m	% of total
Petrochemicals	DCF	44,814	12,312	80%	35,851	9,849	40%
Fuel additives	Multiples	5,218	1,433	50%	2,609	717	3%
Fertilisers	DCF	55,715	15,306	75%	41,787	11,480	46%
Steel	Multiples	10,101	2,775	100%	10,101	2,775	11%
Total EV					90,347	24,821	100%
Investments					2,068	568	
Net cash (debt) 2010					-2,252	-619	
Equity value					90,164	24,770	
Number of shares					550		
Equity value per share					164		

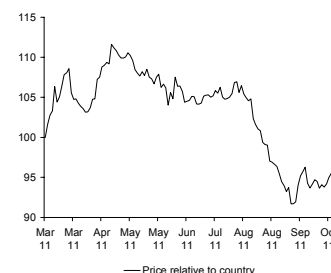
Source: Rasmala forecasts

Company description

Buy

Price relative to country

Industries Qatar is the largest publicly listed company in Qatar and the second-largest listed industrial company in the MENA region after SABIC by market capitalisation. It produces petrochemicals (ethylene and derivatives), fuel additives (methanol, MTBE), nitrogen fertilisers and steel. IQ was incorporated as a Qatari joint stock company on 19 April 2003. IQ operates as a holding company with direct shareholdings in a number of subsidiary and JV companies that are independently managed by their respective boards of directors and management teams.



Strategic analysis

Average SWOT company score:

4

Revenues by segment, 2010

Strengths

4

One of the lowest-cost producers globally of urea, ammonia and petrochemicals. Joint ventures with strong international partners guarantee access to their distribution networks.

Weaknesses

3

No control over selling prices of its main products. For steel, reliant on import of iron ore.

Opportunities

5

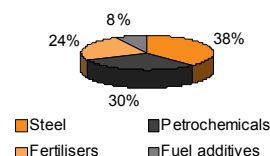
IQ could use its strong balance sheet to expand capacity, or acquire assets abroad.

Threats

3

Increased exports from China due to reduced export tax. Petrochemical competition from neighbouring (low-cost) countries.

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters
P.O. Box 3212, Doha, Qatar

Website
www.industriesqatar.com.qa

Shares in issue
550.0m

Freefloat
30%

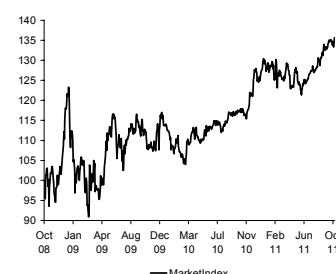
Majority shareholders
Qatar Petroleum (70%)

Country view: Qatar

Country rel to M East & Africa

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation of RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score:

4+

Broker recommendations

Supplier power

3+

Natural gas is IQ's main raw material, currently linked to volumes and selling prices of end products, but the government controls the supply and allocation of natural gas.

Barriers to entry

4+

Considerable investment is needed to enter the segments (fertilisers, petrochemicals and steel) in which IQ operates. IQ has access to cheap gas, which many competitors outside the region do not.

Customer power

3+

Customers can choose other suppliers from any location in the petrochemical industry, hence pricing is the key variable. In fertilisers, customers can reduce application depending on circumstances.

Substitute products

4+

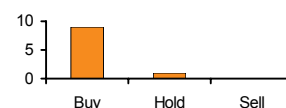
Other types of fertiliser depending on the crop. Other materials than petrochemicals.

Rivalry

4+

Competition in most markets is significant, but IQ has the advantage of being one of the lowest-cost producers globally. In steel, IQ is the main supplier in Qatar, with little competition.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

13 October 2011

Initiation of coverage

Buy

Target price

££284.00

Price

££208.53

Short term (0-60 days)

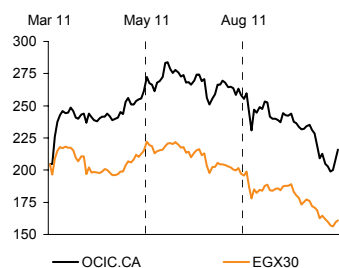
n/a

Market view

No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (££)	243.8	256.0	n/a
Absolute (%)	-14.5	-18.5	n/a
Rel market (%)	-2.6	-0.0	n/a
Rel sector (%)	n/a	n/a	n/a

**Market capitalisation**

££42.98bn (€£5.27bn)

Average (12M) daily turnover

££36.49m (€£4.32m)

Sector: European-DS Tot Mkt
 RIC: OCIC.CA, OCIC EY
 Priced ££208.53 at close 11 Oct 2011.
 Source: Bloomberg

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Orascom Construction Ind.

Look at the bright side

We believe the market is discounting the stock too much for political risk, the potential breach of contract by the government for gas prices, and margin pressure expectations for construction. We believe the next 12 months will be about new fertiliser capacity, providing positive catalysts for the share.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (££m)	21,313	27,552	31,896	35,324	37,947
EBITDA (££m)	4,421	6,051	8,666	10,052	10,777
Reported net profit (££m)	2,417	3,344	4,348	5,527	6,392
Normalised net profit (££m)	2,417	3,344	4,348	5,527	6,392
Normalised EPS (££)	11.74	16.23	21.10	26.82	31.02
Dividend per share (££)	9.90	11.30	11.30	13.40	15.50
Dividend yield (%)	4.75	5.40	5.40	6.43	7.44
Normalised PE (x)	17.80	12.90	9.88	7.78	6.72
EV/EBITDA (x)	11.40	9.06	5.92	4.60	3.77
EV/invested capital (x)	2.01	1.74	1.68	1.60	1.51
ROIC - WACC (%)	4.87	7.46	7.00	12.90	17.00

Accounting standard: Local Egyptian standards
 Source: Company data, Rasmala forecasts

year to Dec, fully diluted

New capacities drive strong earnings growth

OCI has four major capacity start-ups planned for the next 12 months. Sorfert Algeria is still on track for start-up at the end of this year, and recently acquired Pandora Methanol has a start-up date at the beginning of 2012. Hence we expect strong EBITDA growth of 21% for 2012. At the same time, OCI's construction business has begun to show some positive momentum, with recent new project wins in Saudi Arabia.

A healthy outlook for fertilisers

Key to our investment case is our view that agricultural prices are likely to remain elevated, demand for fertilisers will remain strong and industry operating rates will remain healthy during 2011-13. OCI appears well positioned to benefit, as it has some of the lowest production costs globally and can capture this positive environment through its new capacity additions.

Yet, the share price seems to be discounting a worst-case scenario

We believe the market is discounting the stock too much for political risk, expectations that the gas price for fertiliser operations EFC and EBIC will rise in Egypt, and margin pressure for construction. Yet, we estimate that even if the gas price were to rise to US\$4/MMBtu in Egypt, our valuation would still offer 27% upside potential. For the other risks, we apply high discount rates to adjust for political risk in Egypt in particular.

We initiate coverage with a Buy recommendation

We value OCI on a sum-of-the-parts DCF valuation, which yields a target price of ££284/share, or 36% upside potential from current levels. We see further upside potential to our forecasts if fertiliser prices remain high longer than we expect, or if the construction business recovers more quickly than we currently assume.

Important disclosures can be found in the Disclosures Appendix.

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The basics

Versus consensus

EPS (E£)	Ours	Cons	% diff
2011F	21.1	22.0	-4.1%
2012F	26.8	26.7	0.3%
2013F	31.0	28.4	9.1%

Source: Bloomberg, Rasmala forecasts

Catalysts for share price performance

We see two main catalysts for the share. First, OCI's earnings are sensitive to any changes in fertiliser prices, hence these would be the main catalyst for share price performance. Grain futures are a key driver for these. The next key catalyst for grain futures will be the release of the World Agricultural Supply and Demand estimates (WASDE) report, scheduled to be published 9 November. Second, the successful start-up of the new fertiliser plants in Algeria towards the end of the year is one of the main drivers for our forecast earnings growth in 2012.

Earnings momentum

One of the main drivers for earnings growth for OCI is volume growth. Historical capacity utilisation has been in the range of 95-105%, and we expect it to remain within this range. Hence volume growth is mainly based on OCI's planned capacity additions over the next 12 months. Other drivers are price movements for fertilisers and growth in the construction segment. We forecast net income will grow on average 24% per year during 2010-13.

Valuation and target price

We derive our target price by using a sum-of-the parts valuation for construction and fertilisers, in which we value each of OCI's fertiliser operations (EFC, EBIC, Sorfert Algeria, OCI Nitrogen and Pandora Methanol) separately. For this purpose, we use a DCF valuation to capture the planned capacity expansions, which are not completely reflected in the 2011F and 2012F multiples. This results in a valuation of E£284 per share. We check our valuation with peer multiples in each of the segments.

How we differ from consensus

We are in line with consensus with our Buy recommendation: Bloomberg lists 12 Buys, six Holds and zero Sell recommendations, with an average target price of E£281/share. We are slightly below consensus for 2011F EPS, likely caused by our relatively conservative fertiliser price forecasts and tax rate assumptions, but above consensus for 2013F EPS.

Risks to central scenario

The key risks to our investment thesis are as follows. 1) our forecasts and valuation are highly sensitive to commodity price movements. Hence on the one hand, lower-than-expected prices would have a negative impact; on the other, higher-than-expected prices would result in upside risk to our estimates. Such price movements are dependent on the supply demand balance of the products, hence substantial new capacity build-up by competitors inside or outside the region could result in lower-than-expected prices than currently anticipated; 2) delays in planned capacity expansions could negatively affect our earnings forecasts; 3) growth in the construction segment is highly dependent upon OCI's ability to gain new contract awards; 4) an increase in gas prices in Egypt could lead to a cut in our earnings forecasts; 5) political risk in the Middle East and North Africa.

Forced ranking*

Company	Rec	Upside/downside
Yara	Buy	+41%
OCI	Buy	+36%
Industries Qatar	Buy	+32%
SAFCO	Buy	+13%

*by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: RBS and Rasmala forecasts

Key events

Date	Event
Nov	3Q results

Source: Company

Key assumptions and sensitivities

OCI's earnings are particularly sensitive to changes in fertiliser prices and input costs (gas). We estimate we would have to cut our 2012F net income about 7% or 12% if Egypt increased the gas price to US\$3/MMBtu or US\$4/MMBtu, respectively.

Table 1 : Key price assumptions (US\$/tonne)

	2010	1Q11	2Q11	3Q11F	4Q11F	2011F	2012F	2013F
Ammonia (EBIC)	334	419	484	484	490	469	415	435
Ammonia (OCI Nitrogen)	485	497	549	549	555	537	475	435
Urea (fob Egypt)	313	357	361	422	425	391	375	385
CAN (cif Germany)	247	257	331	368	371	332	330	290
UAN		222	272	318	320	283	281	247
Melamine	1,559	1,877	1,709	1,650	1,550	1696	1450	1494
Methanol							420	430
Natural gas (US\$/mmBtu)								
Hub gas Henry	4.40	4.20	4.40	4.20	4.70	4.50	5.30	5.50
Hub gas Zeebrugge	7.50	8.60	9.50	9.30	11.00	9.60	10.90	11.30
Egypt								
EFC	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
EBIC	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
Algeria						0.57	0.60	0.63

Source: Company data, Rasmala forecasts

Sensitivity to changes in selling prices of key product prices is high. We estimate that for every 10% drop in average prices, our forecasts for 2012 EBITDA would drop 14% and for net income by 18%.

Table 2 : Sensitivities to changes in key products

	2012E revenues	EBITDA 2012E	Net income 2012E
Key product price 10% change	-4%	-14%	-18%
Key product price US\$100/t change	-10%	-34%	-44%

Source: Rasmala estimates

We also check sensitivities to potential increases in gas prices in Egypt. If the gas price were to increase to US\$3.00/MMBtu, or even US\$4.00/MMBtu, more or less in line with US prices but well above regional ones, then we estimate EFC's urea cash cost would rise to about US\$/140/tonne for US\$3.00/MMBtu and about US\$170/tonne for US\$4.00/MMBtu. We estimate that we would have to cut our net income forecast by about 7% or 12% for 2012 under a scenario of a gas price of US\$3/MMBtu or US\$4.0/MMBtu, respectively.

Table 3 : OCI – EFC cash cost under different gas price assumptions

	2011E	2012E	2013E	2014E	2015E
EFC gas price (US\$/MMBtu) – base case	1.50	1.50	1.50	1.50	1.50
Cash cost (US\$/t)	103	104	106	109	111
EBITDA margin	74%	69%	70%	70%	70%
EFC gas price (US\$/MMBtu)	1.50	3.00	3.00	3.00	3.00
Cash cost (US\$/t)	103	142	144	146	148
EBITDA margin	74%	58%	59%	60%	60%
EFC gas price (US\$/MMBtu)	1.50	4.00	4.00	4.00	4.00
Cash cost (US\$/t)	103	167	169	171	173
EBITDA margin	74%	51%	52%	53%	53%

Source: Company data, Rasmala estimates

Executive summary

Many positives should help the share recover, but the market has focused on the negatives in recent months. We examine in this note what we think the market is discounting and conclude that the 26% share price decline since June is overdone.

Many catalysts for the share

Key to our investment case for OCI is our view that agricultural prices are likely to remain elevated, demand for fertilisers will remain strong, and industry operating rates will remain healthy during 2011-13. OCI appears particularly well positioned because it has some of lowest-cost plants globally in Egypt and Algeria, and plans to start up significant new capacity over the next 12 months, giving a boost to volumes.

Market is disregarding start-ups

OCI has four major capacity start-ups scheduled for the next 12 months. We see many positive catalysts for the share, even if we exclude the positive macro environment for fertilisers:

- Sorfert Algeria is still on track for start-up at the end of this year;
- recently acquired Pandora Methanol has a start-up date in mid-2012;
- positive momentum in the construction business follows two years of decline; and
- 3Q results are due 23 November. We expect strong performance for the fertiliser business and have pencilled in US\$1bn of new contract awards for the quarter.

At the same time, OCI's construction business has begun to show some positive momentum, with recent new project wins in Saudi Arabia.

What is the share discounting?

Rather than focus on all the positives, we will attempt to address the major concerns investors have about OCI. We believe the share has underperformed its peers in the region because of the political environment in Egypt, concerns that gas prices in Egypt will increase, doubts that Sorfert Algeria will be delayed or contracts cancelled, and because of a declining backlog in the construction segment. We believe these arguments are valid; however, our analysis shows that the share price decline is overdone, even using conservative forecasts and valuation metrics.

- We value OCI's operations using a cost of equity of 26.5% for EFC and EBIC, leading to a WACC of about 18%. Those two combined account for less than 20% of our total valuation.
- For the construction business, we use a blended (by backlog exposure) WACC of 11.1%, using similar discount rates as for the fertilisers for the Egyptian part of the backlog.
- For the construction backlog, we apply a modest recovery in 2012, but, long term, we assume normalised revenues below the current level and a lower EBITDA margin of 12%.
- An increase in gas prices is a risk for OCI's plants in Egypt (EFC and EBIC) if the government decides to break contracts unilaterally, which has been the case in other industries. However, the plants account for only about 19% of our equity valuation, and if we increase the gas prices from US\$1.50 and US\$1.25 for EFC and EBIC to US\$4/MMBtu, respectively, our target price would decrease from E£284/share to E£265/share, still 27% upside potential from current levels. Only a gas price of approximately US\$12/MMBtu would justify the current share price, if everything else remains the same.
- As a company headquartered in Egypt, OCI is exposed to the political situation there, but we feel we have given large enough discounts to account for this. Furthermore, OCI depends mainly on markets outside the country, both for the construction (Egypt 20% of backlog) and fertilisers, which are export-oriented and becoming increasingly more international.

Attractive valuation

Our sum-of-the-parts DCF valuation of E£284/share suggests upside potential of 36% for the share. We see upside in our forecasts, if selling prices for fertilisers remain high for longer than we currently build into our forecasts. Likewise, for construction, we pencil in only a modest recovery, despite recent encouraging additions to the backlog.

Valuation

We value OCI using a sum-of-the-parts DCF valuation. Construction accounts for about 30% of our total valuation; fertilisers, about 70%. The Egyptian fertiliser operations account for less than 20% of the total valuation.

We use DCF analysis and comparative multiples to value OCI, which yields a fair value of £284 per share, thus offering 36% upside potential from the current price. Implied 2012 EV/EBITDA estimates are 6.4x for construction and 7.0x for fertilisers.

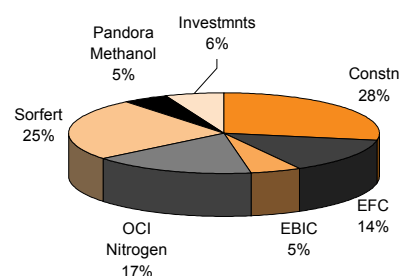
Table 4 : Sum-of-the-parts valuation

	US\$m	Per share (US\$)	£m*	Per share (£)
Construction	2,714	13	16,281	79
Fertilisers	8,761	43	52,566	255
Net debt/cash (1H11)	-2,350	-11	-14,102	-68
Investments (2010)	637	3	3,820	19
Valuation	9,761	47	58,564	284
Number of shares (m)				206
Current share price £				208.53
Valuation £				284
Potential return				36%

* Using an exchange rate of £6.00 per US\$.
Source: Company data, Rasmala forecasts

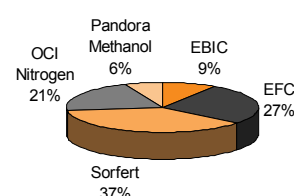
Allowing for debt assigned to each business and taking out the remaining corporate debt, the largest contribution in our valuation stems from construction (28%), followed by Sorfert (25%). EBIC and EFC combined account for about 19% of the total equity valuation.

Chart 1 : Breakdown of our current valuation, percentage of total



Source: Rasmala estimates

Chart 2 : Breakdown of our current fertiliser valuation by location/plant



Source: Rasmala estimates

Valuation of the fertiliser business

We use DCF analysis for the separate fertiliser businesses, which yields a valuation of US\$8.8bn. We use a different WACC for each plant, assigning a cost of equity of 26.5% to the Egyptian plants. We use a beta of 1, a terminal growth rate of 1.5% for each and tax rates dependent on the location of the operation – we take 35% for the US, 25% for Egypt, 25.5% for OCI Nitrogen and 19% for Sorfert.

This yields an overall enterprise value of US\$8.8bn for the fertiliser business, in which EFC and Sorfert combined account for about 64% of the total valuation.

Table 5 : WACC calculation for fertilisers

	EFC	EBIC	Sorfert	OCI Nitrogen	Pandora
Risk-free rate – long-term bonds	14.5%	14.5%	5.0%	2.5%	1.8%
Risk premium	12.0%	12.0%	12.0%	4.5%	4.5%
Marginal tax rate	25.0%	25.0%	19.0%	25.5%	35.0%
Beta	1.0	1.0	1.0	1.0	1.0
Cost of equity	26.5%	26.5%	17.0%	7.0%	6.3%
Cost of debt before tax	6.0%	6.0%	6.0%	6.0%	6.0%
Cost of debt after tax	4.5%	4.5%	4.9%	4.5%	3.9%
Target debt ratio	41%	40%	69%	30%	30%
WACC	17.5%	17.7%	8.6%	6.2%	5.6%

Source: Rasmala forecasts

Valuation of the construction business

We value the construction business using DCF analysis, in which we assume:

- a WACC of 11.1%, weighted by backlog split by country;
- for Egypt (21% of backlog), a sovereign discount rate of 14.5%; for the GCC countries (49% of backlog), 1.8%, in line with the current US sovereign rate. The resulting blended sovereign rate of 5.2%, combined with a beta of 1.0 and (high) specific risk premium of 10% leads to a cost of equity of 13.8%;
- a cost of debt of 6.0% and a marginal tax rate of 20%;
- flat new orders of US\$3.0bn from 2015 to 2020, resulting in normalised revenues of US\$3bn;
- a terminal growth rate of 3% on normalised earnings; and
- an EBITDA margin of 13.5% during 2012-19 and thereafter a long-term margin of 12.5%; equivalent to a long-term operating margin of 8%.

The valuation implies a target 2012F EV/EBITDA of 6.4x, which we believe is reasonable, if not low, compared with its global peer group.

Table 6 : Construction – DCF analysis and implied multiples

US\$m unless otherwise stated	2011F	2012F	2013F	2014F	2015F
New orders	3,100	3,250	3,500	3,500	3,000
Order backlog	5,870	6,070	6,330	6,430	6,030
Revenues	2,940	3,160	3,356	3,522	3,529
EBITDA	412	427	453	475	476
EBITDA margin	14.0%	13.5%	13.5%	13.5%	13.5%
EBIT	268	283	309	332	333
EBIT margin	9.1%	8.9%	9.2%	9.4%	9.4%
Tax rate	-45	-47	-52	-55	-56
Tax rate	16.7%	16.7%	16.7%	16.7%	16.7%
NOPAT	223	236	258	276	277
Depreciation & amortisation	144	144	144	144	144
Capital expenditures	-92	-99	-105	-110	-110
Change in working capital	-29	-32	-34	-35	-35
Free cash flow	245	249	263	275	275
PV of free cash flow	1,644	61%			
Terminal value	1,069	39%			
Enterprise value (US\$m)	2,714				
Enterprise value (E£m)	14,785				
Implied 2011 EV/backlog	0.46				
Implied 2011 EV/EBITDA	6.6				
Implied 2012 EV/EBITDA	6.4				

Source: Rasmala forecasts

Fertilisers

OCI plans to ramp up fertiliser capacity in Algeria, the US, Egypt and the Netherlands, adding about 3.5 mtpa of new production capability between now and the end of 2012.

Four major start-ups to drive fertiliser growth

OCI is rapidly transforming into a major global fertiliser player. The company entered this segment only in 2007, through the acquisition of EFC in Egypt, which began contributing to the bottom line in 2008. The base of OCI's fertiliser business is formed by EFC and EBIC.

- EFC (Egyptian Fertilizer Company) is a 1.3 mtpa urea plant in the Suez Industrial Zone in Egypt. EFC's main end markets are Egypt, Europe and South Asia. EFC has a gas supply contract at US\$1.25/mmBTU.
- EBIC (Egyptian Basic Industries Corporation) is a 0.7 mtpa ammonia plant next to the EFC plant, which has been operational since 2008. EBIC has a 100% offtake partnership for all exportable production with global fertiliser trader Transammonia, as well as a 25-year natural gas contract with the government at a ceiling price of US\$1.25/mmBTU.

Since then, OCI has made several acquisitions, including OCI Nitrogen (the former DSM Agro & Melamine business) in 2010 and Pandora Methanol in 2011. OCI is rehabilitating the currently idle Pandora Methanol, on which it is spending US\$65m.

Table 7 : Fertiliser capacity

mtpa]	Ownership	Country	2007	2008	2009	2010	2011F	2012F	2013F	2014F	2015F
EBIC											
Ammonia	60%	Egypt	0.00	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
EFC											
Urea	100%	Egypt	1.27	1.30	1.30	1.30	1.30	1.55	1.55	1.55	1.55
Urea Ammonium Nitrate (UAN)	100%	Egypt					0.33	0.33	0.33	0.33	0.33
Sorfert											
Ammonia	51%	Algeria						0.80	0.80	0.80	0.80
Urea	51%	Algeria						1.20	1.20	1.20	1.20
Pandora Methanol											
Ammonia	50%	USA						0.25	0.25	0.25	0.25
Methanol	50%	USA						0.75	0.75	0.75	0.75
OCI Nitrogen											
CAN	100%	Netherlands				1.15	1.15	1.45	1.45	1.45	1.45
UAN	100%	Netherlands				0.20	0.20	0.20	0.20	0.20	0.20
Ammonia	100%	Netherlands				1.13	1.13	1.13	1.13	1.13	1.13
Melamine Europe	100%	Netherlands				0.15	0.15	0.15	0.15	0.15	0.15
Melamine Indonesia	60%	Indonesia				0.06	0.06	0.06	0.06	0.06	0.06
Melamine China	49%	China				0.05	0.05	0.05	0.05	0.05	0.05
Total melamine						0.26	0.26	0.26	0.26	0.26	0.26
Other:											
Nitric acid	100%	Netherlands				0.70	0.70	0.94	0.94	0.94	0.94
Ammonium Sulphate	100%	Netherlands				0.60	0.60	0.60	0.60	0.60	0.60
Urea	100%	Netherlands				0.50	0.50	0.50	0.50	0.50	0.50

Source: Company data, Rasmala forecasts

Ramping up production over the next 12 months

We expect the company to reach about 7.5 mt of capacity by 2013, ranking it as one of the larger nitrogen fertiliser companies globally in terms of capacity. Over the next 12 months, OCI will be ramping up capacity exponentially, adding about 3.5 mtpa fertiliser capacity (at 100%). The fertiliser segment is one of the main drivers of growth in our earnings forecasts and will make 2012 a year of capitalising on large capex programmes.

- Sorfert in Algeria is on schedule to become operational towards the end of this year for 1.2 mtpa of urea capacity and in 1Q12 for 0.8 mtpa of ammonia capacity. OCI owns 51% of Sorfert. We have included Sorfert in our forecasts from 2012.
- Pandora Methanol, which is being revamped, will start operations (methanol and ammonia) in the second half of 2012. Ammonia is due for start-up towards the end of this year, but we

include it in our forecasts only from 2012. The 0.75 mtpa methanol is due for start-up in 2Q12.

- OCI Nitrogen will increase calcium ammonium nitrate (CAN) capacity from 1.15 to 1.45 mtpa in 2012.
- Bottlenecking at EFC will increase urea capacity there from 1.3 to 1.55 mtpa.

High utilisation rates, but somewhat lower prices

In our forecasts, we assume high utilisation rates, as has been the case in the past for EFC and EBIC. For Solfert and Pandora Methanol, however, we pencil in some delays in start-ups. Overall, we forecast a 40% increase in tonnage sold from 2011 to 2012.

Table 8 : Capacity utilisation assumptions for main products

Plant	Ownership	Product	2008	2009	2010	2011F	2012F	2013F	2014F	2015F
EFC	100%	Urea	100%	105%	101%	105%	105%	105%	105%	105%
EBIC	60%	Ammonia		55%	88%	105%	105%	105%	105%	105%
Solfert	51%	Ammonia					70%	100%	100%	100%
Solfert	51%	Urea					90%	100%	100%	100%
Pandora Methanol	50%	Ammonia					70%	80%	80%	80%
Pandora Methanol	50%	Methanol					30%	80%	80%	80%
OCI Nitrogen										
CAN	100%				79%	101%	85%	85%	85%	85%
Ammonia	100%				99%	92%	70%	70%	70%	70%
Melamine Europe	100%				55%	63%	73%	73%	73%	73%
Melamine Indonesia	60%				67%	67%	80%	80%	80%	80%
Melamine China (49% equity)	49%				56%	56%	56%	56%	56%	56%

Source: Company data, Rasmala forecasts

Combined with our price forecasts, we expect an increase of only 15% in fertiliser revenues, as the increase in capacity is somewhat offset by a drop in some fertiliser prices and capacity will not be fully available throughout the year. For EBITDA, we expect an increase of 19%, mainly as Solfert has lower cash costs than the other plants.

Table 9 : Revenues and EBITDA by plant

US\$m	2008	2009	2010	2011F	2012F	2013F	2014F	2015F
Revenues								
EFC	644	364	415	541	617	633	642	652
EBIC	-	97	206	345	305	320	325	329
OCI Nitrogen			734	1,565	1,388	1,334	1,352	1,370
Solfert				-	325	413	419	426
Pandora Methanol					168	344	356	360
EFT				15	15	15	15	15
Other			125	(90)	(90)	(90)	(90)	(90)
Total revenues	644	461	1,479	2,376	2,727	2,969	3,019	3,061
% change		-29%	221%	61%	15%	9%	2%	1%
EBITDA								
EFC	510	249	303	395	440	453	459	465
EBIC		62	152	283	243	256	260	264
OCI Nitrogen			169	395	278	211	216	220
Solfert				-	268	341	344	347
Pandora Methanol					61	122	132	134
EFT			-	-	-	-	-	-
Other			(44)	(40)	(40)	(40)	(40)	(40)
Total EBITDA	510	312	580	1,033	1,249	1,343	1,371	1,390
% change		-39%	86%	76%	21%	8%	2%	1%

Source: Company data, Rasmala forecasts

Egypt – uncertainty rules

OCI has long-term contracts for gas prices in Egypt. However, doubt has arisen among investors that those contracts will remain valid given the recent gas price hike in Bahrain from US\$1.50 to US\$2.25/MMBtu, the revocation of licences in the steel sector, the unwinding of contracts in the property sector and given popular demand to raise gas export prices to Israel and Jordan.

EFC (urea) currently pays US\$1.50/MMBtu, which will increase to US\$2.00/MMBtu from 2018, as per the current contract. Total duration of the EFC contract is 25 years. EBIC (ammonia) pays US\$1.25/MMBtu on a 20-year contract. Hence cash costs are about US\$80/tonne for EBIC's ammonia production and US\$105-110/tonne for EFC's urea production.

We do not assume a price increase in Egypt

In our forecasts and scenario for gas pricing in the region, we do not assume that Egypt will renege on its contracts, especially since it recently increased the corporate tax rate from 20% to 25% and OCI began paying taxes effective from 2008, despite being in a free zone. Nevertheless, if the gas price were to rise to US\$3.00/MMBtu, or even US\$4.00/MMBtu, more or less in line with US prices but well above regional ones, then we estimate that EFC's urea cash cost would rise to about US\$140/tonne for US\$3.00/MMBtu and about US\$170/tonne for US\$4.00/MMBtu. This would make exports to the US much less competitive.

Table 10 : OCI – EFC cash cost under different gas price assumptions

	2011E	2012E	2013E	2014E	2015E
EFC gas price (US\$/MMBtu) – base case	1.50	1.50	1.50	1.50	1.50
Cash cost (US\$/t)	103	104	106	109	111
EBITDA margin	74%	69%	70%	70%	70%
EFC gas price (US\$/MMBtu)	1.50	3.00	3.00	3.00	3.00
Cash cost (US\$/t)	103	142	144	146	148
EBITDA margin	74%	58%	59%	60%	60%
EFC gas price (US\$/MMBtu)	1.50	4.00	4.00	4.00	4.00
Cash cost (US\$/t)	103	167	169	171	173
EBITDA margin	74%	51%	52%	53%	53%

Source: Company data, Rasmala estimates

EBIC accounts for about 31.5% of OCI's global ammonia production capacity and EFC 56% of urea capacity (both OCI's share of capacity) in 2012 when all facilities are up and running, so they are relevant. However, the overall impact on EBITDA is diluted by OCI's additional capacity in Algeria, the US and the Netherlands starting up over the next 12 months. We estimate that we would have to cut our net income forecast by about 7% or 12% for 2012 under a scenario of a gas price of US\$3/MMBtu or US\$4.0/MMBtu, respectively.

Construction: recovery in sight or not yet?

OCI recently reported its first quarter in two years with an increase in backlog, and recent project wins seem to confirm this positive trend. The company has made encouraging inroads into Saudi Arabia, which accounted for 21% of new construction awards in 1H11.

How does OCI fare in the regional construction market?

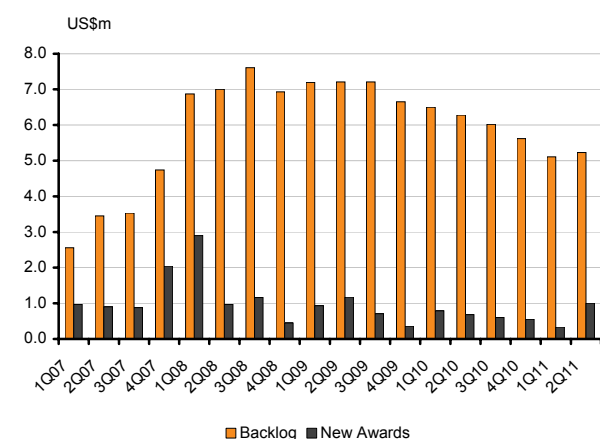
Concerns regarding OCI's construction business tend to centre around three issues:

- the actual level of the backlog;
- exposure of the construction business to Egypt, and to a lesser extent, Algeria; and
- high margins in excess of 13% EBITDA are unsustainable.

OCI's backlog turned around slightly in 2Q; 3Q seems to have been good

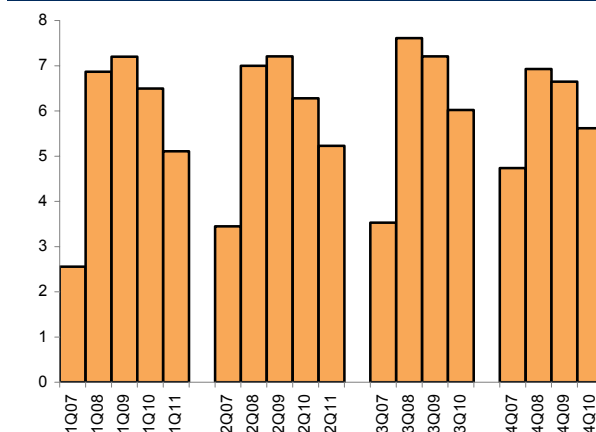
OCI's backlog has been falling steadily over the past two years, which has been an area of major concern for investors. At the end of June 2011, backlog was US\$5.23bn, down from its peak of US\$7.6bn reached in 3Q08. However, during 2Q11, OCI reported its first quarter in two years with an increase in backlog (+2% versus end-March 2011), with new orders of US\$1.0bn during the quarter.

Chart 3 : Backlog and new awards (US\$bn)



Source: Company data

Chart 4 : Backlog and new awards (US\$bn)

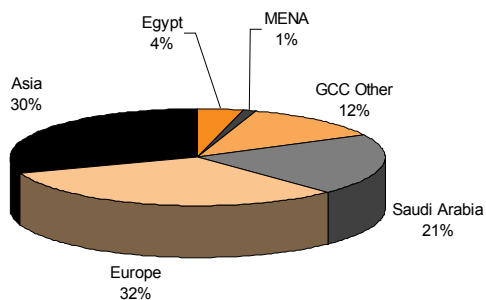


Source: Company data

Finally, inroads into Saudi Arabia

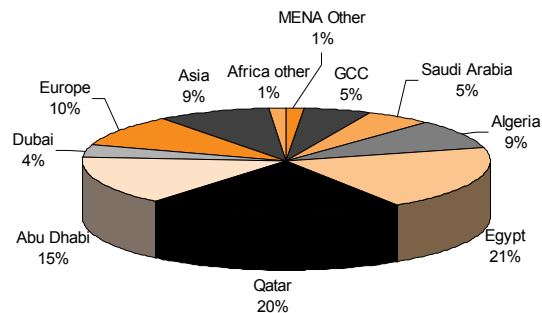
Egypt has undoubtedly been the home market for OCI, but the uprising in the country has made it unclear to what extent projects, especially private, will go ahead. Egypt currently accounts for about 21% of OCI's backlog, but accounted for only 4% of new awards in 1H11. The market that stands out in OCI's list of new contract awards, however, is Saudi Arabia.

Chart 5 : New construction awards by region, 1H11



Source: Company data

Chart 6 : Backlog by region, end-June 2011



Source: Company data

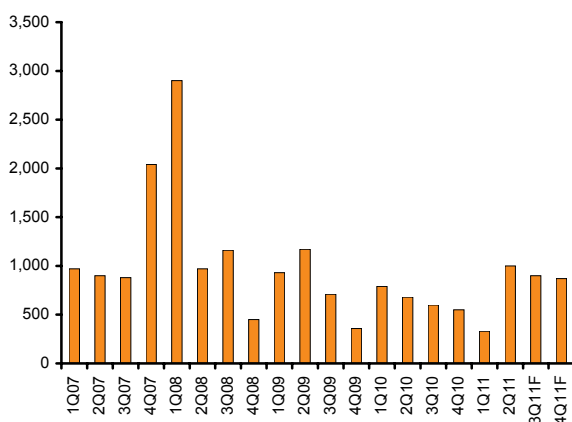
Traditionally, Saudi Arabia has been dominated by local construction firms such as the Saudi Bin Laden Group, but Korean and Chinese contractors have also been successful. OCI has had some substantial recent success in the past few months following the start of the partnership with the Saudi Bin Laden group (a 60:40 joint venture called Orascom Saudi Limited), which has clearly helped achieve 21% of its total new contract wins in 1H11 there, compared with only 5% of OCI's total backlog.

In 3Q, the positive trend of the second quarter seems to have continued, in terms of both size of projects and new wins in Saudi Arabia. New contract awards since the beginning of 3Q include:

- a US\$ 181m civil works package for the 1,500MW Giza North Combined Cycle Power Plant in Egypt;
- US\$450m in infrastructure work in Saudi Arabia; and
- a US\$166m contract to design and construct a major sports stadium in Jeddah, Saudi Arabia (OCI's share would be US\$552m).
- An AED2.0bn (US\$545m) award for the Yas Mall in Abu Dhabi for OCI's subsidiary BESIX.

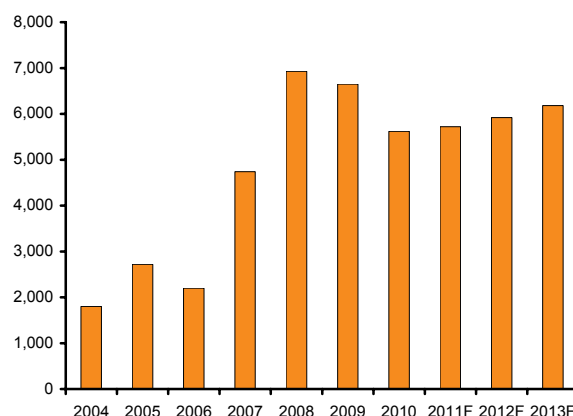
For 3Q11, we forecast OCI will achieve new orders of US\$900m and for 4Q, US\$870m, bringing the total for the year to US\$3.2bn. We forecast the backlog will increase by just 4% in 2011 and 3% in 2012, but a drop in revenues for 2011 of 14% followed by a recovery of +7% in 2012.

Chart 7 : New orders by quarter (US\$m)



Source: Company reports, Rasmala estimates

Chart 8 : Backlog actual and forecasts (US\$bn)



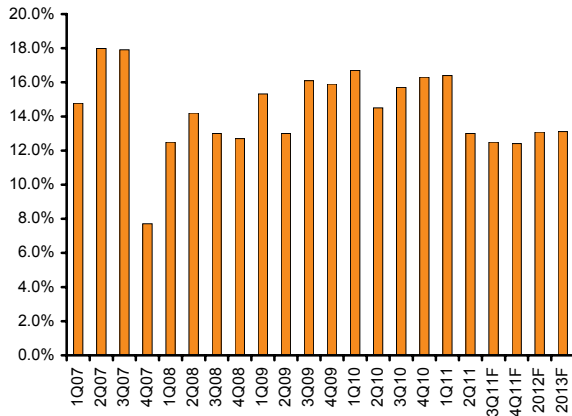
Source: Company data, Rasmala estimates

Are OCI's margins sustainable?

However, the main question always remains if the high EBITDA margins that OCI has been able

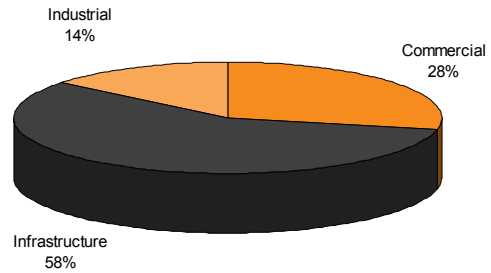
to achieve are sustainable for the longer term. In any given quarter, the margin can fluctuate as a result of the type of projects that are finished during the quarter (infrastructure, etc) or the location of the projects: those in Europe (BESIX) tend to have EBITDA margins in the 6-8% range compared with group EBITDA margins of 15% or higher. Management guides for a group average of 13-14%, which we believe is achievable given the types of projects that make up the backlog. We use a 13.5% margin in our medium-term forecasts and 12.5% for the longer term.

Chart 9 : Construction EBITDA margins



Source: Company data, Rasmala estimates

Chart 10 : Backlog by type, 1H11



Source: Company data

A brief overview of the company

OCI, headquartered in Cairo, is a leading construction contractor active in emerging markets that began building up a presence in fertilisers in 2007. It is the largest listed stock in Egypt by market capitalisation.

Fertilisers account for the bulk of earnings

Largest listed company in Egypt
in terms of market capitalisation

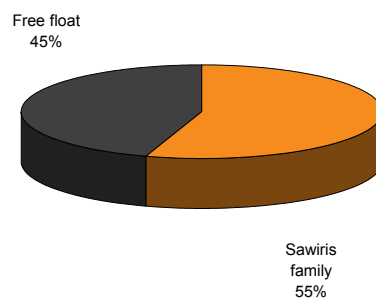
The company was founded by the Sawiris family, which collectively owns and controls 55% of the outstanding shares. OCI's ordinary shares have been listed on the Cairo and Alexandria Stock Exchanges since March 1999, where it is the largest listed company with a market capitalisation of around US\$7bn. OCI's ordinary shares have been listed on the London Stock Exchange in the form of global depository receipts (GDRs) since September 2002 and on the Nasdaq in the form of over-the-counter American Depositary Receipts (ADRs) since December 2010. Each GDR and each ADR represent one OCI ordinary share

The two business segments are:

- **Construction and concessions in the MENA region**, with a focus on infrastructure. The MENA region accounted for about 80% of the backlog of US\$5.23bn as of the end of June 2011.
- **Fertiliser production and its downstream industries**. Focus has been on nitrogenous fertilisers (urea and ammonia). This segment has been active in expanding on a global basis: it acquired DSM Agro in 2010, Pandora Methanol in 2011 and plans to start up production of urea and ammonia in Algeria towards the end of this year/early 2012. In addition, OCI acquired a 20% stake in the Gavilon Group, a US-based distributor of agricultural products, in 2008.

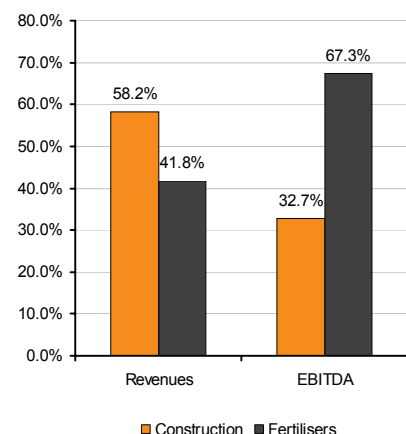
Fertilisers have become more important in OCI's breakdown of earnings. The business has only been in the portfolio since 2007. In 1H11, it accounted for 42% of revenues but 67% of EBITDA during that period, driven by the higher margins generated by that business.

Chart 11 : OCI shareholder structure



Source: Company data

Chart 12 : Breakdown of revenues and EBITDA, 1H11



Source: Company data

Income statement

E£m	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	21313	27552	31896	35324	37947
Cost of sales	-15564	-19383	-20110	-21728	-23769
Operating costs	-1328	-2118	-3120	-3544	-3401
EBITDA	4421	6051	8666	10052	10777
DDA & Impairment (ex gw)	-1017	-1385	-1641	-1848	-1848
EBITA	3404	4666	7024	8204	8929
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	3404	4666	7024	8204	8929
Net interest	-497.4	-570.5	-890.0	-525.0	-320.0
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	134.7	393.3	421.0	258.3	271.2
Reported PTP	3041	4489	6555	7937	8880
Taxation	-491.3	-840.1	-1679	-1609	-1510
Minority interests	-133.6	-304.7	-527.8	-801.2	-978.3
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	2417	3344	4348	5527	6392
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	4421	6051	8666	10052	10777
Normalised PTP	3041	4489	6555	7937	8880
Normalised net profit	2417	3344	4348	5527	6392

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

E£m	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	6136	5746	2638	7770	13333
Other current assets	13214	15909	17267	19080	20467
Tangible fixed assets	10697	12009	15245	17568	15898
Intang assets (incl gw)	9874	11062	8500	7000	7000
Oth non-curr assets	6938	10054	7862	4695	4095
Total assets	46857	54780	51512	56113	60794
Short term debt (2)	2266	3342	1000	1000	1000
Trade & oth current liab	13163	14647	15371	16658	17643
Long term debt (3)	11219	14251	10000	10000	10000
Oth non-current liab	3066	3634	3648	3648	3648
Total liabilities	29715	35875	30019	31306	32291
Total equity (incl min)	17143	18905	21494	24807	28503
Total liab & sh equity	46857	54780	51512	56113	60794
Net debt	7349	11847	8362	3230	-2333

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

E£m	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	4421	6051	8666	10052	10777
Change in working capital	n/a	n/a	n/a	n/a	n/a
Net interest (pd) / rec	n/a	n/a	n/a	n/a	n/a
Taxes paid	n/a	n/a	n/a	n/a	n/a
Other oper cash items	n/a	n/a	n/a	n/a	n/a
Cash flow from ops (1)	4421	6051	8666	10052	10777
Capex (2)	0.00	0.00	0.00	0.00	0.00
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	n/a	n/a	n/a	n/a	n/a
Cash flow from invest (3)	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in equity	n/a	n/a	n/a	n/a	n/a
Incr / (decr) in debt	n/a	n/a	n/a	n/a	n/a
Ordinary dividend paid	n/a	n/a	n/a	n/a	n/a
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	n/a	n/a	n/a	n/a	n/a
Cash flow from fin (5)	0.00	0.00	0.00	0.00	0.00
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Incl/(decr) cash (1+3+5+6)	4421	6051	8666	10052	10777
Equity FCF (1+2+4)	4421	6051	8666	10052	10777

Source: Company data, Rasmala forecasts

year to Dec

Standard ratios	OCI					Yara			Industries Qatar		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	5.23	29.3	15.8	10.7	7.43	24.2	-3.01	2.32	34.4	10.4	18.0
EBITDA growth (%)	-7.91	36.9	43.2	16.0	7.22	10.2	-7.91	0.30	50.0	12.1	14.8
EBIT growth (%)	-16.4	37.1	50.5	16.8	8.84	11.2	-13.0	-0.15	54.0	5.08	15.9
Normalised EPS growth (%)	-37.8	38.3	30.0	27.1	15.7	44.2	-10.2	0.09	46.2	7.19	16.9
EBITDA margin (%)	20.7	22.0	27.2	28.5	28.4	15.3	14.5	14.2	52.4	53.2	51.8
EBIT margin (%)	16.0	16.9	22.0	23.2	23.5	12.0	10.8	10.5	47.9	45.6	44.8
Net profit margin (%)	11.3	12.1	13.6	15.6	16.8	12.5	11.5	11.3	49.2	47.7	47.3
Return on avg assets (%)	6.78	8.30	10.8	12.7	13.2	14.8	12.0	11.0	23.8	21.8	22.0
Return on avg equity (%)	14.3	19.5	22.6	24.8	24.8	25.5	19.2	16.7	33.5	29.9	29.6
ROIC (%)	16.1	18.6	22.3	26.8	31.0	13.3	11.1	10.7	33.1	29.5	31.1
ROIC - WACC (%)	4.87	7.46	7.00	12.9	17.0	5.58	3.34	2.98	22.0	18.4	20.0
	year to Dec					year to Dec			year to Dec		
Valuation											
EV/sales (x)	2.36	1.99	1.61	1.31	1.07	1.18	1.14	1.06	4.22	3.72	3.00
EV/EBITDA (x)	11.4	9.06	5.92	4.60	3.77	7.69	7.87	7.47	8.05	6.98	5.79
EV/EBITDA @ tgt price (x)	14.9	11.6	7.72	6.14	5.21	9.66	10.0	9.60	10.5	9.21	7.73
EV/EBIT (x)	14.8	11.7	7.31	5.63	4.55	9.79	10.6	10.1	8.81	8.15	6.70
EV/invested capital (x)	2.01	1.74	1.68	1.60	1.51	1.73	1.58	1.43	2.47	2.19	1.93
Price/book value (x)	2.63	2.40	2.08	1.79	1.55	1.66	1.43	1.25	2.55	2.17	1.83
Equity FCF yield (%)	10.3	14.1	20.2	23.4	25.1	4.69	10.1	8.81	5.72	8.92	11.2
Normalised PE (x)	17.8	12.9	9.88	7.78	6.72	7.18	7.99	7.98	8.41	7.84	6.71
Norm PE @ tgt price (x)	24.2	17.5	13.5	10.6	9.16	9.59	10.7	10.7	11.1	10.3	8.84
Dividend yield (%)	4.75	5.40	5.40	6.43	7.44	2.63	2.83	3.04	5.95	6.37	7.45
	year to Dec					year to Dec			year to Dec		
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	205.9	206.1	206.1	206.1	206.1	Net debt to equity (%)	42.9	62.7	38.9	13.0	-8.19
Reported EPS (EGP)	11.7	16.2	21.1	26.8	31.0	Net debt to tot ass (%)	15.7	21.6	16.2	5.76	-3.84
Normalised EPS (EGP)	11.74	16.23	21.10	26.82	31.02	Net debt to EBITDA	1.66	1.96	0.96	0.32	-0.22
Dividend per share (EGP)	9.90	11.3	11.3	13.4	15.5	Current ratio (x)	1.25	1.20	1.22	1.52	1.81
Equity FCF per share (EGP)	21.5	29.4	42.0	48.8	52.3	Operating CF int cov (x)	0.00	0.00	0.00	0.00	0.00
Book value per sh (EGP)	79.2	86.7	100.4	116.2	134.2	Dividend cover (x)	1.18	1.44	1.87	2.00	2.00
	year to Dec						year to Dec				

Priced as follows: OCIC.CA - E£208.53; YAR.OL - Nkr235.60
Source: Company data, Rasmala forecasts

Valuation methodology – sum-of-the-parts valuation

We value OCI using a sum-of-the-parts DCF valuation for the construction and each of the fertiliser plants.

	US\$m	Per share (US\$)	E£m*	Per share (E£)
Construction	2,714	13	16,281	79
Fertilisers	8,761	43	52,566	255
Net debt/cash (1H11)	-2,350	-11	-14,102	-68
Investments (2010)	637	3	3,820	19
Valuation	9,761	47	58,564	284
Number of shares	206			
Current share price E£	208.53			
Valuation E£	284			

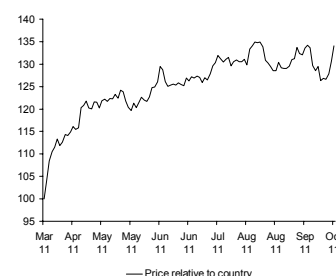
*Using an exchange rate of E£6.00 per US.
Source: Company data, Rasmala forecasts

Company description

Buy

Price relative to country

OCI, headquartered in Cairo, Egypt, is a leading construction contractor active in emerging markets. Since 2007, it has begun to build up a presence in fertilisers. At that time, it acquired a production facility in Egypt. It has since expanded internationally by acquiring DSM Agro, now renamed OCI Nitrogen, in the Netherlands, and Pandora Methanol in the US. It plans to launch a large urea and ammonia facility at the end of 2011. The company was founded by the Sawiris family, which collectively owns and controls 55% of the outstanding shares.



Strategic analysis

Average SWOT company score:

4

EBITDA by segment 1H11

Strengths

4

One of the lowest-cost producers of ammonia and urea globally, expanding across all major markets. Construction business enjoys high margins, specialised in infrastructure work across the region.

Weaknesses

3

Focus on nitrogen-based fertiliser, no phosphate and potash. Weather dependence for crop productivity, fertiliser pricing.

Opportunities

5

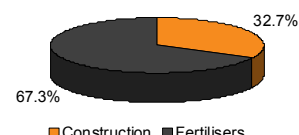
Global consolidation of the fertiliser industry continues, and we believe OCI is likely to play a significant role in this process given its recent acquisitions in Europe and the US at low prices.

Threats

4

Increased exports from China due to reduced export tax. Threat of increased gas prices in Egypt if the government decides to raise those unilaterally.

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters

Nile City Towers, Cairo Egypt 11221

Website

www.orascomci.com

Shares in issue

206.1m

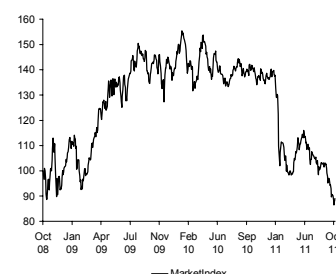
Freefloat

45%

Majority shareholders

Sawiris family (55%), Free float (45%)

Country rel to M East & Africa



Competitive position

Average competitive score:

4+

Broker recommendations

Supplier power

2+

OCI pays a fixed price for natural gas in Egypt and will do so in Algeria; market prices elsewhere. However, governments make decisions on future gas pricing, which could change OCI's cost basis.

Barriers to entry

4-

Considerable investment is needed to enter the fertiliser industry and access feedstock at low enough prices to be competitive. The construction business is very competitive.

Customer power

4-

Crop yields increase if fertiliser is applied, but customers can reduce application or delay buying of fertilisers temporarily. In construction, customer power is strong.

Substitute products

5+

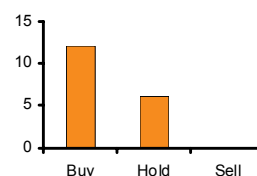
Other types of fertiliser, depending on the crop, or no fertiliser at all can substitute for OCI's products. However, this will affect yield and ultimately the customer must buy the product.

Rivalry

4+

Competition in most markets is significant for both the construction and fertiliser businesses, but OCI is one of the lowest-cost producers of ammonia and urea globally.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

13 October 2011

Initiation of coverage

Buy

Target price

SR207.00

Price

SR183.25

Short term (0-60 days)

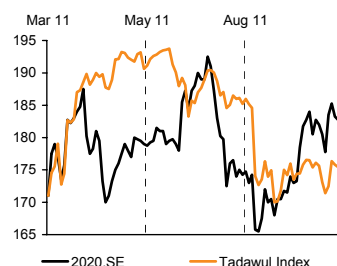
n/a

Market view

No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (SR)	174.0	183.0	n/a
Absolute (%)	5.3	0.1	n/a
Rel market (%)	4.1	6.5	n/a
Rel sector (%)	n/a	n/a	n/a

**Market capitalisation**

SR45.81bn (€8.94bn)

Average (12M) daily turnover

SR29.97m (€5.63m)

Sector: European-DS Tot Mrkt
 RIC: 2020.SE, SAFCO AB
 Priced SR183.25 at close 11 Oct 2011.
 Source: Bloomberg

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SAFCO

Attractive dividend play

SAFCO is the only nitrogen fertiliser pure play in the region. We see upside potential of only 13% for the share, but view a 7% dividend yield as attractive. We initiate with a Buy recommendation and target price of SR207.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (SRm)	2,741	3,789	4,919	4,828	5,252
EBITDA (SRm)	1,889	2,921	3,820	3,706	3,986
Reported net profit (SRm)	1,804	3,235	3,745	3,617	3,868
Normalised net profit (SRm)	1,733	2,933	3,745	3,617	3,868
Normalised EPS (SR)	6.93	11.73	14.98	14.47	15.47
Dividend per share (SR)	12.00	12.00	13.00	12.00	12.00
Dividend yield (%)	6.55	6.55	7.09	6.55	6.55
Normalised PE (x)	26.40	15.60	12.20	12.70	11.80
EV/EBITDA (x)	23.00	15.00	11.40	12.00	11.20
EV/invested capital (x)	9.36	8.39	7.64	6.34	5.51
ROIC - WACC (%)	21.70	45.30	55.30	47.70	40.10

Accounting standard: Saudi Arabia GAAP
 Source: Company data, Rasmala forecasts

year to Dec, fully diluted

A cash generator

We expect SAFCO to generate the highest EBITDA margin in the industry globally (78% in 2011F) and strong FCF in excess of US\$600m on average per year during 2011-13. We also project net cash for the company of about US\$600m as of end-2011. However, SAFCO has yet to become as aggressive in expanding its capacity or product portfolio compared to its Middle East and North Africa (MENA) peers. Earlier this year, the company announced a 60% capacity expansion, due for completion by end-2013, which should boost earnings strongly. We estimate the value of the expansion at about SR50 per share.

Direct beneficiary of a healthy outlook for agricultural markets

We have a healthy outlook on fertilisers. As a pure-play fertiliser company, with just urea and ammonia in the portfolio and among the lowest cash costs globally (we estimate the company's urea cash cost at about US\$85/tonne), SAFCO appears well positioned until at least 2013. In the short term, high urea prices should result in strong earnings, also confirmed with net income growth of 100% in 3Q, reported earlier this week. We forecast a 28% increase in net income in 2011.

We see a lack of catalysts, but some potential upside and healthy dividend yield

We see limited earnings upside potential from volume growth for SAFCO, unlike at peers Industries Qatar (IQ) and Orascom Construction Industries (OCI), which plan to start up substantial capacities over the next 12 months. Nevertheless, we see about 13% potential upside to our TP for SAFCO and find its 7% dividend yield for 2011F highly attractive.

We believe the share is discounting the positive outlook

The stock has risen 19% ytd, vs a drop of 22% for OCI and 7% for IQ. However, at 12.0x 2012F EV/EBITDA, we believe the positive macro environment for fertilisers and planned capacity expansion are largely discounted. We value SAFCO on a DCF basis to derive a TP of SR207, and initiate at Buy, given 13% upside potential. The dividend yield should offer a floor for the share price.

Important disclosures can be found in the Disclosures Appendix.

Distributed outside MENA by The Royal Bank of Scotland N.V. and its affiliates under a strategic alliance with Rasmala Investment Bank Ltd.

The basics

Versus consensus

EPS (SR)	Ours	Cons	% diff
2011F	15.0	14.8	+1.4%
2012F	14.5	15.2	-4.6%
2013F	15.5	14.8	+4.6%

Source: Bloomberg, Rasmala forecasts

Catalysts for share price performance

SAFCO's earnings are highly sensitive to any changes in urea and ammonia prices; hence these would be the main catalysts for any share price performance, either positive or negative. Grain futures are key drivers of fertiliser prices, with the next major catalyst for grain futures likely to be the release of the World Agricultural Supply and Demand estimates (WASDE) report due on 9 November. In our view, the second potential key catalyst for SAFCO's share would be progress on the construction of SAFCO V, which is important for earnings growth future from 2014 onward.

Earnings momentum

We believe the main drivers for SAFCO are volume growth and selling prices. Historical capacity utilisation of 90-100% (our estimate) should be sustained in the long term. Price movements of SAFCO's two products – ammonia and urea – are also important earnings drivers, in our view. We forecast average net income growth of 10% during 2010-13, with the biggest increase in 2011. We expect the start-up of SAFCO V towards end-2013 to boost revenues and earnings considerably and net income to grow 39% in 2014, driven almost entirely by higher volumes.

Valuation and target price

We derive our target price by using a DCF valuation methodology in order to capture the planned capacity expansion, which is not reflected in the 2011F and 2012F multiples. This results in a valuation of SR207 per share.

How we differ from consensus

We are more optimistic on the stock than the market: Bloomberg lists three Buy and seven Hold recommendations, with an average target price of SR191/share. Our earnings forecasts are largely in line with consensus in 2011, but 5% below in 2012, which could be due to our relatively conservative forecast for product pricing.

Risks to central scenario

Our forecasts and valuation are highly sensitive to commodity price movements. On the one hand, lower-than-expected prices would have a negative impact. On the other hand, higher-than-expected prices would result in upside risk to our estimates. Such price movements are dependent on the supply demand balance of the products, hence substantial new capacity build-up by competitors inside or outside the region could result in lower-than-expected prices than currently anticipated. Also, delays in planned capacity expansions could negatively affect our earnings forecasts or the gas price scenario could turn out to be different from what we assume – a natural gas price of US\$0.75/MMBtu in 2012, moving to US\$2.00 starting 2016 – leading to changes in our estimates for cost of sales.

Forced ranking*

Company	Rec	Upside/downside
Yara	Buy	+41%
OCI	Buy	+36%
Industries Qatar	Buy	+32%
SAFCO	Buy	+13%

*by difference to target price as at time of publication. Recommendations may lie outside the structure outlined in the disclosure page.

Source: RBS and Rasmala forecasts

Key events

Date	Event
October 2011	3Q results
January 2012	2011 results

Source: Company

Key assumptions and sensitivities

SAFCO's revenues are highly sensitive to product price changes. We see a 10% drop in 2012 prices. A further 10% fall implies 13% lower earnings. We assume a US\$0.75/MMBtu gas price in 2012. If the price reaches US\$1.25/MMBtu, our forecasts would decrease 9%.

Table 1 : Key assumptions

	2010	1Q11	2Q11	3Q11F	4Q11F	2011F	2012F	2013F
Natural gas (US\$/MMBtu)	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Product prices (US\$/tonne)								
Ammonia	339	421	480	495	490	444	400	425
Urea	301	373	378	454	470	413	375	381
Utilisation rates								
Ammonia	102%	91%	95%	101%	102%	98%	105%	100%
Urea	102%	91%	95%	101%	102%	98%	105%	100%
Exchange rate								
US\$/SR	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75

Source: Company data, Rasmala forecasts

In our forecasts, we assume that the gas price in Saudi Arabia will stay at US\$0.75/MMBtu vs market expectations of an increase to US\$1.25/MMBtu from 2012 onwards. If the market scenario materialises, we estimate that the average cash cost for urea will increase from about US\$85/tonne under our current assumptions to just over US\$100/tonne. This would be still well below cash costs in other regions, even after accounting for freight costs of about US\$30/tonne.

Table 2 : Sensitivity of revenues and earnings to changes in prices and feedstock costs

	Revenues 2012E	EBITDA 2012E	Net income 2012E
Ammonia and urea price - 10% drop	-10%	-13%	-13%
Ammonia and urea price - US\$100/t drop	-26%	-34%	-34%
Gas price +US\$0.50/MMBtu to US\$1.25/MMBtu	0%	-5%	-5%
Gas price +US\$1.75/MMBtu to US\$2.25	0%	-14%	-14%

Source: Rasmala estimates

It is clear, however, that prices must not rise too much, to remain competitive. Under a gas-price scenario of a US\$2.50/MMBtu, we estimate that SAFCO's urea cash cost would be about US\$135/tonne, close to cash costs in the US of US\$140-150/tonne.

Table 3 : SAFCO's urea margins under different gas price scenarios

	2011E	2012E	2013E	2014E	2015E
Gas price (US\$/MMBtu)	0.75	1.25	1.25	1.25	1.25
Cash cost (US\$/t)	85	101	104	108	112
EBITDA margin	79%	73%	73%	73%	73%
Gas price (US\$/MMBtu)	0.75	2.00	2.00	2.00	2.00
Cash cost (US\$/t)	85	119	123	127	130
EBITDA margin	79%	68%	68%	68%	68%
Gas price (US\$/MMBtu)	0.75	2.50	2.50	2.50	2.50
Cash cost (US\$/t)	85	132	135	139	143
EBITDA margin	79%	65%	65%	65%	65%

Source: Rasmala estimates

Executive summary

SAFCO is the only pure-play nitrogen fertiliser company in our regional coverage universe. We initiate coverage with a Buy rating and TP of SR207/share, which implies 13% upside.

A healthy outlook for fertilisers until at least 2013

Healthy outlook for fertilisers

Urea and ammonia prices have rallied by 54% and 39% on average during the first three quarters of 2011 compared with the same period last year, with particularly strong movements in 2Q and 3Q. A combination of strong farm economics, high grain prices and reduced exports from China has been the driving force behind this performance. We expect fertiliser demand and pricing to remain strong until 2013 at least.

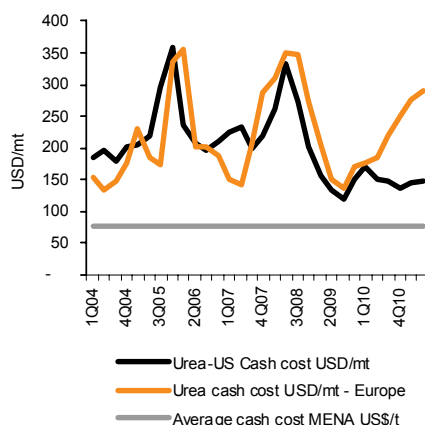
Cash costs of US\$85/tonne some of the lowest globally

We have a positive outlook on fertilisers and SAFCO is the only pure fertiliser play in our regional coverage universe. The company appears well positioned to benefit: it has one of the lowest production costs globally, which we estimate at around US\$60/tonne for ammonia and US\$85/tonne for urea, well below European cash costs, which we estimate at more than US\$300/tonne at current gas prices. As a pure play, SAFCO is likely to benefit more than OCI and IQ, which are also into petrochemicals and construction, two businesses on which we are not as bullish as fertilisers.

Limited volume growth potential

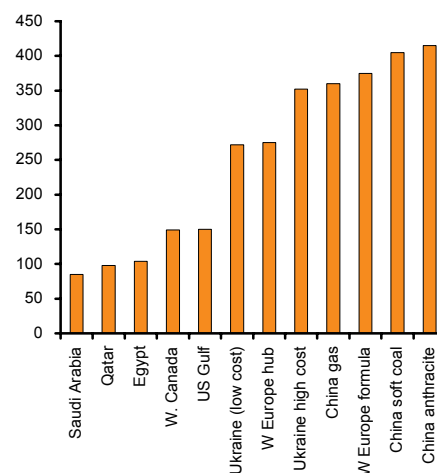
However, we believe SAFCO's existing plants are already running close to full capacity (we estimate 90-95% utilisation for 1H11), with little upside potential. Furthermore, unlike IQ and OCI, SAFCO has no imminent capacity start-ups, which we generally see as value-accretive for MENA producers. Therefore, we see little earnings upside from volume growth, at least until end-2013/early-2014, when SAFCO's new capacity is due to come on-stream, likely boosting ammonia capacity by 1.2mtpa to 3.3mtpa and urea from 2.3mtpa to 3.8mtpa.

Chart 1 : Urea cash cost – MENA vs US and European producers



Source: Bloomberg, Rasmala estimates

Chart 2 : SAFCO is one of the lowest-cost producers globally (US\$/tonne)



Source: Bloomberg, Rasmala estimates

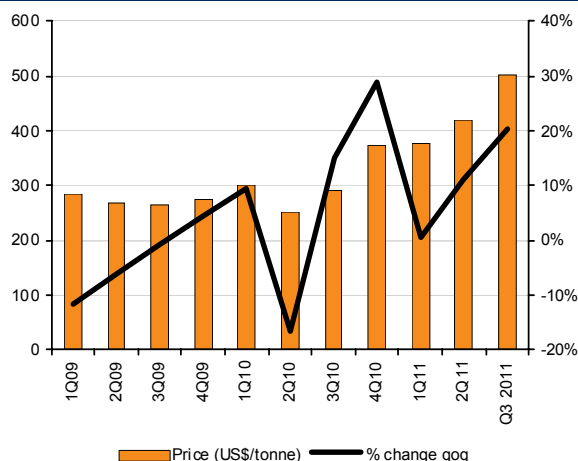
Valuation reflects positive environment and new capacity, in our view

Over a 12-month period, we prefer OCI and IQ as SAFCO's expansion plans are further out and the 12.0x 2012F EV/EBITDA already seems to reflect the planned expansion. The share has been a good performer, rising 19% ytd, but it hasn't kept pace with the recent sharp increase in the urea price. This suggests that the market thinks this high level (well above US\$500/tonne) is unsustainable. Nevertheless, we see upside potential of about 13% to our target price for SAFCO, and view a 7% dividend yield as attractive and also providing a floor for the share price.

3Q11 another bumper quarter

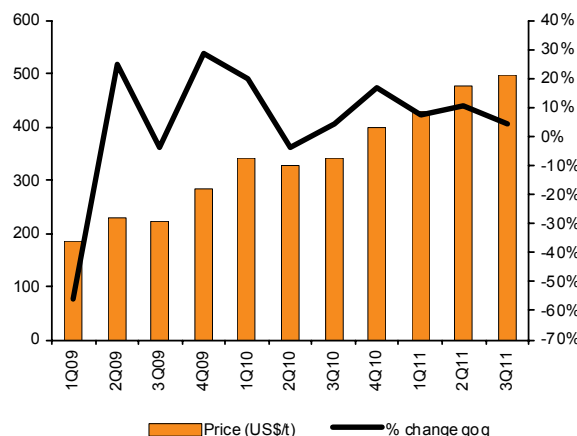
SAFCO reported strong 3Q results this week. Revenues increased 55% and net income 100% compared with 3Q10, but no details for volumes and prices have been disclosed. We expect demand to have remained at high levels during the quarter and the average urea price increased 20% compared with 2Q11 and 73% compared with 3Q10. Ammonia prices increased at a lower rate than urea, only +4% compared with 2Q11, but still up 46% vs 3Q10. We expect the positive environment to continue throughout 4Q, providing a short-term positive share-price catalyst.

Chart 3 : Average quarterly urea prices (US\$/tonne) and qoq % change



Source: Bloomberg

Chart 4 : Average quarterly ammonia (US\$/tonne) and qoq % change



Source: Bloomberg

Risks

The single biggest risk to our forecasts is that our forecasts for selling prices of ammonia and urea are either too conservative or too optimistic. We estimate that for every 10% change in average selling prices in 2012, net income changes about 13% compared with our current forecasts.

Furthermore, our forecasts and assumptions are functions of industry demand and supply. Short- and long-term competitive forces could emerge with the build-up of new capacities, which represents a downside risk to our forecasts.

Political risks remain a broader risk for the region, but within the region, the GCC has been more stable than North Africa during the recent Arab uprisings. Saudi Arabia has been relatively stable and the government has announced a large spending package in response to unrest elsewhere in the region.

The market is widely expecting a change in the gas price regime in the region, with prices in Saudi Arabia moving from US\$0.75/MMBtu to US\$1.25/MMBtu. However, we assume that such increases are not imminent, but that longer-term gas prices will have to increase – we assume a level of US\$2.0/MMBtu from 2016 onwards. However, it is possible that Saudi Arabia increases gas prices this year itself, even to a higher level, especially in light of Bahrain's recent increase from US\$1.50 to US\$2.25/MMBtu.

Performance and valuation

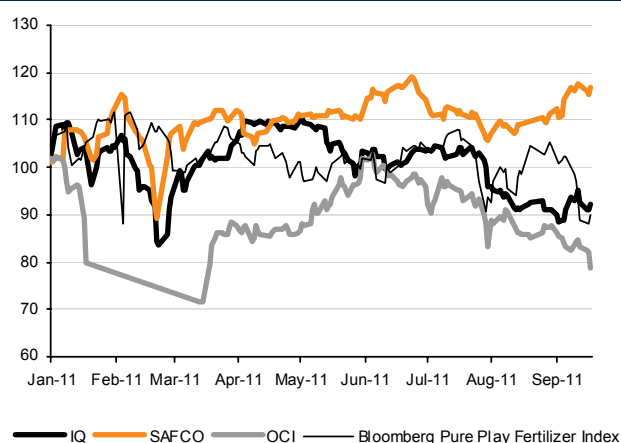
Valuing SAFCO on a DCF basis suggests a target price of SR207/share and upside potential of 13%. SAFCO trades on a 2012F EV/EBITDA of 12.0x (vs its historical average of about 10x), which we believe discounts most of the future capacity expansion of SAFCO V.

Only SAFCO's stock has outperformed its peers

Share price performance of MENA fertiliser stocks has been mixed in the year to date. Compared with its global fertiliser peers, only SAFCO has outperformed, and IQ has been more or less in line. OCI staged a strong comeback following market closure between end-January and March, but has underperformed since June, we believe, as a result of the company's higher exposure to the US and European markets and, more recently, market concerns about a potential increase in gas prices in Egypt. Ytd, SAFCO's shares are up 19%, IQ's down 7% and OCI's down 22% compared to a 10% drop in the Bloomberg Pure Play Fertiliser index.

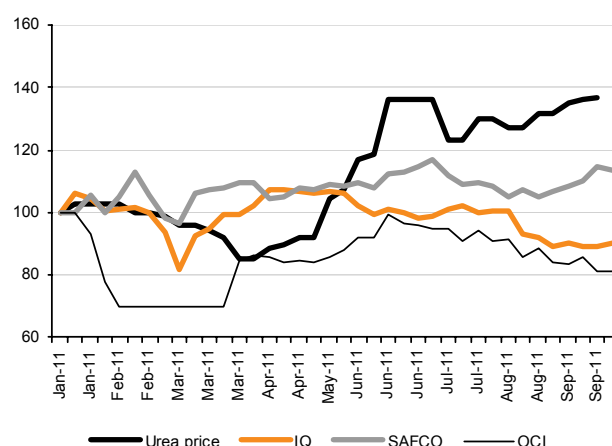
Compared with urea prices, all three stocks, even SAFCO, have underperformed, especially since the beginning of June, possibly indicating that the market sees a level in excess of US\$500/tonne as unsustainable. This gives us comfort in our forecasts, as we assume a drop of about 10% for urea and ammonia prices in 2012 compared with our average forecast for 2011.

Chart 5 : Share price performance vs global peers



Source: Bloomberg

Chart 6 : Share price performance vs urea prices



Source: Bloomberg

Valuation

We value SAFCO on a DCF basis, which yields a fair value of SR207/share. In our analysis, we assume a cost of equity of 10.0% (a risk-free rate of 2%, country and stock-specific risk 8.0%), beta of 1.0x and no debt, yielding a WACC equivalent to the cost of equity. We have explicit forecasts for the period 2011-20, after which we apply a terminal growth rate of 1.5%, equivalent to the historical growth for agricultural markets.

Table 4 : WACC computation

Risk-free rate	1.8%
Risk premium	8.0%
Beta	1.0
Cost of equity	10.0%
Cost of debt	6.0%
Tax rate	3.0%
Equity	100.0%
Debt	0.0%
WACC	10.0%

Source: Rasmala estimates

SAFCO is trading on what we see as relatively high valuations of 11.4x 2011F and 12.0x 2012F EV/EBITDA and a 2011F P/BV of about 5.8x, in our view, discounting most of the positive environment and the announced capacity expansion. We value the expansion at about SR52/share. If we take this out of our valuation of SR207/share, then the implied current EV/EBITDA is 8.7x for 2012F, which we see as relatively low compared with SAFCO's historical multiple (about 10x) and the multiple we subscribe to as being fair for Industries Qatar's QAFCO business.

Table 5 : SAFCO – DCF analysis

SRm	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
EBITDA	3,820	3,706	3,986	5,633	5,401	4,832	4,870	4,905	4,938	4,968
D&A	-299	-309	-354	-462	-467	-442	-418	-397	-377	-359
EBIT	3,521	3,397	3,632	5,170	4,933	4,390	4,452	4,508	4,560	4,609
Taxes	-116	-112	-120	-166	-159	-142	-143	-144	-145	-146
NOPAT	3,405	3,285	3,512	5,004	4,775	4,248	4,309	4,364	4,415	4,462
	0	0	0	0	0	0	0	0	0	0
Capex	-550	-1,250	-1,250	-900	-145	-147	-149	-152	-154	-156
Change in working capital	-164	-315	-136	-721	83	-35	-36	-36	-36	-37
Depreciation & amortisation	299	309	354	462	467	442	418	397	377	359
FCF	2,990	2,029	2,480	3,845	5,180	4,508	4,542	4,573	4,602	4,629

Source: Rasmala forecasts

**High dividend yield limits
downside potential for the share**

We do expect the share to be held up by dividends. The payout ratio was about 70% on average during 2005-10 and 93% in 2010. For 2011, we have assumed a dividend of SR13.00/share, or a 90% payout ratio, which implies a yield of about 7%. Given SAFCO's strong balance sheet (net cash position), strong cash flow generation and limited expansion plans except for SAFCO V, we do not see a risk to the company's dividend policy.

Fertiliser peer multiples

We cross-check our valuations with peers outside the region, but note that MENA multiples tend to be higher, reflecting higher EBITDA margins and lower tax rates than elsewhere. The peers include large fertiliser companies in Europe, the US and Asia.

Table 6 : Fertilisers – comparable multiples

	Country	Market cap	EBITDA margin		EV/EBITDA		PE	
		US\$m	2010	2011F	2011F	2012F	2011F	2012F
Potash Corp of Saskatchewan	Canada	42,332	42%	57%	9.1x	7.7x	12.9x	10.7x
Mosaic Co/The	US	25,581	25%	32%	5.7x	5.1x	10.1x	8.9x
Yara International ASA	Norway	12,523	15%	14%	7.4x	7.6x	6.8x	7.2x
Agrium Inc	Canada	11,860	15%	17%	5.2x	5.1x	8.0x	7.8x
CF Industries Holdings Inc	US	10,534	32%	50%	3.8x	3.9x	6.9x	7.2x
Weighted average			30%	40%	7.2x	6.4x	10.4x	9.3x

Priced as at close of 11 October 2011

Source: RBS forecasts for Yara, all others Bloomberg consensus forecasts

SAFCO overview

SAFCO is a pure play nitrogen fertiliser company with 2.3mtpa urea and 2.1mtpa ammonia capacities. In January 2011, SAFCO resumed studies to build SAFCO V, which should lift total capacity to 3.8mtpa urea and 3.3mtpa ammonia by 2014.

It's just two products

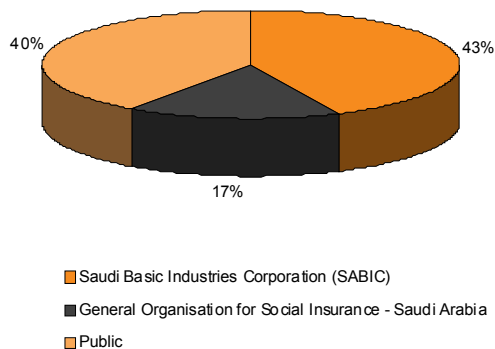
Saudi Arabian Fertilizer Company (SAFCO), headquartered in Saudi Arabia, was established in 1965. The company is listed on Saudi Arabia's Tadawul stock market, where it is one of the large listed stocks. Saudi Arabian Basic Industries Corporation (SABIC) owns 42.99% of the company, General Organisation for Social Insurance 16.7% and 40% is free float. Other than its main consolidated operations, SAFCO owns 50% of National Chemical Fertilizer (Ibn Al-Baytar) and smaller stakes in other affiliates.

The company is a pure-play nitrogen fertiliser company with total capacity of 2.3mtpa urea and 2.1mtpa ammonia and is constructing new production capability, which is due to come on-stream in 2H13. The majority of SAFCO's products are sold through SABIC, and long-term marketing agreements are in place for this purpose.

SAFCO V to lift capacity by almost 60%

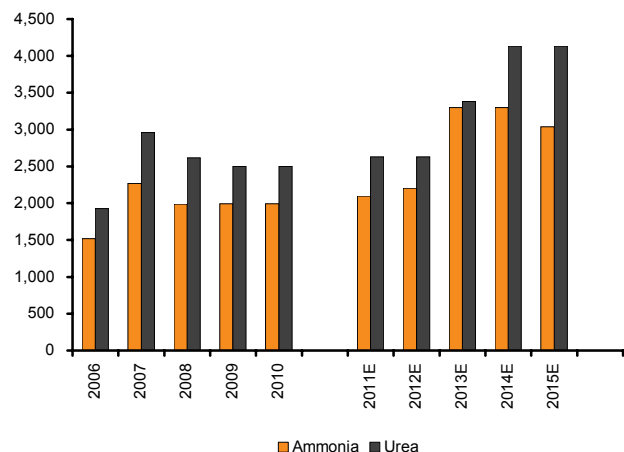
SAFCO decided to resume work on SAFCO V in January this year, after the company finalised an agreement with the Ministry of Petroleum and Mineral Resources for feedstock supply. The plant was first delayed in 2008 due to a sharp drop in urea prices and again put on hold in December 2009, pending Aramco's feedstock decision. The plant will have a capacity of 1.5mtpa ammonia and 1.2mtpa urea, bringing SAFCO's total capacity to 3.8mtpa of urea and 3.3mtpa ammonia. We expect about 60% of ammonia production to be used to make urea and the rest to be sold in the open market. The company expects to complete the project in 2H13 and we have included it in our forecasts from end-2013 onwards.

Chart 7 : SAFCO shareholding structure



Source: Company data

Chart 8 : Urea and ammonia production ('000 tonnes)



Source: Company data, Rasmala forecasts

A relatively long history for regional corporates

A brief history

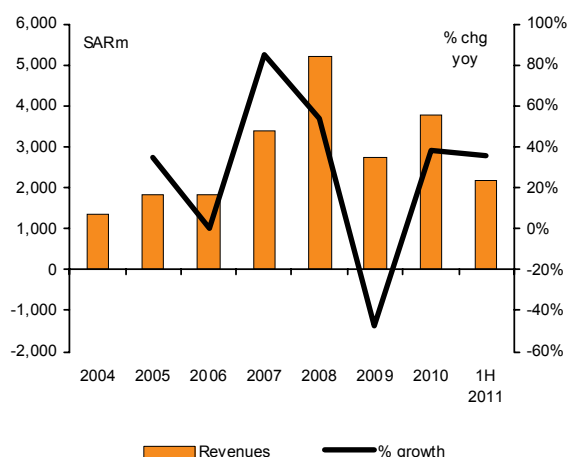
The company started construction of its first ammonia/urea plant in Dammam in September 1966 and started commercial production in March 1970 with capacity of 202,000 tonnes/annum (tpa) of ammonia and 330,000 of urea. This plant was shut down in September 2008. In 1979, SAFCO constructed a sulphuric acid plant with a production capacity of 100,000tpa, a product used in desalination, chemical cleaners, medicines, insecticides and phosphate fertilisers. In 1983, SAFCO established a 20,000tpa melamine plant.

Between 1993 and 2007, the company embarked on a capacity increase in nitrogen fertilisers in Jubail Industrial City, building capacity of 2.3mtpa urea and 2.1mtpa ammonia (SAFCO's current production capacity). SAFCO IV (1.1mtpa urea and 1.1mtpa ammonia) started in September 2007.

Historical performance

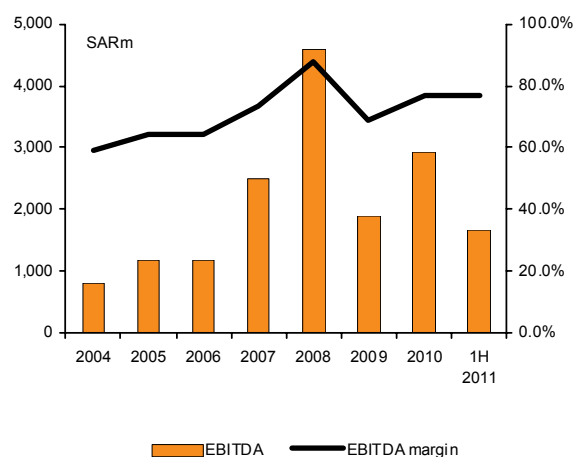
SAFCO revenues have grown by on average 18.7% per year over 2004-10. The company registered the highest revenue in 2008 when product prices peaked, with urea at almost US\$800/tonne. In 2010, revenues were up 38.3% yoy to SR3,790m from SR2,741m in 2009, driven by higher sales volumes and higher product prices. The company's EBITDA saw a CAGR of 24.1% over 2004-10.

Chart 9 : Revenue trend, 2004-1H11



Source: Company data

Chart 10 : EBITDA and EBITDA margin, 2004-1H11



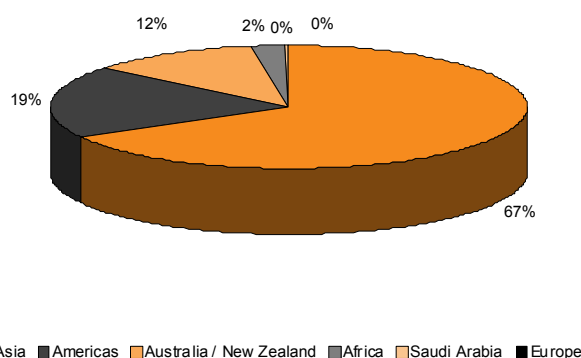
Source: Company data

Given its ideal geographical location, SAFCO sells most of its products in the Asian region, which accounted for two-thirds of its revenues in 2009.

SAFCO enjoys some of the highest margins globally

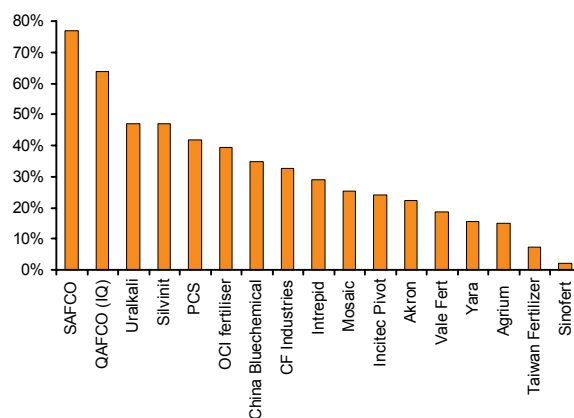
The company reported an EBITDA margin of 77.1% in 2010, which was high compared to its industrial peers in Saudi Arabia and compared with its fertiliser peers. We expect the margin to remain high at about 77% in 2012, as we do not assume a change in the gas price regime in Saudi Arabia.

Chart 11 : SAFCO revenues by end market, 2009



Source: Company data

Chart 12 : SAFCO enjoys the highest margin in the sector – global EBITDA margins, 2010



Source: Company data, Bloomberg, Rasmala

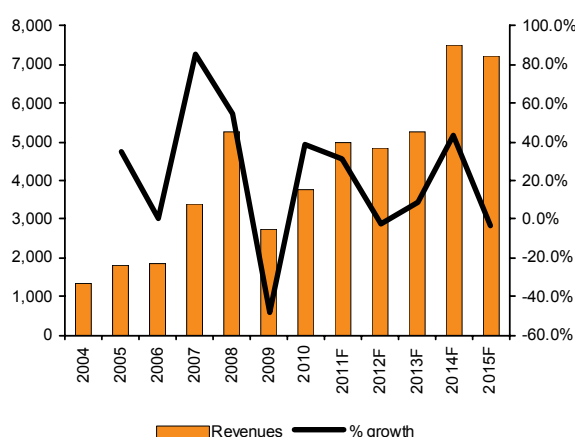
Financial outlook

We expect limited revenue and EBITDA growth during 2011-13, followed by a boost in growth in 2014 with the start-up of SAFCO V.

Based on our assumptions for urea and ammonia pricing, and capacity utilisation of 90-100% during our forecast period, we expect:

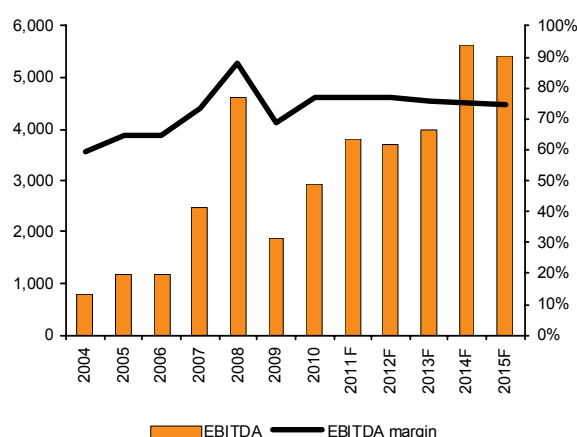
- Revenue growth of about 11% on average during 2011-13, but with the strongest growth (30%) this year. For 2014, when we expect the new plant SAFCO V to be fully up and running, we forecast revenue growth of almost 43%.
- EBITDA growth of 11% during 2010-13 on average, again with the strongest growth in 2011, followed by a small drop in 2012, as a result of a likely drop in fertiliser prices.
- EBITDA margin of 75-77% during 2011-15. From 2016 onwards, we forecast margin of 64-65%, as a result of our assumption of a gas price increase to US\$2.0/MMBtu.
- SAFCO has a comfortable balance sheet. Net cash was about SR1.9bn at the end of 2010 and we expect the company to remain in a net cash position despite capital expenditure (which we assume at about US\$1.0bn) for SAFCO V between now and 2014.

Chart 13 : Revenues (SRm) and % growth



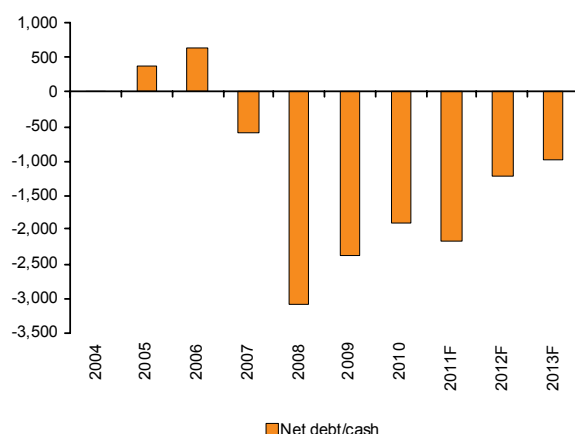
Source: Company reports, Rasmala forecasts

Chart 14 : EBITDA (SRm) and EBITDA margin



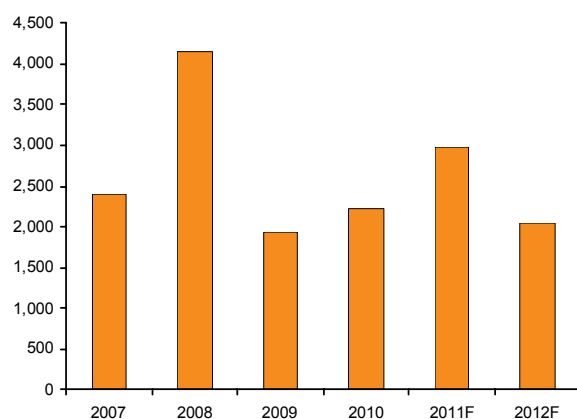
Source: Company reports, Rasmala forecasts

Chart 15 : SAFCO: net debt/(cash) – SRm



Source: Company reports, Rasmala forecasts

Chart 16 : SAFCO FCF generation – SRm



Source: Company reports, Rasmala forecasts

Income statement

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	2741	3789	4919	4828	5252
Cost of sales	-799.5	-800.8	-1314	-1334	-1489
Operating costs	-52.1	-68.0	215.4	212.4	222.9
EBITDA	1889	2921	3820	3706	3986
DDA & Impairment (ex gw)	-231.5	-298.7	-299.0	-308.9	-354.2
EBITA	1658	2622	3521	3397	3632
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	1658	2622	3521	3397	3632
Net interest	38.0	8.37	5.05	-22.6	-8.22
Associates (pre-tax)	128.9	306.6	320.0	329.6	339.5
Other pre-tax items	4.33	56.8	15.0	25.0	25.0
Reported PTP	1829	2994	3861	3729	3988
Taxation	-95.7	-61.2	-115.8	-111.9	-119.6
Minority interests	0.00	0.00	0.00	0.00	0.00
Other post-tax items	71.1	302.0	0.00	0.00	0.00
Reported net profit	1804	3235	3745	3617	3868
Tot normalised items	71.1	302.0	0.00	0.00	0.00
Normalised EBITDA	1889	2921	3820	3706	3986
Normalised PTP	1829	2994	3861	3729	3988
Normalised net profit	1733	2933	3745	3617	3868

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	2964	2256	2523	1567	1334
Other current assets	1110	1381	1820	2028	2206
Tangible fixed assets	3452	3243	3494	4435	5331
Intang assets (incl gw)	0.00	0.00	0.00	0.00	0.00
Oth non-curr assets	1280	1498	1562	1629	1698
Total assets	8808	8379	9399	9658	10569
Short term debt (2)	236.8	192.9	192.9	192.9	192.9
Trade & oth current liab	654.5	315.5	590.3	482.8	525.2
Long term debt (3)	352.9	160.0	160.0	160.0	160.0
Oth non-current liab	548.9	576.2	576.2	576.2	576.2
Total liabilities	1793	1245	1519	1412	1454
Total equity (incl min)	7015	7134	7880	8247	9115
Total liab & sh equity	8808	8379	9399	9658	10569
Net debt	-2375	-1903	-2170	-1214	-981.2

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	1889	2921	3820	3706	3986
Change in working capital	377.7	-524.5	-164.0	-315.0	-135.7
Net interest (pd) / rec	11.9	6.18	4.95	32.6	18.2
Taxes paid	-95.7	-61.2	-115.8	-111.9	-119.6
Other oper cash items	48.1	93.4	15.0	25.0	25.0
Cash flow from ops (1)	2231	2435	3560	3336	3774
Capex (2)	-243.2	-122.6	-550.0	-1250	-1250
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	295.3	466.3	256.6	207.9	243.1
Cash flow from invest (3)	52.1	343.7	-293.4	-1042	-1007
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	-236.8	-236.8	0.00	0.00	0.00
Ordinary dividend paid	-3000	-3250	-3000	-3250	-3000
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	0.00	0.00	0.00	0.00	0.00
Cash flow from fin (5)	-3237	-3487	-3000	-3250	-3000
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Incl/(decr) cash (1+3+5+6)	-953.6	-708.6	267.0	-955.7	-233.2
Equity FCF (1+2+4)	1988	2312	3010	2086	2524

Source: Company data, Rasmala forecasts

year to Dec

Standard ratios	SAFCO					Yara			OCI		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	-47.7	38.3	29.8	-1.86	8.78	24.2	-3.01	2.32	15.8	10.7	7.43
EBITDA growth (%)	-59.0	54.6	30.8	-3.00	7.56	10.2	-7.91	0.30	43.2	16.0	7.22
EBIT growth (%)	-61.0	58.2	34.3	-3.53	6.91	11.2	-13.0	-0.15	50.5	16.8	8.84
Normalised EPS growth (%)	-61.7	69.2	27.7	-3.43	6.94	44.2	-10.2	0.09	30.0	27.1	15.7
EBITDA margin (%)	68.9	77.1	77.7	76.8	75.9	15.3	14.5	14.2	27.2	28.5	28.4
EBIT margin (%)	60.5	69.2	71.6	70.4	69.2	12.0	10.8	10.5	22.0	23.2	23.5
Net profit margin (%)	63.2	77.4	76.1	74.9	73.7	12.5	11.5	11.3	13.6	15.6	16.8
Return on avg assets (%)	18.2	34.0	42.1	38.2	38.3	14.8	12.0	11.0	10.8	12.7	13.2
Return on avg equity (%)	23.0	41.5	49.9	44.9	44.6	25.5	19.2	16.7	22.6	24.8	24.8
ROIC (%)	31.8	55.4	65.3	57.7	50.1	13.3	11.1	10.7	22.3	26.8	31.0
ROIC - WACC (%)	21.7	45.3	55.3	47.7	40.1	5.58	3.34	2.98	7.00	12.9	17.0
	year to Dec					year to Dec			year to Dec		
Valuation											
EV/sales (x)	15.8	11.6	8.87	9.24	8.54	1.18	1.14	1.06	1.61	1.31	1.07
EV/EBITDA (x)	23.0	15.0	11.4	12.0	11.2	7.69	7.87	7.47	5.92	4.60	3.77
EV/EBITDA @ tgt price (x)	26.1	17.1	13.0	13.6	12.7	9.66	10.0	9.60	7.72	6.14	5.21
EV/EBIT (x)	26.2	16.7	12.4	13.1	12.3	9.79	10.6	10.1	7.31	5.63	4.55
EV/invested capital (x)	9.36	8.39	7.64	6.34	5.51	1.73	1.58	1.43	1.68	1.60	1.51
Price/book value (x)	6.53	6.42	5.81	5.56	5.03	1.66	1.43	1.25	2.08	1.79	1.55
Equity FCF yield (%)	4.34	5.05	6.57	4.55	5.51	4.69	10.1	8.81	20.2	23.4	25.1
Normalised PE (x)	26.4	15.6	12.2	12.7	11.8	7.18	7.99	7.98	9.88	7.78	6.72
Norm PE @ tgt price (x)	29.9	17.6	13.8	14.3	13.4	9.59	10.7	10.7	13.5	10.6	9.16
Dividend yield (%)	6.55	6.55	7.09	6.55	6.55	2.63	2.83	3.04	5.40	6.43	7.44
	year to Dec					year to Dec			year to Dec		
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	250.0	250.0	250.0	250.0	250.0	Net debt to equity (%)	-33.9	-26.7	-27.5	-14.7	-10.8
Reported EPS (SAR)	7.22	12.9	15.0	14.5	15.5	Net debt to tot ass (%)	-27.0	-22.7	-23.1	-12.6	-9.28
Normalised EPS (SAR)	6.93	11.73	14.98	14.47	15.47	Net debt to EBITDA	-1.26	-0.65	-0.57	-0.33	-0.25
Dividend per share (SAR)	12.0	12.0	13.0	12.0	12.0	Current ratio (x)	4.57	7.16	5.55	5.32	4.93
Equity FCF per share (SAR)	7.95	9.25	12.0	8.35	10.1	Operating CF int cov (x)	-194.7	-402.9	-741.4	-104.9	-212.7
Book value per sh (SAR)	28.1	28.5	31.5	33.0	36.5	Dividend cover (x)	0.58	0.90	1.25	1.11	1.29
	year to Dec						year to Dec				

Priced as follows: 2020.SE - SR183.25; YAR.OL - NKr235.60
Source: Company data, Rasmala forecasts

Valuation methodology – SAFCO DCF analysis

SRm	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
EBITDA	3,818	3,706	3,986	5,633	5,401	4,832	4,870	4,905	4,938	4,968
D&A	-299	-309	-354	-462	-467	-442	-418	-397	-377	-359
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NOPAT	3,403	3,285	3,512	5,004	4,775	4,248	4,309	4,364	4,415	4,462
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Capex	-550	-1,250	-1,250	-900	-145	-147	-149	-152	-154	-156
Change in working capital	-177	-302	-136	-721	83	-35	-36	-36	-36	-37
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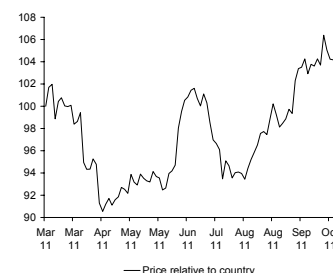
Source: Rasmala forecasts

Company description

Buy

Price relative to country

Saudi Arabian Fertilizer Company (SAFCO), headquartered in Saudi Arabia, was established in 1965. The company is a pure-play nitrogen fertiliser company with total capacity of 2.3mtpa urea and 2.1mtpa ammonia. In January 2011, SAFCO resumed studies to build SAFCO V, which will increase its total capacity to 3.8mtpa urea and 3.3mtpa ammonia by 2014.



Strategic analysis

Average SWOT company score:

4

SAFCO shareholder structure

Strengths

4

One of the lowest-cost producers globally of urea and ammonia. SABIC, one of the largest chemical companies worldwide, is a significant shareholder.

Weaknesses

2

One-product company without any diversification into other fertiliser product areas. No control over selling prices of its main products, which are set on a global basis.

Opportunities

5

SAFCO could use its strong balance sheet to expand its capacity, move into other product areas further downstream, and acquire assets outside the region.

Threats

3

Increased exports from China due to reduced export tax. Increases in natural gas pricing in Saudi Arabia.

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters
PO Box 11044 Jubail 31961

Website
www.safco.com.sa

Shares in issue
250.0m

Free float
40%

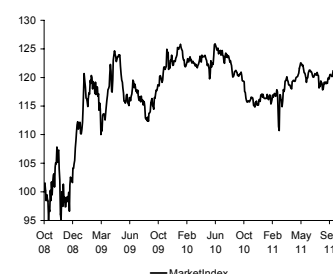
Majority shareholders
SABIC (43%), Gen. Org. for Social Ins. (17%)

Country view: Saudi Arabia

Country rel to M East & Africa

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation of RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score:

4+

Broker recommendations

Supplier power

2+

SAFCO pays a fixed price for natural gas, the main raw material, but the government makes decisions on future pricing as well as on allocation of gas in Saudi Arabia.

Barriers to entry

4+

Considerable investment is needed to enter the fertiliser industry and access feedstock at low enough prices to be competitive.

Customer power

4-

Crop yields increase if fertiliser is applied, but customers can reduce application or delay buying of fertilisers temporarily due to farm economics or unfavourable weather conditions.

Substitute products

5+

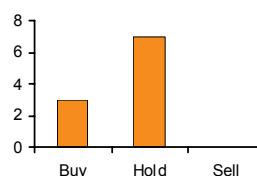
Other types of fertiliser depending on the crop, or no fertiliser at all can substitute for SAFCO's products. However, this would affect yield, and ultimately the customer must buy the product.

Rivalry

4+

Competition in most markets is significant, and the nitrogen fertiliser industry is still fragmented. However, SAFCO is one of the lowest-cost producers of ammonia and urea globally.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

Industries Qatar (RIC: IQCD.QA, Rec: Buy, CP: QR124.60, TP: QR164.00): We derive our target price by using a sum-of-the-parts valuation of each of the three business segments: petrochemicals, fertilisers and steel. For this purpose, we use a DCF valuation to capture the planned capacity expansions, which are not completely reflected in the 2011 and 2012 multiples. We check our valuation with peer multiples in each of the segments. Key risks are 1) lower-than-expected selling prices, 2) delays in planned capacity expansions, 3) a worsening economic outlook, 4) political risks.

Orascom Construction Ind (RIC: OCIC.CA, Rec: Buy, CP: E£208.53, TP: E£284.00): We value OCI using a sum-of-the-parts DCF valuation, in which we value the construction and each fertiliser plant separately. The main risks to our investment case include commodity price movements, political risk in the Middle East and North Africa, increases in gas prices that affect production costs, and execution risks in planned capacity expansions that could result in delayed start-ups and thus affect our earnings forecasts.

SAFCO (RIC: 2020.SE, Rec: Buy, CP: SR183.25, TP: SR207.00): We derive our target price by using a DCF valuation methodology in order to capture the planned capacity expansion, which is not reflected in 2011F and 2012F multiples. We use a WACC of 10% and terminal growth rate of 1.5%. Key risks to our investment thesis are commodity price movements, execution risks in planned capacity expansion, substantial new capacity build-up by competitors, higher-than-expected gas prices, and political risks in the Middle East and North Africa.

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