Energy Related Sector Initiation 2011

QNB Financial Services

GCC Energy Related Sector: Leveraged to Gas

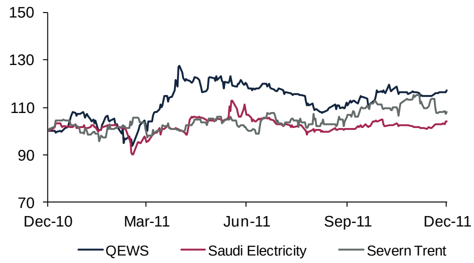
Highlights

December 29, 2011

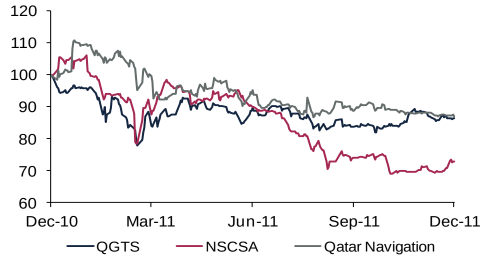
- **Qatar is a global gas powerhouse.** Endowed with the third largest reserves of natural gas (894 trillion cubic feet) globally after Russia and Iran, Qatar is the fastest growing economy in the world with its real GDP growing by a CAGR of 15.7% from 2006-2010. QNB Capital estimates that growth will continue at a rapid pace in 2011 and 2012 at 21.0% and 10.2%, respectively.
- **Gaining exposure to Qatar's growth story.** Upstream natural gas activities remain largely under state control through Qatar Petroleum (QP). *However, we believe that our three Qatari stock picks allow investors to indirectly benefit from the growth associated with Qatar's gas industry and participate in its economic growth.*
- **Initiating coverage on Industries Qatar (IQCD) with an Outperform rating; IQCD is our top pick.** Our target price of QAR171.2 implies an upside of 28%. IQCD has emerged as a key player in Qatar's strategy of diversifying into industries that leverage its competitive advantages of inexpensive gas feedstock and cheap energy inputs. The company has been able to use Qatar's gas wealth for generating high margins in its petrochemical and fertilizer businesses coupled with sustained organic growth. IQCD remains a global low-cost player allowing it to enjoy full capacity utilizations even in economic down-cycles. The company's steel business, which primarily caters to the infrastructure and construction needs of Qatar and the MENA region, remains profitable and continues to grow despite the recent postponement of phase 2 and 3 expansions.
- **We are bullish on Qatar Electricity and Water (QEWS) in the utilities space and initiate coverage with an Outperform rating.** Our target price of QAR176.2 implies an upside of 25%. QEWS, practically Qatar's sole power and water producer, is a direct beneficiary of the state's robust real GDP growth and the resultant uptick in demand for power and water. The company offers clear revenue and cash flow visibility due to its long-term off-take/take-or-pay contracts with Kahramaa (buyer) and QP (gas supplier). Moreover, fuel costs are passed through to Kahramaa. We believe that QEWS' recent moves to expand beyond Qatar could act as a growth catalyst.
- **Deeply linked to Qatar's LNG story, we are optimistic on QGTS (Nakilat) and initiate with an Accumulate rating.** Our target price of QAR20.5 implies an upside of 17%. QGTS is Qatar's dominant LNG carrier. The company enjoys a stable revenue stream due to exclusive 25-year fixed (price and quantity) charter contracts with the state-controlled LNG producers, Qatargas and RasGas. While growth is limited given the ongoing North Field moratorium, upside from the company's shipyard business and potential LPG fleet expansion could provide momentum.
- **Expanding our coverage beyond Qatar, we also initiate coverage on Renaissance Services (RNSS) in Oman with an Accumulate rating.** Our target price of OMR0.67 implies an upside of 18%. With offshore exploration and production heralded as the next growth area for oil and gas, RNSS is well positioned given its status as a leading global offshore support vessel operator. The stock has come under pressure in 2011 as RNSS has suffered from one-time losses, fraud issues and a lack of major profitable contract wins in its engineering segment. We are optimistic that these are only near-term challenges and that RNSS will offer growth in the long-term.

Relative Price Performance vs. Peers

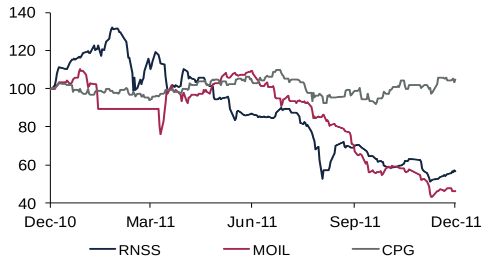
Source: Bloomberg; Note: SABIC is Saudi Basic Industries Corp and SIIG is Saudi Industrial Investment group



Source: Bloomberg



Source: Bloomberg; Note: NSCSA is National Shipping Company of Saudi Arabia



Source: Bloomberg; Note: MOIL is Maridive and Oil Services and CPG is Compass Group

Saugata Sarkar
+974 4476 6534
saugata.sarkar@qnbfs.com.qa

Table of Contents

Summary of Recommendations

Industries Qatar – Outperform – TP QAR171.2

IQCD, Qatar's largest conglomerate by market capitalization, offers investors an indirect exposure to Qatar's gas potential through its diverse operations in petrochemicals, fertilizers and steel that use low-cost gas as their key feedstock. The company procures gas at ~USD2 per million British thermal units (mmbtu) from Qatar Petroleum (parent company) as compared to global prices ranging between ~USD3-15/mmbtu. This translates into significant cost savings and enhanced profitability versus its global peers. We project overall revenue to grow at a CAGR of 20.4% over 2010-2013 driven by attractive price realizations in 2011 and capacity additions going forward. FCF (to the firm) yield (including projects under development), which was 1.2% in 2010, is expected to jump from 2012 onward and reach 15.2% by 2016. We believe this sets up IQCD well to tap future growth ventures and/or boost dividends. Growth is being driven by the fertilizer segment. The company recently inaugurated its USD3.2bn QAFCO-5 project. With QAFCO-6 expected to come on line in Q3 2012, we expect total gross fertilizer capacity to grow 85% from 4.9mtpa in 2010 to 9.1mtpa in 2012. The petrochemical segment will see the launch of its LDPE-3 plant next year. Moreover, we expect the steel segment to be a key beneficiary of the expected growth in infrastructure/construction spending in the region, especially in Qatar, which accounted for 45% of volumes YTD. Main risks to our thesis include a global economic downturn which could impact the company's cyclical businesses, delays in capacity additions and lower-than-estimated price realizations.

Qatar Electricity and Water – Outperform – TP QAR176.2

QEWS, practically Qatar's sole power and water producer, is a direct beneficiary of the state's robust real GDP growth and the resultant uptick in demand for power and water. Essentially an Independent Water and Power Producer (IWPP), QEWS procures natural gas (primary feedstock) from Qatar Petroleum (supplier; 100% government-owned) through long-term take-or-pay contracts and sells power and water to Kahramaa (buyer; 100%) under long-term off-take power and water purchase agreements. Moreover, fuel costs are passed through to Kahramaa. These agreements result in stable operating margins and any expansion should lead to growing revenue and bottom-line. We project EPS to grow at a CAGR of 5.2% (2011-2013) after growing by 18.7% in 2011 in our base-case model, which assumes no further expansion in Qatar or elsewhere beyond the already announced Sur power project in Oman. We believe that the company's free cash flows (to the firm) are at an inflection point and predict a FCF yield of ~17% (~QAR23 a share) over 2011 to 2013 with capex requirements down significantly after 2010. In our view, this strong FCF trajectory should allow QEWS to pursue expansion opportunities and/or boost dividends. Expansions outside of QEWS' comfort zone in Qatar, while creating opportunities also create risks but we remain optimistic.

Qatar Gas Transport – Accumulate – TP QAR20.5

QGTS or Nakilat is Qatar's dominant LNG carrier. With ~77mtpa in production capacity, Qatar is the top global LNG player. Nakilat is the world's largest LNG ship owner (~16% market share) and forms a crucial link between Qatar's gas production and its monetization in the form of LNG exports. The company enjoys a stable revenue stream due to exclusive 25-year fixed (price and quantity) charter contracts with the state-controlled LNG producers, Qatargas and RasGas. These agreements result in stable revenue but flattish absolute EBITDA, irrespective of fleet utilization. The company is not exposed to spot rate volatility for its wholly-owned vessels which could be a double-edged sword. After experiencing a 27% increase in 2011 due to capacity expansion, EPS should improve at a CAGR of 6.4% (2011-2016) largely on the back of declining financial charges. Given the North Field moratorium, we assume no further expansion in QGTS' fleet. We expect QGTS to generate an average FCF (to the firm) yield of 25% (~QAR2.4bn) over 2011 to 2016 allowing the company to comfortably repay its huge debt load of QAR25.1bn (as of Q3 2011) taken for its fleet expansion program. Upside from the shipyard business and potential LPG fleet expansion could provide momentum while lower-than-estimated price realizations through the JV businesses and unexpected and prolonged fleet downtimes could add risk.

Renaissance Services – Accumulate – TP OMR0.67

From its roots as a domestic contract services operator, RNSS has transformed itself to become a leading global offshore support vessel operator. The company's marine segment is the most profitable (EBITDA margin of ~52% in 2010 versus ~29% overall) and commands a significant presence in the hydrocarbon-rich Caspian region. RNSS' contract services segment is secure as it caters to many Omani government institutions and has long-term contracts with the Petroleum Development of Oman for permanent accommodation facilities. However, the company has been suffering in 2011 due to a rash of bad news in its engineering segment given a lack of major profitable contracts and one-time losses. Management is taking steps to restructure the segment. However, given the underperformance thus far in 2011, we predict operating losses in the engineering segment in 2011-2012, with breakeven only in 2013. We believe that continued traction in the marine segment, signs of a turnaround in engineering and potential financing announcements could act as key catalysts. We are modeling revenue and EBITDA from the marine segment to grow at CAGRs of 9.1% and 8.8%, respectively, over 2010-2016. However, delays in fleet addition plans and further hiccups in the engineering segment remain as risks.

Financial Services

Industries Qatar (IQCD)

Dec. 29, 2011

Recommendation	**OUTPERFORM**	**Risk Rating**	**R-3**
Share Price	**QAR133.4**	**Target Price**	**QAR171.2**
Implied Upside	**28%**		

Qatar's Industrial Behemoth

Exposure to the Qatar gas story; high-margins on the back of low feedstock costs; diverse product mix; cash rich with low leverage; significant fertilizer growth a key catalyst and attractive valuation.

Highlights

- **Access to Qatar's gas story.** IQCD, Qatar's largest conglomerate by market capitalization, offers investors an indirect exposure to Qatar's gas potential through its diverse operations in petrochemicals, fertilizers and steel that use low-cost gas as their key feedstock.
- **Low input costs – a key differentiator.** IQCD procures gas at ~USD2/mmbtu from Qatar Petroleum (parent company) as compared to global prices ranging between ~USD3-15/mmbtu. This translates into significant cost savings and enhanced profitability versus its global peers.
- **Diversification is a risk mitigant.** IQCD's revenue distribution is a mix across different geographies and products. This reflects a sound strategy mitigating any unforeseen risks, which could affect a particular market or a product.
- **Significant revenue and cash flow growth.** We project overall revenue to grow at a CAGR of 20.4% over 2010-2013 driven by attractive price realizations in 2011 and capacity additions going forward. FCF (to the firm) yield (including projects under development), which was 1.2% in 2010, is expected to jump from 2012 onward and reach 15.2% by 2016. We believe this sets up IQCD well, to tap future growth ventures and/or boost dividends.

Catalysts

- **Significant fertilizer expansion.** IQCD recently inaugurated its USD3.2bn QAFCO-5 project. With QAFCO-6 expected to come on line in Q3 2012, we expect total gross fertilizer capacity to grow 85% from 4.9mtpa in 2010 to 9.1mtpa in 2012. Despite our somewhat cautious outlook on urea and ammonia prices next year, capacity additions should drive fertilizer revenue and EBITDA by CAGRs of 35.6% and 38.8%, respectively, over 2010-2013. We expect revenue to grow by 61% in 2011 driven by a significant increase in urea and ammonia price realizations.
- **Steel segment could benefit from Qatar's infrastructure growth.** We view the postponement of the ambitious capacity expansion (phase 2 and 3) in the lower-margin steel segment as a positive. However, we expect steel to be a key beneficiary of the expected growth in infrastructure/construction spending in the region, especially in Qatar, which accounted for 45% of volumes YTD.

Recommendation, Valuation and Risks

- **Recommendation and valuation.** *We rate IQCD an Outperform with a price target of QAR171.2.* Currently, the stock is trading at a discount to its petrochemical and fertilizer peers which we believe is unwarranted considering IQCD's growth prospects and strong balance sheet.
- **Risks:** 1) Cyclical businesses remain suspect to a global downturn; 2) Delays in capacity additions and 3) Lower-than-estimated price realizations.

Key Financial Data and Estimates

QAR mn	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	9,857	12,331	16,870	18,457	21,500
Net Profit	4,959	5,575	8,299	8,975	10,224
EPS (QAR)	9.02	10.14	15.09	16.32	18.59
PE (x)	14.8	13.2	8.8	8.2	7.2
Dividend Yield %	3.7	4.1	5.7	6.1	7.0

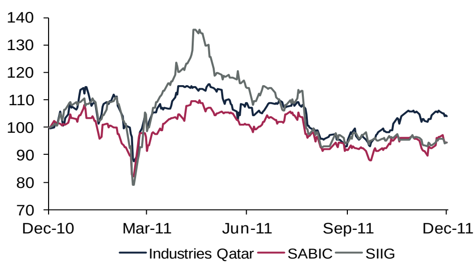
Source: Company Data, QNBFS Estimates

Key Data:

Bloomberg ticker	IQCD QD
ADR/GDR ticker	NA
Reuters ticker	IQCD.QA
ISIN	QA000A0KD6K3
Sector	Industrials
52wk high/52wk low (QAR)	154.5/116.0
3-m average volume ('000)	278.3
Mkt. cap. (USD bn/QAR bn)	20.1/73.4
Shares outstanding (mn)	550
FOL* (%)	7.5
FOL Limit* (mn)	41
1-year total return (%)	3.9
Fiscal year end	Dec 31

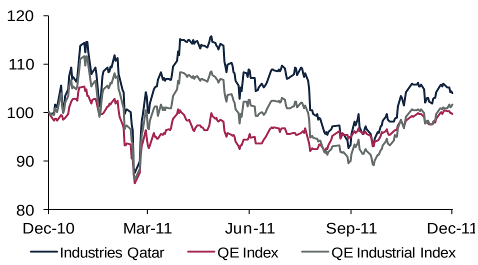
Source: Bloomberg (as of December 15, 2011), *Qatar Exchange

Relative Price Performance vs. Peers



Source: Bloomberg; Note: SABIC is Saudi Basic Industries Corp. and SIIG is Saudi Industrial Investment group

Relative Price Performance vs. Market



Source: Bloomberg; Note: QE Index is Qatar Exchange Index and QE Industrial is Qatar Exchange Industrial Index

Broker Recommendations

Recommendation	Number
Buy	12
Hold	0
Sell	0

Source: Bloomberg

Executive Summary

Access to Qatar's Gas Story

IQCD, Qatar's largest conglomerate by market capitalization, offers investors an indirect exposure to Qatar's gas potential. With the third-largest reserves of gas (894 trillion cubic feet) globally after Russia and Iran, Qatar remains a global gas powerhouse. However, upstream natural gas activities remain largely under state control through Qatar Petroleum (QP). IQCD allows investors to indirectly benefit from the growth associated with Qatar's gas industry. The company utilizes cheap gas obtained from parent QP through long-term contracts for its diverse operations in petrochemicals, fertilizers and steel that use gas as their key feedstock. IQCD has emerged as a key player in Qatar's strategy of diversifying into industries that leverage its competitive advantages of inexpensive hydrocarbon feedstock and cheap energy inputs.

Low Input Costs is the Key Differentiator

IQCD procures gas at a significant discount from QP … IQCD procures ethane gas at less than USD2 per million British thermal units (mmbtu) from QP against global prices ranging between USD3-15/mmbtu. In 2010, IQCD's weighted average natural gas cost was USD1.91/mmbtu (petrochemical: USD1.75, fertilizer: USD2.35 and steel: USD0.98). Looking forward, IQCD expects QP to continue providing feedstock at an average of ~USD2/mmbtu over the next four years. IQCD's gas cost continues to be determined on a plant/product basis and includes a fixed base cost, an annual inflation adjustment and an escalator, primarily linked to end-product prices. Besides gas, IQCD purchases butane as a feedstock for methyl tertiary-butyl ether (MTBE) and linear low-density polyethylene (LLDPE), at market prices. For the steel segment, IQCD sources iron ore from four suppliers.

… As a result, profitability should remain strong ... In 2010, the company posted an EBITDA margin of ~47% (petrochemical and fertilizer segments both posted around 60%). We expect the group's EBITDA margins to expand to roughly 52% by 2013 due to the capacity ramp-up in its higher-margin segments offset by lower price realizations in 2012. Over 2010 to 2013, we are modeling group EBITDA to grow at a compound annual growth rate (CAGR) of 24.3%.

... And the company should be able to continue operating at full utilization levels. Softening of product prices (as we expect next year) should directly impact high-cost marginal producers. Despite a fall in profitability, the company remains assured of operating its plants at full-utilization levels. This was most recently seen in 2009, when despite significant 20%-47% declines in petrochemical and fertilizer prices, IQCD operated at 100% or better utilization levels across these product lines.

Diversification is a Risk Mitigant

IQCD enjoys a well-diversified revenue stream. IQCD's revenue distribution is well-diversified across geographies and products. The company markets a majority of its higher-margin petrochemical and fertilizer products to the rapidly growing emerging markets of Asia. The petrochemical segment derived 61% and 26% of its sales volume from Asia and the Middle East and North Africa (MENA) region, respectively, in the nine months ended September 2011; we note that Asia has increased its contribution from 45% in 2008. The fertilizer segment derived 50%, 45% and 5% of its sales volume from Asia, rest of the world (excluding MENA) and MENA, respectively, YTD. The company continued to be a major player in the domestic steel market, with Qatar making up 45% of its YTD steel volumes while the MENA region contributed 49%.

Revenue contributions of the petrochemicals, fertilizer and steel segments are expected to be 32.2%, 33.8% and 34.0% respectively, by 2013 as against a revenue mix of 38.1%, 23.6% and 38.3%, respectively, in 2010. A diverse mix of products and markets, which contribute to the company's results, reflects a sound corporate strategy to mitigate any unforeseen risks.

Significant Growth and Strong Financial Position

We project overall revenue to grow at a CAGR of 20.4% over 2010-2013, driven by attractive price realizations in 2011 and capacity additions going forward. Free cash flow to the firm (FCF) yield (including projects under development), which was 1.2% in 2010, is expected to jump from 2012 onward and reach 15.2% by 2016. We think this sets up IQCD well to tap future growth ventures and/or boost dividends. We believe the company could increase its dividend payouts, (payout was ~55% for the last two financial years) as IQCD generates significant cash from operations going forward. The company continues to maintain a healthy balance sheet. IQCD had QAR6.4bn in cash as of Q3 2011, while its net-debt-to-equity ratio stood at 0.03x. The company also recently secured an Aa3 credit rating with a Stable outlook from Moody's, which speaks to its financial strength.

Q3 2011 Results

IQCD reported total revenue of QAR4.4bn for Q3 2011, an increase of 40.6% YoY, helped by higher selling prices across the board. Utilization rates remained high, coming in at 104% on an YTD basis for the group. Sequentially, revenue grew by 5.1% mainly due to increases in price realizations. While urea and ammonia price realizations remained strong on a quarterly basis, IQCD reported declines in petrochemical prices except for Methanol (which is part of its fuel additives segment). Surprisingly, urea sales volumes fell around 22% QoQ due to sale timing differences, which should be resolved in the fourth quarter. EBITDA increased by 46.1% YoY to QAR2.3bn (EBITDA margin 51.6%) versus QAR1.5bn (49.6% margin) in the corresponding quarter of 2010 mainly due to healthy top-line growth. Improved performance at the operating level led to an improvement of 45.6% YoY in net income to QAR2.1bn.

Catalysts

Significant Fertilizer Expansion

With a major capacity expansion expected over 2012, fertilizer growth should act as a short-term stock catalyst. IQCD recently inaugurated its USD3.2bn QAFCO-5 project. With QAFCO-6 expected to come on line in Q3 2012, we expect total gross fertilizer capacity to grow 85% from 4.9mn tons per annum (mtpa) in 2010 to 9.1mtpa in 2012. QAFCO-5 will add 1.5mtpa of ammonia and 1.3mtpa of urea capacity, while QAFCO-6 will contribute another 1.3mtpa of urea capacity next year. Despite our somewhat cautious outlook on urea and ammonia prices next year, capacity additions should drive fertilizer revenue and EBITDA by CAGRs of 35.6% and 38.8%, respectively, over 2010-2013. We expect revenue to grow by 61% in 2011, driven by a significant increase in urea and ammonia price realizations.

Steel is a Play on Qatar's Infrastructure Growth Story

Significant expansion plans were recently put on hold. IQCD, through its wholly-owned subsidiary QSC, is the dominant steel producer in Qatar controlling almost all of the market. The company announced last year that it would embark on an ambitious expansion program in steel, almost doubling its capacity from 6.1mtpa to around 11.7mtpa by 2015. These phase 2 and 3 expansion plans were however put on hold in August after consultations with QP given the lack of natural gas allocations. IQCD management has stated that they would reassess these projects once the necessary natural gas allocations have been secured, which could happen if the moratorium on the North Field is lifted by year-end 2015. Currently, we have not considered any impact from these expansions in our model. Since IQCD imports iron ore, this segment has the lowest margins among the group and we tend to view this postponement as a positive. Apart from these projects, QSC plans to spend ~QAR1.3bn for its new electric furnace replacement (EF1-R), Dubai rolling mill and other small projects. These projects are expected to add capacity of around 1mtpa in re-bars in Q1 2013 as per company forecasts and has been included in our model.

However, we continue to believe that the steel segment could benefit from Qatar's infrastructure growth. Steel remains leveraged to the infrastructure/construction spending in the region, especially in Qatar, which represented 45% of steel volumes YTD. According to the National Development Strategy (NDS) for 2011-2016, Qatar is planning around USD65bn in infrastructure spending over 2011-2016. This is in the run up to Qatar hosting the 2022 FIFA World Cup and is based on the model of sustainable development envisaged in the Qatar National Vision for 2030. The NDS also recommends additional infrastructure investments beyond those already planned, costing between USD8.5-12.5bn. Furthermore, ~QAR100bn (USD27bn) in investments by Barwa and Qatari Diar for residential and business construction projects are also expected over the same period. We believe that these domestic spending initiatives will benefit IQCD's steel business going forward. QSC also has exposure to Saudi Arabia and the UAE and is well poised to tap the growth in those countries (especially Saudi Arabia as the UAE construction market remains tepid).

Valuation

Our target price of QAR171.2 per share implies an upside of 28% on the stock. We have arrived at the fair value of IQCD using a blend of discounted cash flow (DCF), sum-of-the-parts (SOTP) EV/EBITDA multiple and SOTP P/E multiple methodologies. We have assigned more weight to the DCF method given the fact that it fully reflects IQCD's capacity addition plans and the company's long-term cash generating potential.

Valuation Summary

Valuation Summary	Value (QAR)	Weights	Fair Value (QAR)
DCF	174.9	60%	105.0
SOTP (EV/EBITDA multiple)	160.7	20%	32.1
SOTP (P/E multiple)	170.8	20%	34.2
Target Price			**171.2**
Potential Upside/Downside			28%

Source: Bloomberg, QNBFS Estimates

Our DCF valuation reveals a fair value of QAR174.9 per share. We account for the company's fertilizer expansion program (QAFCO-5 and QAFCO-6) over 2012-2013 and factor in the impact from the ~1mtpa steel plant in Q2 2013. In terms of petrochemicals, we factor in the start-up of the LDPE-3 plant in Q3 2012. We generally factor in some additional lag time versus management guidance of capacity increases in order to be conservative. We explicitly model cash flows until 2016 and use a terminal growth rate of 2%.

DCF Valuation

Particulars	Fair Value of Equity (QAR mn)	Fair Value per Share (QAR)
Cumulative PV of FCFF	34,229	
PV of Terminal Value	60,552	
PV of Cash Flows	**94,781**	**172.3**
Add:		
Cash Balances (Q3 2011)	6,439	11.7
Investments (Q3 2011)	2,537	4.6
Less:		
Debt balances (Q3 2011)	7,141	13.0
Minority interest (Q3 2011)	406	0.74
Fair Value of Equity	**96,210**	**174.9**

Source: QNBFS Estimates

Our WACC assumptions remain fairly conservative. For weighted average cost of capital (WACC) calculations, we have assigned a weight of 90% to equity and 10% to debt based on our expectation of the company's long-term capital structure (IQCD's current market capitalization is around 91% of its total debt and market capitalization). We also use an emerging market risk premium of 8% and a beta of 1.14, which has obtained from Bloomberg. This results in a WACC of almost 12.5%.

WACC Analysis

WACC Calculations	
Risk free rate (Estimated yield for 10-year government bonds) (%)	4.5
Risk premium (%)	8.0
Beta	1.1
Cost of Equity (%)	**13.6**
Cost of Debt (%)	**2.0**
Tax rate (%)	0.0
WACC (%)	**12.5**

Source: Bloomberg, QNBFS Estimates

Sensitivity Analysis

We have performed a sensitivity analysis on WACC and terminal growth rate to our DCF valuation model. As per the sensitivity analysis table, we can see that a reduction in WACC by 100bps would increase the fair value by 10.8% while a 25bps increase in terminal growth rate would increase the fair value by 1.7%. The results of our sensitivity analysis are depicted below:

Sensitivity Analysis

WACC \ Terminal Growth Rate	1.50%	1.75%	2.00%	2.50%	2.75%
10.5%	208.1	212.5	217.1	222.0	227.3
11.5%	186.8	**190.2**	**193.8**	**197.6**	201.5
12.5%	169.4	**172.1**	**174.9**	**177.9**	181.0
13.5%	154.9	**157.1**	**159.4**	**161.8**	164.3
14.5%	142.7	144.5	146.3	148.3	150.3

Source: QNBFS Estimates

Relative Valuation

IQCD remains attractive versus its peers. We have valued IQCD's business segments on an individual basis, applying the third-quartile 2012 EV/EBITDA multiple of comparable regional and global players in each segment. We have chosen to use the third-quartile multiple given IQCD's better risk/return profile and generally superior profitability relative to its peers. We also believe that using the third-quartile multiple adjusts for the fact that the company's 2012 results will not fully reflect contributions from all capacity additions. Additionally, we have also valued IQCD using the third-quartile P/E multiple of comparable players for each business line. Our SOTP EV/EBITDA and P/E relative valuation techniques lead to the following conclusions:

SOTP EV/EBITDA Analysis

Particulars	EBITDA (QAR mn)	EV/EBITDA Multiple	Equity Value (QAR mn)	Value per Share (QAR)
Petrochemicals	3,915	9.6	37,545	68.3
Fertilizers	4,304	9.0	38,796	70.5
Steel	1,720	6.2	10,607	19.3
Total			**86,947**	**158.1**
Add:				
Cash balances (Q3 2011)			6,439	11.7
Investments (Q3 2011)			2,537	4.6
Less:				
Debt balances (Q3 2011)			(7,141)	(13.0)
Minority interest (Q3 2011)			(406)	(0.7)
Total equity value			**88,376**	**160.7**

Source: QNBFS Estimates

SOTP P/E Analysis

Particulars	Earnings before Minority	Multiple	Equity Value (QAR mn)	Value per Share (QAR)
Petrochemicals	3,270	9.6	31,455	57.2
Fertilizers	3,579	11.3	40,445	73.5
Steel	2,131	10.5	22,436	40.8
Less: Minority			(406)	(0.7)
Total equity value			**93,931**	**170.8**

Source: QNBFS Estimates

EV/EBITDA Multiples (x)

Company Name	FY08	FY09	FY10	FY11e	FY12e
Industries Qatar*	9.7	18.7	12.9	8.5	7.2
Petrochemicals					
Yanbu National Petrochemicals	N/M	N/M	13.0	8.0	8.1
Saudi Kayan Petrochemical Co	N/A	N/A	N/M	44.8	11.1
Saudi Basic Industries Corp	7.2	15.3	8.1	6.2	6.1
Rabigh Refining & Petrochemical	N/A	29.1	23.9	13.6	9.6
Saudi International Petrochemical	8.5	31.6	10.8	7.0	6.7
Fertilizers					
Potash Corp of Saskatchewan	7.6	25.7	13.0	7.7	6.7
Arab Potash Co	9.1	15.3	14.1	9.3	8.4
SAFCO	9.2	19.9	15.8	10.8	10.9
Agrium Inc	5.4	14.5	8.8	4.8	4.8
Steel					
ArcelorMittal	2.3	10.1	6.3	5.3	5.0
ThyssenKrupp AG	2.6	19.9	4.2	3.7	3.8
Nucor Corp	4.0	63.8	14.7	7.3	6.1
United States Steel Corp	2.2	N/A	13.8	7.1	4.9
JFE Holdings Inc#	4.4	7.3	5.5	7.4	6.5
POSCO	6.0	9.0	6.8	6.8	6.2
Steel Authority of India Ltd#	3.9	3.5	4.1	5.3	4.0
JSW Steel Ltd#	8.7	6.9	6.5	5.8	4.5

Source: Bloomberg, *QNBFS Estimates; Note: # Year end is not December

P/E Multiples (x)

Company Name	FY08	FY09	FY10	FY11e	FY12e
Industries Qatar*	10.1	14.8	13.2	8.8	8.2
Petrochemical					
Yanbu National Petrochemicals	N/M	N/A	14.6	7.6	8.0
Saudi Kayan Petrochemical Co	N/M	N/A	N/A	N/M	11.6
Saudi Basic Industries Corp	10.5	38.9	13.4	9.2	9.3
Rabigh Refining & Petrochemical	N/A	25.3	52.8	18.9	8.6
Saudi International Petrochemical	11.0	95.7	16.6	10.8	9.6
Fertilizer					
Potash Corp of Saskatchewan	11.0	40.8	19.7	10.8	9.2
Arab Potash Co	13.3	21.4	20.1	13.2	11.2
SAFCO	10.4	22.4	15.8	11.4	11.5
Agrium Inc	7.8	26.4	13.4	6.9	6.9
Steel					
ArcelorMittal	1.8	N/M	7.2	7.7	6.5
ThyssenKrupp AG	4.0	N/A	11.1	9.5	10.5
Nucor Corp	6.7	N/A	N/M	16.5	12.5
United States Steel Corp	1.5	N/A	N/A	N/M	10.6
JFE Holdings Inc#	5.9	25.4	9.9	96.9	10.4
POSCO	6.7	8.3	7.2	8.6	7.1
Steel Authority of India Ltd#	5.7	4.8	5.8	7.3	6.6
JSW Steel Ltd#	12.1	7.6	8.5	10.1	6.2

Source: Bloomberg, *QNBFS Estimates; Note: # Year end is not December

Risks to Our Target Price

- **Cyclical businesses remain suspect to a global downturn.** IQCD's business segments are largely cyclical in nature. The petrochemical segment remains especially sensitive to global economic growth forecasts and oil prices. A further escalation in the European crises and slowdown in the US could have ripple effects across the globe and crimp demand and prices for IQCD's key petrochemical and fertilizer products. This could, in turn, affect the company's profitability although utilization levels should remain robust given IQCD's feedstock cost advantage.
- **Delays in capacity additions.** IQCD has had a less than stellar track record in on-time capacity additions. The company's QAFCO-5 project has been delayed by around six months. Additionally, the new 0.3mtpa LDPE plant in Mesaieed is about nine months behind schedule. Further delays in completion of projects could negatively affect our fair value and estimates.
- **Lower-than-estimated price realizations.** Given the weakness seen generally across the board in product prices in the fourth quarter, we have chosen to be conservative and forecasted lower price realizations by around 12% YoY for the company's major petrochemical and fertilizer products. Any further downside to our forecasted prices could hurt the company's results.

Petrochemicals

Asian Demand to be the Key For Petrochemical Producers …

Petrochemical demand and supply dynamics are favorable for Middle East producers. We look at the petrochemical demand and supply dynamics using the market dynamics of ethylene (generic petrochemical that is used for derivatives such as polyethylene, ethylene dichloride, ethylene oxide, etc.). High volumes and diverse usages of ethylene make it a proxy for the performance of the petrochemical complex, in our view. According to various industry sources, emerging markets, especially China and India, are expected to drive ethylene consumption growth over the medium term. On the supply side, according to ICIS, China and the Middle East will account for more than 80% of the incremental global ethylene production over the next five years.

Ethylene Derivatives

Derivatives	End Product Uses
Polyethylene	Plastic sheets & films, bags & containers, geomembranes
Ethylene Dichloride	PVC products
Ethylene Oxide	Consumer products, antifreeze, solvents, detergents,
Ethylbenzene	Polystyrene packaging, paints
Alpha Olefins	Polymers, lubricants, detergents
Vinyl Acetate	Adhesives, coatings, textiles, packaging

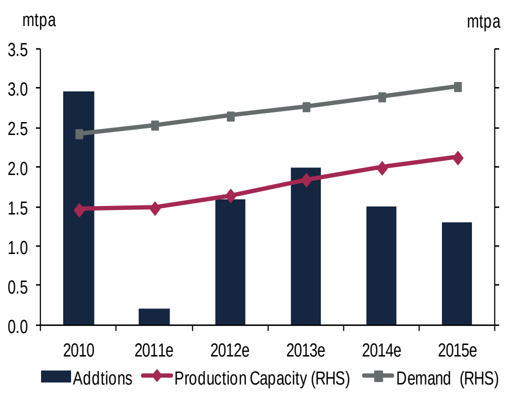
Source: CMAI, Industry reports

- **While Chinese capacity is increasing, it will be insufficient to meet local demand in the medium-term.** China's consumption of ethylene was around 24.3mtpa in 2010 and it was a net importer. According to Sinopec and Chemical Market Associates (CMAI), Chinese ethylene capacity is expected to grow at a 7.7% CAGR over 2010-2015 to 21.3mtpa from 14.6mtpa. Apart from expansions by companies such as PetroChina, Sinopec, Sinochem and CNOOC, local governments are also racing to build new ethylene plants. As China builds up its capacities for ethylene, imports are expected to decline. Assuming 100% operating rates of the plants and a demand growth CAGR of 4.5%, ethylene consumption is expected to be around 30mtpa by 2015, indicating a net shortfall of 9mtpa.
- **Chinese capacity build-up to mainly affect Asian producers.** Expanding on the above point, the Chinese move towards self-sufficiency will impact neighboring Asian producers such as Japan, South Korea and Taiwan who use naphtha-based production as compared to low-cost ethane-based Middle East producers. Already, Japanese companies have been cutting production levels, shifting to high-performance grades and forming alliances while South Korean crackers are expected to see reduced utilization rates in the fourth quarter of 2011.
- **India is a potential market for export.** A similar growth story is waiting to happen in India, which currently has a very low consumption of polyethylene (PE) as compared to the developed world. Demand from India is also expected to accelerate over the next five years, thanks to its large population and urbanization leading to a growing middle class. Since India is starting off at a lower base, it will remain a growth market in the long-term and with supply constraints, would be a potential market for Middle East producers.
- **The US shale gas advantage will take time to develop.** Although the US could be seen as a potential exporter of ethylene in the medium-to-long-term on the back of significant shale gas deposits, new facilities for petrochemicals would take several years to come into operation. Shale gas, however, is not without its issues with environmental concerns being at the top of that list. A significant amount of shale gas reserves are located in populated areas in North America and Europe and there are concerns about the contamination of water supplies caused by the extraction of these reserves.

… And Middle East Players Remain Well Positioned to Gain …

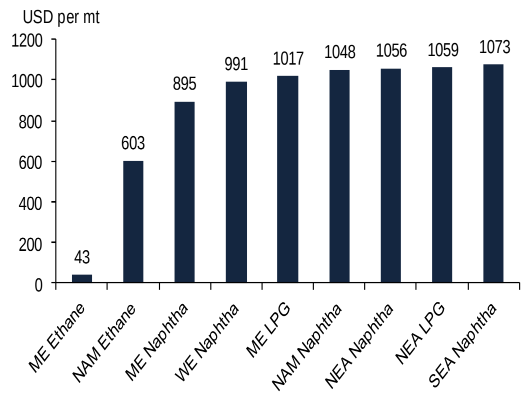
The above situation clearly gives an upper hand to Middle East producers. Middle East producers will stand to benefit from this environment and operate at higher rates compared to others on the back of unique advantages such as: 1) low feedstock cost (cheap ethane versus naphtha at market rates); 2) support from the government (ethane allocation, low power costs, exemption from import duty on machinery, no or low taxes, etc.) and 3) geographical proximity to Asian markets providing a logistics advantage over Western producers. The growing influence of the Middle East can be seen in the example of growing PE exports to China from this region. Currently, PE consumption accounts for around 60% of ethylene demand globally and is expected to remain a key driver of ethylene demand in the future. In 2009, China's consumption of PE was around 45% more than the US signifying its importance to the PE market. Sensing a market opportunity, Middle East producers have been quick to respond – between 2009 and 2011 (January-August), Middle East PE exports to China surged by 60% to around 2mn tons while the geographically closer North-East Asian exports declined by 34% YoY to around 1mn tons, according to Global Trade Information Services. PE Exports to China from the North American Free Trade Agreement region, which includes the US and Canada, fell by 47% over the same period to around 0.4mn tons.

China Ethylene Supply-Demand Forecasts



Source: ICIS, CMAI, QNBFS Estimates

Ethylene Cash Cost Comparison – February 2011



Source: CMAI; Note: ME is average value of Saudi and Iran, NAM is North America, WE is Western Europe, NEA is North East Asia, SEA is South East Asia

… However, an Uncertain Global Environment Remains a Risk

Global macroeconomic environment may crimp demand. Despite strong fundamentals (solid revenue growth and high margins) of petrochemical companies in the Middle East (including IQCD), we believe an escalation of the European debt crisis and a slowdown in the US economy could affect the performance of these companies. Further, China and India, which have driven growth for petrochemical products, on the back of solid economic growth in the past few years, are facing prospects of a slowdown. China's Q3 2011 GDP growth number, at 9.1%, was the slowest in the past two years. In the first week of December 2011, India's leading credit rating agency, CRISIL, scaled down India's GDP growth rate for fiscal 2012 to 7.0% from earlier forecasts of 7.6%, citing the global slowdown and a weak investment climate in the country.

A slowdown in the Asian economies coupled with a global recession could lead to a fall in demand for petrochemicals, which is closely correlated to GDP growth. This would have an impact on the earnings of petrochemical companies, including IQCD, which derives a majority of its revenue from Asia (61% of petrochemical sales volumes YTD). While margins could be compressed, these producers should still enjoy full utilizations given their feedstock cost advantage.

Real GDP Growth Forecasts (%)

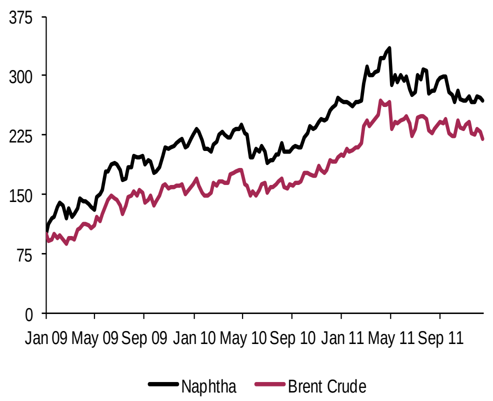
Country	2009	2010	2011E	2012e	2013e	2014e	2015e
China	9.2	10.4	9.0	8.2	8.3	8.1	8.1
MENA	1.5	4.2	3.1	4.0	4.5	4.9	4.7
Japan	-6.3	4.0	-0.3	2.3	1.3	1.3	1.3
US	-3.5	3.0	1.6	1.3	1.9	2.2	2.4
Euro Area	-4.2	1.7	1.6	-0.3	1.1	1.5	1.6
World	-2.5	3.9	2.5	2.1	2.8	2.9	3.1

Source: The Economist Intelligence Unit, October 2011; Note: Market exchange rates

Oil Sets the Trend for Petrochemical Prices and We Expect Oil Prices to Decline in 2012

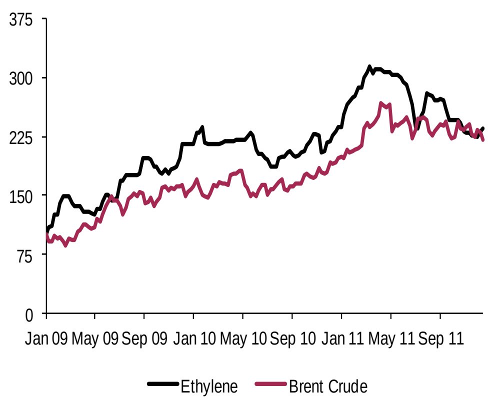
While petrochemical prices track oil, middle east producers still retain an advantage given their low-cost structure. As mentioned previously, a majority of petrochemical producers use costlier naphtha as feedstock. Production via naphtha accounts for around 50% of the ethylene produced globally. A high correlation of naphtha price with the Brent crude price (98.0% since the beginning of 2009), results in ethylene price to have a 90.9% correlation with Brent.

Naphtha Has High Correlation with Brent



Source: Bloomberg; Note: Prices rebased to 100

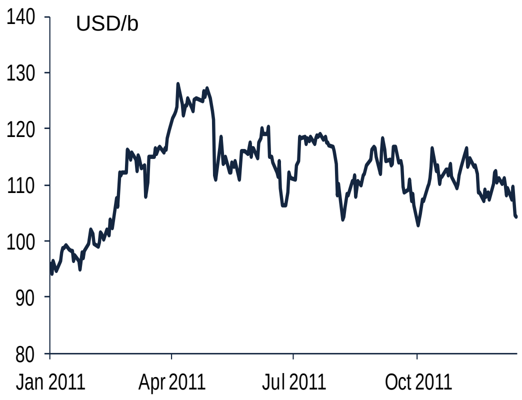
As a Result, Ethylene Follows Brent



Source: Bloomberg; Note: Prices rebased to 100

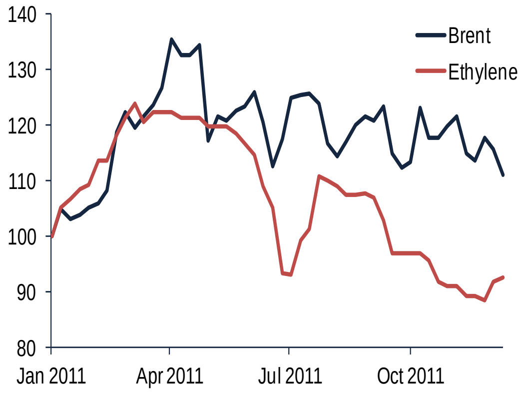
While oil prices have held up relatively well this year, we expect a decline in 2012 given the tepid economic environment. Despite an uncertain environment, Brent prices have shown resilience and continue to trade above USD100 per barrel since the beginning of February 2011. Oil prices continue to factor in fears of potential supply disruptions and have held up despite prospects of an economic downturn next year. While estimates of Libyan crude production to reach pre-uprising levels of 1.6mn barrels a day only by 2014 are proving to be grossly incorrect, fears of disruptions from Iran and Syria have kept prices buoyant. However, prices are clearly showing a downward trend as economic concerns come into play. Moreover, the Organization of the Petroleum Exporting Countries (OPEC) members in their meeting on 14 December 2011 agreed to increase OPEC's production ceiling to 30mn barrels a day (b/d) from their last ceiling of 24.52mn b/d set three years back. Demand forecasts for crude in 2011 and 2012 have been revised downward by agencies such as OPEC and the International Energy Agency (IEA) in December due to slowing oil demand in the developed as well as the BRIC nations. QNB Capital expects the Brent oil price to average around USD108 per barrel in 2011, followed by fall of around 9% YoY in 2012 due to the European debt crisis and a weak US economy. Post 2012, we expect Brent prices to recover.

Brent Price is Showing a Declining Trend



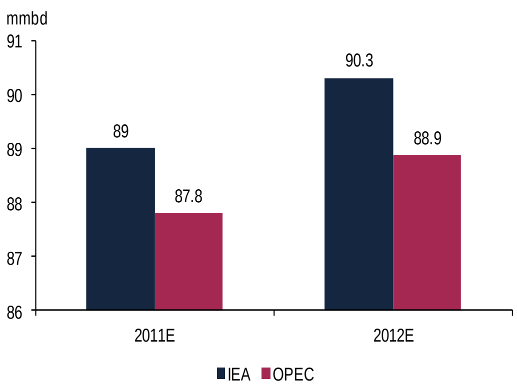
Source: Bloomberg

Ethylene has Declined More than Brent YTD



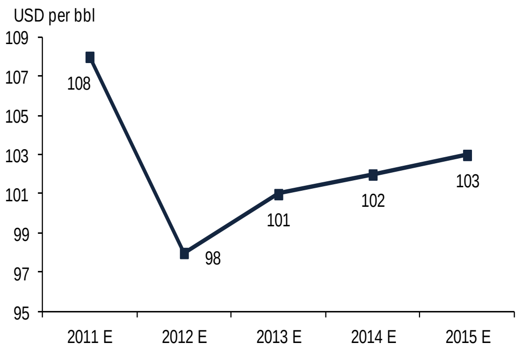
Source: Bloomberg; Note: Prices rebased to 100

Expected Global Demand for Oil



Source: IEA Oil Market Report December 2011, OPEC Oil Market Report December 2011

Brent Price Forecasts



Source: QNB Capital Estimates

Consequently, we think prices of petrochemical products will track the Brent price decline in 2012. *However, to be conservative we have assumed around 12% YoY declines in IQCD's petrochemical price realizations in 2012 followed by a 3% increase in 2013 (in line with our Brent price forecast increase).* In any event, we expect cost-advantaged producers, such as IQCD to enjoy full utilizations of their capacity.

Fertilizers

Demand for Nitrogen Fertilizers Should Remain Robust Long-Term

According to the IFA, global nitrogen fertilizer demand is estimated to reach 109.5mn tons of nutrients in 2012/13. The financial crisis of 2008/09 had a major impact on global fertilizer demand, which contracted by around 7.5% YoY. Fertilizer market conditions deteriorated sharply around Q4 2008 as the economic and financial weakness led to a severe tightening of credit availability. However, nitrogen fertilizer (primarily urea and ammonia) demand remained more resilient (down 2.3%) to the global downturn given that this type of fertilizer needs to be applied annually to maintain yields. Nitrogen fertilizer demand made up around 61% of the overall fertilizer demand over the last four years, followed by 23% (phosphorous) and 16% (potassium). Looking ahead, the International Fertilizer Industry Association (IFA) expects nitrogen fertilizer demand to increase by 3.1% in 2011/2012 followed by another 1.7% growth in 2012/2013.

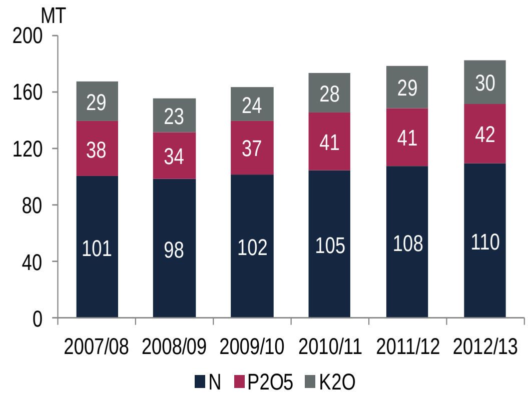
We continue to believe that over the long term, the demand for nitrogen fertilizers will remain in a secular growth mode. This is due to the following reasons:

- With a growing population, demand for soft grains (food for direct or indirect consumption) is likely to increase.
- Moreover, with growing affluence of the emerging world, demand for higher-quality, protein-rich food such as meat, eggs, dairy and fish are also likely to grow. This in turn will create the need for grain feed as the majority of soft grains are used as feedstock for beef, pork and poultry.
- Although demand for grain is on the rise, arable areas are shrinking and thus the need for fertilizers becomes increasingly pertinent. It is estimated that the size of global agricultural land per capita has fallen by 50% since the 1960s. Moreover, the availability of water also remains challenging across regions in Asia. Thus, to achieve the demanded production levels, farmers need to either increase yields of available arable land or create new arable plots, both of which require more fertilizers.

Demand Growth Declining but Remains Positive

Source: IFA Short-Term Fertilizer Outlook 2011-2012

Fertilizer Demand to Increase in Absolute Terms



Source: IFA Short-Term Fertilizer Outlook 2011-2012

Supply of Fertilizers is Expected to Increase Strongly

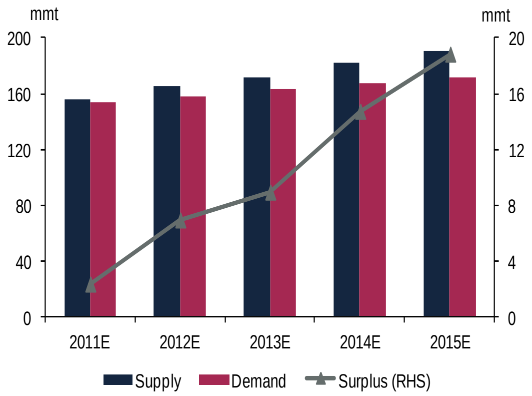
Over the next five years, global fertilizer capacity will increase significantly. Approximately 250 capacity-related projects are in the pipeline, along with a large number of expansion programs at existing sites. The IFA estimates that about USD88bn will be invested by the fertilizer industry between 2010 and 2015.

Ammonia capacity is projected to grow by 19% over 2010 and reach 229.6mn tons in 2015. The IFA, in its 2011 Global Capacity Survey, expects China to account for one-third of this incremental capacity. However, we expect most of the capacity to be used for internal consumption. China imposes high export tariffs (~110% during the peak season for fertilizer products) favoring domestic consumption versus exports. Going forward, we believe that the growth in ammonia capacity will be driven by urea capacity expansions; urea capacity accounted for 90% of growth in ammonia-based products over the last decade. Furthermore, ammonia is usually consumed mainly in its home markets, where it is produced, except in the MENA region.

Global urea capacity is projected to reach 224.5mn tons by 2015. This represents a CAGR of 5% over 2011-2015. The IFA estimates 58 new plants to come on line by 2015, of which 41 will be located outside China. However, these are only estimates based on initial timelines as the track record of plants coming on stream without delays is far from impressive. Hence, delays cannot be ruled out. In fact, QAFCO's own expansion projects, QAFCO-5 and QAFCO-6, have been delayed despite enjoying the advantage of secured feedstock.

If everything goes according to estimates, the world urea markets will experience a relatively tight balance in 2011, followed by a large increase in supply leading to a potential surplus in excess of 18mn tons in 2015. The IFA expects this surplus to increase from 2.3mn tons in 2011 to 6.9mn tons in 2012.

Global Urea Demand Supply Forecasts



Source: IFA Fertilizer Outlook 2011-2015

Spot Urea Prices, FOB Middle East

Source: Bloomberg, Fertecon, Profercy

Strong Pricing Power in 2011 is Unlikely to Persist

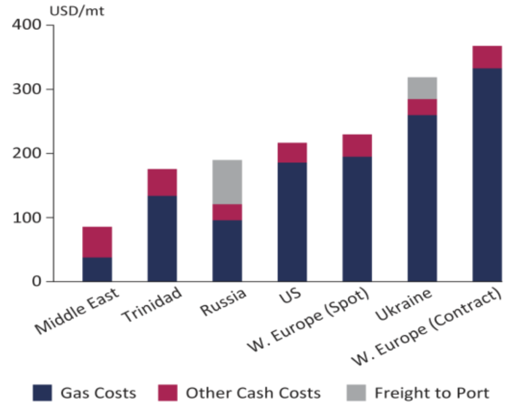
Strong demand growth led to a relatively strong urea price for 2011. Low grain inventories and high prices also helped farmers' economics leading to a significant uptick in prices. However, given a weak global economy and incremental supply, we are expecting a price correction in 2012. Already urea prices have corrected significantly over the last four weeks as the kharif application season has ended in India.

Beyond 2012, prices are likely to remain subdued but we remain optimistic and are modeling in a modest uptick. Our view is based on the following: 1) As mentioned previously, the track record of projects coming on stream without delays is dubious and 2) Close to 30% of the new urea projects will come on line in China, which continues to face tariff restrictions.

Middle East Producers Enjoy Cost Advantage

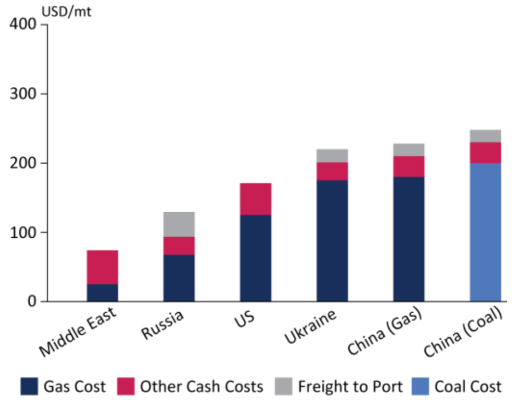
Middle Eastern producers such as QAFCO enjoy a significant cost advantage versus other international players given their access to cheap feedstock. Hence, they tend to dominate the global trade of ammonia and urea, despite the growing weight of China. In fact, QAFCO is almost doubling capacity of nitrogen fertilizers from 4.9mtpa to 9.1mtpa by end of 2012 (primarily through the QAFCO-5 and QAFCO-6 projects). *While we are predicting price softness in the fourth quarter into next year, we continue to believe that IQCD and its other cost-advantaged peers in the region (such as Saudi Arabian Fertilizer and Orascom Construction Industries) will continue to enjoy full capacity utilizations at the expense of marginal producers.*

Cost of Production Estimates – Ammonia



Source: Fertecon, Profercy, PotashCorp

Cost of Production Estimates – Urea



Source: Fertecon, Profercy, PotashCorp

Steel

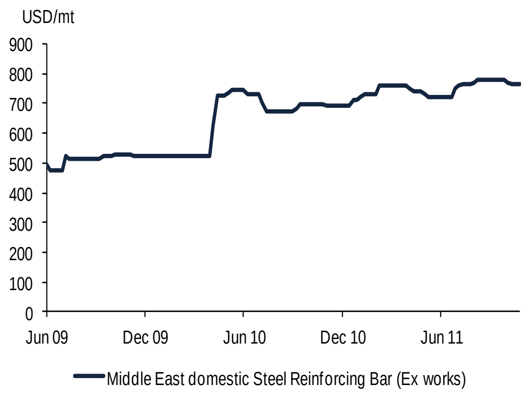
Regional Construction Activity Remains a Key Driver

Infrastructure development in the MENA region should drive demand for steel. While around 45% of the steel volumes being produced by IQCD (as of YTD 2011) are consumed by Qatar domestically, another 49% is being exported to the rest of the MENA region. Thus, the company remains somewhat insulated from the vagaries of global fluctuations in steel demand. Moreover, we would like to note that we expect the steel segment to be a key beneficiary of the expected growth in infrastructure/construction spending in the region, especially in Qatar, which represented 45% of steel volumes YTD. According to the National Development Strategy (NDS) for 2011-2016, Qatar is planning around USD65bn in infrastructure spending over 2011-2016. This is in the run up to Qatar hosting the 2022 FIFA World Cup and is based on the model of sustainable development envisaged in the Qatar National Vision for 2030. The NDS also recommends additional infrastructure investments beyond those already planned costing between USD8.5-12.5bn. Furthermore, circa QAR100bn (USD27bn) in investments by Barwa and Qatari Diar for residential and business construction projects are also expected over the same period. We believe that these domestic spending initiatives will benefit IQCD's steel business going forward. QSC also has exposure to Saudi Arabia and the UAE and is well poised to tap the growth in those countries (especially Saudi Arabia as the UAE construction market remains tepid).

Volatility in Global Prices Could Persist but Middle Prices Relatively More Stable

The steel industry is highly sensitive to the cost of raw materials. Increasing volatility and levels in the cost of steelmaking raw materials have a marked impact on the sustainability of the steel industry. China, the major consumer of iron ore (more than 40% of global consumption), is trying to reduce its reliance on imports. Prices of iron ore have fallen by 25% from the beginning of September 2011. Reduced iron-ore costs could prove beneficial to the operating margins of QSC in the near-term as Qatar imports all its iron ore. A weak global economy could lead to a steeper fall in global steel prices. However, companies like QSC, which are more focused on consumption in the Gulf Cooperation Council (GCC), will likely be less affected than steel producers who export to other parts of the world.

Prices Have Been more stable in the Middle East



Source: Bloomberg

Iron Ore Prices are Declining Near-Term

Source: Bloomberg

However, Availability of Natural Gas Could be a Key Constraint

QSC recently decided to put its phase 2 and 3 capacity expansion plans on hold. Overall, these two phases were supposed to add additional capacity of 3.6mtpa of DRI, 1.2mtpa of hot/cold rod coils, 0.7mtpa of re-bar and 0.1mtpa of wire to meet the growing demand for steel across the GCC region. However, recently it was announced that these phases have been put on hold due to non-availability of gas as a feedstock. Given the abundance of Qatar's gas reserves, we feel the company will be able to revisit these plans if the North Field moratorium is lifted by year-end 2015.

Company Background

Company Description

A regional heavyweight. Incorporated in 2003, IQCD is a holding company, which through its subsidiaries and joint ventures, is engaged in petrochemicals, fertilizers, steel and fuel additives. IQCD operates through its 100%-owned subsidiary – Qatar Steel Company (QSC) and the following proportionately consolidated joint ventures: 1) Qatar Petrochemical Co. (QAPCO); 2) Qatar Fuel Additives Co. (QAFAC); 3) Qatar Fertilizer Co. (QAFCO) and 4) Fereej Real Estate Co. (FEREEJ). As of YTD 2011, the company's top-line mix was as follows: 39% (petrochemicals and fuel additives); 36% (steel) and 26% (fertilizers). The company has a presence in Qatar and the UAE and exports its products to the Middle East and North Africa (MENA) region, emerging Asia and the Americas. IQCD's competitive advantage, relative to the global players, lies in its ability to source natural gas feedstock at a economical price (USD1.91/mmbtu in 2010) from the government. The company currently has a ~9.9% weightage (as of October 2, 2011) in the QE index of the Qatar Exchange. QP retains a 70% ownership in the company providing strong state support to IQCD.

Company Snapshot

Revenue 5-year CAGR (%)	13.4	EBITDA 5-year CAGR (%)	9.7
Capital investment (2006-10) (QR	9.8	Enterprise value (QAR bn)	73.8

Source: Company Data, *Bloomberg

Company History

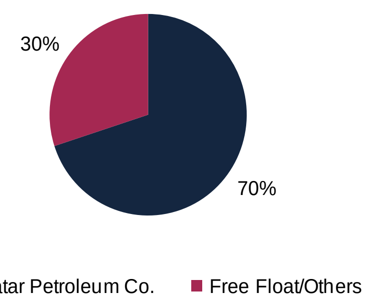
An amalgamation of diverse industries, IQCD was formed with a common goal. The company has emerged as a key player in Qatar's strategy of diversifying into industries that leverage its competitive advantages of inexpensive hydrocarbon feedstock and cheap energy inputs. Wealth distribution to Qatari nationals through dividends and capital appreciation remains another important mandate for the company. Industries Qatar was formed as a result of a reorganization of QP in 2003. Earlier, QP owned a stake in all the subsidiaries, which were transferred to IQCD during this reorganization. QAFCO was incorporated in 1969 as part of Qatar's industrial diversification program and its first plant commenced operations in 1973. QAFCO is the largest single site producer of urea and ammonia in the world. This was followed by the incorporation of QAPCO and QSC in 1974. QSC started operations in 1978 as the first integrated steel manufacturer in the Middle East, while QAPCO commenced operations in 1981. QAFAC was incorporated in 1991 and its commercial operations began in 1999. FEREEJ was the last to be incorporated in 2008.

Management Team

Name	Designation
Dr. Mohamed Saleh Al Sada	Chairman, MD
Hamad Rashid Al Mohannadi	Vice Chairman
Fahad Hamad Al Mohannadi	Director
Dr. Ibrahim Al Ibrahim	Director
Abdullah Hussain Salatt	Director
Faisal Mohammed Al Suwaidi	Director

Source: Company Data

Major Shareholders



Source: Company Data

Project and Contract Announcements (Since 2010)

Date	Contract value	Contract details
21-Dec-11	N/A	QAFCO entered into 2 long-term sale agreements – the first with Coromandel International to supply a fixed quantity of 150,000 metric tons and an optional quantity of 50,000 of anhydrous Ammonia annually and the second with Paradeep Phosphates Limited to supply them with 100,000 metric tons.
20-Dec-11	USD3.2bn	QAFCO-5 is inaugurated, making QAFCO the world's largest single site producer of ammonia and urea.
06-Oct-11	N/A	Fereej announced the liquidation of its real estate portfolio. It sold one of its buildings to Qatar Real Estate Investment Company and another to Qatar Telecom.
14-Oct-10	USD350mn	QAFCO launched Qatar Melamine. The plant is the second largest in the world with a capacity of 60,000 tons.
15-Aug-10	N/A	QSC entered into a contract with Samarco Mineracao SA, Brazil, for receiving supply or iron-ore pellets for six years. The pellets are a key raw material for QSC.
05-Jul-10	N/A	Qatofin reached 80% capacity utilization of its LLDPE plant with a capacity of 0.45mtpa of which IQCD's share amounted to 226,800 metric tons. The plant was expected to reach full capacity by 2011.

Source: Company Data

M&A Announcements (Since 2010)

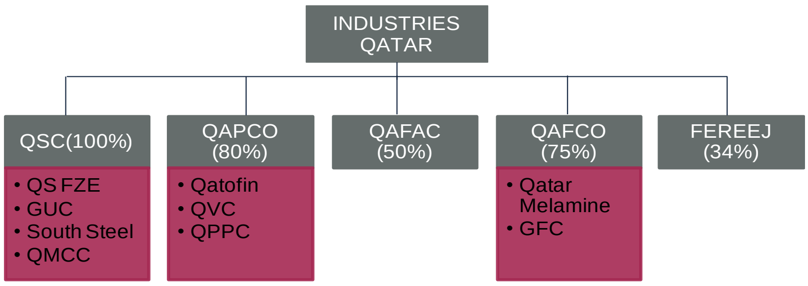
Date	Value	Details
20-Dec-11	USD24mn	QSC increases its stake in South Steel from 20.9% to 29.74%, which currently serves the requirements of the local Saudi market and neighboring Yemen and Africa
11-Apr-10	N/A	QSC acquires a 20% stake in South Steel Company, Saudi Arabia. The first phase of the project with a production capacity of 1mtpa of steel billets and 0.5mtpa of steel bars was to begin by the middle of 2011.

Source: Company Data

Business Profile, Subsidiaries/Joint Ventures and Segments

Success story of Qatar's diversification agenda. IQCD has strong fundamentals, given the fact that it derives value from diverse segments (petrochemicals/fuel additives, fertilizers and steel) catering mainly to the rapidly growing emerging markets.

Group Structure



Source: Company Data

Subsidiaries and Joint Ventures

Qatar Petrochemical Company: QAPCO was incorporated in 1974 as a joint venture entity. QAPCO is currently owned by IQCD and Total Petrochemicals (France), with 80% and 20% stakes, respectively. Commercial production began in 1981. QAPCO, which is involved in the production and sale of petrochemical products, including ethylene and variable grade LDPE and LLDPE, has investments in the following joint ventures and associates:

Joint Ventures and Associates

Company	Stake	Major products
Qatofin Company Limited	63.0%	LLDPE
Ras Laffan Olefins Company	28.8%*	Ethylene
Qatar Vinyl Company Limited[#]	31.9%	Caustics soda, ethylene dichloride and vinyl chloride monomer
Qatar Plastic Products Company[#]	33.3%	Plastic heavy-duty bags, sheet and industrial products

Source: Company Data; Note: *Qatofin owns a 45.7% stake in Ras Laffan, hence effective stake of QAPCO is 28.8%, [#] recently reclassified as JVs

Qatar Fertilizer Company: Incorporated in 1969, QAFCO is the world's largest single site producer of ammonia and urea. QAFCO is a joint venture between IQCD and Yara Netherland B.V., with 75% and 25% stakes, respectively. QAFCO owns 70% and 60% stakes in Gulf Formaldehyde Company and Qatar Melamine Company, respectively. Commercial production at QAFCO began in 1973.

Qatar Steel Company: QSC was incorporated in 1974 as the first integrated steel producing company in the GCC region. It began commercial production in 1978 and became a wholly-owned subsidiary of IQCD in 2003. QSC operates a UAE-based subsidiary – Qatar Steel Dubai FZE and has strategic investments in: 1) Qatar Metal Coating Company (50% stake); 2) Gulf United Steel Company (25%) and 3) South Steel Company (30%).

Qatar Fuel Additives Company: Incorporated in 1991, QAFAC is a joint venture between IQCD (50%), OPIC Middle East Corporation (20%), International Octane Limited (15%) and LCY Middle East Corporation (15%). It is involved in the production and export of methanol and MTBE. QAFAC is the outcome of Qatar's strategic plan to diversify its petrochemical base and expand its downstream industries. Commercial production at QAFAC began in 1999.

Fereej Real Estate Company: Incorporated in 2008, Fereej is a joint venture between IQCD (34%), Qatar Real Estate Investment Company (33%) and Al-Koot Insurance and Re-Insurance Company (33%). It is engaged in making real estate investments and providing facilities management as well as third-party project management services in construction. This company recently underwent restructuring leading to the exit of Qatar Real Estate Investment.

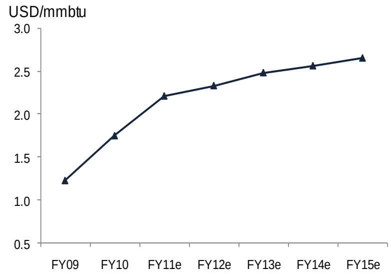
Business Segments

Petrochemicals: QAPCO is one of the leading producers of ethylene and LDPE in the Middle East region. Around 50% of the ethylene produced by QAPCO is used for producing LDPE, while 25% is used by Qatar Vinyl Company and the rest is exported to Asian countries. The variable grade LDPE is exported across 85 countries globally. Sulfur, which is generated as a byproduct from the ethylene process, is mostly exported to India and China.

QAPCO has gross annual rated capacities of 2mtpa of ethylene, 0.4mtpa of LDPE and 0.45mtpa of LLDPE. The company is undergoing expansion of its LDPE capacity by establishing a third LDPE plant, with a capacity of 0.3mtpa thereby increasing its total LDPE capacity to 0.7mtpa. The project, which is expected to be completed by Q2 2012, will be one of the largest LDPE production plants in the world. QAPCO has spent around QAR1.5bn to date and plans to spend an additional QAR0.3bn in 2012 for construction of its LDPE-3 facility.

Revenue from the petrochemicals segment (excluding fuel additives) grew at a CAGR of 19% over 2007-2010 to reach QAR3.7bn. This was primarily driven by higher volumes. This segment contributed nearly 30% to IQCD's total revenue in 2010. In 2010, QAPCO procured gas at a cost of USD1.75/mmbtu but this cost is expected to increase significantly to USD2.21/mmbtu in 2011. From 2011 onward, the company expects feedstock cost to grow in the range of 3-7% annually.

Petrochemicals & Fuel Additives – Gas Cost



Source: Company Data

Petrochemical Capacity

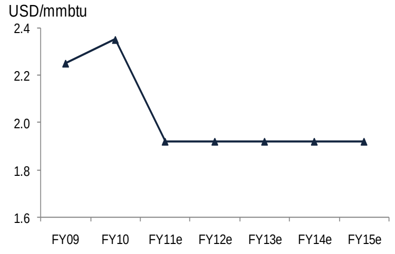
Plant rated capacities (000 MT)				Production		Saleable		Normal
Plant	Product	Launch Year	Total	IQCD Share	%	IQCD Share	%	Utilization Date
Ethylene-1	Ethylene	Pre-2009	525	420	80	256	44	
Ethylene-1	Ethylene	Pre-2009	195	156	80			
RLOC	Ethylene	2010	1,300	302	23	75	25	
LDPE-1	LDPE	Pre-2009	210	168	80	168	100	
LDPE-2	LDPE	Pre-2009	190	152	80	152	100	
LDPE-3	LDPE	2012	300	240	80	240	100	Q3 2012
Qatofin	LLDPE	2010	450	227	50	227	100	

Source: Company Data

Fertilizers: QAFCO is a heavyweight in nitrogen-based fertilizers. The QAFCO complex comprises four completely integrated trains: QAFCO-1 (launched in 1973); QAFCO-2 (1979); QAFCO-3 (1997) and QAFCO-4 (2004). Each train is made up of two units – one for the production of ammonia and the other for urea. Approximately 80% of the ammonia produced is used as feedstock for the production of urea and ammonium phosphate, while the rest is exported to India, Japan and the United States of America. Urea, which is produced in both prilled and granular form, is exported to more than 20 countries globally. Even though fertilizer demand depends on crop cycles, QAFCO is able to mitigate volume uncertainty as it has an off-take agreement with its JV partner, Yara Nederland.

QAFCO has gross annual rated capacities of 2.1mtpa and 2.9mtpa of ammonia and urea, respectively. Consumption of nitrogen fertilizers is expected to increase going forward considering a growing population across the globe, especially in the emerging markets (which is major market of QAFCO). QAFCO plants have been already operating at an average of 106% of capacity over the last two years. To meet the growing demand for fertilizers, QAFCO has launched its QAFCO-5 project recently and is building QAFOC-6, thereby expanding production capacity of ammonia and urea by 1.5mtpa and 2.7mtpa, respectively by end-2012. The total cost of these projects is estimated to be around QAR11.2bn, of which QAR9.8bn has already been spent by September 2011. The commercial launch of QAFCO-5 took place in December 2011 while QAFCO-6 is expected to start by Q3 2012. In addition, the commercial production of melamine started in Q1 2011.

Fertilizer – Gas cost



Source: Company Data

During 2006-2010, fertilizer revenue grew at a CAGR of ~7% from QAR2.2bn to QAR2.9bn, mainly due to strong prices. The fertilizer segment contributed an average of 28% to IQCD's total revenue over the same period. In the previous two years, QAFCO had procured gas at an average cost of USD2.3/mmbtu. However, from 2011 to 2016, the company estimates its cost of gas to decrease to USD1.92/mmbtu.

Fertilizer Capacity

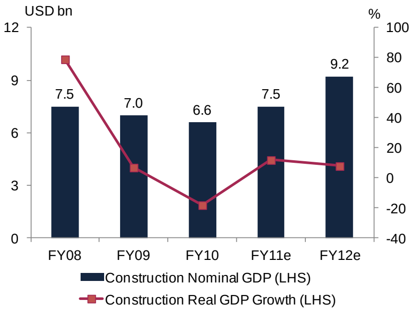
Plant rated capacities (000 MT)				Production		Saleable		Normal
Plant	Product	Launch Year	Total	IQCD Share	%	IQCD Share	%	Utilization Date
QAFCO 1	Ammonia	Pre-2009	394	296	75	110	37	
QAFCO 1	Urea	Pre-2009	427	320	75	320	100	
QAFCO 2	Ammonia	Pre-2009	393	295	75	78	26	
QAFCO 2	Urea	Pre-2009	498	374	75	374	100	
QAFCO 3	Ammonia	Pre-2009	592	444	75	91	20	
QAFCO 3	Urea	Pre-2009	812	609	75	609	100	
QAFCO 4	Ammonia	Pre-2009	688	516	75	29	6	
QAFCO 5	Ammonia	2011	1,540	1155	75	576	50	Q1 2012
QAFCO 5	Urea	2011	1,330	998	75	998	100	Q1 2012
QAFCO 6	Urea	2012	1,330	998	75	998	100	Q4 2012
Melamine	Melamine	2010	60	27	45	27	100	

Source: Company Data

Steel: QSC is Qatar's sole steel producer and manufactures hot briquetted iron (HBI), direct reduced iron (DRI), steel billets and steel bars. The company markets HBI and DRI in the Middle East, India and the Far East, while steel bars are sold mainly into Qatar's construction industry. QSC purchases iron ore from four suppliers – Companhia Vale do Rio Doce and Samarco Mineracao (Brazil), Luossavaara-Kiirunavaara Aktiebolag (Sweden) and Gulf Industrial Investment Co. (Bahrain) at quarterly spot prices.

QSC has gross annual rated capacities of 1.8mtpa and 2.3mtpa of steel bars and DRI/HBI respectively. The company had drawn up plans to expand under its phase 2 and phase 3 projects. However, the commercial launches of these phases have been currently shelved due to the non-availability of gas. Apart from these projects, QSC also plans to spend ~QAR1.3bn for its new electric furnace replacement (EF1-R), Dubai rolling mill and other small projects. These projects are expected to add capacity of ~1mtpa in re-bars in Q1 2013 as per company forecasts.

Qatar – Construction Sector Forecasts



Source: Qatar Statistics Authority, QNB Capital Estimates

Steel Expansion

Expansion Plans	Investment (QAR mn)	Commercial Launch
EF1-R	1,300	Q1 2013

Source: Company Data

During 2006-2010, revenue from the steel segment grew at a CAGR of 14% from QAR2.8bn to QAR4.7bn largely due to higher volumes. The segment contributed an average 38% to IQCD's total revenue during the same period.

Steel Capacity

Plant rated capacities (000 MT)				Production		Saleable	
Plant	Product	Launch Year	Total	IQCD Share	%	IQCD Share	%
QS Phase 1	DRI / HBI	Pre-2009	2,300	2,300	100	691	30
QS Phase 1	Billets	Pre-2009	1,800	1,800	100	0	0
QS Phase 1	Bars	Pre-2009	1,500	1,500	100	1,500	100
QS Dubai	Bars	Pre-2009	300	300	100	300	100
QS Dubai	Coils	Pre-2009	240	240	100	240	100

Source: Company Data

Fuel additives: QAFAC produces methanol and MTBE. Most of the methanol produced is exported to Asia and Europe while a small portion is used as feedstock for the production of MTBE and for local consumption. The MTBE produced is mainly exported to other countries in the Middle East while the rest is sold globally.

QFAC has gross annual rated capacities of 1mtpa and 0.6mtpa of methanol and MTBE, respectively. Currently, the company does not have any plans to expand its capacity for fuel additive products.

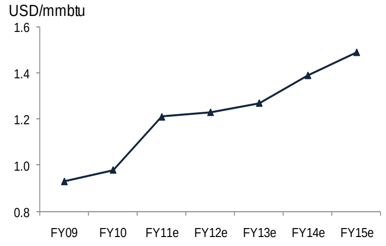
Fuel Additives Capacity

Plant rated capacities (000 MT)				Production		Saleable	
Plant	Product	Launch Year	Total	IQCD Share	%	IQCD Share	%
QAFAC 1	Methanol	Pre-2009	1,000	500	50	390	78
QAFAC 2	MTBE	Pre-2009	610	305	50	305	100

Source: Company Data

Real estate: Fereej owned two commercial towers in Doha and had a total rentable floor space of 32,000 square meters. In 2010, the real estate segment reported revenue of only QAR4mn from its real estate business. Recently, IQCD announced that it liquidated its real estate portfolio in October 2011. Currently, the company does not have any plans for new real estate investments.

Steel – Gas Cost



Source: Company Data

Key Forecasts

Revenue

We project overall revenue to grow at a CAGR of 20.4% over 2010-2013, driven by attractive price realizations in 2011 and capacity additions going forward. We have forecasted revenue growth by product and segment by modeling capacity, utilization rates, sales volumes and prices.

Revenue Distribution by Products

QAR mn	FY10	FY11e	FY12e	FY13e
Petrochemicals	3,656	4,920	4,806	5,540
Fuel additives	1,037	1,749	1,482	1,382
Fertilizers	2,910	4,688	6,752	7,259
Steel	4,725	5,510	5,416	7,320
Rental income	4	3	0	0
Total	**12,331**	**16,870**	**18, 457**	**21,500**

Source: Company Data, QNBFS Estimates

We expect the petrochemical segment to remain dominant but grow slowly. The petrochemical group, including fuel additives, is modeled to grow its top-line at a CAGR of 13.8% over 2010-2013. Most of this growth comes from 2011 with revenue projected to increase by 42%. The LDPE-3 project is the sole remaining expansion with an announced launch period of Q2 2012. Overall top-line contribution is modeled to decrease from approximately 38% in 2010 to 32% by 2013.

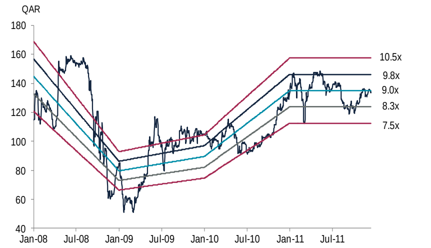
- **We expect sales volumes to grow at a CAGR of ~7% from 2010 to 2013.** While ethylene volumes are projected to fall by an CAGR of 9% over the period, we are expecting LDPE and LLDPE sales volumes to increase by 22% and 23%, respectively.
- **We adopt a cautious stance on 2012 price realizations.** After the strong growth expected in 2011, we model ethylene, LDPE and LLDPE prices to fall by 12% in 2012. For 2013, we model in a cautious recovery with prices climbing by around 3% across the board.

The fertilizer segment should grow in contribution. We are modeling in a CAGR of 35.6% in overall top-line growth from QAFCO during 2010 to 2013. This significant increase should be driven by the QAFCO-5 and QAFCO-6 projects. Overall top-line contribution is modeled to increase from roughly 24% in 2010 to 34% by 2013.

- **We expect sales volumes to grow at a CAGR of ~23% from 2010 to 2013.** This should be driven by a significant growth in urea sales volume, which is projected to increase by 26% over the same period.
- **Prices could be soft after a very strong 2011.** Overall, we are expecting QAFCO's ammonia and urea price realizations to grow around 40% in 2011. Next year, we adopt a cautious stance and lower our modeled price realizations by 12%. However, we believe that the fertilizer market remains fundamentally healthy and fears of a significant glut in supply may not materialize. Hence, we are modeling a 6% YoY increase in fertilizer prices in 2013.

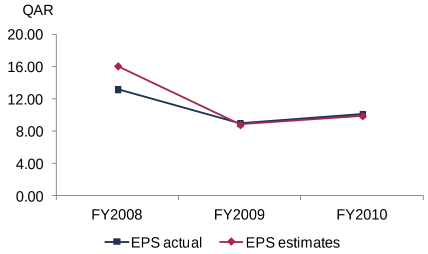
The steel segment should remain stable. Revenue from the steel segment registered a YoY growth of 18% to QAR4.7bn in 2010 on account of high capacity utilization rates and increasing prices. Given the ongoing expansion of the steel segment by 1mtpa in early 2013, we expect segment revenue to grow at a CAGR of ~16% over 2010 to 2013. Segment contribution is expected to be around 34% in 2013.

1 Year Forward P/E Band



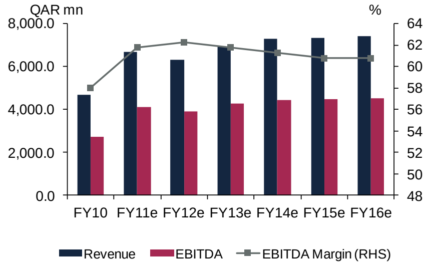
Source: Bloomberg

Earnings Surprise



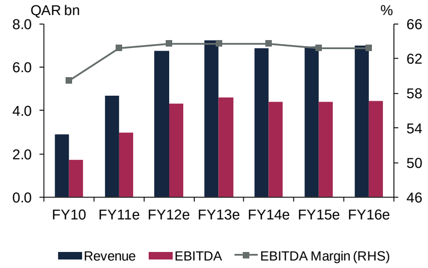
Source: Bloomberg

Petrochemical – Revenue and Margins



Source: Company Data, QNBFS Estimates

Fertilizer – Revenue and Margins



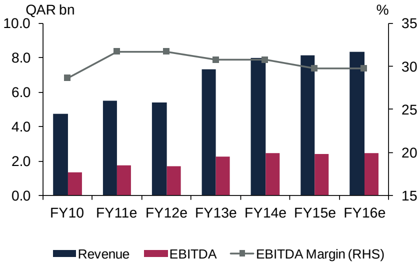
Source: Company Data, QNBFS Estimates

Profitability

We expect operating margins to remain high (above 45%) in the medium-term, though witnessing a declining trend. Operating margins should witness a gradual decline due to higher feedstock costs in the petrochemical and steel segments and lower utilization in the new capacities commencing operations.

Total revenue growth in 2010 translated into a YoY improvement in the EBITDA margin by 731 bps to 47.1%. We expect this to further expand to 52.4% in 2011 and 53.8% in 2012 due to the expansion in the higher-margin petrochemical and fertilizer segments. However, in 2013, we are modeling a drop in the EBITDA margin to 51.9% given the addition of lower-margin steel revenue. We expect the same effect to be cascaded to net margins and expect it to decline by 164 bps from 49.2% in 2011 to 47.6% in 2013.

Steel – Revenue and Margins



Source: Company Data, QNBFS Estimates

Capacity

The only addition in the petrochemical segment will be the LDPE-3 plant coming on stream in 2012 adding 0.3mtpa. In the fertilizer segment, QAFCO-5 and QAFCO-6 are expected to scale-up gross capacity by around 85% from current levels to 9.1mtpa by 2012. The capacity of the steel segment is expected to grow by 1mtpa by 2013.

Capital Expenditures

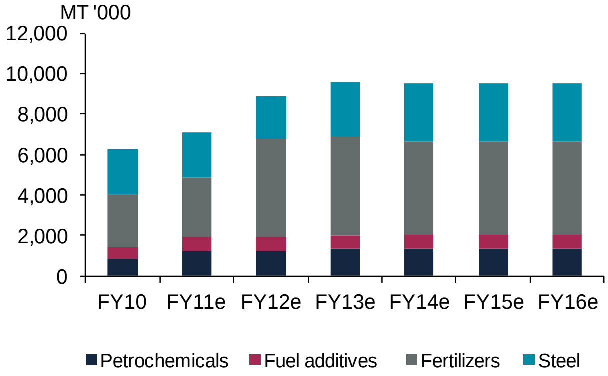
We expect capital expenditures (capex) to increase by 8% in 2011 to QAR4.5bn. Spending on projects under development in 2011 is expected to total QAR2.9bn (QAFCO-5, QAFCO-6 and QAPCO LDPE-3) with around QAR700mn to be spent on the construction of the new steel plant. Capex for projects under development should decline significantly in 2012 falling to around QAR930mn with LDPE-3 and QAFCO-6 coming on-line. With all projects completed, we expect the company to essentially spend maintenance capex of around QAR1bn in 2013.

Financial Position

IQCD has a bullet proof balance sheet. Net cash generated from operating activities will be robust in 2011 at QAR7.9bn (it was QAR6.5bn YTD) and in 2012 at QAR9.4bn due to the contribution of new projects. Post 2011, we expect cash used in investing activities to be subdued due to lower capex plans. Strong revenue growth in the fertilizer segment coupled with reduced capex will lower the company's net debt-to-equity ratio to (0.2x) by 2013 from 0.1x in 2010. The postponement of Phase 2 and 3 steel expansions will release significant cash with cash and cash equivalents expected to increase to around QAR13.4bn by 2013.

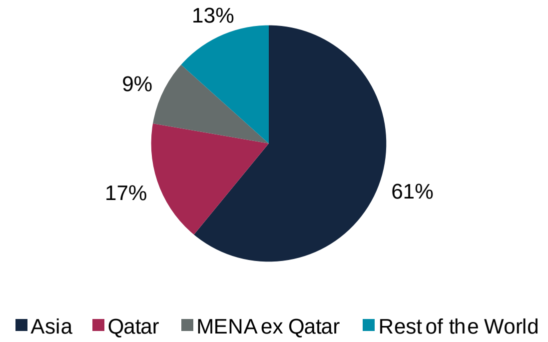
Revenue and Operations: Growing and Diversified

Sales by Volume



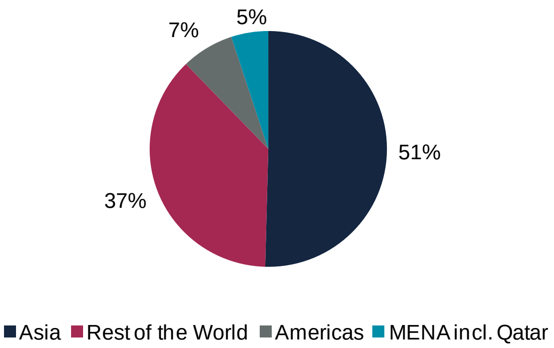
Source: Company Data, QNBFS Estimates

Geographical Sales Volume Mix (9M 2011) – Petrochemical



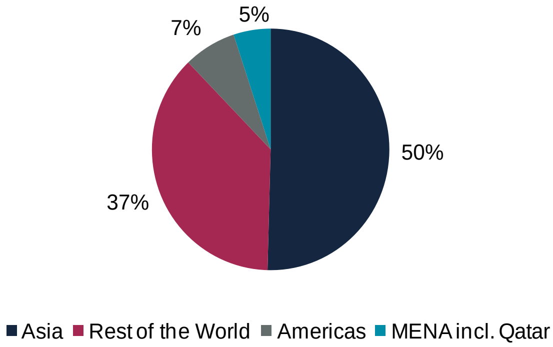
Source: Company Data

Geographical Sales Volume Mix (9M 2011) – Fertilizer



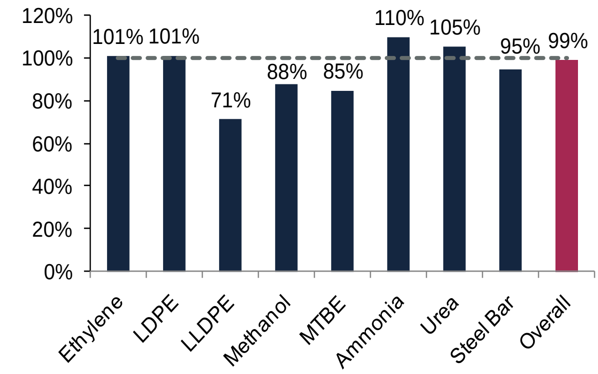
Source: Company Data

Geographical Sales Volume Mix (9M 2011) – Steel



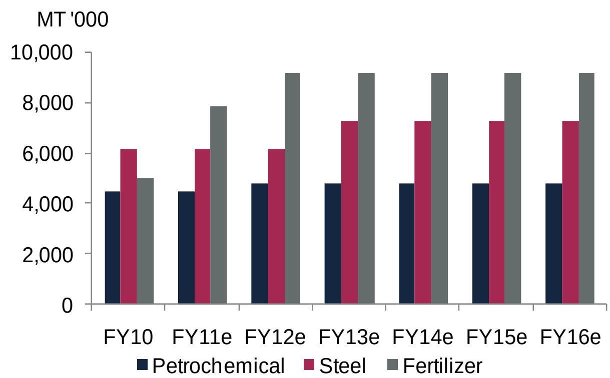
Source: Company Data

Plant Utilization Rates – 2010



Source: Company Data

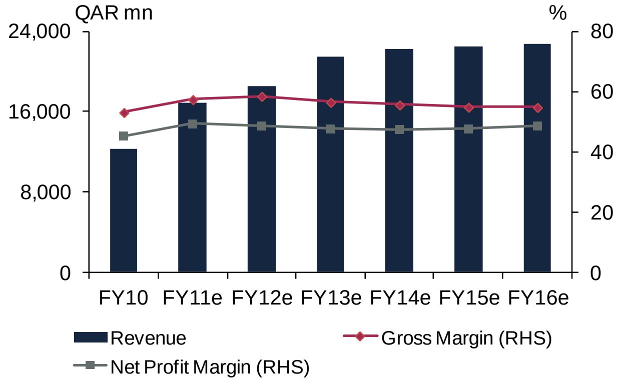
Expected Overall Rated Capacities



Source: Company Data

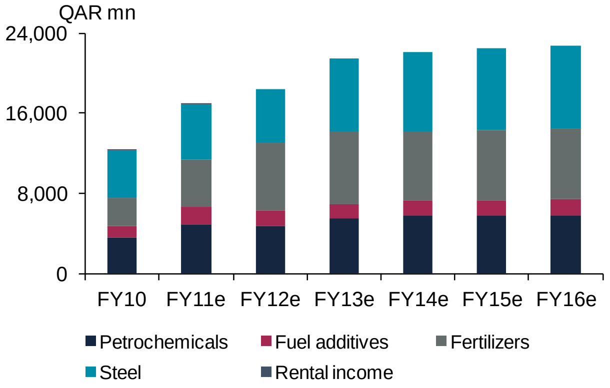
Financial Analysis: Revenue, Returns and Capex

Revenue and Margins



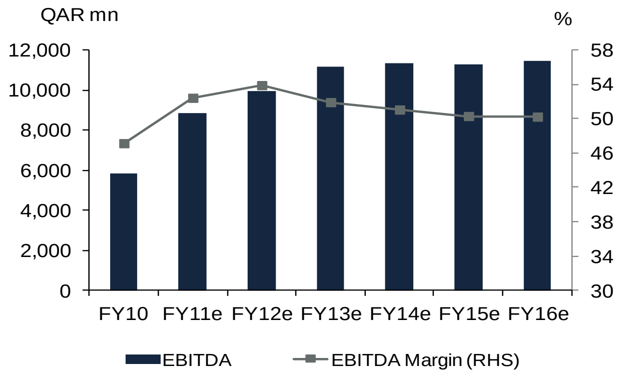
Source: Company Data, QNBFS Estimates

Revenue by Products/Services



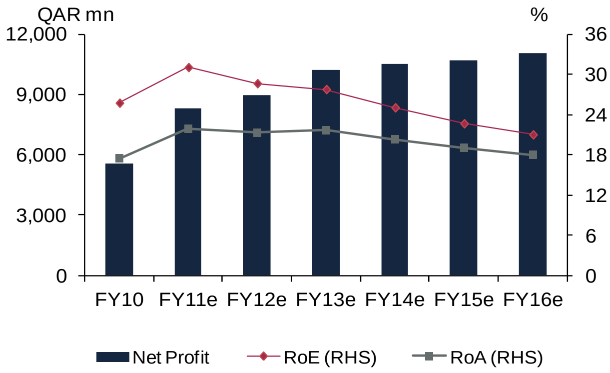
Source: Company Data, QNBFS Estimates

EBITDA and EBITDA Margins



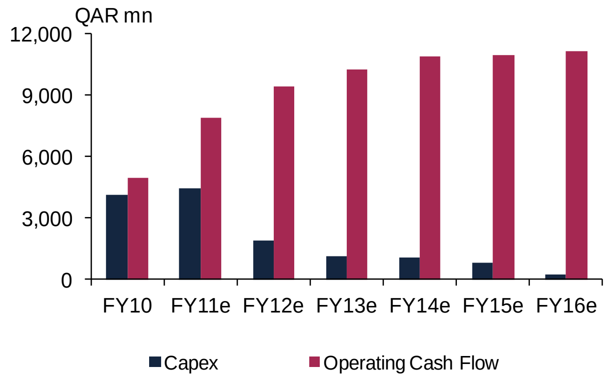
Source: Company Data, QNBFS Estimates

Profitability



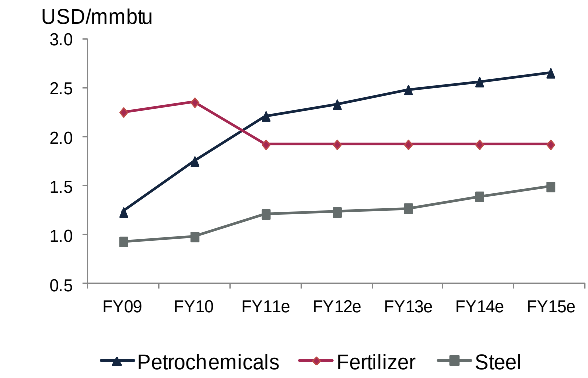
Source: Company Data, QNBFS Estimates

Capex and Operating Cash Flow



Source: Company Data, QNBFS Estimates

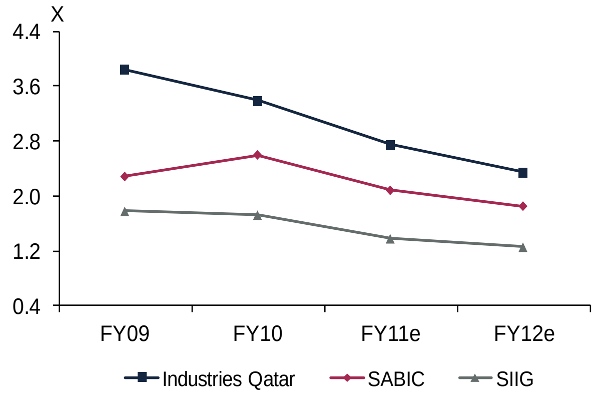
Feedstock Costs



Source: Company Data

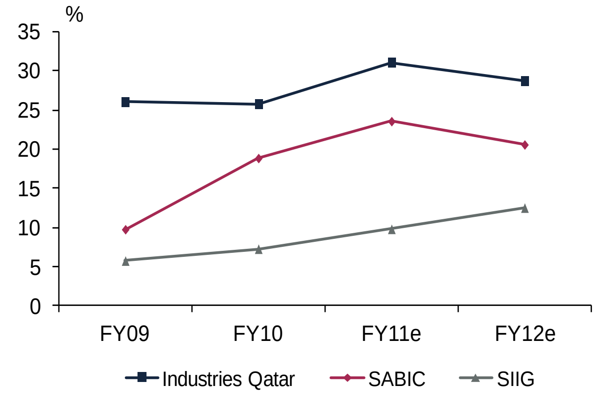
Peer Trend Analysis

P/B



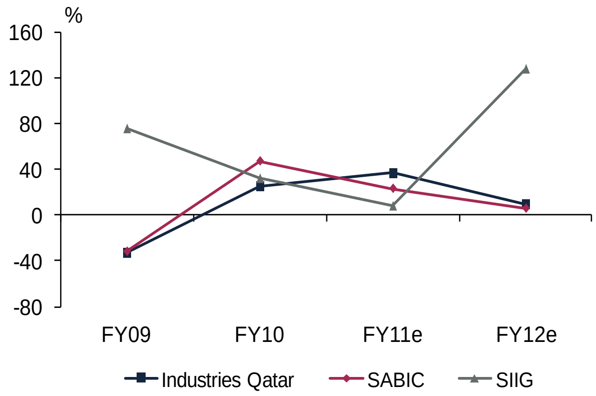
Source: Bloomberg, QNBFS Estimates

ROE



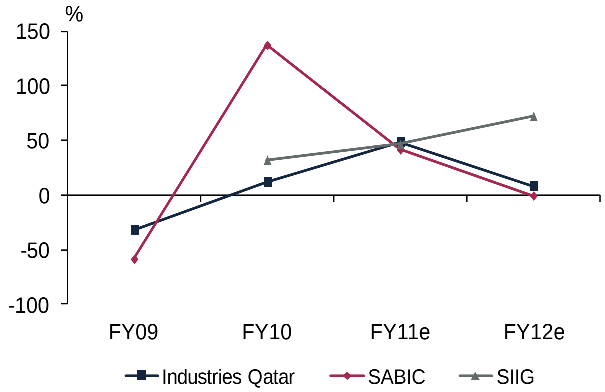
Source: Bloomberg, QNBFS Estimates

Revenue Growth



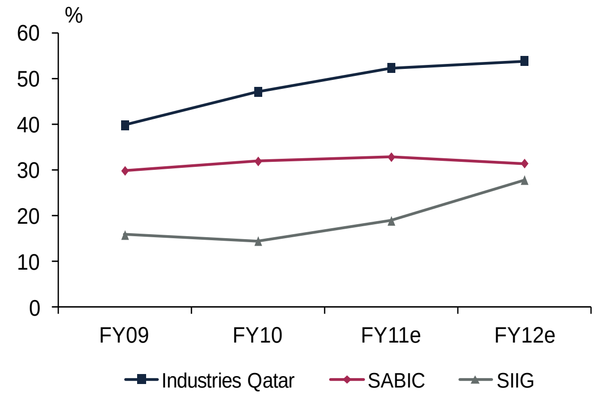
Source: Bloomberg, QNBFS Estimates

EPS Growth



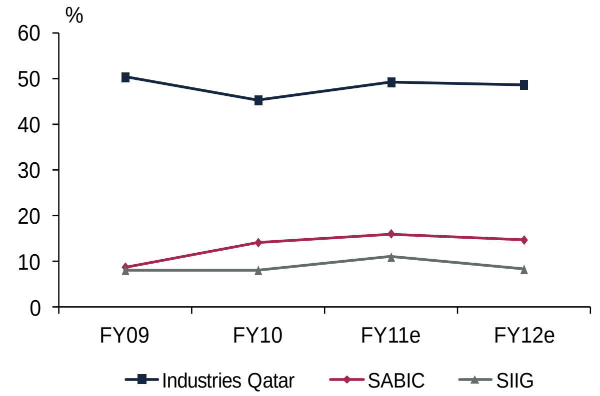
Source: Bloomberg, QNBFS Estimates; Note: EPS growth of SIIG for FY09 has not been taken as it is N/M.

EBITDA Margin



Source: Bloomberg, QNBFS Estimates

Net profit Margin



Source: Bloomberg, QNBFS Estimates

Detailed Financial Statements

Income Statement

Figures in QAR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
Revenue	**9,857**	**12,331**	**12,538**	**16,870**	**18,457**	**21,500**
Cost of sales (ex Dep)	(5,214)	(5,787)	(5,232)	(7,194)	(7,671)	(9,365)
Gross profit	**4,643**	**6,544**	**7,306**	**9,676**	**10,786**	**12,136**
General and admin. exp.	(577)	(549)	(452)	(629)	(617)	(714)
Selling expenses	(145)	(189)	(159)	(211)	(231)	(269)
EBITDA	**3,921**	**5,806**	**6,695**	**8,836**	**9,939**	**11,153**
Depreciation & amortization	(551)	(650)	(506)	(689)	(1,281)	(1,368)
EBIT	**3,370**	**5,157**	**6,189**	**8,147**	**8,658**	**9,785**
Finance costs	(118)	(147)	(121)	(160)	(158)	(145)
Income from investments	385	183	164	208	242	345
Share from associates	(42)	117	55	84	113	120
Other, net	1,366	268	(38)	25	125	125
Profit before tax	**4,961**	**5,578**	**6,249**	**8,304**	**8,980**	**10,230**
Income tax expense	0	0	0	0	0	0
Profit after tax	**4,961**	**5,578**	**6,249**	**8,304**	**8,980**	**10,230**
Minority interest	(2)	(2)	(5)	(5)	(5)	(6)
Profit for shareholders	**4,959**	**5,575**	**6,245**	**8,299**	**8,975**	**10,224**
EPS(QAR)	9.02	10.14	11.35	15.09	16.32	18.59

Source: Company Data, QNBFS Estimates

Balance Sheet

Figures in QAR mn	FY2009	FY2010	Q3FY2011	FY2011e	FY2012e	FY2013e
Non-current Assets						
Property, plant and equipment	7,926	8,874	9,549	19,623	22,797	23,529
Projects under development	8,121	10,669	11,514	3,691	1,166	176
Investment properties	197	200	136	136	136	136
Investment in associates	1,033	1,406	1,762	1,884	1,997	2,116
Available-for-sale investments	289	462	448	462	462	462
Catalysts & Other	266	257	286	278	250	222
Total Non-current Assets	**17,832**	**21,868**	**23,695**	**26,073**	**26,808**	**26,642**
Current Assets						
Inventories	1,410	1,833	1,887	1,971	2,102	2,566
Accounts receivables	1,604	1,984	2,471	2,588	2,832	3,299
Due from related parties	464	754	670	928	1,015	1,183
Held for trading invt. & Other	131	179	191	179	179	179
Cash and short term deposits	5,990	5,290	6,439	6,267	9,230	13,428
Total Current Assets	**9,600**	**10,040**	**11,657**	**11,932**	**15,356**	**20,653**
TOTAL ASSETS	**27,432**	**31,908**	**35,353**	**38,006**	**42,164**	**47,295**
EQUITY						
Share capital	5,500	5,500	5,500	5,500	5,500	5,500
Reserves	23	53	(143)	53	53	53
Retained earnings	10,783	13,073	19,278	17,015	21,278	26,135
Proposed dividends	2,750	3,025	0	4,150	4,487	5,112
Equity attributable to the parent	**19,056**	**21,651**	**24,634**	**26,718**	**31,318**	**36,800**
Minority interest	13	14	406	406	406	406
Total Equity	**19,069**	**21,664**	**25,040**	**27,124**	**31,724**	**37,206**
Non-current Liabilities						
Loans and borrowings	5,868	6,118	5,784	6,460	5,836	4,984
Employees' benefits & Other	443	624	806	624	624	624
Total Non-Current Liabilities	**6,311**	**6,741**	**6,590**	**7,084**	**6,460**	**5,608**
Current Liabilities						
Accounts payables & accruals	1,170	1,288	1,341	1,419	1,513	1,847
Due to related parties & Other	534	790	1,024	955	1,042	1,209
Loans and borrowings	348	1,424	1,357	1,424	1,424	1,424
Total Current Liabilities	**2,052**	**3,502**	**3,723**	**3,798**	**3,979**	**4,481**
EQUITY AND LIABILITIES	**27,432**	**31,908**	**35,353**	**38,006**	**42,164**	**47,295**

Source: Company Data, QNBFS Estimates

Cash Flow Statement

Figures in QAR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
Operating activities						
Profit for the year	4,961	5,578	6,249	8,299	8,975	10,224
Adjustments for:						
Depreciation and amortization	551	650	506	717	1,309	1,396
Income from associates	42	(117)	(55)	(84)	(113)	(120)
Finance costs	118	147	121	160	158	145
Interest income	(362)	(159)	(55)	(208)	(242)	(345)
Others	(1,068)	15	83	0	0	0
Changes in working capital	322	(819)	(174)	(620)	(280)	(597)
Cash from operations	**4,564**	**5,295**	**6,675**	**8,264**	**9,807**	**10,703**
Interest paid	(118)	(147)	(121)	(160)	(158)	(145)
Staff benefits paid	(40)	(33)	(32)	0	0	0
Contribution to social fund	0	(125)	0	(207)	(224)	(256)
Net Cash from operations	**4,406**	**4,990**	**6,523**	**7,897**	**9,425**	**10,302**
Investing activities						
Purchase of PP&E	(990)	(1,191)	(1,289)	(900)	(1,000)	(1,000)
Projects under development	(3,892)	(2,952)	(845)	(3,560)	(930)	(110)
Others	2,713	872	(2,117)	(170)	242	345
Cash used in investing	**(2,169)**	**(3,271)**	**(4,251)**	**(4,630)**	**(1,688)**	**(765)**
Financing activities						
Net movement in loans	(83)	1,326	(401)	343	(624)	(852)
Dividends paid	(4,400)	(2,750)	(3,025)	(3,025)	(4,150)	(4,487)
Others	1,165	(2)	388	392	0	0
Cash used in financing	**(3,319)**	**(1,426)**	**(3,038)**	**(2,290)**	**(4,774)**	**(5,339)**
Net decrease in cash and cash equivalents	(1,081)	294	(766)	976	2,963	4,198
Cash and cash equivalents at the beginning of the year	6,078	4,997	5,290	5,290	6,267	9,230
Cash and cash equivalents at the end of the year	**4,997**	**5,290**	**4,524**	**6,267**	**9,230**	**13,428**

Source: Company Data, QNBFS Estimates

Growth Rates

Figures in percentage	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	(33.1)	25.1	36.8	9.4	16.5
Gross Profit	(40.1)	40.9	47.9	11.5	12.5
EBITDA	(45.5)	48.1	52.2	12.5	12.2
EBIT	(50.0)	53.0	58.0	6.3	13.0
PBT	(31.8)	12.4	48.9	8.1	13.9
PAT	(31.8)	12.4	48.9	8.1	13.9
EPS	(31.8)	12.4	48.9	8.1	13.9

Source: Company Data, QNBFS Estimates

Key Ratios

Key Ratios	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Operating Ratios (%)					
Gross Margin	47.1	53.1	57.4	58.4	56.4
EBITDA Margin	39.8	47.1	52.4	53.8	51.9
EBIT Margin	34.2	41.8	48.3	46.9	45.5
Net Margin	50.3	45.2	49.2	48.6	47.6
Working Capital Ratios (Days)					
Inventory days	98.7	115.6	100.0	100.0	100.0
Average collection period	59.4	58.7	56.0	56.0	56.0
Payable days	81.9	81.2	72.0	72.0	72.0
Finance Ratios					
Debt-Equity Ratio	0.3	0.3	0.3	0.2	0.2
Net Debt-Equity Ratio	0.0	0.1	0.1	(0.1)	(0.2)
Interest Coverage	28.5	35.2	50.9	54.9	67.4
Effective Borrowing rate (%)	1.9	2.1	2.0	2.0	2.0
Effective Tax rate (%)	0.0	0.0	0.0	0.0	0.0
Return Ratios (%)					
ROCE	17.4	22.3	28.5	26.1	25.3
Incremental ROCE	223.7	48.7	54.8	11.1	20.6
ROE	26.0	25.8	31.1	28.7	27.8
ROA	18.1	17.5	21.8	21.3	21.6
Liquidity Ratios					
Current Ratio	4.7	2.9	3.1	3.9	4.6
Quick Ratio	4.0	2.3	2.6	3.3	4.0
Valuations (x)					
EV/Sales	7.4	6.1	4.4	3.9	3.1
EV/EBITDA	18.7	12.9	8.5	7.2	5.9
EV/EBIT	21.7	14.5	9.2	8.2	6.8
P/E	14.8	13.2	8.8	8.2	7.2
P/BV	3.9	3.4	2.7	2.3	2.0

Source: Company Data, QNBFS Estimates

Qatar Electricity and Water Co (QEWS)

Dec. 29, 2011

Recommendation	OUTPERFORM	Risk Rating	R-2
Share Price	QAR140.8	Target Price	QAR176.2
Implied Upside	25%		

Leading Power Player in the GCC

Low-risk defensive play deeply linked to the Qatar growth story; visible earnings & cash flows; stable & sustainable EPS growth; attractive FCF yields; potential for increased dividend payouts and attractive valuation.

Highlights

- **Growing with Qatar.** As per the IMF, Qatar, currently the fastest growing economy in the world, should grow its real GDP at a CAGR of ~7% over 2010 to 2016. As a result, Qatar's electricity & water demand is set to grow by a CAGR of 8-11% over the next few years. State-backed QEWS, practically Qatar's sole power & water producer, should benefit from this secular growth.
- **Watertight contracts ensure visible earnings and cash flows.** Essentially a capacity provider, QEWS procures natural gas (primary feedstock) from Qatar Petroleum (supplier; 100% government-owned) through long-term take-or-pay contracts and sells power and water to Kahramaa (buyer; 100%) under long-term off-take power and water purchase agreements. Moreover, fuel costs are passed through to Kahramaa. These agreements result in stable operating margins and any expansion should lead to growing revenue and bottom-line.
- **Stable and sustainable EPS growth.** EPS should grow at a CAGR of 5.2% (2011-2013) after growing by 18.7% in 2011 in our base-case model, which assumes no further expansion in Qatar or elsewhere beyond the already announced Sur power project in Oman.
- **FCF at an inflection point.** We expect QEWS to generate a FCF (to the firm) yield of ~17% (~QAR23 a share) over 2011-2013 with capex down significantly after 2010. Strong FCF trajectory should allow QEWS to pursue expansion opportunities and/or boost dividends beyond our base-case model.

Catalysts

- **Announcements of new expansion plans.** As comments by the management indicate, QEWS is aggressively positioning itself in its local, regional and international markets. We believe the company could announce expansion plans which could provide positive triggers for the stock price. *Our DCF-based target price jumps to QAR196.7 from QAR176.2 (base case) in the expansion-case scenario.*
- **Dividend payouts to increase.** With all planned capacities online in H1 2011, capex requirements should decline significantly allowing QEWS to boost dividends in the future. We expect QEWS to increase dividend payouts by a conservative ~14% over 2010 to 2013 (in line with a CAGR of 14.5% over 2007-2010) boosting the dividend yield to 6.3% by 2013. Risks to our dividend forecasts remain on the upside especially if QEWS does not expand further.

Recommendation, Valuation and Risks

- **Recommendation and valuation.** *We rate QEWS an Outperform with a price target of QAR176.20.* Currently, the stock is trading at a discount to its peers.
- **Risks:** 1) International expansion risks; 2) Liquidated damages (penalties) for underperformance and 2) Changes in the tariff structure.

Key Financial Data and Estimates

QAR mn	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	2,651	3,430	4,555	4,721	4,824
Net Profit	945	1,163	1,381	1,475	1,527
EPS (QAR)	9.45	11.63	13.81	14.75	15.27
P/E (x)	14.9	12.1	10.2	9.5	9.2
Dividend Yield %	3.6	4.3	4.9	5.6	6.3

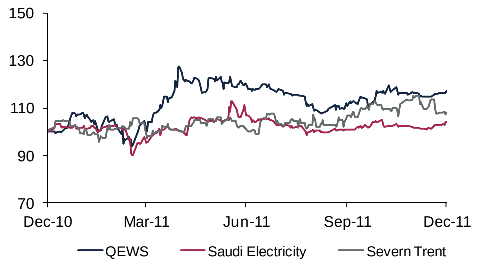
Source: Company Data, QNBFS Estimates

Key Data:

Bloomberg ticker	QEWS QD
ADR/GDR ticker	N/A
Reuters ticker	QEWS.QA
ISIN	QA0006929812
Sector	Services
52wk high/52wk low (QAR)	154.9/116.0
3-m average volume ('000)	45.6
Mkt. cap.(USD bn/QAR bn)	3.9/14.1
Shares outstanding (mn)	100
FOL* (%)	25.0
FOL Limit* (mn)	25
1-year total return (%)	17.0
Fiscal year end	Dec 31

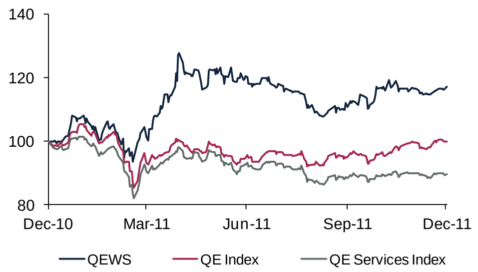
Source: Bloomberg (as of December 15, 2011), *Qatar Exchange

Relative Price Performance vs. Peers



Source: Bloomberg

Relative Price Performance vs. Market



Source: Bloomberg

Broker Recommendations

Recommendation	Number
Buy	10
Hold	2
Sell	1

Source: Bloomberg

Executive Summary

A Play on the Strong GDP Growth of Qatar

Qatar is currently the world's fastest growing economy with a real GDP CAGR of around 16% in 2006-2010. According to QNB Capital, growth will continue at a rapid clip in 2011 and 2012, with real gross domestic product (GDP) expected to expand by 21% and 10.2%, respectively. Moreover, the International Monetary Fund (IMF) estimates that Qatar's real GDP will grow at a compound annual growth rate (CAGR) of around 7% over 2010 to 2016.

As a result, water and power demand should grow rapidly. Kahramaa, the sole authorized supplier of power and water in Qatar (QEWS sells electricity and water to Kahramaa, which is 100% owned by the Qatari government) expects water consumption to grow at an approximate CAGR of 8% (2009-17). In addition, according to Economist Intelligence Unit (EIU) estimates, power consumption should grow at a CAGR of around 10.6% (2011-20).

According to Kahramaa, the Qatari government has allocated around USD13.7bn over the next decade for electricity and water projects. The Qatar National Development Strategy (NDS) 2011-2016 report has also outlined the government's plan to expend more than USD65bn in infrastructure (including water and power projects) through 2016. Additionally, Qatar is hosting the 2022 FIFA World Cup, which could further lead to higher governmental spending on power and water.

State-backed QEWS should benefit from these growth tailwinds. QEWS enjoys strong government support through a direct ownership of 42% and an indirect ownership of 11% through Qatar Petroleum. It is the largest utility in Qatar accounting for ~63% and 80% of Qatar's electricity and water capacity, respectively. Moreover, the company also participates in all Independent Water and Power Producers (IWPPs) and Independent Power Producers (IPPs) in Qatar and retains a strategic stake in them. Thus, given its strong and entrenched market position, QEWS remains well positioned to benefit from the secular demand growth expected in Qatar.

Visible Earnings and Cash Flows

Watertight contracts ensure visible earnings and cash flows. QEWS is a low-risk utility, much like an IWPP, as the company does not take any demand or commodity price risk. Essentially a capacity provider, QEWS procures natural gas (primary feedstock; 51.6% of YTD cost of sales) from Qatar Petroleum or QP (supplier; 100% government-owned) through long-term take-or-pay contracts and sells power and water to Kahramaa (buyer) under long-term (12-25 years) off-take power and water purchase agreements. The pact with Kahramaa allows QEWS to pass on any increase in the cost of gas. Besides the company's long-term agreement with QP for the supply of gas, QEWS has also forged a strategic partnership with Qatar National Cement Company for the supply of limestone, which is an essential raw material for its water desalination units. These agreements, which are at fixed prices (adjusted for inflation) guarantee stable and predictable revenue/operating margins over the contract period and any expansion should lead to growing revenue and bottom-line.

Stable and Sustainable EPS Growth

We expect EPS to grow at a CAGR of 5.2% (2011-2013) in our base-case model, which assumes no further expansion in Qatar or elsewhere. This growth is due to: 1) new capacity (Ras Girtas project) coming online in 2011, which should cause 2011 EPS to increase by 18.7%; 2) inflation adjustment; 3) absence of liquidated damages to Kahramaa and 4) declining finance charges. In fact, there have been no liquidated damages to Kahramaa thus far in 2011. The company has already paid QAR539.2mn in finance charges for the first three quarters of 2011 compared to QAR465.6mn for the full year of 2010. Going forward, we assume the company will pay off an USD300mn loan coming due in 2013 and model in other small annual debt repayments. While the expected EPS growth may not look that impressive, we would point to the company's stable and visible business model as a mitigating factor. Moreover, we believe that going forward investors would increasingly view QEWS as a free cash flow and dividend growth story.

Impressive Expected FCF Yield of ~17%; Should Turn ~50% of Revenue to Operating Cash Flows

QEWS is at an inflection point. We expect the company to generate a free cash flow to the firm (FCF) yield of ~17% (~QAR23 per share) from 2011 versus negative FCF yields in 2008-2009 (due to high capital expenditures or capex needs; 2010 FCF was marginally positive). In our base-case model, the growth in FCF is coming from higher operating cash flows as well as a reduced need of capital expenditure in the coming years.

On the operating side, QEWS has been converting ~43% of its revenue into cash from operations over the last two years (2009-10) on an average. Looking ahead, we expect this conversion rate to improve to around 50% as the increased working capital (receivable and prepayments) requirements in prior years stabilize.

Significant operating cash flows provide flexibility to reinvest in growth, improve dividends and create capital buffers. Although most of QEWS' debt is in the form of long-term loans and is tied to existing projects, increasing cash flows should allow the company flexibility in retiring its debt leaving more FCF for equity holders in the form of dividends. We have also built an expansion-case model, where the company will be able to invest in attractive expansion opportunities in the region (please refer to the expansion-case overview later in this report)

Q3 2011 Results

Q3 2011 results were below Street estimates but operationally solid. In Q3 2011, the company reported total revenue of QAR1.2bn, up 29.1% YoY but only up 1.5% QoQ. This took some investors by surprise as Q3 is usually a seasonally strong quarter. However, we note that the company's Q2 2011 results already reflected the impact of its capacity expansion at Ras Girtas. This is because although the final ~1 gigawatt (GW) of capacity at Ras Girtas (Ras Laffan C) came online only around June 2011, QEWS started receiving revenue associated from this plant from Kahramaa in April 2011. Electricity and water revenue grew by 2% and 2.6% on a QoQ basis, respectively, while lease income declined 1.2% on a sequential basis. Going ahead, 2012 will be the first complete year to benefit from the full impact of the Ras Girtas project. Net income to equity holders for Q3 2011 grew 2.74% YoY, but was down 15.5% QoQ. As mentioned previously, given that Ras Girtas only started full operations around the end of Q2 2011, its associated cost of sales became visible only in the September quarter. Moreover, the Q2 2011 net income benefited from a QAR58mn credit as the company exercised its take-or-pay rights with Kahramaa (an action usually taken in the fourth quarter). Finance costs also remained upwardly sticky given that all projects were fully operational in Q3 2011 and the company was no longer able to capitalize interest associated with plants under construction.

Catalysts

Announcements of New Expansion Plans

In our view, the company could announce new expansion plans outside of Qatar in the coming years. As recent comments by the management indicate, QEWS is aggressively positioning itself in its local and regional markets. We believe the company could announce expansion plans which could provide positive triggers for the stock price. QEWS is part of an international consortium, which will build the 2GW Sur power plant in Oman (estimated to be worth USD1.82bn in which QEWS has a 15% stake). Further, news reports indicate that the company is close to completing a 23% stake in a 380-megawatt (MW) power plant near Amman, Jordan (Amman East 1). QEWS is also bidding for the first phase (1.5GW; ~17% stake) of the Hassyan IPP project in Dubai with a decision expected by May 2012. Besides these projects, the firm is also considering opportunities in Saudi Arabia and Bahrain. On the international front, QEWS is mulling expansion in India, South Korea and Vietnam.

Investors also need to be cognizant that Kahramaa is very proactive in ensuring that the demand of the country is met without any shortfall. Kahramaa has invited bids for a plant with 71 million imperial gallons per day (MIGD) of water desalination capacity to be up and running by 2015 (bids expected next year). QEWS also has drawn up plans to tender for an IWPP project known as Facility D (~2,000MW) that is expected to come online around 2016. There are also plans to scale up capacity of Ras Girtas by 750MW and 25MIGD by 2014. Thus, expectations for growing industry demand and infrastructure growth coupled with preparation for the 2022 FIFA World Cup all point toward another cycle of expansion in the future. We highlight that in our base-case model we do not include any impact from these projects (except the already announced Sur power plant in Oman). *If we account for an incremental 2,000MW of electricity and 40MIGD of water, as we do in our expansion-case model, QEWS' target price jumps to QAR196.7 from QAR176.2.*

Dividend Payouts to Increase

We expect dividends to increase by around 14% from 2010 to 2013 leading to a dividend yield of 6.3% in 2013. With all planned capacities online in H1 2011, capex requirements should decline significantly allowing QEWS to boost dividends in the future. We are modeling dividends per share to grow from QAR6 to QAR8.9 in 2013. Our forecasts remain in line-to-slightly conservative with the company's previous history of dividend payments, which has grown at a CAGR of 14.5% over 2007 to 2010. Consequently, the dividend yield should climb to 6.3% in 2013 from 4.3% in 2010. Risks to our dividend forecasts remain on the upside especially if QEWS does not expand further.

Valuation – Compelling on All Scales

Our target price of QAR176.2 per share implies an upside of 25% on the stock. For valuing the company, we choose to use the discounted cash flow (DCF) technique exclusively rather than rely on a combination of DCF and relative multiples. This is because we believe that given QEWS' unique business model with locked-in economics, a DCF method accurately reflects the company's cash generating potential and fair value. We have however also provided relative valuation multiples for reference purposes.

Discounted Cash Flow (DCF)

We have estimated the fair value of QEWS using the DCF valuation methodology. In terms of major assumptions, starting from 2013, we have grown QEWS' top-line to keep pace with inflation of around 2% per annum. We have also used a terminal growth rate of 2% in our model.

DCF Valuation

Particulars	Fair Value of Equity (QAR mn)	Fair Value per share (QAR)
PV of FCFF	8,597	
PV of Terminal Value	20,780	
PV of Cash Flows	**29,377**	**293.8**
Add:		
Cash balances	2,665	26.7
Less:		
Debt balances and others	14,224	142.2
Minority interest	196	2.0
Fair Value of Equity	**17,623**	**176.2**

Source: QNBFS Estimates

Our WACC assumptions remain fairly conservative. For weighted average cost of capital (WACC) calculations, we have assigned a weight of 50% to equity and 50% to debt, which is in line with the relative weights of QEWS' current market capitalization and debt. We also use an emerging markets risk premium of 8% and a beta of 0.90. This results in a WACC of 8.35%.

WACC Analysis

WACC Calculations	
Risk-free rate (Estimated yield of 10-year government bonds) (%)	4.5
Risk premium (%)	8.0
Beta	0.9
Cost of Equity (%)	**11.7**
Cost of Debt (%)	**5.0**
Tax rate (%)	0.0
WACC (%)	**8.4**

Source: Bloomberg, QNBFS Estimates

Sensitivity Analysis

We have performed sensitivity analysis on the WACC and terminal growth rate. As per the sensitivity analysis table, a reduction in WACC by 50 basis points (bps) increases QEWS' fair value by 13.7%, while a 50bps increase in the terminal growth rate increases the fair value by 10.7%. The results of our sensitivity analysis are depicted below:

Sensitivity Analysis

WACC \ Terminal growth rate	1.00%	1.50%	2.00%	2.50%	3.00%
7.4%	186.2	205.7	229.0	257.0	291.5
7.9%	164.7	**181.1**	**200.4**	**223.2**	250.7
8.4%	146.2	**160.1**	**176.2**	**195.1**	217.5
8.9%	130.0	**141.9**	**155.6**	**171.4**	189.9
9.4%	115.8	126.1	137.8	151.2	166.7

Source: QNBFS Estimates

Relative Valuation

QEWS remains attractively valued versus its peers. We have used the mean EV/EBITDA and P/E multiples for 2012 of comparable global players to value the company. QEWS is trading at 10x enterprise value to EBITDA (EV/EBITDA) on 2011 estimates versus Saudi Electric Company (SECO), which is trading at 10.6x. Furthermore, 2011 did not fully incorporate the impact of the Ras Girtas project (the project became operational at the end of Q2 2011); thus in 2012 the EV/EBITDA multiple will further decline to 9.3x. In terms of the price to earnings (P/E) ratio, QEWS trades at 9.5x 2012 EPS, which is again lower than its peers.

EV/EBITDA Multiples (x)

	FY08	FY09	FY10	FY11e	FY12e
Qatar Electricity and Water Co*	18.2	17.3	14.3	10.0	9.3
Saudi Electricity Co	15.0	14.5	11.3	10.6	9.8
Electric Power#	10.0	10.3	9.7	10.5	10.9
Tata Power#	15.2	12.3	10.7	7.5	6.4
Severn Trent#	9.8	9.2	9.1	9.2	8.7

Source: Bloomberg, *QNBFS Estimates; Note: # Year end is not December

P/E Multiples (x)

	FY08	FY09	FY10	FY11e	FY12e
Qatar Electricity and Water Co*	18.6	14.9	12.1	10.2	9.5
Saudi Electricity Co	50.0	40.7	22.4	20.5	20.0
Electric Power#	14.6	12.6	14.0	11.4	10.0
Tata Power#	13.5	15.4	12.5	11.1	11.3
Severn Trent#	16.4	14.6	16.3	17.2	14.4

Source: Bloomberg, *QNBFS Estimates; Note: # Year end is not December

Risks to Our Target Price

- **Hiccups in international expansion.** As QEWS ventures out of its comfort zone in Qatar, there can be no guarantee that it will enjoy the same level of success as it has experienced thus far domestically. Moreover, the company will not be able to rely on the solid backing of the Qatari government in its international projects, which could expose them to execution and operational risks. Thus, international expansions may not necessarily lead to value accretion.
- **Liquidated damages.** In the past, Kahramaa has charged liquidated damages for delays in the commissioning of new projects, which in turn was generally collected from the Engineering, Procurement and Construction (EPC) contractor or other partners responsible for that project. Kahramaa also charges penalties if availability levels of plants fall short of contracted levels. Here we note that QEWS' partnerships with experienced international IWPP players, such as Chubu Electric Power and Marubeni Corporation go a long way in mitigating this risk and ensuring that efficiency targets are met or even exceeded. So far in 2011, there have been no liquidated damages from Kahramaa, and we have not built any in our model as well. This is reasonable given our base-case model does not consider any future expansion. However, to the extent that the company faces penalties for underperformance in availability levels, we see downside risk to our estimates and price target.
- **Changes in the tariff structure.** We note that QEWS has watertight agreements with Kahramaa. However, any adverse renegotiations of the tariff structure could impact margins and our target price. Being the sole buyer of electricity and water, Kahramaa holds significant bargaining power regarding most facets of the domestic market, including the tariff structure.

Qatar Power and Water Industry

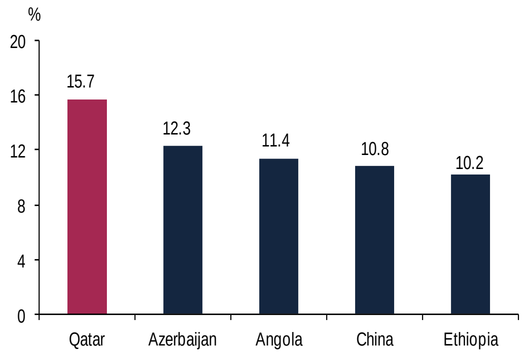
Structure of the Qatari Electricity and Water Sector

Qatar Petroleum, QEWS, other IWPPS/IPPs and Kahramaa make up the power and water value chain. As discussed previously, QP supplies natural gas for electricity generation and water desalination. However, it was only in 2000 that the utility sector was partially privatized, whereby power production and water desalination was switched over to the private sector thus leading to the creation of QEWS in its present form. The responsibility for distributing power and water was retained with the government through Kahramaa.

The Power and Water Sector Has Grown and Will Grow with the Economy

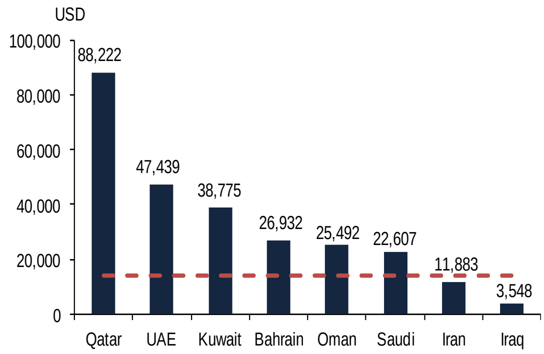
A growing population backed by a fast-growing economy has boosted demand for power and water. As detailed previously, Qatar has emerged as one of the fastest-growing economies in the world with its real GDP growing at a CAGR of 15.7% during 2006-2010. Moreover, the Qatari population grew at a fast pace with a CAGR of 13.9% during 2006-2010 to reach 1.7mn as per the April 2010 census. However, Qatar's population remains the lowest in the GCC region, just ahead of Bahrain, providing the country with one of the highest per capita income not just in the Middle East but also around the world.

Fastest Growing Global Economies (2006-2010



Source: QNB Capital, IMF

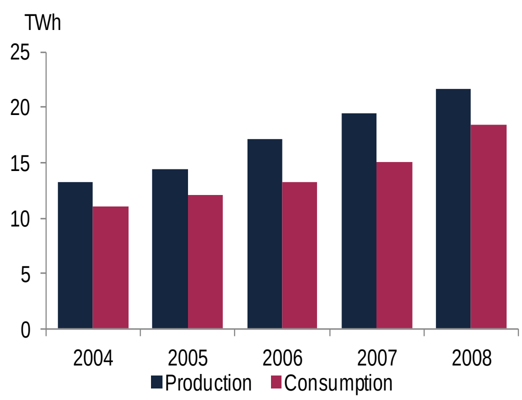
GDP per Capita – Purchasing-Power-Parity 2010



Source: IMF World Economic Outlook (WEO) September 2011

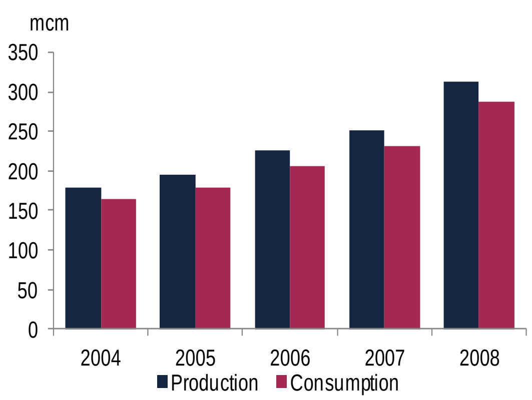
Demand for electricity and water has grown rapidly. According to Kahramaa, the demand and supply of power grew at a CAGR of 13.4% and 13.1%, respectively, over 2004 to 2008. In terms of desalinated water, both demand and supply increased by an average of 15.1% over the similar period.

Power Generation and Consumption



Source: Kahramaa

Water Generation and Consumption



Source: Kahramaa

- **The GCC Interconnection Grid presents further opportunity for Qatar to extend its reach.** Qatar is the only GCC nation that currently enjoys a power surplus to the tune of around 3GW. Thus, it is well positioned to export some of this surplus power to its power-deficit neighbors. With a goal of allowing the GCC nations to rely on each other's excess capacities in times of peak demand, the GCC Interconnection Grid was conceived in 2001. Kuwait, Saudi Arabia, Bahrain and Qatar are already connected under Phase I of the project (Northern System). The UAE and Oman joined into the grid during Phase II in April 2011 (Southern System). Phase III of this project will connect the Northern and Southern systems completing the entire grid by next year. Qatar, which has the ability to export or import around 750MW of power through this grid, has already started to reap the benefits of supplying power (200MW in 2010, of which 150MW was supplied to Bahrain) through the GCC Grid.

Growth is expected at a rapid clip going forward. As mentioned before, industry expectations call for an 8-11% CAGR in demand for water and power over the next few years.

- **Despite excess power capacity, further expansion is slated by 2014.** Currently, there is about a ~3GW surplus in power capacity relative to demand. However, QEWS management believes that further expansion in the power sector is likely by 2014 (online by 2016) given the healthy expectations for consumption growth.
- **The water market remains tight with further capacity expansion likely in the near-term.** According to the NDS 2011-2016, Qatar's per capita water consumption (310 liters per day) is one of the highest in the world**.** With meager rainfall, around half of the country's fresh water is derived from its desalination plants. Qatar's water reserves, based on current consumption rates, can only last for three days. The government, in a bid to increase its reserves, is investing USD2.75bn in a mega-reservoir to hold 1.9bn imperial gallons. As far as QEWS is concerned, we believe the company will be involved in bidding for a new water desalination facility (71MIGD) in 2012.
- **Further upside is possible in terms of domestic capacity expansion.** It is likely that higher demand for power will also emanate from Qatar's plan of diversification from hydrocarbon production to energy-intensive industries like petrochemicals and aluminum. Further, large-scale investments in infrastructure (more than USD100bn over the next decade) as part of the NDS 2011-2016 on the back of hosting the 2022 FIFA World Cup, will also result in a surge in power consumption. Overall, the Qatari government has budgeted around USD13.7bn to be spent for electricity and water projects over the next decade.

QEWS stands to gain directly from further investments in the power and water sector given its dominant market share and its considerable stakes in all remaining IWPPs/IPPs in Qatar.

Company Background

Company Description

Qatar's leading listed provider of utility services. QEWS owns and operates power generation and water desalination plants in the State of Qatar. The company is considered as one of the first private sector companies to operate in the field of power and water production in the GCC accounting for more than ~63% and 80% of Qatar's electricity and water capacity, respectively. By the end of 2010, QEWS' share of capacity reached ~5.6GW of electricity and 277MIGD of water, respectively.

Company Snapshot

Electricity installed capacity	8,892	Water production capacity (MIGD)	348
Number of plants	11	Revenue 5-yr. CAGR (%)	18.3

Source: Company Data; Note: *Total capacity in Qatar in MW

Management Team

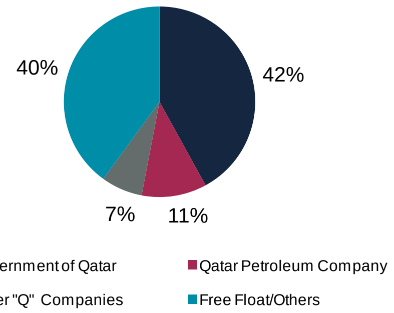
Name	Designation
Abdulla Bin Hamad Al Attiyah	Chairman
Essa Shaheen Al Ghanim	Vice Chairman
Fahad Hamad Al Mohannadi	General Manager
Hassan Mohd. Al Muftah	Production Manager
Jimmy Chung	Finance Manager
Mohammad Adel Kanaan	IT Manager

Source: Company Data

Company History

QEWS was established in 1992 for acquiring and managing power generation and water desalination plants in Qatar. Since then, the company has grown its operations both organically (expansion of RAF B1, RAF B2 and RAF A1) as well as inorganically (an increase in its stake to 80% in Ras Laffan Power Company). QEWS also participates in all IWPPs/IPOPs in Qatar and retains a strategic stake in them. These include Qatar Power or Q Power (55%), Mesaieed Power (40%) and Ras Girtas Power (45%). The recent award of the Sur power project in Oman to QEWS (as part of a consortium) can be construed as a stepping stone for further geographical expansion, with potential targets including Jordan, Saudi Arabia, India and Korea.

Major Shareholders



Source: Company Data

Project and Contract Announcements (Since 2010)

Date	Value	Details
14-Jul-11	OMR700mn (USD1.8bn)	Contract with Oman Power and Water Procurement Company to build a 2GW power plant in Oman called the Sur Independent Power Project

Source: Company Data

M&A Announcements (Since 2010)

Date	Value	Details
8-Oct-10	QAR584.2mn	Acquisition of AES Corporation's stake in Ras Laffan Power Company, which increased QEWS' ownership in Ras Laffan Power Company and Ras Laffan Operating Company to 80% (from 25%) and 100% (from 30%), respectively

Source: Company Data

Business Profile, Subsidiaries/Joint Ventures and Segments

Business Profile

On the cusp of growth. QEWS is the largest power generation company in the state of Qatar. With surplus power capacity, coupled with a secure revenue stream with no demand or costs risk and aggressive expansion plans, the company has the potential to emerge as one of the key operators in the power deficit GCC region. Further, the demand for water in Qatar is expected to overshoot supply by 2014, which will ensure full capacity utilization of the company's desalination plants.

Business Segments

QEWS' operations are split between three segments – electricity, water and lease income. Electricity, water and lease income contributed 54%, 34%, 12% of the company's total top-line over 2007 to YTD 2011. Lease income is also related to the production of power and water but has come about due to the differing accounting treatment of new plants (treated as finance leases).

Subsidiaries

Ras Laffan Power Company Limited (RLPC) was established to operate the Ras Laffan A power project. This plant has an installed electricity generation capacity of 750MW and a seawater desalination unit producing 45MIGD of potable water. In October 2010, QEWS acquired an additional 55% of the voting shares in RLPC increasing its stake to 80%. This plant operates under a power and water purchase agreement (PWPA) through which production is sold to the government (Kahramaa) for 25 years.

Ras Laffan Operating Company (RLOC) is engaged in the management, operation, maintenance and development of electricity and water desalination plants in Qatar. RLOC became a wholly-owned subsidiary of QEWS in October 2010.

Joint Ventures

Q Power was incorporated to operate the Ras Laffan B project, which has an installed electricity generation capacity of 1,025MW and potable water capacity of 60MIGD. Q Power is jointly-owned by QEWS (55%), International Power-UK (40%) and Chubu Electric Power (5%). It operates under a PWPA though which production is sold to the government for 25 years.

Mesaieed Power Company (MPC) operates a 2,007MW Combined Cycle Gas Turbine power plant and supplies output to the national grid and the Mesaieed aluminum smelter. MPC is jointly-owned by QEWS (40%), Marubeni Corporation (40%) and Qatar Petroleum (20%).

Ras Girtas Power Company (RGPC) was incorporated to install and operate the Ras Girtas or the Ras Laffan C power project. This plant has an electricity generation capacity of 2,730MW and potable water capacity of 63MIGD. The plant started operating at full capacity from June 2011. QEWS has a 45% ownership alongside QP's stake of 15% in RGPC. QEWS is exploring further opportunities to expand RGPC's electricity generation capacity by 750MW and water desalination capacity by 40% to 88MIGD by 2014.

Projects

RAF B: Commissioned in 1995, QEWS acquired a 100% stake in this plant from the government in 1999. RAF B's total capacity is 609MW of electricity and 33MIGD of potable water. It operates under a PWPA under which production is sold to the government for 20 years

RAF B1: Commissioned by QEWS in 2002, RAF B1 serves as an extension to the existing RAF B Facility. The total capacity of this plant is 377MW. It operates under a 20-year power purchase agreement.

RAF B2: This project, which is 100% owned by QEWS, was completed in December 2008. It has a production capacity of 567MW of electricity and 30MIGD of potable water.

RAF A: Commissioned in different phases during 1970-1993, QEWS acquired this plant from the government in 2003. RAF A's electricity generation capacity stands at 626MW of electricity while its potable water capacity stands at 70MIGD. It operates under a PWPA under which production is sold to the government for 12 years.

RAF A1: The project, which is 100% owned by QEWS, was completed in December 2010 achieving its full production capacity of 45MIGD of water.

Satellite power stations: Forming part of RAF A, the satellite stations consist of Al Wajbah, Al Saliayah and Doha South Super located on the outskirts of Doha. These power plants were built in 1980 with capacities of 301MW, 134MW and 67MW, respectively. These satellites operate under a PWPA under which production is sold to the government for 12 years. In 2010, QEWS discontinued operations at Al Wajbah but the other plants still remain on active duty.

Dukhan desalination plant: Commissioned in 1997, this 2MIGD plant was acquired by QEWS in 2003 from QP. This plant is operated under a water purchase agreement under which production is sold to the government for 25 years.

Oman project marks QEWS first regional foray. As a part of QEWS' strategy of international/regional expansion, the company in partnership with two Japanese partners, Marubeni and Chubu Electric Power and a local Omani company Multitech, won a new project in Sur, Oman in July 2011. The Sur project, which will be owned and operated by this consortium, is expected to be a 2,000MW gas-fired power generation facility. Oman Power and Water Procurement Company will purchase power under a 15-year agreement, providing secured, long-term income stream for QEWS. The USD1.82bn project is expected to become operational in two phases, with an initial capacity of 433MW in 2013 and an additional 1,567MW in 2014.

Other non-Qatari projects are currently on the drawing board. The company is also studying a proposal for establishing a power plant in India in partnership with National Thermal Power Corporation and a power plant in Seoul, Korea in partnership with SK E&S. QEWS is close to finalizing a stake purchase in Jordan and will be bidding for the first phase of a large power project in Dubai. Besides these projects, the company is also considering opportunities in Saudi Arabia and Bahrain.

Total Capacity by 2011

We estimate QEWS' net power and water capacity to grow by ~43% and ~65%, respectively, over 2009 to 2011. Expansion during this period included the formation of the Ras Abu Fontas desalination plant (RAF A1) and the acquisition of a controlling stake in Ras Laffan Power Company as well as expansion and commissioning of two major projects, Mesaieed (2,007MW) and Ras Girtas (2,730MW).

Capacity Details

Project	Qatar Power (MW)	Qatar Water (MIGD)	QEWS Stake	QEWS Power (MW)	QEWS Water (MIGD)
RAF B	609	33	100%	609	33
RAF B1	377	-	100%	377	-
RAF B2	567	30	100%	567	30
RAF A	626	70	100%	626	70
RAF A1	-	45	100%	-	45
Satellite Stations	201	-	100%	201	-
Dukhan Desalination Plant	-	2	100%	-	2
Ras Laffan Power Company	750	45	80%	600	36
Q Power Project	1,025	60	55%	564	33
Mesaieed Power Company	2,007	-	40%	803	-
Ras Girtas Power Company	2,730*	63*	45%	1,229	28
Total	**8,892**	**348**		**5,575**	**277**
Percentage of Total				**62.7%**	**79.7%**

Source: Company Data; Note: *Full capacity of Ras Girtas came online in June 2011

Key Forecasts – Base Case

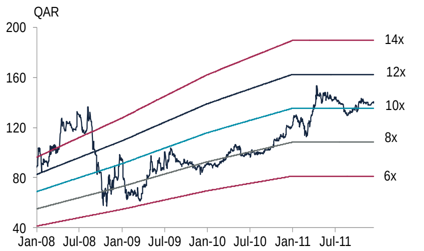
Revenue

We forecast revenue to grow at a CAGR of 4.8% from 2010 to 2016. However, a major portion of this growth is already visible in the top-line reported thus far in 2011 as the last of the current expansion projects came online in Q2 2011. Post 2012, we expect revenue to grow by around 2% based on inflation adjustments to existing contracts. We do note that we expect a yearly decline of 9% in 2015 as we are modeling in tariff reductions at RAF A and the satellite stations given that their purchase agreements come up for renewal in 2014. *In our base case model, we have not modeled any capacity expansion over our forecast period.*

Going ahead, we expect the electricity, water and lease income segments to contribute 50.8%, 28.3% and 20.9% to total revenue over 2011 to 2016. By segment:

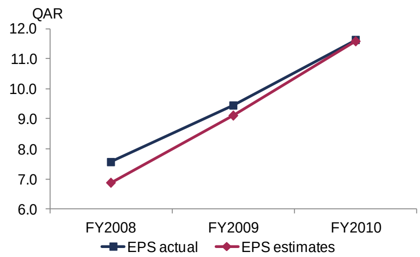
- **We model revenue from electricity and water to grow at a CAGR of 4.6% and 2%, respectively, from 2010 to 2016.** Electricity revenue should grow from QAR1.8bn in 2010 to QAR2.4bn in 2016. Revenue from desalinated water sales is modeled to increase to QAR1.2bn in 2016 from QAR1.1bn last year.
- **Lease income will almost double to QAR1,018mn in 2011 versus QAR518mn in 2010.** This segment will be the fastest growing as all new plants (beginning from Q Power in 2006 and followed by MPC, RGPC and RLPC) are accounted for as finance leases. Over 2010-2016, this segment's top-line is anticipated to grow at an average rate of 10.2% to reach QAR930mn. The finance leases represent QEWs' share of investments in joint ventures, which are essentially build, own, operate and transfer (BOOT) schemes, where all risks, benefits and ownership of the assets are transferred to Kahramaa. The net investment (gross investment discounted at an implied rate) in the lease is accounted as receivables in the balance sheet, and a periodic rate of return on net investments is recognized as revenue.

1 Year Forward P/E Band



Source: Bloomberg

Earnings Surprise



Source: Bloomberg

Costs

Costs should remain in line-to-slightly higher relative to historical norms. Cost of sales, excluding depreciation has averaged 42.6% of revenue in the last three years (2008-10). In the first nine months of this year, it has averaged around 39.1% primarily due to greater lease income from JVs such as Ras Girtas. Going forward, we have estimated that these costs would average in the range of 40% to 42.5% (gradually increasing) in order to be conservative. General and administrative expenses have averaged around QAR53mn a quarter this year and were 4% of revenue in Q3 2011. Looking ahead, we assume this expense line to average around 4.6% (in line with 2010 performance) to 5.4% of revenue.

Finance Charges and Liquidated Damages

Finance charges should come down as QEWS pays down debt. Ras Girtas came online in H1 2011 resulting in finance charges getting visible on the income statement against being capitalized previously. Hence, we expect a 55% YoY jump in finance cost in 2011. Going forward, we assume the company will pay off an USD300mn loan coming due in 2013 and model in other small annual debt repayments. Overall, we expect finance charges to decline by 23% in 2016 from its peak in 2011.

Net liquidated damages to remain a non-factor. As previously mentioned, liquidated damages, which are primarily due to delays in commissioning plants, are penalized by Kahramaa. However, the company is generally able to pass these costs through to the project manager or the EPC contractor. Kahramaa also charges penalties if availability levels of plants fall short of contracted levels. Here we note that QEWS' partnerships with experienced international IWPP/IPP partners go a long way in mitigating this risk and ensuring that efficiency targets are met or even exceeded. Liquidated damages of QAR325mn paid to Kahramaa (2007-2010) were somewhat offset by the share of liquidated damages received (QAR219mn). However, there have been no liquidated damages to Kahramaa thus far in 2011. Going forward, we have not built any liquidated damages in our base-case model. We do expect the company to recoup around QAR106mn in total from its EPC contractors (for past damages) over 2012-2013.

EBITDA and Net Income

We forecast a CAGR of 4.4% and 3.4% for EBITDA and net income over 2010 to 2016. Operating income is modeled to grow at an average clip of 5.2% over the same period. Our profitability growth forecasts generally keep pace with our modeled revenue growth estimates. This is hardly surprising given the steady nature of the business model with QEWS' stable top-line being complemented by its ability to pass input costs through to Kahramaa, thus allowing it to maintain operating margins.

The growth in profitability in the first two years is coming from capacity expansion, followed by declining finance charges and efficient management in the later years. Looking ahead, we expect gross margin (excluding depreciation) to remain in the band of 60% to 57.5% and EBITDA margins to be within the range of 55.4% to 52.2% (both gradually declining).

Finance Lease Receivables

Finance lease receivables should decline as QEWS recognizes lease income. Finance lease receivables accounted for 53.5% of total assets at QAR11.8bn in 2010 (QAR3.8bn in 2009), mainly due to the addition of the Mesaieed and Ras Girtas projects. We expect lease receivables to gradually decline after 2011 (at a rate of 3-4% per annum), as the company recognizes lease income from its recent power projects in the coming years.

Cash Flow Statement

Net cash from operating activities (after finance costs) increased by a massive 67.4% YoY to QAR1.6bn in YTD 2011. On the other hand, capex dropped to QAR219.5mn from QAR1.4bn. In fact, QEWS' capex declined by 63.5% YoY to QAR1.5bn in 2010 following heavy spending by the company in 2008 and 2009 (average of QAR4bn). In 2010, the company paid close to QAR0.6bn to increase its stakes in Ras Laffan Operating Company and Ras Laffan Power Company to 100% and 80% from 30% and 25%, respectively.

Going forward, we expect the firm to generate QAR2bn (2011) to QAR2.3bn (2016) in net cash from operating activities while we expect the outflow on investing activities to be average around QAR300mn. This will allow the company the flexibility to pay down its debt or/and increase dividend payouts to shareholders.

Debt and Leverage

Leverage levels are high but manageable. QEWS had a net debt-to-equity ratio of 3.3x as of September 2011 and December 2010, higher than the 2009 ratio of 2.7x. However, we note the following mitigating factors:

- **Currently, 96.7% of the debt is long term in nature.** QEWS has little debt at the corporate level with long-term debt (project financing for operating plants) maturities aligned to the useful lives of its plants. Current cash of QAR2.7bn is more than enough to cover debt maturities of QAR1.1bn in 2013.
- **Interest coverage remains more than adequate at 3x in 2010.** Moreover, if we use EBITDA instead of EBIT to calculate the interest cover, the ratio jumps to 3.9x for 2010. As QEWS' domestic operations have no exposure to demand risk and very limited exposure to costs risks (to the extent of non-payment of liquidated damages), we believe this interest coverage remains more than adequate.
- **Our conservative base case model predicts net-debt-to-equity to decline to 2.9x by 2011, and further to 0.9x by 2016.** Moreover, Moody's has assigned the company an investment grade credit rating of A1 (Stable Outlook).

Key Forecasts – Expansion Case

Our target price increases by around QAR20 per share under our conservative expansion-case model. QEWS is aggressively pursuing expansion opportunities. The firm has already shown interest in almost all of the capacity expansion plans underway in other GCC countries. We also feel that given the conservative nature of Kahramaa an expansion in Qatar three-to-five years down the road to meet any expected shortfall cannot be ruled out. Hence, in order to give investors a flavor of how an expansion could impact earnings, cash flows and dividends we have created an expansion-case model.

Key Assumptions

Our assumptions remain firmly entrenched in historical norms. Key assumptions include:

- The new expansion is on the lines of existing contracts (including metrics such as revenue per KW and MIGD, based on available capacity).
- New capacity of 2,000MW and 40MIGD should come online in two phases – 50% in 2015 and the remaining in 2016. This project will be 100% owned by QEWS.
- Debt-to-equity financing ratio of 75:25 for the new plant (in line with previous expansions).

- A combined capital cost of QAR8bn (QAR4,000/KW based on recent power plant awards in MENA, adjusted for inflation).
- Total debt would peak at QAR 17.1bn in 2015 from QAR14.2bn in 2011 (in the base-case model).

Revenue

The new expansion would arrest the revenue decline expected from RAF A and other satellite stations built into our base-case model. As a result, revenue should grow 1% YoY in 2015 versus a decline of 9% modeled in our base-case estimate. Overall, we forecast revenue to grow at a CAGR of 8.5% from 2010 to 2016.

Costs

Costs should benefit from efficiencies created by the new plant. Cost of sales, excluding depreciation should decline by 100bps in 2015 and 2016 as has been the case with previous expansions, benefiting from efficiency of new plants. Nonetheless, we have kept the percentage of cost relative to sales above 40% with gradual increases in subsequent years (cost of sales was 39% of revenue over the first nine months of this year). In terms of depreciation charges, we have assumed the new plant to have a useful life of 25 years. This results in depreciation expense to increase by QAR330mn in 2016, depressing the growth in EBIT.

Debt and Finance Charges

Leverage and interest expenses will grow given the additional debt. The new debt of QAR6bn (75% of the QAR8bn expansion) at current hedged interest rates would lead to QAR300mn in additional financial charges in 2016 relative to our base-case model.

Earnings and Free Cash Flows

While EPS growth will remain muted, we forecast free cash flows to reach QAR2.6bn in 2016. Due to higher depreciation and financial charges in 2015 and 2016, the earnings growth would be limited with a CAGR of 3.9% over our forecast period (still higher than our base-case model). We estimate EPS of QAR14.60 per share in 2016 in the expansion-case model compared to QAR14.17 in the base-case model. Also, free cash flows are expected to improve by QAR685mn by 2016.

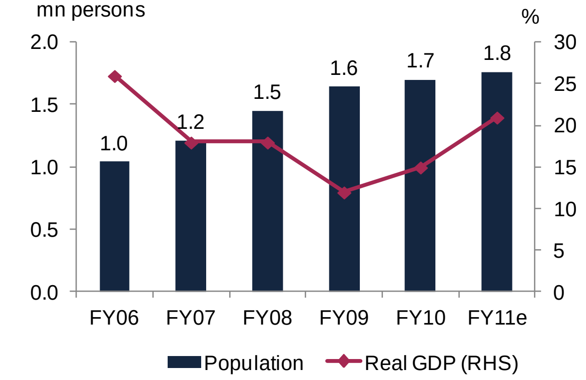
Comparison – Base-Case Model vs. Expansion-Case Model (In QAR mn unless specified)

Total Revenue	**2014**	**2015**	**2016**
Expansion	4,899	4,972	5,592
Base	4,899	4,444	4,534
Cost of Sales - Excluding Depreciation			
Expansion	(2,082)	(2,064)	(2,265)
Base	(2,082)	(1,889)	(1,927)
Depreciation			
Expansion	509	759	839
Base	509	509	509
EBITDA			
Expansion	2,592	2,680	3,070
Base	2,592	2,318	2,369
Finance Cost			
Expansion	(603)	(728)	(853)
Base	(603)	(578)	(553)
EPS (QAR)			
Expansion	15.58	12.86	14.60
Base	15.58	13.37	14.17
DPS (QAR)			
Expansion	9.95	10.95	12.04
Base	9.95	10.95	12.04
Operating Cash Flow			
Expansion	2,481	2,378	2,669
Base	2,481	2,171	2,283
Investing Cash Flow			
Expansion	(4,336)	(4,340)	(397)
Base	(336)	(325)	(370)
Financing Cash Flow			
Expansion	1,559	1,468	(1,564)
Base	(1,441)	(1,533)	(1,563)
Net Cash on BS			
Expansion	3,138	2,644	3,351
Base	4,138	4,451	4,801
Total Debt on BS			
Expansion	14,558	17,057	16,628
Base	11,558	11,057	10,628
Total Equity on BS			
Expansion	6,188	6,479	6,844
Base	6,188	6,531	6,853
FCFF			
Expansion	(1,708)	(1,748)	2,617
Base	2,292	1,895	1,932

Source: Company Data, QNBFS estimates

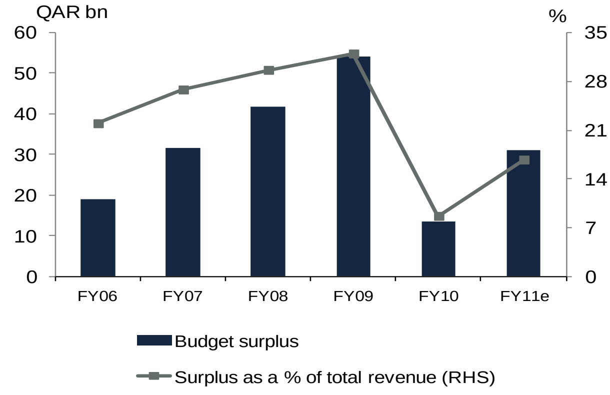
Qatar Overview: Macro Trends

Real GDP Growth and Population



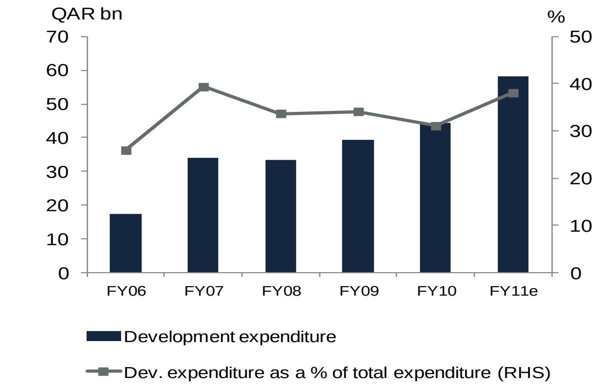
Source: QNB Capital

Budget Surplus



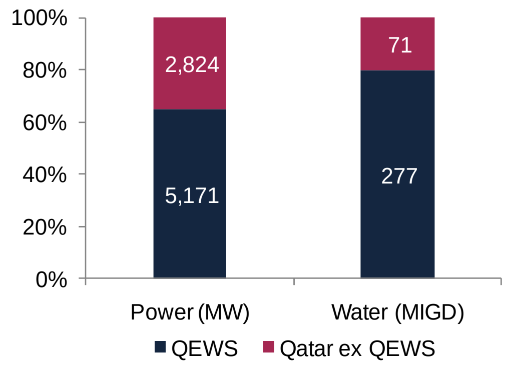
Source: Qatar Central Bank, QNB Capital Estimates

Development Expenditure



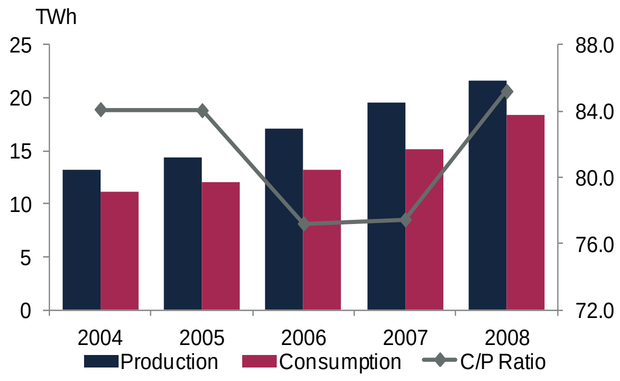
Source: Qatar Central Bank, QNB Capital Estimates

Power and Water Capacity – 2010



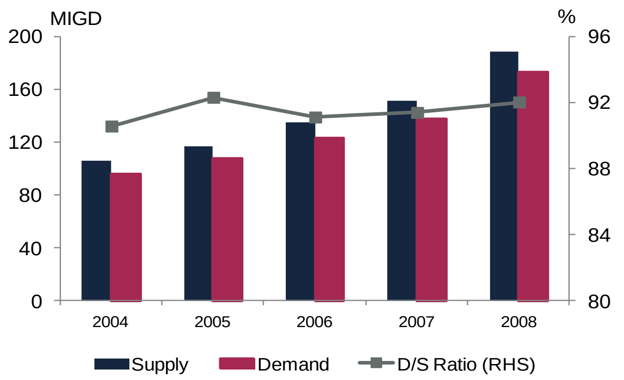
Source: Company Data, QNBFS Estimates

Power Generation and Consumption



Source: Kahramaa; Note: C/P = Consumption/production

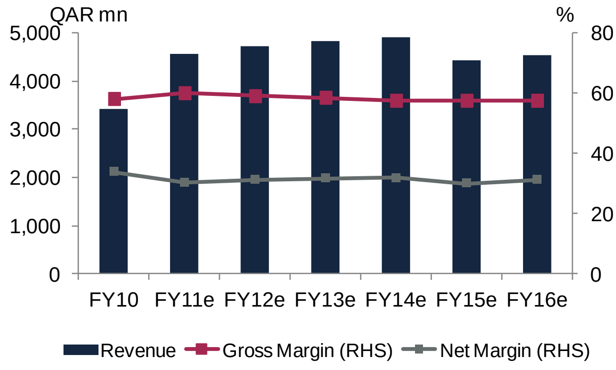
Water Demand and Supply



Source: Kahramaa; Note: D/S = Demand/supply

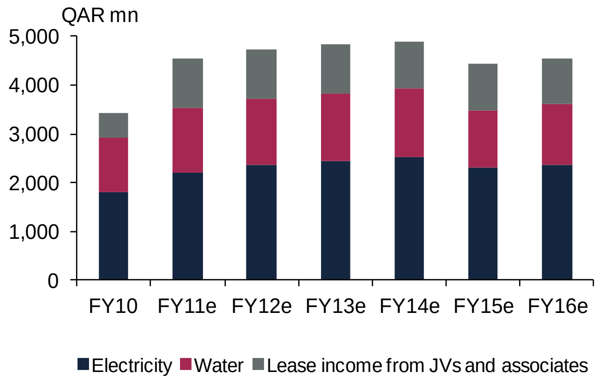
Financial Statements Analysis: Revenue, Returns and Capex

Revenue and Margins



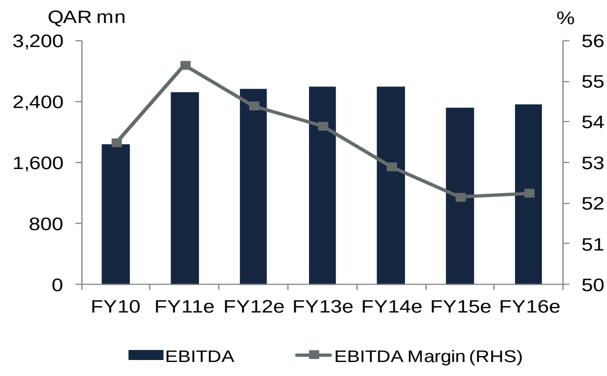
Source: Company Data, QNBFS Estimates

Revenue Distribution by Business Segment



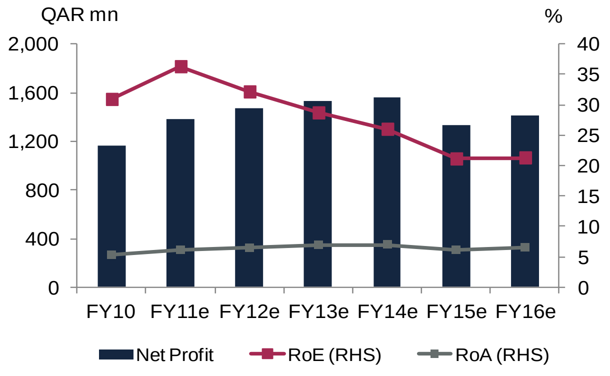
Source: Company Data, QNBFS Estimates

EBITDA and EBITDA Margins



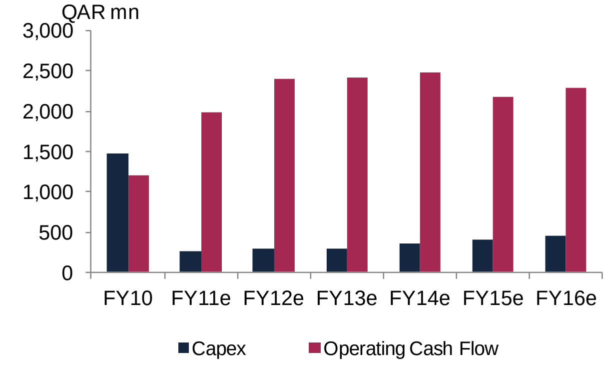
Source: Company Data, QNBFS Estimates

Profitability Ratios



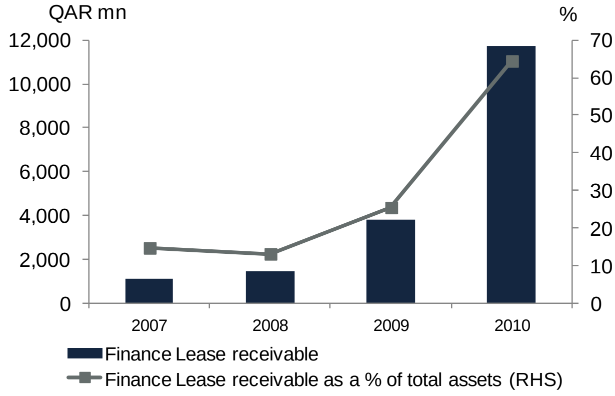
Source: Company Data, QNBFS Estimates

Capex and Operating Cash Flow



Source: Company Data, QNBFS Estimates

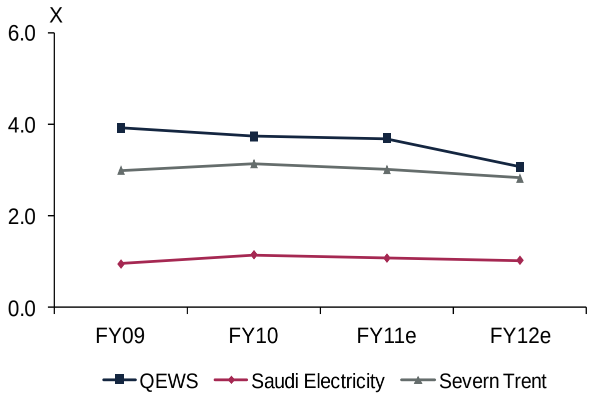
Finance Lease Receivables



Source: Company Data

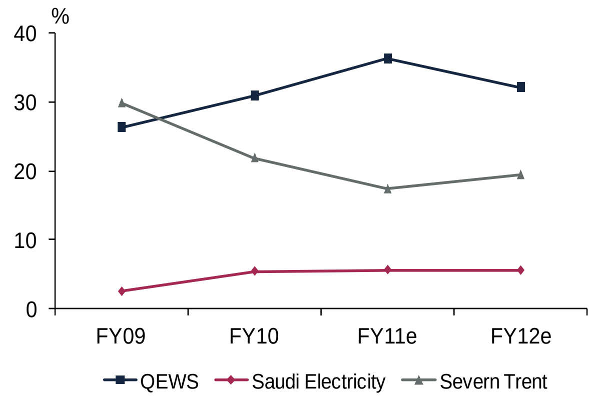
Peer Trend Analysis

P/B



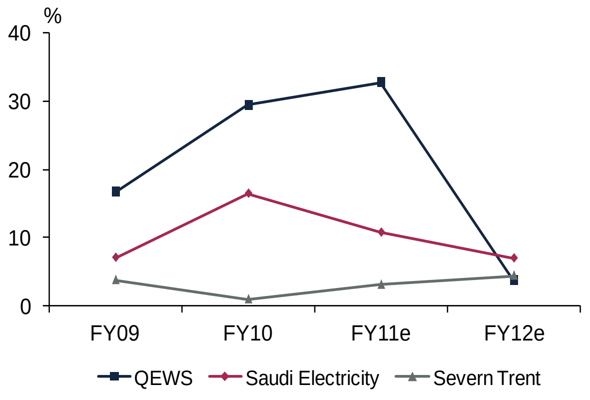
Source: Bloomberg, QNBFS Estimates

ROE



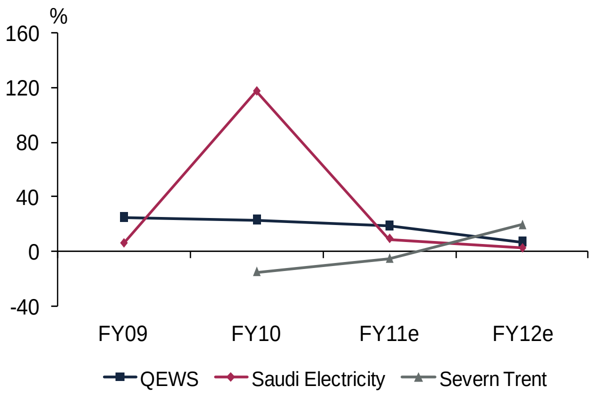
Source: Bloomberg, QNBFS Estimates

Revenue Growth



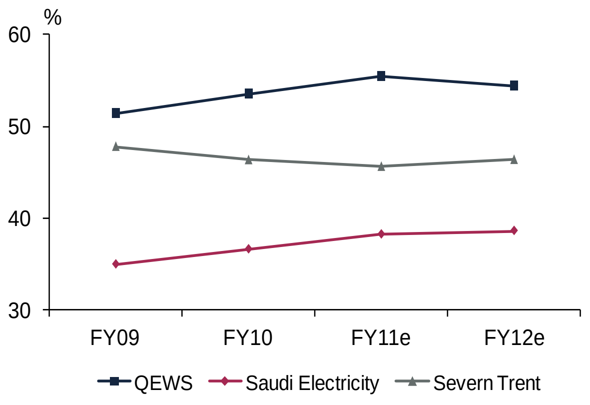
Source: Bloomberg, QNBFS Estimates

EPS Growth



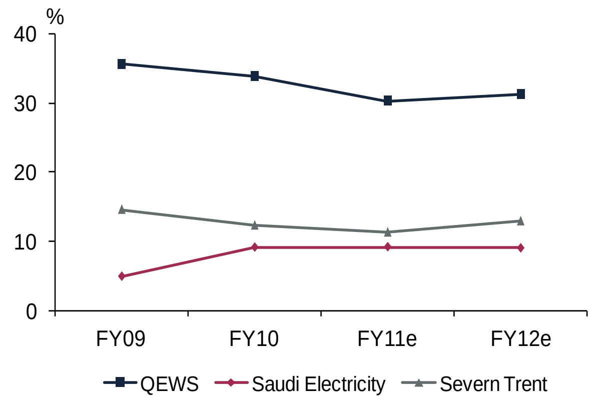
Source: Bloomberg, QNBFS Estimates; Note: Since there was negative EPS for Severn Trent in FY08, EPS growth for FY09 is N/M.

EBITDA Margins



Source: Bloomberg, QNBFS Estimates

Net Profit Margins



Source: Bloomberg, QNBFS Estimates

Detailed Financial Statements

Income Statement

Figures in QAR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
Revenue	2,651	3,430	3,343	4,555	4,721	4,824
Cost of sales (ex Dep.)	(1,129)	(1,438)	(1,307)	(1,822)	(1,935)	(2,002)
Gross profit	**1,522**	**1,993**	**2,037**	**2,733**	**2,785**	**2,822**
General and admin. exp.	(161)	(158)	(159)	(210)	(217)	(222)
EBITDA	**1,362**	**1,835**	**1,878**	**2,523**	**2,568**	**2,600**
Deferred income	7	7	5	7	7	7
Depreciation & amortization	(409)	(463)	(380)	(509)	(509)	(509)
EBIT	**960**	**1,379**	**1,503**	**2,021**	**2,066**	**2,098**
Finance costs	(194)	(466)	(539)	(721)	(711)	(683)
Interest & dividend income	141	135	41	48	58	70
Other/Misc. income / exp.	15	70	68	70	50	31
Share of associates	47	32	0	0	0	0
Net liquidated damages	(23)	17	0	0	53	53
Profit before tax	**945**	**1,167**	**1,073**	**1,419**	**1,516**	**1,569**
Income tax expense	0	0	0	0	0	0
Profit after tax	**945**	**1,167**	**1,073**	**1,419**	**1,516**	**1,569**
Minority interest	0	(4)	(26)	(38)	(41)	(42)
Profit for shareholders	**945**	**1,163**	**1,047**	**1,381**	**1,475**	**1,527**
EPS (QAR)	9.45	11.63	10.47	13.81	14.75	15.27

Source: Company Data, QNBFS Estimates

Balance Sheet

Figures in QAR mn	FY2009	FY2010	Q3 2011	FY2011e	FY2012e	FY2013e
Non-current Assets						
Property, plant and equipment	10,664	5,974	5,379	5,285	5,076	4,868
Goodwill	0	109	109	109	109	109
Investment in associates	247	0	33	33	83	233
Available-for-sale investments	275	358	350	350	350	350
Finance lease receivables	3,821	11,700	11,803	11,790	11,400	11,010
Other non-current assets	0	24	17	17	16	14
Total Non-current Assets	**15,007**	**18,165**	**17,691**	**17,584**	**17,034**	**16,584**
Current Assets						
Finance lease receivables	27	136	458	458	458	458
Inventories	274	295	295	299	318	329
Accounts receivables	432	1,454	1,268	1,248	1,293	1,322
Cash and short term deposits	2,307	2,074	2,665	3,000	3,825	3,433
Total Current Assets	**3,041**	**3,959**	**4,686**	**5,006**	**5,895**	**5,542**
Total Assets	**18,048**	**22,123**	**22,377**	**22,589**	**22,929**	**22,126**
EQUITY						
Share capital	1,000	1,000	1,000	1,000	1,000	1,000
Reserve & surplus and other	3,208	3,742	3,742	3,742	3,742	3,742
Retained earnings	500	600	1,047	1,372	2,157	2,891
Other equity	(1,118)	(1,579)	(2,309)	(2,309)	(2,309)	(2,309)
Equity to the parent	**3,590**	**3,763**	**3,480**	**3,805**	**4,590**	**5,324**
Minority interest	0	176	196	196	196	196
Total Equity	**3,590**	**3,938**	**3,675**	**4,000**	**4,786**	**5,519**
Non-current Liabilities						
Loans and borrowings	11,281	12,798	13,756	13,756	12,067	11,558
Deferred income	41	34	29	27	20	14
Employees’ service benefits	51	64	74	72	80	88
Total Non-Current Liabilities	**11,373**	**12,896**	**13,859**	**13,855**	**12,167**	**11,660**
Current Liabilities						
Accounts payables & other	1,109	1,864	1,863	1,754	1,863	1,927
Loans and borrowings	774	1,619	468	468	1,601	509
Derivatives	1,202	1,806	2,512	2,512	2,512	2,512
Total Current Liabilities	**3,086**	**5,289**	**4,843**	**4,734**	**5,976**	**4,947**
Equity And Liabilities	**18,048**	**22,123**	**22,377**	**22,589**	**22,929**	**22,126**

Source: Company Data, QNBFS Estimates

Cash Flow Statement

Figures in QAR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
OPERATING ACTIVITIES						
Profit for the year	**945**	**1,167**	**1,073**	**1,419**	**1,516**	**1,569**
Adjustments for:						
Depreciation	409	463	380	509	509	509
Others	71	345	525	689	664	624
	1,424	**1,975**	**1,978**	**2,616**	**2,688**	**2,702**
Changes in working capital	103	(296)	180	91	435	415
Cash from operations	**1,527**	**1,679**	**2,158**	**2,707**	**3,123**	**3,116**
Finance costs paid	(194)	(466)	(539)	(721)	(711)	(683)
Others	(1)	(5)	(2)	(8)	(8)	(8)
Net cash from operating activities	**1,331**	**1,208**	**1,617**	**1,978**	**2,404**	**2,425**
INVESTING ACTIVITIES						
Purchase of PP&E	(4,050)	(1,477)	(220)	(267)	(300)	(300)
Others	96	(519)	(5)	58	8	(80)
Net cash used in investing activities	**(3,954)**	**(1,996)**	**(225)**	**(209)**	**(292)**	**(380)**
FINANCING ACTIVITIES						
Dividends paid	(450)	(512)	(609)	(647)	(731)	(836)
Change in loans and borrowings	3,765	1,068	(192)	(192)	(556)	(1,601)
Others	0	0	0	(5)	0	(0)
Net cash used in financing activities	**3,315**	**555**	**(801)**	**(844)**	**(1,287)**	**(2,437)**
Net decrease in cash and cash equivalents	692	(233)	591	926	825	(392)
Cash and cash equivalents at the beginning of the year	1,615	2,307	2,074	2,074	3,000	3,825
Cash and cash equivalents at the end of the year	**2,307**	**2,074**	**2,665**	**3,000**	**3,825**	**3,433**

Source: Company Data, QNBFS Estimates

Growth Rates

Figures in percentage	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	16.6	29.4	32.8	3.6	2.2
Gross Profit	18.4	30.9	37.1	1.9	1.3
EBITDA	20.6	34.8	37.5	1.8	1.3
EBIT	22.3	43.7	46.6	2.2	1.6
PBT	24.9	23.5	21.6	6.9	3.5
PAT	24.9	23.1	18.7	6.9	3.5
EPS	24.9	23.1	18.7	6.9	3.5

Source: Company Data, QNBFS Estimates

Key Ratios

Key Ratios	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Operating Ratios (%)					
Gross Margin	57.4	58.1	60.0	59.0	58.5
EBITDA Margin	51.4	53.5	55.4	54.4	53.9
EBIT Margin	36.2	40.2	44.4	43.8	43.5
Net Margin	35.6	33.9	30.3	31.3	31.7
Working Capital Ratios (Days)					
Inventory days	88.7	74.8	60.0	60.0	60.0
Average collection period	59.5	154.7	100.0	100.0	100.0
Payable days	356.6	471.5	350.0	350.0	350.0
Finance Ratios					
Debt-Equity Ratio	3.4	3.8	3.7	3.0	2.3
Net Debt-Equity Ratio	2.7	3.3	2.9	2.1	1.6
Interest Coverage	4.9	3.0	2.8	2.9	3.1
Effective Borrowing rate (%)	1.9	3.5	5.0	5.0	5.0
Effective Tax rate (%)	0.0	0.0	0.0	0.0	0.0
Return Ratios (%)					
ROCE	6.1	7.5	11.1	11.2	11.9
Incremental ROCE	2.9	15.5	N/M	19.5	(3.7)
ROE	26.3	30.9	36.3	32.1	28.7
ROA	5.2	5.3	6.1	6.4	6.9
Liquidity Ratios					
Current Ratio	1.6	1.1	2.3	1.7	2.3
Quick Ratio	1.5	1.1	2.1	1.6	2.1
Valuations					
EV/Sales	8.9	7.6	5.5	5.0	4.7
EV/EBITDA	17.3	14.3	10.0	9.3	8.7
EV/EBIT	24.5	19.0	12.4	11.5	10.8
P/E	14.9	12.1	10.2	9.5	9.2
P/BV	3.9	3.7	3.7	3.1	2.6

Source: Company Data, QNBFS Estimates

Qatar Gas Transport Company (QGTS)

Dec. 29, 2011

Recommendation	ACCUMULATE	Risk Rating	R-3
Share Price	QAR17.5	Target Price	QAR20.5
Implied Upside	17%		

Qatar's LNG Nakilat

Deeply linked to Qatar's LNG growth story; exclusive government contracts ensure top-line stability but with flattish absolute EBITDA; declining financial charges to boost bottom-line; strong FCF and attractive valuation.

Highlights

- **Qatar's LNG carrier.** With ~77mtpa in capacity, Qatar is the #1 global LNG player. Nakilat (which means carrier in Arabic) or QGTS, the world's largest LNG ship owner (~16% market share), forms a crucial link between Qatar's gas production and its monetization in the form of LNG exports. QGTS carries virtually all Qatari LNG exports. The state has shown strong support for Nakilat and owns a ~20% stake through 100%-owned government entities.
- **A state-of-the-art fleet.** Since its formation in 2004, QGTS has invested around USD11bn to own 54 state-of-the-art LNG carriers, 25 of which are wholly-owned. 83% of these vessels are of the Q-Max and Q-Flex type, which have the largest capacity in the world. QGTS also jointly owns four LPG ships.
- **Stable revenue due to exclusive government contracts.** QGTS has inked 25-year fixed (price and quantity) charter contracts with the state-controlled LNG producers, Qatargas and RasGas. These agreements result in stable revenue but flattish absolute EBITDA, irrespective of fleet utilization.
- **Declining financial charges to spur EPS growth.** After experiencing a 27% increase in 2011 due to capacity expansion, EPS should improve at a CAGR of 6.4% (2011-2016) largely on the back of declining financial charges. Given the North Field moratorium, we assume no further expansion in QGTS' fleet.
- **25% FCF yield should facilitate debt repayments.** We expect QGTS to generate an average FCF (to the firm) yield of 25% (~QAR2.4bn) over 2011 to 2016. Strong FCF should allow QGTS to comfortably repay its huge debt load of QAR25.1bn (as of Q3 2011) taken for its fleet expansion program.

Catalysts

- **Upside from the shipyard business.** The 6-phased, USD2.8bn project (financed by state-owned Qatar Petroleum) is expected to be fully completed in 2013. Given the lack of guidance, we have assumed marginal contribution from this business in our estimates leaving potential for an upside surprise.
- **LPG growth.** Our model assumes marginal impact from QGTS' LPG JV operations leaving room for an upside if Nakilat decides to expand further.
- **Capacity expansion.** If the North Field moratorium is lifted, QGTS will likely have to expand. However, chances of this before end-2015 are remote.

Recommendation, Valuation and Risks

- **Recommendation and valuation.** *We rate QGTS an Accumulate with a price target of QAR20.5.* Currently, the stock is trading at a discount to its peers.
- **Risks:** 1) Lower-than-estimated price realizations through the JV businesses; 2) Shale gas discoveries in key markets and 3) Limited operating history of the Q-Max and Q-Flex vessels leading to unexpected and prolonged downtimes.

Key Financial Data and Estimates

QAR mn	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue (Net)	1,812	3,023	3,418	3,449	3,480
Net Profit	588	665	846	889	959
EPS (QAR)	1.06	1.20	1.53	1.60	1.73
PE (x)	16.5	14.6	11.5	10.9	10.1
Dividend yield %	2.9	4.3	4.3	4.3	4.3

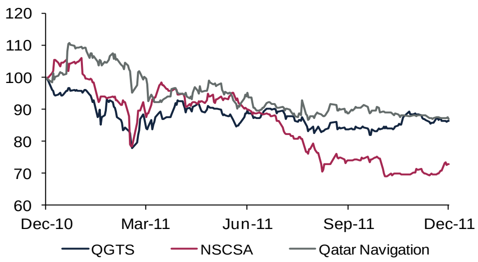
Source: Company Data, QNBFS Estimates

Key Data:

Bloomberg ticker	QGTS:QD
ADR/GDR ticker	N/A
Reuters ticker	QGTS.QA
ISIN	QA000A0KD6L1
Sector	Services
52wk high/52wk low (QAR)	21.6/16.0
3-m average volume ('000)	548.8
Mkt. cap. (USD bn/QAR bn)	2.7/9.7
Shares outstanding (mn)	554
FOL* (%)	24.7
FOL Limit* (mn)	138
1-year total return (%)	(13.6)
Fiscal year end	Dec 31

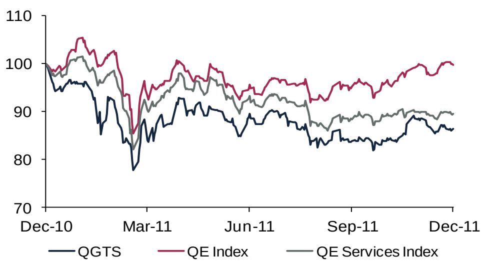
Source: Bloomberg (as of December 15, 2011), *Qatar Exchange

Relative Price Performance vs. Peers



Source: Bloomberg; Note: NSCSA is National Shipping Company of Saudi Arabia

Relative Price Performance vs. Market



Source: Bloomberg; Note: QE Index is Qatar Exchange Index and QE Services Index is Qatar Exchange Services Index

Broker Recommendations

Recommendation	Number
Buy	6
Hold	2
Sell	1

Source: Bloomberg

Executive Summary

The Fuel of Choice

According to the International Energy Agency (IEA), gas is the only fossil fuel whose share in the energy mix is projected to increase by 2035. Demand for gas is set to rise in the emerging markets of Asia and the Middle East and North Africa (MENA) region. While economic growth in countries like China and India as well as the nuclear crisis in Fukushima drives demand in Asia, increasing demand for power generation and water desalination using gas should boost consumption in the MENA region. Despite MENA having almost half of the global gas reserves, it accounts for only around a fifth of the total gas supply according to British Petroleum, pointing to the immense potential from the region in the future.

Qatar was quick to realize the potential of the LNG market. Within MENA, Iran and Qatar represent around 65% of the reserves available in the region. While Iran has the second-largest reserves after Russia globally, the country has not been able to capitalize on this due to political isolation and international sanctions. In contrast, third-placed Qatar has been able to use its non-associated gas reserves in the North Field to position itself as the top liquefied natural gas (LNG) exporter in the world, with current production capacity at roughly 77mn tons per annum (mtpa). With Australia yet to come on-line with its new large LNG projects, Qatar is set to dominate the LNG market in the near-to-medium term, while continuing to remain a key supplier in the long term.

Qatar's LNG Carrier

With a roughly 16% market share of the global LNG shipping tonnage, Nakilat is Qatar's and indeed the world's largest LNG shipping company. QGTS forms a crucial link between Qatar's gas production and its monetization in the form of LNG exports. The company is responsible for shipping virtually all of Qatar's LNG. The state has shown strong support for Nakilat and owns a ~20% stake through 100%-owned government entities.

QGTS has a state-of-the-art fleet. Since its formation in 2004; according to management, QGTS has invested around USD11bn to own 54 state-of-the-art LNG carriers, of which 25 are wholly-owned. 83% of these vessels are of the Q-Max and Q-Flex type, which have the largest capacity in the world. QGTS also jointly owns four LPG ships.

Stable Revenue but Flattish Absolute EBITDA

We expect QGTS to report stable revenue and cash flows irrespective of fleet utilization. Given the cyclical nature of the shipping business and uneven top-lines resulting from global volatility in charter rates, QGTS is in an enviable position. The company enjoys secured revenue streams and guaranteed asset utilization through its 25-year fixed charter contracts for its fully-owned vessels. QGTS has inked these fixed (price and quantity) charter contracts with the state-controlled LNG producers, Qatargas Operating Company (Qatargas) and Ras Laffan Company (RasGas). Thus, the company's wholly-owned vessels are not exposed to the volatility in spot rates. However, on the flip side, these contracts restrict revenue and profitability growth as the top-line only increases with the inflation factor built into the operating costs of wholly-owned vessels. Thus, EBITDA is expected to remain flattish in absolute terms from 2012. With deliveries of all vessels completed by 2010, we expect revenue from wholly-owned vessels to grow by 11.8% in 2011. Beyond 2011, we model revenue from QGTS' 25 wholly-owned ships to stabilize tracking an expected 2.5% inflation adjustment in the operating costs of these vessels. Thus, over the 2011-2016 timeframe, we are forecasting revenue from the wholly-owned vessels to grow at a compound annual growth rate (CAGR) of 0.5%. The jointly-owned vessels operate under a mix of spot and charter contracts. However, the exact details of these charters remain unknown and we model modest growth over our forecast horizon.

EPS should Grow Driven by Declining Finance Charges

We are modeling EPS to grow by 27% YoY in 2011 due to capacity expansion. After 2011, EPS should improve at a CAGR of 6.4% over 2011 to 2016 largely on the back of declining financial charges. It is pertinent to note that we do not model in any further expansion of QGTS' fleet. While the expected EPS growth may not look that impressive, we would point to the company's stable and visible business model as a mitigating factor.

Impressive Expected FCF Yield of ~25% Should Facilitate Debt Repayments

We expect QGTS to generate an average FCF (free cash flow to the firm) yield of 25% (~QAR2.4bn) over 2011 to 2016. In our model, the growth in FCF is coming from higher operating cash flows as well as a reduced need of capital expenditures in the coming years. To expand rapidly, QGTS has borrowed in excess of QAR25bn and strong FCF should allow the company to comfortably repay its huge debt load.

Q3 2011 Results

In Q3 2011, QGTS improved its net income by ~42% YoY and 26% QoQ. Revenue from wholly-owned vessels increased 11.3% YoY and 8.6% QoQ. Gross profits from wholly-owned vessels also grew by 8.6% YoY and 7.4% QoQ. Income from marine and agency service rose by more than 29% YoY and around 10.4% QoQ. Interestingly, the company's share of profits from joint ventures (JVs) fell sequentially by almost 10% despite growing by 6.1% on a yearly basis. Finance costs remained upwardly sticky given the fixed rates entered through interest rate swaps and the significant debt on the balance sheet. Gains on derivatives from JVs also posted QAR20mn in Q3 2011 further aiding the bottom-line of the firm.

Catalysts

Shipyard Business Could Support Further Growth

Nakilat is aggressively trying to diversify and increase its revenue sources. Given its experience in the shipping business, the company has ventured into construction of small, high-value vessels along with maintenance of ships in the Ras Laffan Port. The 6-phased project is underway at an estimated cost of USD2.8bn, which has been fully financed by state-owned Qatar Petroleum (QP). The project is a joint venture between Nakilat, Damen Shipyards and Keppel Offshore & Marine. Upon completion in 2013, the shipyard will provide crucial vessel maintenance services to Qatari vessels reducing dependence on shipyards abroad. Further, Nakilat's LNG carriers will occupy only 25% of the yard's repair and maintenance capacity leaving the majority for repair of other vessels on a commercial basis. With around 4,000 vessels expected to call at Ras Laffan by 2020, the remaining 75% capacity can serve as a significant source of income. Phase 1, 2 and 4 of the project were inaugurated in November 2010, while work is in progress for the completion of the remaining phases. The shipyard will be able to serve more than 150 ships a year once all the phases are completed. Given the lack of guidance, we have assumed marginal contribution from this business in our estimates leaving potential for an upside surprise.

LPG Growth Could Drive Upside

Our model assumes marginal impact from QGTS' LPG JV operations leaving room for upside if Nakilat decided to expand further. Nakilat has a JV with Qatar Shipping Company (now a wholly-owned subsidiary of Qatar Navigation or QNNS) that provides shipping services to the state-owned liquefied petroleum gas (LPG) firm Tasweeq. Currently, this JV operates four LPG vessels. Comments made by Nakilat's managing director, Mohamed Ghannam, suggest that a majority of LPG sales happen on a free-on-board (FOB) basis, where the customers provide the transportation of the LPG themselves. QGTS could try to change this arrangement and provide the transport of LPG. This would require the company to expand its LPG fleet and could provide upside to our model.

Lifting of the North Field Moratorium Could Lead to Capacity Expansion

If the North Field moratorium is lifted, QGTS will likely have to expand. However, chances of this happening before end-2015 are remote. Thus, we have not incorporated any fleet expansion in our model.

Valuation

Our target price of QAR20.5 per share implies an upside of 17% on the stock. We have arrived at the fair value of QGTS using a blend of discounted cash flow (DCF), sum-of-the-parts (SOTP) EV/EBITDA multiple and P/E multiple methodologies. We have assigned more weight to the DCF method given that it reflects the company's long-term cash generating potential.

Valuation Summary

Valuation summary	Value (QAR)	Weights	Fair Value (QAR)
DCF	19.5	70%	13.7
SOTP (EV/EBITDA multiple)	23.2	15%	3.5
P/E multiple	22.1	15%	3.3
Target Price			**QAR 20.5**
Potential Upside/Downside			17%

Source: Bloomberg, QNBFS Estimates

Discounted Cash Flow (DCF)

Our DCF valuation reveals a fair value of QAR19.5 per share. We expect the company's top-line from wholly-owned vessels to just track inflation in operating expenses (of around 2.5%) from 2012 onward. We have been conservative in our modeling and have not assumed any expansion of Nakilat's fleet in the future. Our estimates for the company's JV vessels (modest inflation in rates) and shipyard business (lack of clear guidance) also remain fairly subdued. We explicitly model cash flows until 2016 and use a terminal growth rate of just 0.5%. While we can justify using a zero terminal growth rate, we chose to use a 0.5% rate instead. This implicitly assumes some improvement in cash flows and margins from wholly-owned vessels in the future, which can happen if the charters are renegotiated to include an inflation factor for the capital element. The DCF derived fair value drops to QAR17 if we assume a zero terminal growth rate.

DCF Valuation

Particulars	Fair Value of Equity (QAR mn)	Fair Value per share (QAR)
PV of FCFF	9,335	
PV of Terminal Value	20,835	
PV of Cash Flows	**30,170**	**54.5**
Add:		
Cash Balances	2,576	4.7
Investment in joint venture companies	1,905	3.4
Loans to joint venture companies	1,152	2.1
Available-for-sale investments	119	0.2
Less:		
Debt balances	25,116	45.3
Minority interest	5	0.01
Fair Value of Equity	**10,800**	**19.5**

Source: QNBFS Estimates

Our WACC assumptions remain fairly conservative. For weighted average cost of capital (WACC) calculations, we have assigned a weight of 35% to equity and 65% to debt based on our expectation of the company's long-term capital structure (QGTS' current market capitalization is around 27.5% of the total debt and market capitalization). We also use an emerging market risk premium of 8% and a beta of 1.0. This results in a WACC of almost 8%.

WACC Analysis

WACC calculations	
Risk free rate (Estimated yield for 10-year government bonds) (%)	4.5
Risk premium (%)	8.0
Beta	1.0
Cost of Equity (%)	**12.5**
Cost of Debt (%)	**5.5**
Tax rate (%)	0.0
WACC (%)	**8.0**

Source: Bloomberg, QNBFS Estimates

Sensitivity Analysis

We have performed sensitivity analysis on the WACC and terminal growth rate. As per the sensitivity analysis table, a reduction in WACC by 50 basis points (bps) increases QGTS' fair value by 19.9%, while a 25bps increase in the terminal growth rate increases the fair value by 7.2%. The results of our sensitivity analysis are depicted below:

Sensitivity Analysis

Terminal growth rate / WACC	0.00%	0.25%	0.50%	0.75%	1.00%
7.0%	24.4	26.0	27.9	29.8	31.9
7.5%	20.4	**21.8**	**23.4**	**25.0**	26.8
8.0%	17.0	**18.2**	**19.5**	**20.9**	22.4
8.5%	13.9	**15.0**	**16.1**	**17.3**	18.6
9.0%	11.2	12.1	13.1	14.2	15.3

Source: QNBFS Estimates

Relative Valuation

QGTS remains attractive versus its peers. We have valued the business segments of the company on an individual basis, applying the third-quartile 2012 EV/EBITDA multiple of comparable global players in each segment. We have used the third-quartile multiple given QGTS' near-monopoly status when it comes to shipping Qatar's LNG. Additionally, we have also valued Nakilat using the third-quartile P/E multiple of comparable global players. Our SOTP EV/EBITDA and P/E relative valuation techniques leads to the following conclusions:

SOTP EV/EBITDA Analysis

	EBITDA (QAR mn)	EV/EBITDA Multiple	EV (QAR mn)	Value (QAR)
Wholly-owned business	2,462	13.1x	32,220	58.2
Add:				
Cash Balances			2,576	4.7
Investment in JVs			1,905	3.4
Loans to JVs			1,152	2.1
Available-for-sale investments			119	0.2
Less:				
Debt balances			25,116	45.3
Minority interest			5	0.0
Total equity value			**12,850**	**23.2**

Source: QNBFS Estimates

P/E Analysis

Particulars	EPS (QAR)	P/E Multiple	Value (QAR)
2012 EPS	1.60	13.8x	22.1

Source: QNBFS Estimates

EV/EBITDA Multiples (x)

Company name	FY08	FY09	FY10	FY11e	FY12e
Qatar Gas Transport*	N/M	19.9	12.9	11.4	11.0
National Shipping Co of Saudi	N/A	12.0	10.9	15.6	12.7
Qatar Navigation	25.3	N/A	15.6	14.0	10.6
Teekay LNG Partners LP	21.2	19.6	16.8	16.2	14.1
China Shipping Development Co	4.5	12.4	10.4	11.0	7.7

Source: Bloomberg, *QNBFS Estimates using Adjusted EBITDA

P/E Multiples (x)

Company name	FY08	FY09	FY10	FY11e	FY12e
Qatar Gas Transport*	75.2	16.5	14.6	11.5	10.9
National Shipping Co of Saudi	N/A	9.1	8.0	16.5	12.8
Qatar Navigation	8.4	10.4	11.1	10.7	8.0
Teekay LNG Partners LP	32.7	23.3	18.5	20.0	16.1
China Shipping Development Co	3.5	15.6	10.5	16.4	13.0

Source: Bloomberg, *QNBFS Estimates

Risks to Our Target Price

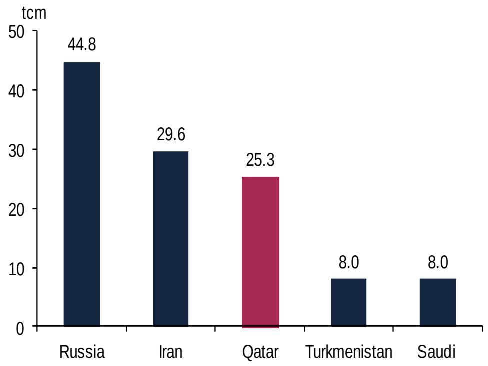
- **Lower-than-estimated price realizations from shipping JVs.** QGTS has watertight agreements with gas producers for its wholly-owned vessels. However, there is a general assumption that the same applies to the JVs as well. Thus, any adverse changes in the contract terms of the JVs could impact margins and our target price. We note that given the strength expected in charter rates in the near-to-medium term, QGTS' shipping JVs stand to benefit. However, future volatility in spot rates cannot be ruled out.
- **Shale gas discoveries.** Shale gas has changed the market dynamics of the North American market with gas prices trading at a steep discount to Asian prices. LNG importers have been actively pursuing shale gas technology to reduce their dependence on imports. Success of shale gas in the consumer markets could lead to lower demand of Qatari LNG. Shale gas, however, is not without its issues with environmental concerns being at the top of that list. A significant amount of shale gas reserves are located in populated areas in North America and Europe and there are concerns about the contamination of water supplies caused by the extraction of these reserves.
- **Limited operating history of new LNG vessels.** QGTS has heavily invested in new Q-Max and Q-Flex ships due to their size and operational efficiencies. However, given that these vessels have a very brief operating history; unexpected and prolonged downtimes cannot be ruled out.

LNG Industry

Global LNG Market and the Role of Qatar

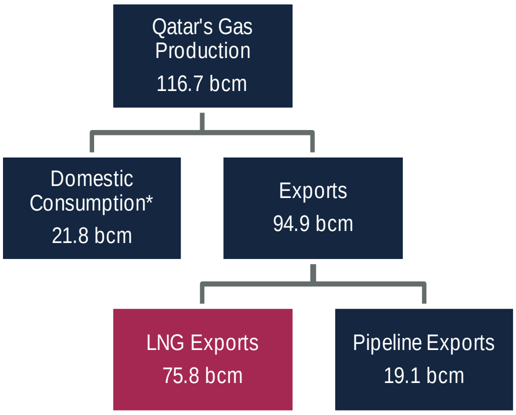
Qatar has the third largest reserves of gas (894 trillion cubic feet) globally after Russia and Iran. Most of this comes from the giant North Field, which is the largest non-associated gas field discovered to-date. Qatar operates fourteen trains for processing natural gas into LNG (including six mega-trains). The country is now the top LNG exporter in the world (65% of the gas produced in 2010 was exported as LNG, while 16% was exported through the Dolphin pipeline to the UAE). According to British Petroleum, LNG accounted for 30.5% of the global gas trade in 2010 with Qatar holding a 25.5% market share.

Gas Giants – Proven Gas Reserves



Source: BP – Statistical Review of World Energy 2011

Qatar's Gas Production and Exports, 2010



Source: BP – Statistical Review of World Energy 2011; Note: *∆ of production and exports taken as domestic consumption

Qatari LNG production capacity is expected to remain at ~77mn tons per annum (mtpa) over the medium-term. The Barzan project, which is the last announced significant project in Qatar for natural gas production, is expected to produce 1.4 billion cubic feet a day (bcf/d) when it becomes fully operational by 2015. However, this production will be used for meeting the energy needs of Qatar rather than for exports. Hence, we envisage LNG production capacity for export to remain at around 77mtpa until the country lifts its moratorium on new projects in the North Field (not expected before the end of 2015) or makes significant gas finds in other regions within the country. We detail some ongoing exploration prospects below:

- In 2009, Qatar entered into an agreement with CNOOC for the development of Block BC in which three wells are planned to be drilled by 2014. Total S.A. acquired a 25% stake in this project in May 2011.
- Block D was the next to follow in May 2010 with Shell and PetroChina. The Exploration and Production Sharing Agreement (EPSA) is for a period of 30 years with the first five years allocated for exploration. QP will off-take any potential gas produced under this agreement.
- In May 2011, QP signed a 30-year agreement with JX Nippon Oil & Gas Exploration Corp. for the development of Block A at an initial investment of USD100mn. According to recent press reports, JX Nippon is seeking a partner to explore this block.

The UK and emerging Asia are key LNG markets for Qatar. In the past, Japan and South Korea were the largest customers of Qatari gas. However, the UK overtook Japan, as the top export market at 10.2mn tons in 2010, followed by India at 7.7mn tons. Japan and South Korea came next at 7.5mn tons each. While China only received around 1.6bcm of Qatari LNG in 2010, it has the potential to become a major market in the future. The first regular LNG exports to China began last month, and PetroChina has a contract for 3mn tons with Qatargas. There are also further preliminary agreements with PetroChina and China National Offshore Oil, for up to 12mn tons in deliveries. Sinopec has also evinced interest in receiving Qatari LNG. It is unclear how much of these additional volumes will be contracted, and on what timescale, but clearly China will become a major market.

Qatar should increasingly enjoy flexible LNG sales contracts. The vast majority of Qatar's LNG is still sold through sales and purchase agreements (SPAs), rather than on the spot LNG market. However, as QNB Capital in its "Qatar – Economic Insight" report points out, these SPAs now include clauses with more price flexibility, which allow cargoes to be diverted if the buyer is oversupplied. This flexibility has helped Qatar to explore investment opportunities in regasification terminals, which can receive Qatar's exports and explore new export markets. For example, Qatar has been nimble in diverting its LNG from an oversupplied US to countries such as China and Japan. The state has also entered new markets, signing a long-term agreement with Argentina and is also sending LNG cargoes to Brazil. Qatar is continuing to consider other potential export markets in South America and the Caribbean.

LNG is the World's Fastest Growing Fuel

LNG has been the fastest growing fuel over the past decade (registering consumption growth at a CAGR of around 8% during 2000 to 2010) compared to conventional fuels. Total LNG trade of 297.6 billion cubic meters (bcm), though small at 2.2% of the total energy consumed, grew at the fastest rate among fuel types at 22.6% YoY in 2010. With limited pipeline supply growth over the medium-term and mushrooming LNG regasification terminals across the globe, we expect this trend to continue.

Historically, pipelines dominated the transportation of natural gas. LNG trade began in the 1960s with exports being made to Europe. However, by the late 60s, the focus shifted to Asia driven by Japanese utilities, followed by Korea and Taiwan. In 2010, pipeline trade accounted for 69.5% of the global gas trade (678bcm) and LNG represented the remaining 30.5%. Though pipeline trade will continue to dominate in the future, LNG will see a faster growth. As per the IEA, natural gas trade is expected to increase by 620bcm split between pipelines and LNG almost evenly at 330bcm and 290bcm, respectively, by 2035. These estimates assume that new pipeline projects will commence as per schedule. However, we believe that the share of pipeline trade could be lower due to cross-border political uncertainties leading to delays.

LNG regasification terminals are mushrooming across the globe. Regasification terminals are being set up around the world at a rapid clip and around 69bcm of new regasification capacity is expected to come on line in 2011. Almost 40% of this capacity is expected to be derived from Asia, with 20 terminals being built in various countries (China: 6, India: 2, Indonesia: 3 and Malaysia: 2). In Europe, terminals are being set up in the Netherlands and Poland over the next 3-4 years, while Sweden has recently opened a terminal at Nynashamn in May 2011.

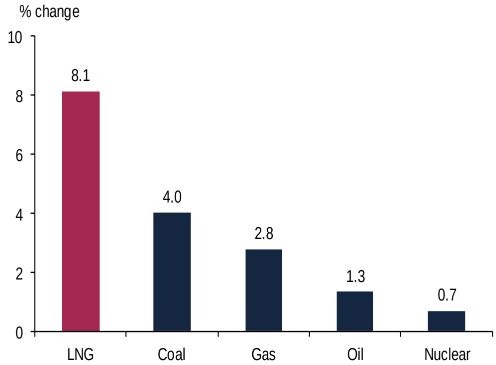
LNG Demand is on the Upswing …

We believe that there are secular tailwinds boosting LNG demand. These include:

- **Significant demand is expected from China and India.** According to the IEA, although China is expected to be one of the top producers of natural gas (unconventional) by 2020, the country will continue to rely heavily on imports. Imports are expected to increase from 5bcm in 2008 to 150bcm by 2020 in order to meet demand. India will also transform from being a small gas importer at 10bcm to importing around 100bcm during the same period.
- **Traditional LNG consumers, Japan and South Korea, will remain import markets.** Japan and South Korea have been the prime LNG consumers accounting for nearly half (46.4% in 2010) of the global LNG consumption. Post the earthquake and the nuclear crisis in Fukushima in March 2011, demand for LNG has increased sharply in Japan. South Korea expects natural gas demand to increase at a CAGR of 1.8% between 2009 and 2024 to 34.12 million tons. Going forward, South Korea will need to secure additional supplies as its contracted supply declines.
- **LNG is seen as a safer alternative to nuclear fuel.** Expanding on the previous point about Japan, post the nuclear crisis, many countries have been revising their plans to add nuclear capacity as a means for power generation. Prominent among these have been Germany (planned phase-out of all nuclear plants by 2022), Switzerland (phase out by 2034) and Italy (Italian voters rejected the June referendum for renewing nuclear power). LNG will be a reliable and clean source of fuel to facilitate the transition from nuclear power to alternative fuel sources in the future (for instance, in Germany).

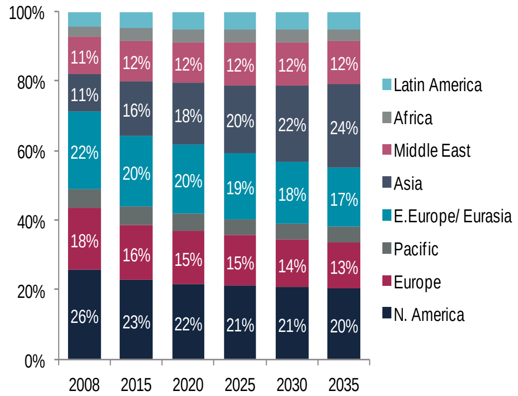
- **New markets are emerging in the GCC.** Rapid population growth, rising affluence, subsidized supply and economic diversification away from hydrocarbon production are leading to high demand for energy across the Gulf Cooperation Council (GCC) region. With the exception of Qatar and Saudi (in the near-term), all GCC countries are facing a gas shortage and have turned into net importers of gas. Demand for gas in the Middle East is expected to nearly double by around 300bcm, reaching 632bcm by 2035, rivaling that of China. Qatar, being the largest LNG exporter, will benefit from the rising imports of gas by the neighboring countries.
- **LNG enjoys all the benefits of natural gas.** We provide more details on the benefits of LNG versus other fuel sources at the end of this industry section.

Fuel Consumption Growth (CAGR 2000-2010)



Source: BP – Statistical Review of World Energy 2011, BP Energy Outlook 2030

Global Gas Demand Changes



Source: IEA, Golden Age of Gas, June 2011

… While Global LNG Supply is Tightening in the Medium Term

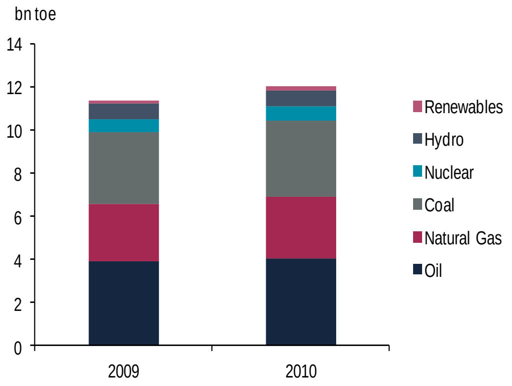
We expect the LNG market to be supply constrained over the medium term. Supply could be constrained due to a self-imposed moratorium on new developments in the North field and new Australian LNG projects (like Gorgon) taking at least another three years to commence production. We believe that the potential demand supply mismatch could exert upward pressure on LNG pricing in the near term. We explain the factors underpinning our view on future LNG supply below.

- **Moratorium for new projects in the North Field will crimp LNG capacity growth**. Qatar announced a self-imposed moratorium in 2005 on new developments in the North field to allow time to assess the quality of its reserves. The moratorium on new allocations, initially for three years (until 2008), has been extended and is now unlikely to be lifted before the end of 2015. This will result in a slowdown in global supply growth over the next two to three years before the Australian LNG projects come on line.
- **Australian LNG projects may be affected by labor shortages.** Australia has significant aspirations when it comes to LNG but the majority of Australian projects will start operations only from 2014. However, these projects face the risk of construction delays and cost escalations due to paucity of skilled labor, which is in high demand for competing large-scale projects. Australia is set to become the first coal bed methane (CBM)-based LNG exporter, with two projects – Gladstone LNG and Queensland Curtis – and more planned. However, these projects would have to address sensitive environmental and water management issues.

Advantages of LNG

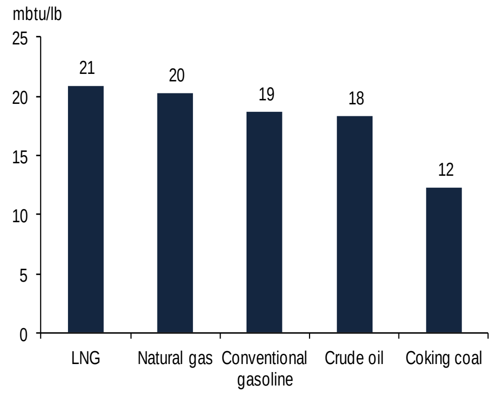
LNG is a cleaner and more efficient source of energy compared to other conventional fuels. LNG is the super-cooled form of natural gas and hence retains the benefits of natural gas. Natural gas is universally regarded as a cleaner and more efficient fuel than coal or crude oil for producing energy. Natural gas also has diverse applications, including use as a feedstock for petrochemical and metal production, use in the construction sector for welding and cutting, use in the residential sector for cooking, heating and air-conditioning and as a fuel in the transport sector. Causing less pollution than other fuels, natural gas is ideal for industries like food processing, glass and paint manufacturing. In terms of net calorific value, LNG produces the highest amount of energy per unit among conventional fuels.

Natural Gas – Fastest Growing Fossil Fuel



Source: BP – Statistical Review of World Energy 2011

Fuel Comparison (Net Calorific Value)



Source: IEA, Golden Age of Gas, June 2011

With Qatar expected to remain a dominant player in the global LNG market, we feel that QGTS, which acts as a crucial link between Qatar and the rest of the world, provides investors exposure to Qatar's gas growth story.

Company Background

Company Description

Qatar's LNG carrier. QGTS or Nakilat is engaged in the ownership and management of a fleet of vessels for transportation of natural gas and its derivatives. With a total effective LNG shipping capacity of ~8.6mn cubic meters, the company owns 16% of the global LNG shipping capacity. Apart from LNG, QGTS also jointly owns 4 vessels for transporting LPG. Nakilat enjoys stable revenue and cash flows due to long-term (25 years) and fixed-rate time charter contracts with Qatargas, RasGas and Tasweeq.

Company Snapshot

No. of LNG vessels (including 29 jointly-owned vessels)	54	S&P rating	AA-
No. of LPG vessels	4	Total assets –2010 (QAR bn)	220

Source: Company Data

Management Team

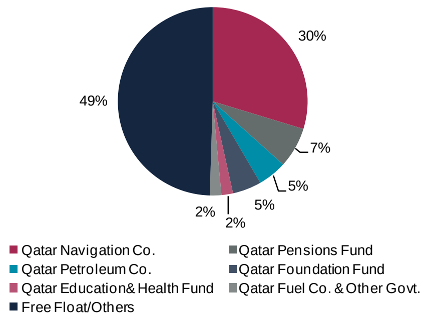
Name	Designation
Hamad Rashid Al Mohannadi	Chairman
Khalid Bin Khalifa Al Thani	Vice Chairman
Mohammed Ghannam	MD
Eddy Saputra	CFO
Martin Ronald	Fleet Director
Mukul Sinha	Fleet Op. Manager

Source: Company Data, Zawya

Company History

QGTS was incorporated in 2004 to address the needs for shipping large quantities of LNG that was being produced by Qatar to be exported across the globe. Since then, the company has built up its fleet of vessels to become the largest LNG carrier in the world. The company has also entered into related businesses, including shipyard management and building of high-value ships. QGTS provides maintenance and docking services for vessels besides operating harbor vessels at the Ras Laffan Port.

Major Shareholders



Source: Company Data

Project and Contract Announcements (Since 2010)

Date	Contract value	Contract details
16-May-11	N/A	Nakilat-Keppel Offshore & Marine Ltd. received it the first Qatargas-chartered vessel, 'Al Wakrah' for general maintenance work at its Erhama Bin Jaber Al Jalahma Shipyard.
26-Apr-11	QAR59mn	Contracts with Gulf Drilling International for offshore jack-up rig repair and upgradation until August 2011.
31-Mar-10	N/A	Contract with Qatar Petroleum for the provision of 19 vessels including harbor tugs, pilot and service boats.
30-Mar-10	N/A	Contract with Qatar Emiri Naval Forces for the construction of 6 naval patrol boats in a JV with Damen Shipyards.
30-Mar-10	N/A	Contract with Qatari Navy for ship repair & maintenance services in a JV with Keppel Offshore & Marine Ltd.

Source: Company Data

M&A Announcements (Since 2010)

Date	Value	Details
21-Jan-10	N/A	JV (70% owned by Nakilat) with Damen Shipyards Qatar Holding B.V. to operate a shipbuilding facility.

Source: Company Data

Business Profile, Subsidiaries/Joint Ventures and Segments

Business Profile

Sailing on Qatar's LNG story. QGTS has been created exclusively for the purpose of exporting Qatari LNG to the rest of the world. The company has a secure future, given the fact that Qatar will continue to remain one of the top gas exporters in the world going forward.

Subsidiaries

Nakilat Inc. was founded in April 2006, as a wholly-owned subsidiary of QGTS, for the sole purpose of obtaining financing for acquiring wholly-owned LNG vessels.

Nakilat Shipping (Qatar) Ltd. was incorporated in March 2007 as a wholly-owned subsidiary of QGTS. This subsidiary manages the operations of all wholly-owned LNG vessels of QGTS and the LPG vessels owned by Gulf LPG Transport Company W.W.L.

Nakilat Agency Company Ltd. was incorporated in May 2005 as an exclusive agent for all local and international ships arriving at the Ras Laffan Port. QGTS holds a 95% shareholding in this subsidiary, while Qatar Petroleum (QP) has the remaining 5%.

Other subsidiaries include Nakilat Marine Services, QGTC Nakilat Investment and QGTC Nakilat Holding.

Joint ventures

Nakilat Damen Shipyards Qatar Ltd.: Incorporated in July 2010, this 70%-owned JV with Damen Shipyards Group manages the ship building facility for the construction of high-value ships at the Ras Laffan Port shipyard.

Nakilat-Keppel Offshore & Marine Ltd.: Incorporated in November 2008, this JV with Keppel Offshore & Marine Limited is engaged in the development and management of the shipyard facility at the Ras Laffan Port. QGTS owns an 80% stake in this JV.

Nakilat Svitzerwijsmuller W.L.L.: Formed in September 2006, this JV with Svitzer Middle East Limited owns and operates tug boats, pilot boats and other harbor vessels at the Ras Laffan Port. This JV was signed following the award of a 22-year exclusive service contract to QGTS for harbor-towage and mooring services by QP. QGTS holds a 70% stake in this JV.

Apart from the above JVs for managing vessel-related activities in the Ras Laffan Port, QGTS has formed additional JVs with other shipping operators. The company's share in these JVs range between 20%-60%, leading to an average ownership stake of 43%. The following is a summary of the QGTS' other JVs as of end-2010:

Other Joint Ventures

Joint Venture Name	Ownership	No. of vessels	Vessel Type	Chartered to
Gulf LPG Transport Company W.L.L.	50% QGTS, 50% Qatar Shipping Company	4	VLGCs for LPG	Mitsui O.S.K. Lines, Ltd
Maran Nakilat Company Limited	30% QGTS, 70% Maran Ventures Inc	4	Conventional	RasGas
Peninsula LNG Transport No.4 Ltd.	30% QGTS, 70% J4 consortium	1	Conventional	RasGas
Teekay Nakilat Corporation	30% QGTS, 70% Teekay	3	Conventional	RasGas
OSG Nakilat Corporation	50.1% QGTS, 49.9% OSG International Inc.	4	Q-Flex	Qatargas
QGTC Nakilat (2245-8) Investment Ltd.	45% QGTS, 54% German commercial partners, 1% Pronav	4	Q-Flex	Qatargas
J5 Nakilat No.1 to No.8 Ltd Companies	40% QGTS, 60%, J5 Consortium	8	Q-Flex	RasGas
Teekay Nakilat (III) Corporation	60% QGTS, 40% Teekay	4	Q-Flex	RasGas
India LNG Transport Company (No.3) Limited	20% QGTS, 80% Others	1	Conventional	Petronet

Source: Company Data

Fleet Details

QGTS has three different kinds of vessels for its operations – Conventional, Q-Flex and Q-Max. Both Q-Flex and Q-Max ships consume 40% less energy than the conventional type. The higher capacity of these vessels (50%-80%) as well as new technical features (such as membrane containment systems, re-liquefaction systems and advanced propulsion technology) has led to a reduction in transportation costs by 20-30%. All the vessels have been chartered to Qatar's LNG producers, RasGas and Qatargas to deliver LNG mainly to the UK, Japan, Korea, Spain and China.

Nakilat's LNG vessels are operated and managed through a strategic alliance with Shell International Trading and Shipping Company (STASCO). QGTS entered into a master services agreement with STASCO in 2006, under which the latter agreed to provide a number of key shipping services, including initial handling of the technical management of the wholly-owned LNG vessels. This agreement has a provision for STASCO to hand over the management of these vessels to QGTS between 2018 and 2022. While benefiting from the operating expertise of STASCO, this agreement will allow Nakilat to develop the expertise to manage and operate its LNG fleet in the future.

QGTS Vessels as of December 2010:

Vessel type as of 2010	Number	Capacity
Wholly Owned		
Q-Max	14	263,000 - 266,000 m^3
Q-Flex	11	210,000 - 216,000 m^3
Jointly Owned		
Q-Flex	20	210,000 - 216,000 m^3
Conventional	9	145,000 - 154,000 m^3
LPG Conventional	4	82,200 m^3
Total	**58**	

Source: Company Data

Name List of Wholly-Owned Vessels:

Q-Max	Q-Flex
Moa	Mesaimeer
Umm Slal	Al Sheehaniya
Al Ghuwairiya	Al Ghashamiya
Bu Samra	Al Sadd
lijmiliya	Onaiza
Al Samriya	Al Kharaitiyat
Al Mayeda	Al Rekayyat
Mekaines	Al Khattiya
Al Mafyar	Al Karaana
Al Dafna	Al Nuaman
Shagra	Al Bahiya
Zarga	
Aamira	
Rasheeda	

Source: Company Data

Shipyard Facility

The Erhama Bin Jaber Al Jalahma Shipyard in Ras Laffan port is being developed in phases since late 2007. Three phases were completed in 2010 while the remaining phases are expected to complete gradually by 2013. Upon completion the shipyard will occupy around 110 hectares of land reclaimed from the sea as part of the expanded Ras Laffan port. Nakilat has created a special task force comprising team members from QGTS, QP and other strategic partners to manage the progress of the shipyard. The below table summarizes the commercial activities that will be created as each phase is completed:

Phase	Activity	Completion
Phase 1	Repair and conversion of very large ships	Q4 2010
Phase 2	Repair of medium-sized ships (e.g. 20,000 dwt* to 80,000 dwt)	Q4 2010
Phase 2A	Addition of a Q-Max sized floating dock for ship repair	Q2 2014
Phase 3	Fabrication and maintenance of offshore structures (and components for land-based petrochemical plant)	N/A
Phase 4	Construction of high value small ships (< 120m length)	Q4 2010
Phase 4A	Addition of a hall for finishing and re-fit of "super-yachts" and military vessels.	Q3 2012
Phase 5	Repair of small ships (< 20,000 dwt)	Q2 2012
Phase 6	Production of FRP** boats (Commercial & Leisure)	Q3 2013

Source: Company Data; Note: *dwt: dead weight tons, **FRP: Fiber reinforced plastic

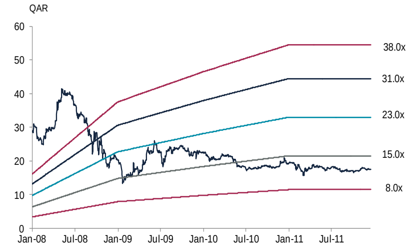
Key Forecasts

Revenue

We expect revenue from wholly-owned vessels to remain flattish thanks to the fixed long-term charters with Qatargas and RasGas. With deliveries of all vessels completed by 2010, we expect revenue to grow by 11.8% in 2011. Beyond 2011, we model revenue from QGTS' 25 wholly-owned ships to stabilize tracking an expected 2.5% inflation adjustment in the operating costs of these vessels. Thus, over 2011 to 2016, we are modeling revenue from the wholly-owned vessels to grow at a CAGR of 0.5%. Fixed long-term take-or-pay agreements with Qatargas and RasGas will guarantee a secured revenue stream as well as full utilization of these vessels.

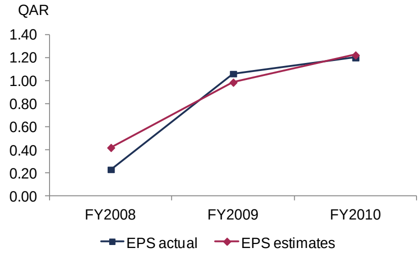
Income from marine and agency services and share of operating profits from JVs should show decent growth going forward. After an anticipated growth of 20% in 2011 (up 24.6% YoY as of nine months ended September 2011), income from marine and agency services is modeled to grow from QAR30mn in 2010 to QAR47mn by 2016 (2010-2016 CAGR of 7.7%). Nakilat's share of operating profits from JVs, which includes vessels deployed under JVs and the company's shipyard business, is projected to grow at a CAGR of 6.8% from QAR248mn in 2010 to QAR368mn by 2016. We expect share of profits from JVs to improve with modest increases in charter rates for jointly-owned vessels over our forecast period. We note that our estimates are likely to remain conservative given the lack of guidance regarding the full potential of the shipyard business. Overall, we model net revenue from these two segments to grow at a CAGR of 6.9% over 2010 to 2016.

1 Year Forward P/E Band



Source: Bloomberg

Earnings Surprise



Source: Bloomberg

Profitability

EBITDA should remain flattish in absolute terms from 2012. Looking ahead, QGTS' revenue from wholly-owned vessels should track the growth in operating expenses in absolute terms. As a result, we predict gross profits of wholly-owned vessels to remain at around QAR2.5bn from 2011 to 2016. EBITDA, as a result, should also remain flattish. Adjusted EBITDA, which includes operating profits from JVs, should grow at a CAGR of 2.2% over 2010-2016.

We expect net profit margins to improve from 2011 onward on account of lower finance charges. Based on our analysis of the company's 2010 debt disclosures, we assume repayments of almost QAR900mn per year as QGTS repays its debt from cash generated from operations. RoA and RoE stood at roughly 2% and 19% in 2010, respectively. We expect both RoA and RoE to improve, reaching almost 4% and 26%, respectively, by 2016.

Capacity

Further capacity growth will be dependent on the moratorium in the North Field being lifted in end-2015. As QGTS completed its huge expansion program in 2010, we believe the company will make investments in new vessels only if the North Field moratorium is lifted.

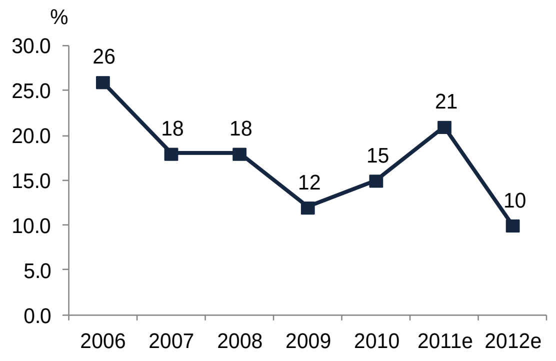
Financial Position

With limited capital expenditures and stable cash flows, we expect the net debt-to-equity ratio to decline significantly by 2016. Capital expenditures dropped by 86% YoY to roughly QAR0.8bn in 2010, as all ship deliveries were received in 2010. Capital expenditures YTD have been a minimal QAR2mn. As a result, the FCF yield (to the firm) is expected to average around 25% from 2011 to 2016. QGTS is highly leveraged with a debt-to-capital ratio and a net-debt-to-equity ratio of 95% and 18.5x, respectively, as of Q3 2011. However, we note the following mitigating factors:

- **Currently, only 3.9% of the debt is short-term in nature.** Moreover, given the stable cash flows expected from QGTS' 25-year fixed contracts, servicing this debt does not pose a challenge, in our view. Q3 2011 cash and bank balances of QAR2.6bn remain more than adequate to cover short-term debt of QAR968mn.
- **Our conservative model predicts net-debt-to-equity to decline to 4.1x by 2016.** The debt-to-capital ratio should also decline to 82% by 2016. Moreover, S&P recently affirmed QGTS' investment grade credit rating of AA- (Stable Outlook).

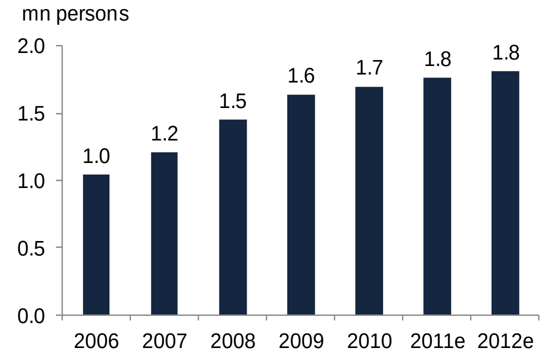
Overview: Qatar & QGTS

Qatar – Real GDP Growth



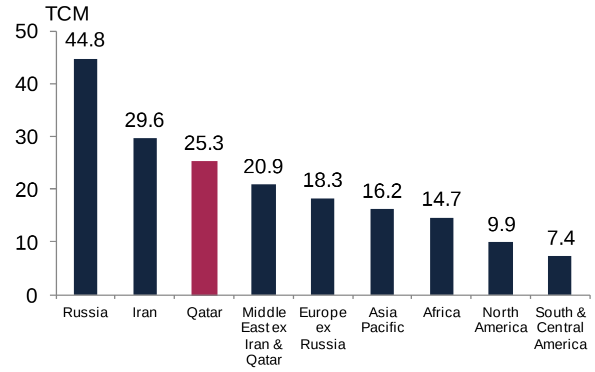
Source: QNB Capital Estimates

Qatar – Population



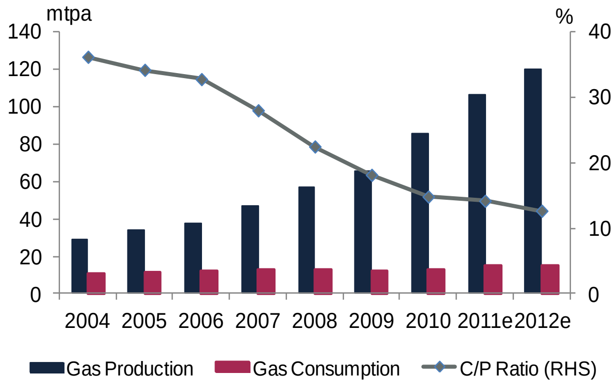
Source: QNB Capital Estimates

Global Proven Natural Gas Reserves



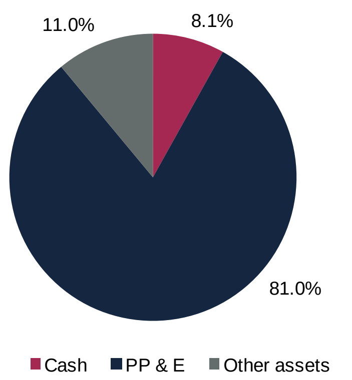
Source: BP Statistical Review 2011

Qatar – Gas Production and Consumption



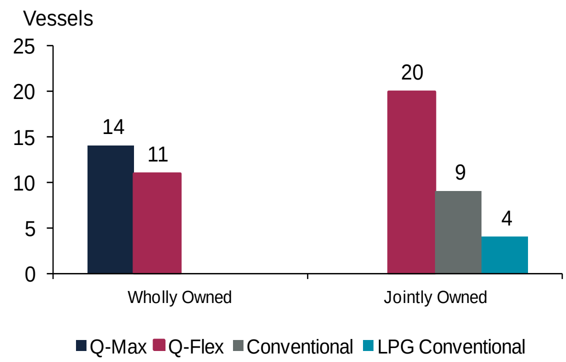
Source: QNB Capital Estimates; Note: C/P = Consumption/production

QGTS – Asset Mix as of Q3 2011



Source: Company Data

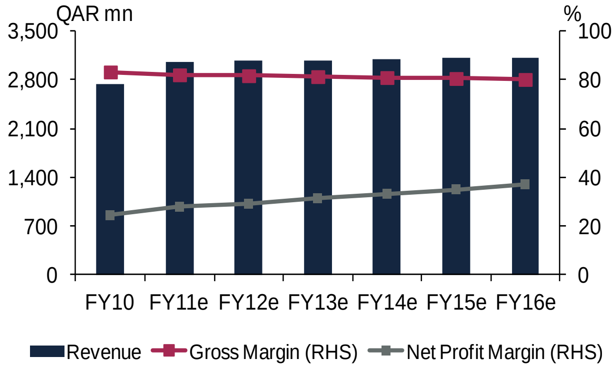
QGTS – Fleet Details



Source: Company Data

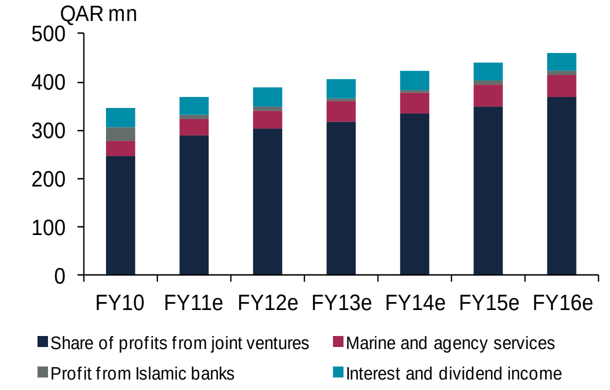
Financial Analysis: Revenue, Returns and Capex

Revenue and Margins



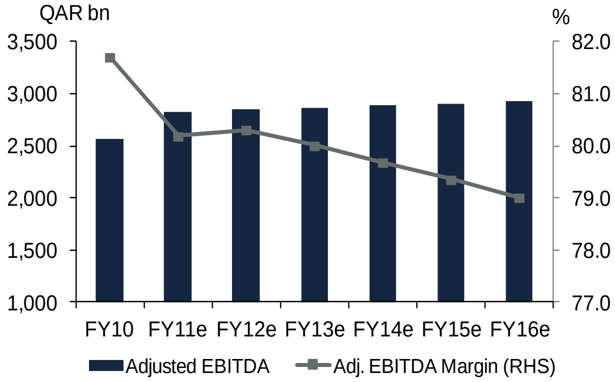
Source: Company Data, QNBFS Estimates

Revenue Mix



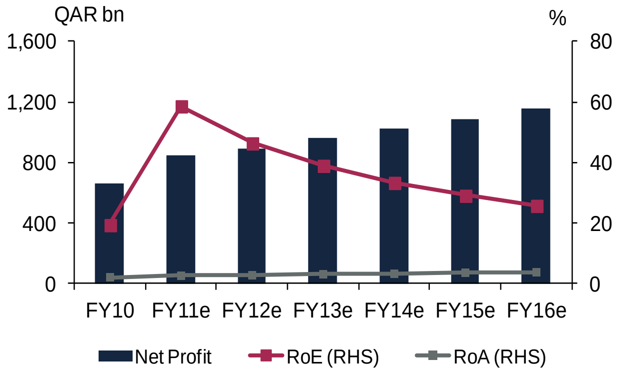
Source: Company Data, QNBFS Estimates

Adjusted EBITDA and Adjusted EBITDA Margins



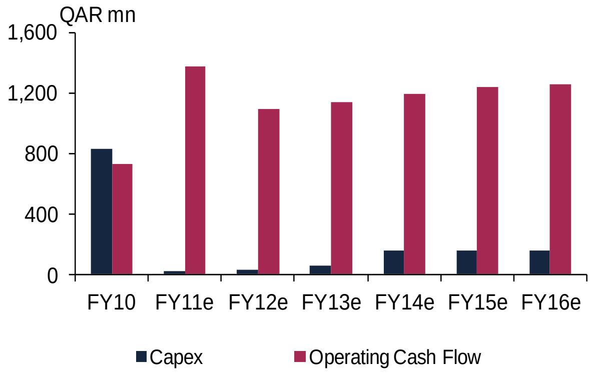
Source: Company Data, QNBFS Estimates

Profitability Ratios



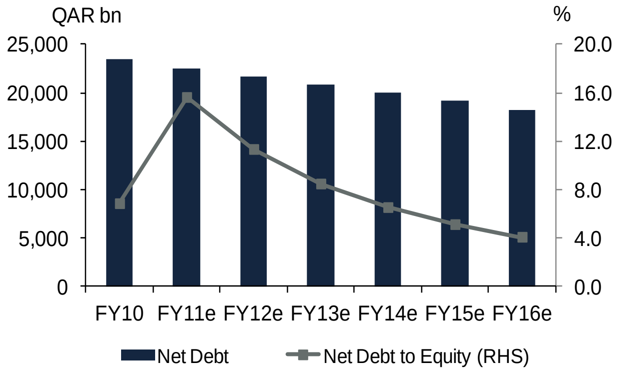
Source: Company Data, QNBFS Estimates

Capex and Operating Cash Flow



Source: Company Data, QNBFS Estimates

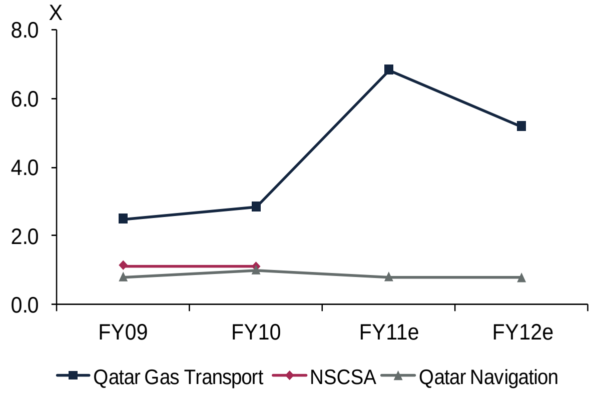
Debt and Debt-Equity Ratio



Source: Company Data

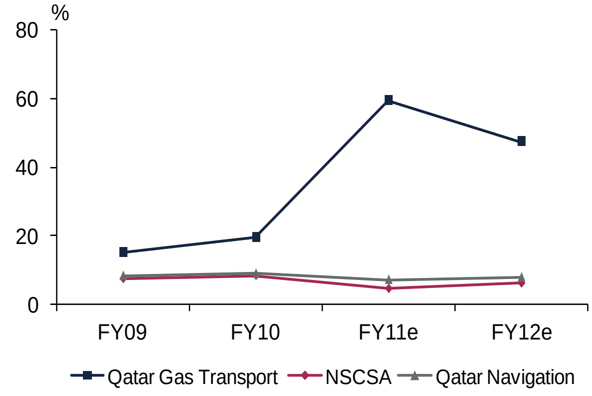
Peer Trend Analysis

P/B



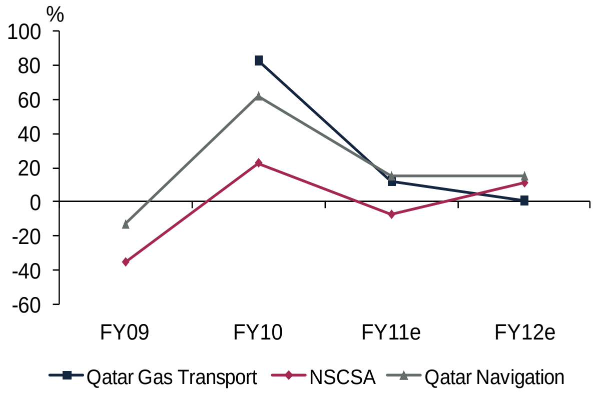
Bloomberg, QNBFS Estimates

ROE



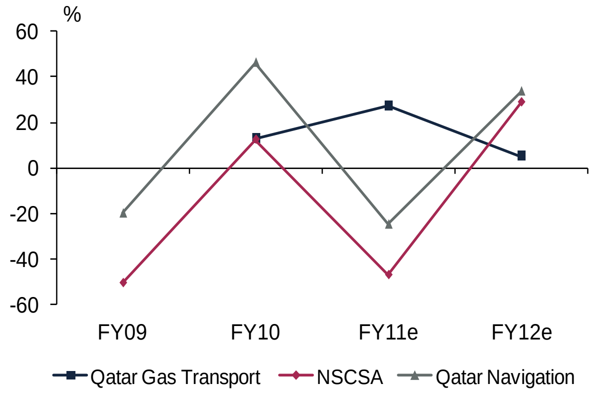
Bloomberg, QNBFS Estimates

Revenue Growth



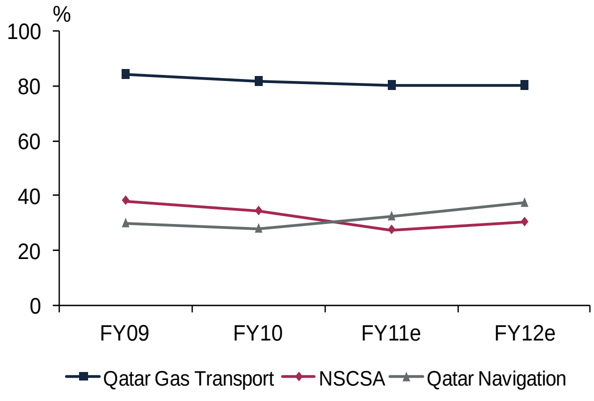
Source: Bloomberg, QNBFS Estimates; Note: N/M for QGTS for 2009

EPS Growth



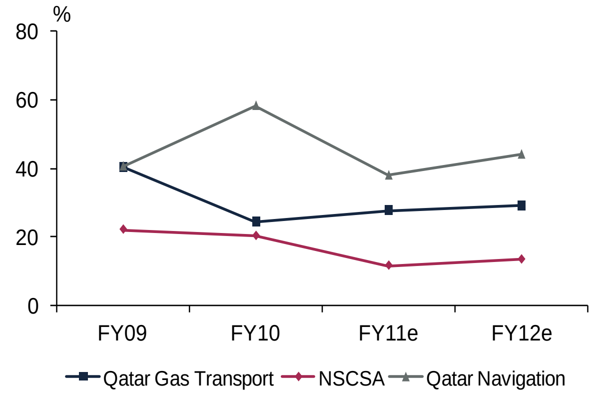
Source: Bloomberg, QNBFS Estimates; Note: N/M for QGTS for 2009

EBITDA Margin



Source: Bloomberg, QNBFS Estimates

Net Profit Margin



Source: Bloomberg, QNBFS Estimates

Detailed Financial Statements

Income Statement

Figures in QAR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
Revenue	1,494	2,729	2,245	3,052	3,065	3,079
Cost of sales (ex Dep)	(205)	(459)	(397)	(549)	(563)	(577)
Gross profit	**1,288**	**2,270**	**1,848**	**2,502**	**2,502**	**2,502**
Income from marine and agency services	29	30	27	36	39	42
General and admin. exp.	(59)	(70)	(65)	(92)	(80)	(80)
EBITDA	**1,259**	**2,230**	**1,810**	**2,447**	**2,462**	**2,464**
Depreciation & amortization	(315)	(557)	(443)	(593)	(605)	(605)
EBIT	**944**	**1,673**	**1,367**	**1,854**	**1,856**	**1,858**
Share of profits from JVs	281	248	206	288	302	318
Finance costs	(754)	(1,321)	(1,046)	(1,405)	(1,357)	(1,303)
Profit from Islamic banks	65	28	7	7	7	7
Interest and dividend income	37	41	28	38	39	39
Other income	8	17	42	42	42	42
Gain / (loss) on derivatives from JVs	20	(20)	22	22	0	0
Profit before tax	**602**	**665**	**625**	**846**	**889**	**960**
Contribution to social fund	(13)	0	0	0	0	0
Profit after tax	**589**	**665**	**625**	**846**	**889**	**960**
Minority interest	(1)	(0)	(0)	(1)	(1)	(1)
Profit for equity shareholders	**588**	**665**	**625**	**846**	**889**	**959**
EPS (QAR)	1.06	1.20	1.13	1.53	1.60	1.73
Adjusted Net Revenue	**1,812**	**3,023**	**2,092**	**3,418**	**3,449**	**3,480**
Adjusted EBITDA	**1,650**	**2,563**	**2,519**	**2,822**	**2,852**	**2,868**

Source: Company Data, QNBFS Estimates

Balance Sheet

Figures in QAR mn	FY2009	FY2010	Q3 2011	FY2011e	FY2012e	FY2013e
Non-current Assets						
Property, plant and equipment	22,450	26,338	25,898	25,765	25,191	24,647
Construction in progress	3,624	0	0	0	0	0
Investment in JV companies	2,077	2,038	1,905	2,222	2,418	2,625
Loans to joint venture companies	1,108	1,121	1,152	1,152	1,152	1,152
Available-for-sale investments	107	130	119	119	119	119
Total Non-current Assets	**29,366**	**29,627**	**29,073**	**29,258**	**28,880**	**28,542**
Current Assets						
Trade and other receivables	102	254	314	336	337	339
Due from joint venture companies	2	22	25	22	22	22
Cash and bank balances	1,779	2,126	2,576	2,147	2,014	2,025
Total Current Assets	**1,882**	**2,402**	**2,915**	**2,504**	**2,373**	**2,385**
TOTAL ASSETS	**31,249**	**32,030**	**31,988**	**31,762**	**31,252**	**30,927**
EQUITY						
Share capital	5,538	5,538	5,538	5,538	5,538	5,538
Other reserves	195	284	273	273	273	273
Hedging reserve	(2,609)	(3,485)	(5,886)	(5,886)	(5,886)	(5,886)
Proposed dividends / Bonus issue	277	416	0	415	415	415
Retained earnings	505	671	1,296	1,101	1,575	2,119
Equity attributable to the parent	3,905	3,424	1,221	1,442	1,916	2,459
Minority interest	4	5	5	5	5	5
Total Equity	**3,909**	**3,428**	**1,226**	**1,447**	**1,921**	**2,464**
Non-current liabilities						
Borrowings	24,556	24,666	24,148	23,698	22,847	21,995
Fair value of interest rate swaps	2,131	2,828	5,013	5,013	5,013	5,013
Provision for end of service benefits	6	9	11	11	11	11
Total Non-Current Liabilities	**26,694**	**27,503**	**29,172**	**28,722**	**27,870**	**27,018**
Current liabilities						
Borrowings	458	886	968	968	852	852
Accounts payables & accruals	188	212	622	625	609	593
Total Current liabilities	**646**	**1,098**	**1,590**	**1,592**	**1,461**	**1,445**
TOTAL EQUITY AND LIABILITIES	**31,249**	**32,030**	**31,988**	**31,762**	**31,252**	**30,927**

Source: Company Data, QNBFS Estimates

Cash Flow Statement

Figures in QAR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
OPERATING ACTIVITIES						
Profit for the year	589	665	625	846	889	959
Adjustments for:						
Depreciation and amortization	315	557	443	593	605	605
Finance charges	754	1,321	1,046	1,405	1,357	1,303
Share of operating profits & others	(281)	(248)	(206)	(288)	(302)	(318)
Others	(130)	(66)	(98)	(109)	(87)	(87)
	1,246	**2,230**	**1,810**	**2,447**	**2,461**	**2,463**
Changes in working capital:						
Trade and other receivables	18	(75)	(60)	(80)	(2)	(2)
Accounts payable and accruals	28	(9)	60	412	(15)	(16)
Others	2	(21)	(5)	(1)	0	0
Cash from operations	**1,294**	**2,125**	**1,805**	**2,778**	**2,445**	**2,445**
Finance charges paid	(1,254)	(1,392)	(709)	(1,405)	(1,357)	(1,303)
Net cash from operating activities	**40**	**732**	**1,096**	**1,372**	**1,088**	**1,142**
INVESTING ACTIVITIES						
Purchase of PP&E	(5,709)	(828)	(2)	(20)	(31)	(62)
Dividend received from JVs	89	83	120	127	106	111
Investment income received	127	97	77	87	87	87
Proceeds from PP&E disposals	(529)	(9)	7	(19)	0	0
Net cash used in investing activities	(6,022)	(656)	201	174	162	137
FINANCING ACTIVITIES						
Changes in borrowings	5,782	537	(437)	(886)	(968)	(852)
Dividends paid to shareholders	0	(266)	(398)	(416)	(415)	(415)
Others	0	(11)	(28)	(224)	0	0
Net cash used in financing activities	**5,782**	**261**	**(863)**	**(1,526)**	**(1,383)**	**(1,267)**
Net decrease in cash and cash equivalents	(200)	337	434	21	(133)	11
Cash and cash equivalents at the beginning of the year	1,953	1,753	2,090	2,090	2,111	1,978
Cash and cash equivalents at the end of the year	**1,753**	**2,090**	**2,524**	**2,111**	**1,978**	**1,989**

Source: Company Data, QNBFS Estimates

Growth Rates

Figures in percentage	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	N/M	82.7	11.8	0.4	0.4
Gross Profit	N/M	123.8	19.6	2.5	2.5
EBITDA	N/M	77.1	9.7	0.6	0.1
EBIT	N/M	77.2	10.9	0.1	0.1
PBT	N/M	10.6	27.2	5.1	7.9
PAT	N/M	13.0	27.2	5.1	7.9
EPS	N/M	13.0	27.2	5.1	7.9

Source: Company Data, QNBFS Estimates

Key Ratios

Key Ratios	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Operating Ratios (%)					
Gross Margin	86.3	83.2	82.0	81.6	81.3
EBITDA Margin	84.3	81.7	80.2	80.3	80.0
Adjusted EBITDA Margin	91.1	84.8	82.6	82.7	82.4
EBIT Margin	63.2	61.3	60.8	60.6	60.3
Net Margin	39.4	24.4	27.7	29.0	31.1
Working Capital Ratios (Days)					
Average collection period	24.8	34.0	40.0	40.0	40.0
Payable days	332.5	168.9	415.0	395.0	375.0
Finance Ratios					
Debt-Equity Ratio	6.4	7.5	17.1	12.4	9.3
Net Debt-Equity Ratio	6.0	6.8	15.6	11.3	8.5
Interest Coverage	1.3	1.3	1.3	1.4	1.4
Ave. Effective Borrowing rate (%)	3.4	5.2	5.5	5.5	5.5
Effective Tax rate (%)	2.1	-	-	-	-
Return Ratios (%)					
ROCE	21.6	38.8	76.8	67.0	56.0
Incremental ROCE	22.3	N/M	(9.6)	0.5	0.3
ROE	15.1	19.4	58.6	46.4	39.0
ROA	1.9	2.1	2.7	2.8	3.1
Liquidity Ratios					
Current Ratio	2.9	2.2	1.6	1.6	1.7
Quick Ratio	2.9	2.2	1.6	1.6	1.7
Valuations (x)					
EV/Sales	22.0	12.1	10.5	10.2	9.9
EV/EBITDA	19.9	12.9	11.4	11.0	10.6
EV/EBIT	34.8	19.7	17.3	16.8	16.4
P/E	16.5	14.6	11.5	10.9	10.1
P/BV	2.5	2.8	6.7	5.1	3.9

Source: Company Data, QNBFS Estimates

Renaissance Services (RNSS)

Dec. 29, 2011

Recommendation	ACCUMULATE	Risk Rating	R-3
Share Price	OMR0.56	Target Price	OMR0.67
Implied Upside	18%		

Value in a Sea of Turmoil?

Growing OSV operator; stable domestic contract services business; initial signs of a turnaround in the troubled engineering segment and attractive valuation.

Highlights

- **Smooth sailing in the marine business.** RNSS, with a diversified fleet, is a leading global offshore support vessel (OSV) operator. The company's marine segment (~40% of YTD revenue) commands a significant presence in the Caspian region (Azerbaijan, Kazakhstan and Turkmenistan) and has a ~5% market share in MENA as of end-2010. Marine remains the most profitable segment with an EBITDA margin of ~52% in 2010 (vs. ~29% overall). With a young fleet (6.5 years vs. a global average of 13 years), RNSS enjoys operating cost benefits as well as premium day rates. With ~60% of revenue coming from long-term contracts, revenue visibility remains solid.
- **Contact services provide stability.** RNSS enjoys a dominant share of the contract services market (34% of YTD revenue) in Oman (67% in December 2010) and Norway (46%). Long-term contracts with diverse clients provide top-line stability although EBITDA margins remain low at roughly 20% in 2010.
- **Engineering remains RNSS' Achilles heel.** Backlog has plummeted 56% YTD to OMR34.4mn versus ~OMR77mn at the beginning of 2011. In fact, the company has not announced a major order win since October 2010. Given the underperformance thus far in 2011, we predict operating losses in 2011-2012, with breakeven only in 2013. RNSS remains open to a potential divestment.

Catalysts

- **Continued traction in the marine segment.** Newsflow regarding fleet expansion (we estimate the total fleet to reach 128 in 2016 from 101 at YE2011) and contract wins should help lift the stock. We model revenue and EBITDA to grow at CAGRs of 9.1% and 8.8%, respectively, over 2010-2016.
- **Signs of a turnaround in engineering.** Backlog boosting new wins and a sooner-than-expected operational turnaround are key catalysts. We forecast revenue and EBITDA to grow at CAGRs of 3.4% and 5%, respectively, over 2010-2016. Our estimates remain conservative allowing for upside.
- **Potential financing announcements shoring up the balance sheet, while providing growth capital.** With plans to float a London IPO of the marine business on ice, RNSS could look to tap the capital markets next year through a convertible bond and/or a rights issue.

Recommendation, Valuation and Risks

- **Recommendation and valuation.** *We rate RNSS an Accumulate with a price target of OMR0.67.* Operational issues in engineering temper our bullish outlook and leads to our subdued recommendation. Given a rash of bad news, RNSS is down 49% YTD leading to a relative valuation opportunity vs. peers.
- **Risks:** 1) Delays in fleet addition plans; 2) Lower-than-estimated charter rates; 3) Further hiccups in the engineering segment and 4) Additional write-downs.

Key Financial Data and Estimates

OMR mn	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	248	253	281	300	318
Net Profit	25	28	(1)	20	25
EPS (OMR)	0.09	0.10	(0.004)	0.08	0.09
P/E (x)	6.0	5.4	N/M	7.5	6.0
Dividend yield (%)	2.1	2.1	0.0	1.6	2.0

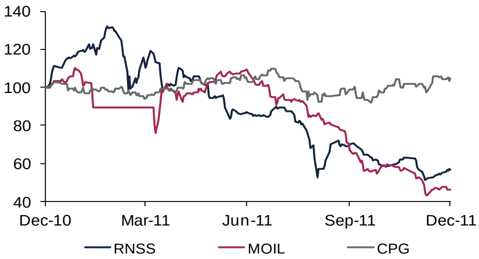
Source: Company Data, QNBFS Estimates

Key Data:

Bloomberg ticker	RNSS OM
ADR/GDR ticker	N/A
Reuters ticker	RNSS.OM
ISIN	OM0000003224
Sector	Services
52wk high/52wk low (OMR)	1.35/0.50
3-m average volume ('000)	345.4
Mkt.cap.(USD mn/OMR mn)	390.1/150.6
Shares outstanding (mn)	268
Float* (%)	79.4
Float* (mn)	213
1-year total return (%)	(43.3)
Fiscal year end	Dec. 31

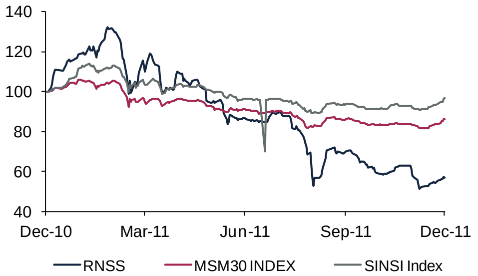
Source: Bloomberg (as of December 15, 2011), *Zawya

Relative Price Performance vs. Peers



Source: Bloomberg; Note: MOIL is Maridive and Oil Services and CPG is Compass Group

Relative Price Performance vs. Market



Source: Bloomberg; Note: MSM30 INDEX is 30 companies of the Muscat Securities Market and SINSI is Services Sector in MSM30 Index

Broker Recommendations

Recommendation	Number
Buy	7
Hold	2
Sell	0

Source: Bloomberg

Executive Summary

Strong Positioning in the Marine Business

RNSS is a leading regional and global OSV operator with an established footprint in the Caspian and the MENA regions. As of 2010, the company enjoyed a diversified fleet of 100 OSVs (including 10 vessels under construction). RNSS' core markets are the oil and gas rich Caspian region (oil reserves of 48bn barrels as of 2010) and the MENA region (Middle East and North Africa, oil reserves of 892.2bn barrels), where it supports blue-chip energy leaders. RNSS operated 63 vessels in the Caspian region with a market share of 55%, 51% and 24% in Azerbaijan, Kazakhstan and Turkmenistan, respectively, as of December 2010. The company's remaining vessels were deployed in the MENA region where RNSS held a market share of 5%. Marine remains the largest and indeed the most profitable segment, contributing around 40% of YTD revenue with an EBITDA margin of ~52% in 2010 (versus an overall company EBITDA margin of approximately 29%).

The company's expansion beyond its comfort zone and into deeper waters has, however, met with mixed success. The next frontier for oil and gas supply (especially oil) growth lies in the offshore and in deep and ultra-deep depths. Cognizant of this fact, RNSS recently made moves to expand its geographical presence in Brazil and Nigeria. Consequently, the company entered into a three-year contract with Brazil's national oil company Petrobras in February 2011. Renaissance also signed an eight-month deal with Nigeria-based AXXIS Petroconsultants Ltd. in April 2011. As the Q3 2011 conference call revealed, the foray into Nigeria has met with success, while the returns from Brazil have not been adequate given the higher-than-expected operating costs in deep waters and regulatory restrictions/costs. While the management has decided to put off further expansion plans in Brazil, we continue to believe that these setbacks serve as a learning curve. We remain optimistic about the company's eventual success in diversifying beyond its core regions (mostly shallow waters) into the next frontiers of oil and gas growth.

Young Fleet and Right Mix of Contracts Makes RNSS Competitive

RNSS' relatively new fleet provides higher day-rates. As of December 2010, RNSS' average fleet age was 6.5 years versus a global average of 13 years. The average fleet age is expected to remain young as our model shows that RNSS will expand its fleet to 128 vessels by 2016 from 101 vessels expected by end-2011. A young fleet ensures lesser consumption of fuel and lower emissions relative to traditional vessels. A young fleet also enjoys premium day rates, as the vessels are safer and technologically advanced.

A mix of spot and long-term contracts makes the marine segment resilient. Besides operating a modern fleet, RNSS has a blend of long-term fixed price contracts in the Caspian region and spot market contracts in the MENA region, which provide earnings visibility and an opportunity to exploit short-term volatility in day rates. This strategy has proved beneficial to RNSS as the company's revenue has been resilient despite the previous economic downturn. We model modestly higher day rates along with conservative fleet utilization levels to drive revenue growth of the marine segment at a compound annual growth rate (CAGR) of 9.1% over 2010 to 2016. Increase in high-margin marine revenue should propel the company's overall EBITDA margin from 27.9% in 2010 to 31.5% by 2015.

Contract Services to Provide Stable Revenue Stream

RNSS holds a significant market share in the contract services segment in Oman and Norway. This division provides facilities management, contract catering, operation and management services in the MENA region serving diverse clients under long-term contracts. In Oman, the company enjoys a 67% market share (as of December 2010), while in Norway and Angola RNSS held a market share of 46% and 18%, respectively. The company owns 3,071 rooms for permanent accommodation for contractors (PAC) primarily employed in oil and gas projects for the Petroleum Development of Oman (PDO, 60% owned by government).

Long-term contracts ensure stability. The contracts with PDO for permanent accommodation facilities at Marmul and Bhaja, based on a build, own and operate model are valid until 2044 ensuring a secure revenue stream. Moreover, RNSS offers catering services to the oil and gas, healthcare, education, military, commerce and industry and ports and marine sectors. This segment contributed 34% of YTD revenue and reported an EBITDA margin of 20.2% in 2010. Meals served per day grew at a CAGR of 17.9% during 2008-2010 to 164,000 in 2010. With the acquisition of UAE-based Al Wasita Emirates in 2010, the company expects meals per day to increase to 197,000, reflecting a 20% jump in 2011. The segment has been a source of funds for the marine and engineering segments in the past. We expect segment revenue to grow at a CAGR of 6.6% over 2010-2016, buoyed by increased PAC capacity and entry into new markets.

Engineering Remains RNSS' Achilles Heel

The company is facing a difficult time in securing new engineering contract wins. Engineering backlog has plummeted 56% YTD to OMR34.4mn versus ~OMR77mn at the beginning of 2011. In fact, the company has not announced a major order win since October 2010. The engineering business has remained in the red this year given its subdued top-line and backlog relative to its large fixed cost base. The segment has also incurred significant reputational damage (more details below) leading to a loss in traction. Given the underperformance seen thus far in 2011, we predict operating losses in 2011-2012, with breakeven only in 2013. We note that our estimates are conservative, as the management has guided to a breakeven performance in 2012. We continue to believe that the company remains open to divestment or partial closures of units.

A Slew of Bad News in 2011 has Shaken Market Sentiment

A string of bad news has hurt investor sentiment and caused RNSS stock to underperform this year. RNSS has had to suffer one-time losses of ~USD30mn in the engineering segment. Moreover, with the IPO of Topaz Marine now on hold, the company is staring at another USD8mn in provisions. Earlier this year, the management came across a fraud of USD2.9mn while implementing a new code of business conduct in Topaz. A junior-level finance manager of an overseas subsidiary of Topaz, who has been subsequently dismissed, perpetrated this fraud over a span of six and a half years. This was announced to the public in mid-August sending RNSS stock into tailspin. While the amount of the fraud was relatively minor, it raised the specter of other lurking issues and was instrumental in a management shakeup at Topaz. Since then, RNSS has undertaken several steps to strengthen its internal controls. Further, the management's investigation has been extended across all Topaz businesses. RNSS has maintained that the subsequent exit of several senior members of Topaz (CEO, Finance Director and the COO of Topaz Engineering) was due to differences in opinion and not related to the fraud. We note that RNSS' Group CEO has proactively taken over the management of Topaz, where restructuring activities are well underway.

Q3 2011 Results

Operating performance disappoints. Revenue grew 5.4% YoY in Q3 2011 to OMR73mn. Revenue from contract services segment grew by 23.6% YoY, while revenue growth from the marine segment slowed down to 10.3% (from 31.9% in Q2 2011). Vessel utilization was subdued during the quarter due to maintenance and dry-docking as well as diversion of vessels from Turkmenistan to Kazakhstan. However, overall utilization came in around 80% at the end of Q3 2011. The engineering segment saw a slight decline in revenue of ~2% YoY, but improved sequentially by 27.3%. In terms of operating profitability, the engineering segment stayed in the red with an operating loss of OMR1.1mn (loss was OMR3mn in Q2 2011). Interestingly, the marine operating profit declined sequentially to OMR7.2mn (25.8% margin) versus OMR10.2mn (35.9%) in Q2 2011. Besides the factors mentioned above, marine profitability was impacted by higher operating costs of certain high-powered vessels acquired last year and a subpar performance in Brazil. Contract services remained a bright area with operating profits of OMR3.9mn, almost 4x its 2Q 2011 performance. Net profit declined ~85% YoY to OMR1mn due to lower operating profit, higher depreciation expense and higher finance costs.

Catalysts

Continued Traction in the Marine Segment

We believe that newsflow regarding RNSS' marine fleet expansion and contract wins should help lift the stock. We estimate the company's total fleet to reach 128 in 2016 from 101 at the end of 2011. We also want to point out that our model is subdued versus management guidance of fleet additions totaling 30-35 vessels over the next three-to-five years. Moreover, our fleet utilization remains at the low end of management's guidance of 85-95%. As a result, revenue and EBITDA are expected to grow at CAGRs of 9.1% and 8.8%, respectively, over 2010-2016 as per our calculations. As we noted previously, the company's recent expansion into other international markets has met with mixed success. However, we remain optimistic about RNSS being able to find success in diversifying beyond its core regions into the next frontiers of oil and gas growth.

Signs of a Turnaround in Engineering

Backlog boosting new wins and a sooner-than-expected operational turnaround should be key stock price triggers. The engineering segment, which had reported an operating loss of OMR3mn in Q2 2011, has seen an improvement posting an operating loss of OMR1mn in Q3 2011. However, the engineering segment is yet to provide for losses of ~USD30mn due to one-time events, which include: 1) Storm damage affecting a client project in Fujairah; 2) Potential cost to the company due to a withdrawal from its loss-making MOBY JV in Kazakhstan and 3) A client claim, estimated to be more than USD1.75mn, for poor welding work by a sub-contractor for a project completed last year. Currently, we have assumed RNSS will account for all of this USD30mn write-down (and an $8mn provision related to the delayed IPO) in the fourth quarter. Moving beyond Q4 2011 issues, we remain heartened by the remedial actions taken by the management thus far. RNSS management, in a bid to curb losses from the segment, assumed direct control and restructured the business into two divisions (Oil & Gas Engineering and Marine Engineering), instead of the erstwhile four in Q2 2011. As part of this restructuring exercise, more than 100 people identified as surplus in the engineering segment are being made redundant. In addition, the company is currently in search for a new CEO for the Topaz Energy and Marine business and expects to make an announcement soon.

Stable growth is possible on growing demand in MENA for engineering and ship repair. We believe the engineering segment could tap several opportunities in the region. One potential area could be working on the old and dilapidated oil and gas infrastructure in Iraq, which needs heavy investments in oil storage tanks, export terminals and pipelines after years of war and economic sanctions. Another opportunity lies in the aging global fleet of OSVs as discussed above, which needs replacement or repair and maintenance. The UAE-based ship building business of the engineering segment seems to be gaining from this scenario, as it reported a turnaround in 2010 after incurring losses in 2009. In the absence of any major order wins, we forecast revenue and EBITDA to grow at CAGRs of 3.4% and 5%, respectively, over 2010-2016. Our estimates remain conservative allowing for upside.

Potential Financing Announcements

We believe that potential financing announcements could help boost the stock. Previously, as part of its expansion plans, RNSS had embarked on investments of more than USD1bn over the last five years and had ambitious plans to invest an additional USD2.3-2.6bn over the period 2011-2013. However, we believe that the delayed IPO of Topaz (once expected to raise USD500mn) and the recent restructuring in the engineering segment will force the company to reduce its spending plan to around USD0.7bn over 2011- 2013. Further, this growth is dependent on additional capital infusion, as RNSS remains free cash flow (FCF) negative. FCF, as defined by net operating cash flow less capital expenditures or capex, was a negative OMR94mn in 2010 due to heavy investments in marine vessels (87.4% of total capex). Given our fleet expansion assumptions, we expect FCF to remain negative over the next two years. The company has already made some progress on this front. RNSS is on track to raise around OMR144mn in debt to refinance roughly OMR97mn in upcoming repayments along with ~OMR48mn for spending on vessels under construction and for capex on new vessels. Going forward, we believe RNSS could look to tap the capital markets next year through a convertible bond and/or a rights issue. The company recently made an announcement that it planned to raise as much OMR50mn of capital through a “quasi-equity instrument” which will be offered to existing shareholders as well as new investors through a private placement next year. Moves of this nature should provide investors with additional comfort regarding the company’s future growth prospects and hence, have a positive effect on the stock.

Valuation – Attractive

Our target price of OMR0.67 a share implies an 18% upside on RNSS stock. We have arrived at the fair value of RNSS using a blend of discounted cash flow (DCF) and sum-of-the-parts (SOTP) EV/EBITDA multiple methodologies. We have assigned more weight to the DCF method as it reflects the company’s long-term cash generating potential.

Valuation Summary

Valuation summary	Value	Weights	Fair Value (OMR)
DCF	0.62	80%	0.50
SOTP (EV/EBITDA multiple)	0.85	20%	0.17
Target Price for RNSS			**0.67**
Potential Upside/Downside			18%

Source: Bloomberg, QNBFS Estimates

Discounted Cash Flow (DCF)

Our DCF valuation reveals a fair value of OMR0.62 per share. We have used a 1.5% terminal growth rate given the uncertain outlook faced by engineering and the soft marine performance in Q3 2011.

DCF Valuation

Particulars	Fair Equity Value (OMR mn)	Fair Value per share (OMR)
PV of FCFF	60	
PV of Terminal Value	452	
PV of Cash Flows	**512**	**1.92**
Add:		
Cash Balances	29	0.11
Investments	2	0.01
Less:		
Debt	352	1.32
Minority Interest	25	0.09
Fair Equity Value	166	0.62

Source: QNBFS Estimates

We derive a WACC of 10.6%. For weighted average cost of capital (WACC) calculations, we have assigned a weight of 40% to equity and 60% to debt based on our expectation of the company’s long-term capital structure (RNSS’ current market capitalization is around 30% of the total of its debt and market capitalization). We also use an emerging market risk premium of 8% and a beta of 1.77, which has been obtained from Bloomberg. While the beta seems high, we note that RNSS has been a volatile stock over the past two years and has been a notoriously poor performer this year.

WACC Analysis

WACC Calculations	
Risk free rate (%)	5.0
Risk premium (%)	8.0
Beta (%)	1.8
Cost of Equity (%)	**19.1**
Cost of Debt (%)	**5.8**
Tax rate (%)	16.0
WACC (%)	**10.6**

Source: Bloomberg, QNBFS Estimates

Sensitivity Analysis

We performed a sensitivity analysis on WACC and terminal growth rate to our DCF valuation model. As per our sensitivity analysis, a reduction in WACC by 50bps would increase the fair value by 23.5%, while a 50bps increase in the terminal growth rate would increase the fair value by 17.3%. The DCF model is sensitive to changes in WACC as most of the fair value is derived from the terminal value, while heavy capex will result in negative cash flows until 2014. The results of our sensitivity analysis are depicted below:

Sensitivity Analysis

WACC \ Terminal growth rate	0.50%	1.00%	1.50%	2.00%	2.50%
9.6%	0.69	0.81	0.93	1.07	1.23
10.1%	0.56	**0.66**	**0.77**	**0.89**	1.03
10.6%	0.44	**0.53**	**0.62**	**0.73**	0.85
11.1%	0.33	**0.41**	**0.49**	**0.59**	0.69
11.6%	0.23	0.30	0.37	0.46	0.55

Source: QNBFS Estimates

Relative Valuation

RNSS remains attractive versus its peers. We have valued the business segments of the company on an individual basis, applying the median 2012 EV/EBITDA multiple of comparable global players in each segment. This sum-of-the-parts (SOTP) relative valuation technique leads to the following conclusion:

SOTP EV/EBITDA Analysis

EV/EBITDA multiple	EBITDA (OMR mn)	Multiple	Equity Value (OMR mn)	Value per share (OMR)
Marine	56	7.1x	392	1.47
Engineering	2.8	6.8x	19	0.07
Contract services	19	8.2x	158	0.59
Other	1	5.0x	3	0.01
Add:				
Cash balances			29	0.11
Investments			2	0.01
Less:				
Debt			352	1.32
Minority interest			25	0.09
Total equity value			**227**	**0.85**

Source: QNBFS Estimates

EV/EBITDA Multiples (x)

Company name	FY08	FY09	FY10	FY11e	FY12e
Renaissance Services*	5.4	5.4	6.2	7.5	7.0
Solstad Offshore ASA	11.7	10.6	11.3	11.4	7.9
Siem Offshore Inc	18.8	23.7	17.7	12.3	8.5
Farstad Shipping ASA	7.0	6.5	7.9	7.5	7.1
BW Offshore Ltd	N/M	23.7	12.2	8.0	5.6
Gulfmark Offshore Inc	5.4	6.8	9.5	8.6	6.4
Tidewater Inc#	4.9	7.2	9.7	9.6	6.4
Bourbon SA	11.1	9.7	12.0	11.1	8.4
Swiber Holdings Ltd	10.3	12.6	12.5	10.5	7.7
Ezra Holdings Ltd#	19.5	17.3	17.1	11.0	9.4
Dayang Enterprise Holdings Bhd	N/A	11.2	9.0	6.6	5.6
Maridive & Oil Services SAE	6.2	7.2	6.7	6.5	5.9
Compass Group Plc#	10.9	9.6	8.9	8.2	7.7
Marriott International Inc/DE	9.6	15.9	11.6	11.4	10.7
Sodexo#	9.6	9.1	8.2	7.4	6.9

Source: Bloomberg, *QNBFS Estimates; Note:# Year end is not December

P/E Multiples (x)

Company name	FY08	FY09	FY10	FY11e	FY12e
Renaissance Services*	6.3	6.0	5.4	N/M	7.5
Solstad Offshore ASA	8.2	4.6	N/M	N/A	9.7
Siem Offshore Inc	7.1	7.5	44.4	95.2	8.9
Farstad Shipping ASA	6.1	5.7	11.3	11.2	9.0
BW Offshore Ltd	N/A	28.6	7.1	14.3	6.4
Gulfmark Offshore Inc	6.2	9.5	21.8	19.7	10.3
Tidewater Inc#	6.2	9.2	18.9	20.5	10.6
Bourbon SA	10.2	9.8	38.7	N/M	13.9
Swiber Holdings Ltd	2.9	5.8	5.6	10.4	5.5
Ezra Holdings Ltd#	7.7	6.1	12.2	7.7	5.9
Dayang Enterprise Holdings Bhd	N/A	19.1	14.4	11.4	10.1
Maridive & Oil Services SAE	5.7	7.7	7.8	9.1	8.0
Compass Group Plc#	19.9	16.6	15.1	13.8	12.5
Marriott International Inc/DE	18.0	31.7	24.7	20.0	17.4
Sodexo#	21.0	19.8	17.6	15.8	14.1

Source: Bloomberg, *QNBFS Estimates; Note: # Year end is not December

Risks to Our Target Price

- **Delays in fleet expansion.** While we remain conservative in our fleet expansion model, any delays could influence revenue and profitability. Although we are comfortable that the company will be able to effectively source growth capital at attractive terms, any further delays could derail expansion plans and jeopardize our estimates and fair value.
- **Lower-than-estimated charter rates.** The management has given guidance for moderate growth in charter rates over the medium term. Given the aging global OSV fleet and a tight market, we tend to agree. Moreover, as noted previously, RNSS continues to enjoy premium rates given its relatively young fleet. In our model, we have been fairly conservative and have only assumed a marginal 2% growth per annum in day rates over 2012 to 2016. However, any weakness seen in day rates could impact RNSS' spot business and hence, our estimates and fair value.
- **Further hiccups in engineering and additional write-downs.** We are of the view that the management has done well to clean house and move forward with its engineering business. However, it remains to be seen if the company can bag profitable contract wins. Our fear remains that the reputational damage suffered due to the fraud incident could have marred the company's credibility with clients. Moreover, further write-downs in this segment cannot be ruled out.

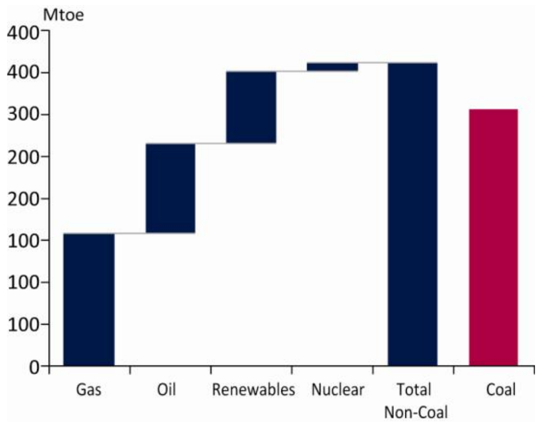
Offshore Drilling Industry Dynamics and Outlook

Demand for Fossil Fuels to Increase Driven by Emerging Markets

The long-term demand outlook for fossil fuels remains robust. The near-term demand for oil and gas is somewhat uncertain, in our view, given the escalating debt crisis in Europe and the slowdown seen in the US However, over the long-term, demand for energy is expected to increase by one-third between 2010 and 2035, on the back of rising demand from emerging economies, according to the International Energy Agency's (IEA) New Policies Scenario in its World Energy Outlook 2011 report. China alone is expected to account for 30% of the global energy demand growth by 2035 even as energy consumption in India, Indonesia, Brazil and the Middle East grows at a faster clip than China.

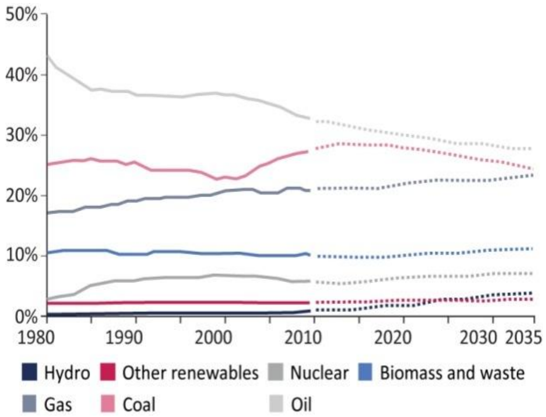
Fossil fuels will dominate despite fast growing alternative energy sources. Though modern alternative energy sources are expected to grow faster than traditional fossil fuel sources and their share in the energy mix increases, their combined supply still falls short of any single fossil fuel by 2035. Fossil fuels will continue to dominate the world energy consumption mix; though to a lesser extent than current levels (75% in 2035 from 81% in 2010). Within fossil fuels, natural gas is the only fuel, whose share is set to rise over the next 25 years (demand expected to grow at a CAGR of 1.7% to reach 4.8tcm by 2035). Demand for oil is expected to grow at a slower pace, rising by around 15% with its share of global primary energy use dropping to 27% in 2035 from 33% currently. Demand for coal is expected to rise over the next 10 years and then stabilize beyond 2020.

Incremental Demand by Fuel, 2000-2010



Source: IEA World Economic Outlook 2011

Share of Energy Sources in Energy – New Policies Scenario

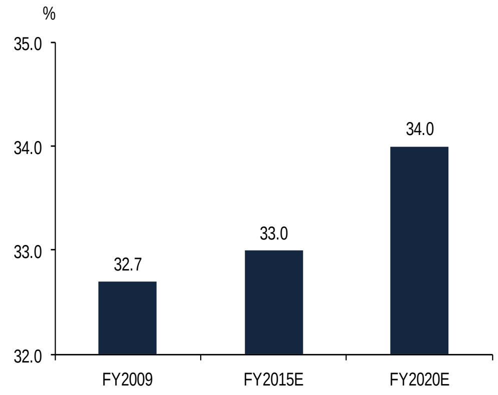


Source: IEA World Economic Outlook 2011

Offshore Drilling is on the Uptrend

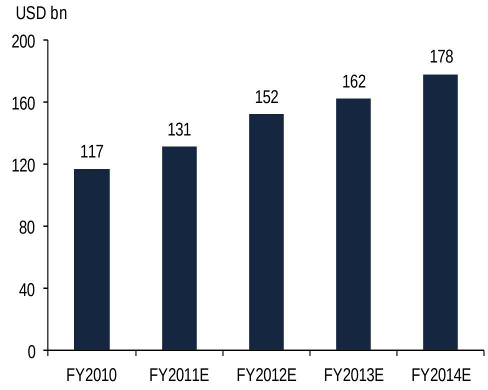
As demand keeps growing for fossil fuels, offshore drilling should drive the next level of growth … Oil and gas production will start shifting offshore considering the declining production from the existing giant onshore oil fields. In 2010, upstream capital spending of 221 global oil and gas companies studied by IHS saw a rebound by 47% YoY to USD558bn. Capital spending by exploration and production companies was more pronounced at USD198bn (~70% increase YoY after a decline in 2009). Going forward, oil and gas combined will require investments of around USD20tn by 2035, primarily in upstream investments, as per the IEA. According to ODS Petrodata, in 2009, global offshore oil wells contributed 32.7% of the total oil supply worldwide. Their contribution is set to rise with growth coming mainly from Latin America, the Middle East and the Arctic Circle. ODS Petrodata's figures show that offshore capex will outpace onshore capex with a CAGR of 11% versus 7% over 2010-2014.

Offshore Oil as a % of Global Oil Production



Source: Company Data, ODS Petrodata

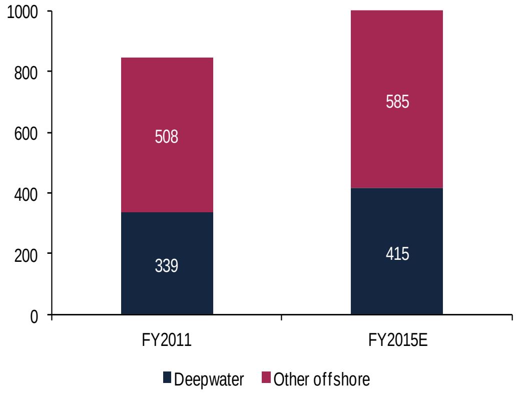
Offshore Capex to Grow at 11% CAGR (2010-2014)



Source: Company Data, ODS Petrodata

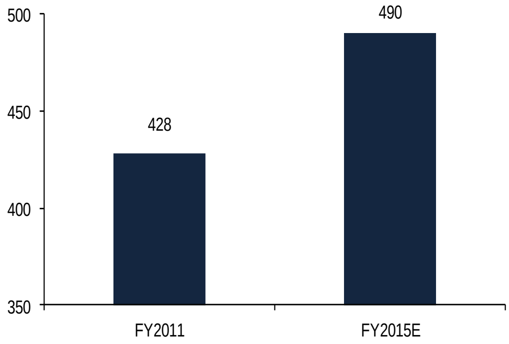
… Reflected by a rise in the number of rigs and FPUs. Increase in E&P activities are reflected in the growing number of rigs being deployed. The current estimate for the offshore global rig count, as of September 2011, is around 847 and industry expectations call for an addition of 153 new build rigs over the next five years. Also, the floating production unit market is expected to add 62 new FPUs to the existing 428 units worldwide over the next six years. These additions are expected to be deployed in international markets rather than in the Gulf of Mexico, where bulk of the E&P activity is now concentrated, due to relatively lower operating costs and higher day rates.

Expected Change in Global Offshore Rigs



Source: Tidewater Q3 2011

Expected Change in Global FPUs

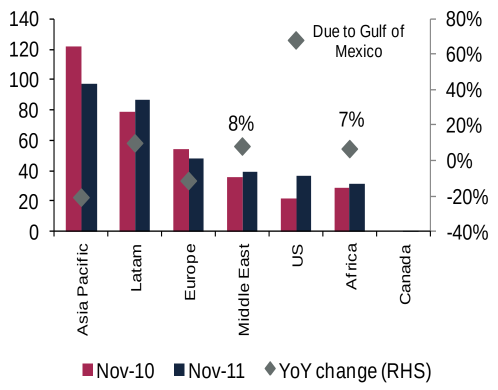


Source: Tidewater Q3 2011

Caspian, Middle East and West Africa Remain in Growth Mode

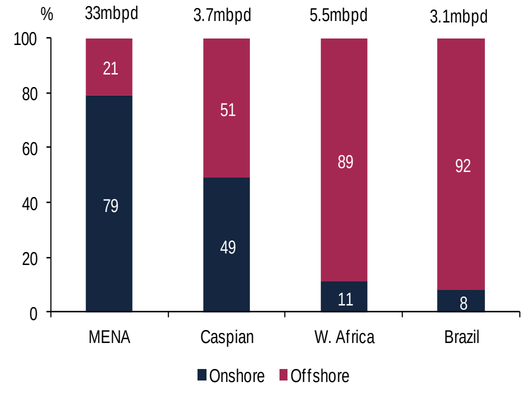
Globally, E&P activity has emerged as one of the highest in the Caspian and the Middle East regions. This can be gauged by the growth in the number of rigs in these regions. According to Mi-Swaco (a Schlumberger company), in May 2011, the offshore rig count increased to 39 in the Caspian region (comprising Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan). According to data from Baker Hughes, as of November 2011, the number of offshore rigs operating in the Middle East and Africa were 39 and 31, respectively. The Middle East constitutes around 11.5% of the offshore global rig count and we expect this share to augment, given the strong outlook for upstream capital expenditure in the Middle East. Similar to the Middle East, the Caspian region is also expected to witness an increase in E&P activity (mainly in Azerbaijan and Kazakhstan), as oil and gas exports from this region are expected to double over the next two decades.

Global Offshore Rotary Rig Count



Source: Baker Hughes, November 2011

2015 Estimates for Oil Production



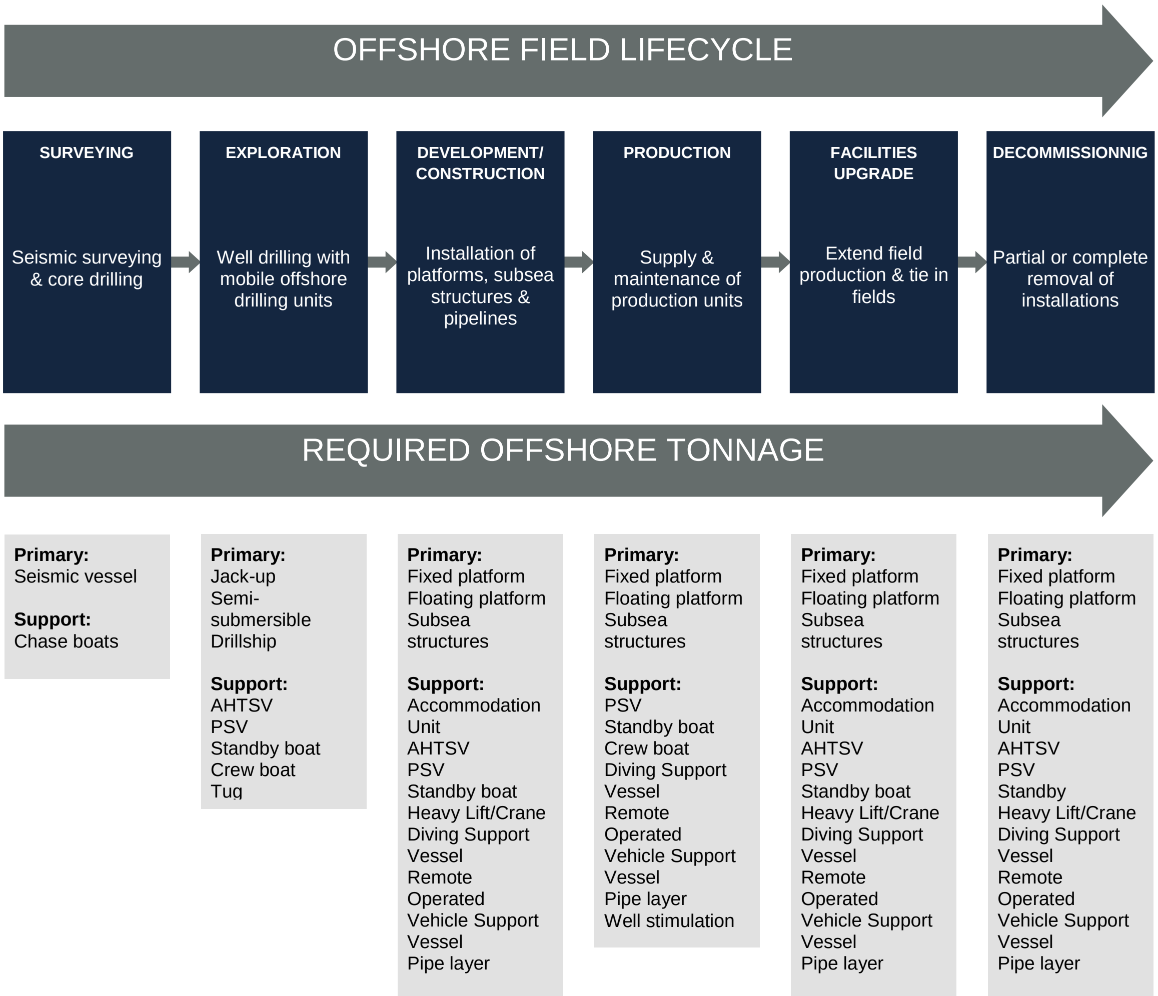
Source: Company Data, ODS Petrodata

Within offshore oil and gas, West Africa is seen as a frontier market. There has been a scale-up in exploration activities along the West African coast after the deepwater discovery of oil in the Jubilee field of Ghana (2007) and in Sierra Leone (2009). Nigeria with proven oil reserves of around 37 billion barrels has the tenth largest oil reserves in the world and remains a key supplier to the US (nearly half of Nigeria's supply is exported to the US representing around 8% of the US oil imports), making it a prominent oil producing region in Africa. Most of the country's primary reserves are concentrated around the Niger River delta, while offshore rigs are also present in the coastal region. Despite the highly volatile conditions in the country, oil majors continue to evince significant interest in Nigeria as the oil found here (Bonny light) is sweet (largely free of sulfur) making it comparable to oil extracted from the North Sea. A recent example is the purchase of concession rights to an offshore field, OPL 245, by Royal Dutch Shell and Italian Eni. This field is estimated to hold around 9bn barrels of oil. Although the deal value has not been disclosed, industry experts peg it at around USD1bn. Other major operators with presence in the country include Exxon Mobil, Chevron, Total, etc.

OSV Operators Should Benefit from the Increase in Offshore E&P Activity

Offshore Support Vessels are used in every part of the offshore value chain. There are a wide range of OSVs in use. Prominent among these are AHTSVs (Anchor-Handling Tug Supply Vessels) and PSVs (Platform Supply Vessels). AHTSVs are used for 1) anchor-handling duties and towage of offshore drilling units, construction vessels and floating production units; 2) offshore supply and 3) emergency response and rescue. AHTSVs are present across the entire spectrum of the offshore value-chain reflecting their versatility. PSVs are used for transporting liquid and dry cargo to and from offshore installations, drilling rigs and construction vessels. As compared to AHTSVs, PSVs do not possess anchor-handling equipment, which provides a larger area for carrying supplies. According to industry reports, demand for PSV new-builds has been growing faster than AHTSVs due to growing interest in deepwater activities.

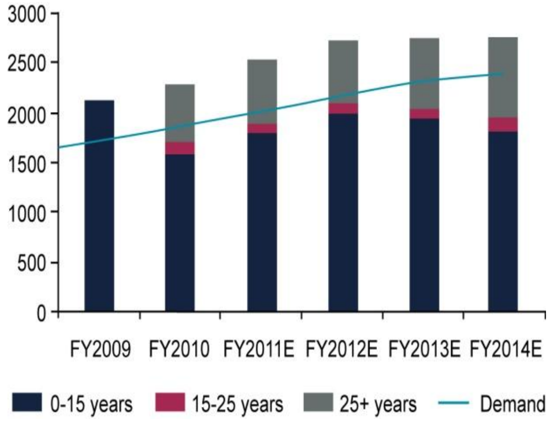
AHTSVs and PSVs Form a Crucial Part of the Entire Offshore Development Lifecycle



Source: RS Platou, industry reports

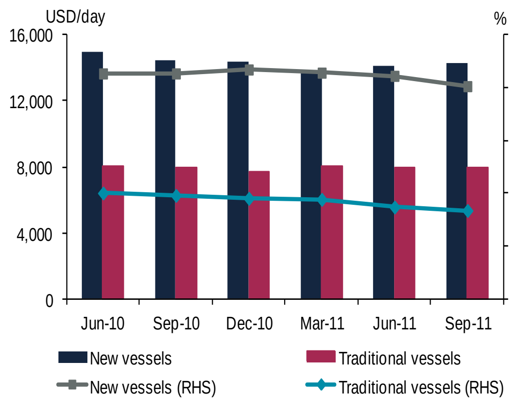
An aging global OSV fleet and lower new additions will result in a tight market … The global OSV fleet is estimated at 2,670 vessels, of which 725 vessels are more than 25 years old (nearly 27% of total vessels). These vessels will soon need to be decommissioned and replaced by new vessels. However, as of September 2011, there were only 455 vessels (17%) under construction over the next five years, clearly indicating a demand-supply mismatch in future. On the other hand, demand for global OSVs is expected to grow with an increase in offshore investments leading to tight market conditions. This should result in increased utilization and higher day rates, benefiting OSV operators.

OSV Demand Exceeds Supply by 2014



Source: Company Data, ODS Petrodata

Day Rate and Utilization for Worldwide Fleet



Source: Tidewater

… Which should benefit OSV operators with younger vessels such as RNSS. OSV operators with a young fleet have better utilization of vessels and command higher day rates, as new vessels 1) consume less fuel; 2) have higher capacity and 3) are able to operate in deeper and harsher environments. We have illustrated the difference in new and traditional vessels, using the data of the worldwide fleet of Tidewater Inc. as a reference case in the above chart ("Day Rate and Utilization for worldwide fleet").

Increasing interest in offshore exploration and production combined with tight OSV markets will augment the marine segment of RNSS, especially considering its young fleet.

Company Background

Company Description

A major regional upstream services provider. Established in 1996, RNSS offers support services to the upstream business operations of oil and gas companies in the Caspian and MENA regions. Currently employing around 11,000 people, the company has a presence in more than 16 countries through three main segments – marine, engineering and contract services. RNSS owns more than 100 OSVs. In 2010, RNSS generated OMR253mn (USD659.1mn) in total revenue (split 37/26/33 between marine/engineering/contract services) and OMR73mn (USD189.4mn) in EBITDA (split 67/9/23).

Company Snapshot

Fleet size (OSVs)	100+	Revenue 2007-2010 CAGR (%)	8.4%
Enterprise value (OMR mn)	497	EBITDA 2007-2010 CAGR (%)	18.2%

Source: Company Data

Company History

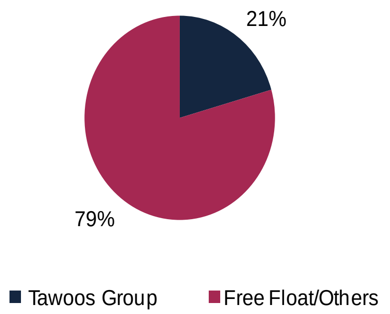
Spun off from the Omani conglomerate, Tawoos Group in 1996, RNSS has grown rapidly. Tawoos Group became the first family-owned business in Oman to offer shares for public ownership with the USD27mn IPO of Renaissance. Initially a contract services player with smaller interests in media, training and IT, RNSS underwent a strategic transformation when it acquired MSM-listed Topaz Energy and Marine in April 2005 in an all-stock deal worth OMR27.2mn (USD70.6mn). This purchase allowed the company to expand into the marine and engineering business segments, while acquiring around three decades of domain expertise in servicing offshore field development activities of major oil and gas companies. Topaz primarily operated in the UAE, the Gulf region and SE Asia. Soon thereafter, RNSS acquired an UK-based private company, BUE Marine, for OMR11mn (USD28.7mn) in cash allowing the company to become a global top-10 offshore support vessel operator and expand its geographical scope to the Caspian Sea region. Since then, RNSS has grown both organically and inorganically – the company established two shipbuilding facilities in Fujairah and Abu Dhabi, while undertaking a series of small acquisitions primarily in oil and gas services. Overall, the company has grown its top line at a CAGR of around 20% over 1996-2010.

Management Team

Name	Designation
Samir J. Fancy	Chairman
Stephen R. Thomas	CEO
Vishal Goenka	CFO
Roy Donaldson	COO, Marine & Eng.
Adil M Bahwan	Fleet Director
Ananda Fernando	CEO, Contract Services

Source: Company Data

Major Shareholders



Source: Zawya

Project and Contract Announcements (Since 2010)

Date	Segment	Contract Value	Contract Details
26-Sep-11	Marine	OMR15.4mn (USD40.1mn)	Contract with BP in Azerbaijan for platform supply vessel for 4 years
28-Jun-11	Contract Services	OMR19.0mn (USD49.4mn)	Services to the Ministry of Health Hospitals in Oman. Services include catering, cleaning, laundry and pest control services for the hospitals
26-Jun-11	Marine	OMR61.5mn (USD160.0mn)	Two long-term vessel contracts. Anchor-handling tug supply vessel was contracted for three-years by Saudi Aramco to carry out offshore oilfield services in the Arabian Gulf. Cable-lay vessel was contracted to client ABB AB High Voltage Cables for five-year wind farm support after successfully completing a two-year charter
June-11	Engineering	N/A	Short-term contract to provide maintenance, engine inspection and supply of parts to an Oman-based client
26-Apr-11	Marine	N/A	Two-vessel contract in offshore Nigeria (West Africa) for 8 months. AXXIS Petroconsultants Ltd. is the client
22-Feb-11	Marine	N/A	3-year contract with Petrobras in Brazil for two offshore supply vessels
14-Jan-11	Marine	OMR18.5mn (USD48.0mn)	Contract with Maersk Oil Qatar for 5 years. Value includes five one-year extension options
31-Jan-11	Contract Services	N/A	Contract with Petroleum Development Oman (PDO). Integrated media services contract for publishing and design services for 3 years
19-Oct-10	Engineering	OMR38.5mn (USD100.0mn)	Contract from GPS Chemoil for Engineering, Procurement and Construction (EPC) services involving construction of an oil storage terminal in Fujairah, UAE
4-Jul-10	Marine	N/A	Contract with ADAMS Offshore Services Ltd. Vietnam involving a multipurpose support vessel
28-Jun-10	Engineering	OMR17.3mn (USD45.0mn)	Contract with Gulf Petrochem to design, procure and construct a petroleum storage terminal near the Port of Fujairah, UAE
12-Apr-10	Marine	OMR86.5mn (USD225.0mn)	Contract with BP in Azerbaijan for a recovery and response vessel deployed in support of 10-year, USD225mn contract signed in 2008

Source: Company Data

M&A Announcements

Date	Segment	Value	Details
20-Dec-10	Contract Services	OMR5.9mn (USD15.3mn)	Acquisition of 100% of Al Wasita Emirates for Services & Catering LLC, an industrial services and catering business based in Abu Dhabi, UAE
3-Nov-10	Contract Services	N/A	JV in Abu Dhabi, UAE to provide catering, cleaning and facilities management services to onshore and offshore oil and gas companies, and services to organizations in the healthcare, education, defense, commercial and industrial sectors

Source: Company Data

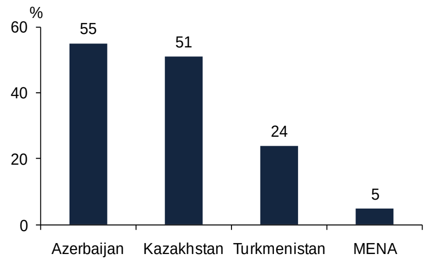
Business Profile and Segments

Business Profile

A leading services provider in the oil and gas industry. RNSS has grown from being a contract services player to a leading OSV operator through strategic acquisitions of Topaz and BUE Marine. RNSS benefits from being:

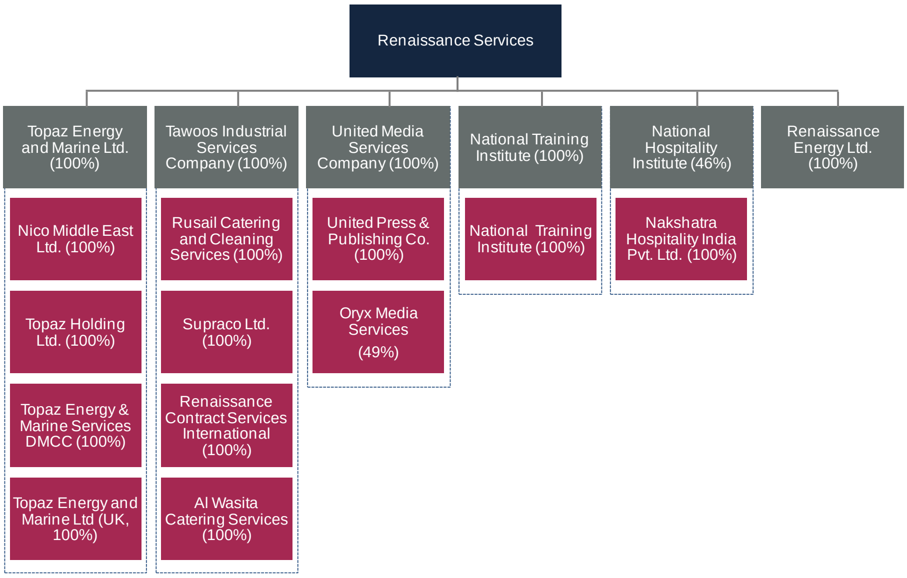
- **A leading OSV operator with a presence in several growth markets …** The company's OSV operations are concentrated in the Caspian Sea (Azerbaijan, Kazakhstan and Turkmenistan), which is a region renowned for its hydrocarbon wealth. Further, RNSS has recently ventured into Brazil and West Africa (Nigeria), which are considered as the next areas of growth in offshore oil and gas exploration. The company also has a presence in the offshore marine service sector of Qatar with more than 20 vessels.
- **… And the top domestic contract services player.** RNSS is the leading contract services player in Oman, especially given its PAC relationship with PDO. The segment also enjoys the patronage of many government-run institutions in Oman, including Diwan of Royal Courts, various ministries, Royal Guard of Oman, Sultan Qaboos University and Sultan Qaboos University Hospital.
- **However, the company's engineering segment is passing through turbulent times.** The performance of the engineering segment has been adversely affected in the last few quarters by the absence of EPC contract wins, turning it into a loss-making unit. Engineering segment contribution has declined from a high of 37.6% in 2008 to 25.9% last year. The last major contract from GPS Chemoil, worth USD100mn, was announced in October 2010. With backlog drying up, the segment needs to bag new contracts to turn profitable and remain as one of the top EPC contractors in the oil and gas industry in the Middle East.

Marine Market Share – 2010



Source: Company Data

Group Structure



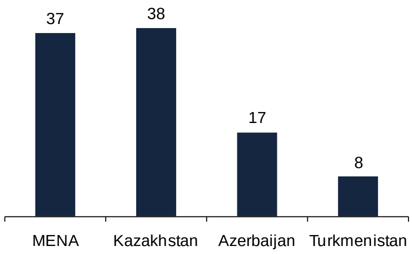
Source: Company Data

Business Segments

Marine: Top-10 largest operator globally. The marine segment, controlled through its wholly-owned subsidiary Topaz Energy and Marine, operates a modern fleet of 100+ OSVs, including AHTSVs, PSVs, survey vessels, specialized barges and ice-breakers. According to company data, around 3% of Topaz's fleet is deployed in support of hydrocarbon exploration while 77% is involved in field development and the remaining 20% in support of oil and gas production. Roughly 80-85% of the existing fleet falls under the shallow water category, while the remaining fleet operates in deep water. The marine segment derives vast majority of its revenue from secure, medium-to-long-term contracts with major oil heavyweights such as BP, Agip KCO, Saipem and Total. Moreover, around 60% of the marine business comes from long-term contracts (5+ years). This gives RNSS a solid visibility of its future marine revenue streams.

- **Marine vessels in the MENA region (37% of the total fleet) operate from Dubai** and consist of fleets operated by Nico International, Doha Marine Services and Topaz Marine Saudi Arabia. RNSS operates two shipbuilding facilities in Fujairah and Abu Dhabi.
- **Marine vessels in the Caspian region (63% of the total) are deployed in fleets operated by BUE Caspian, BUE Kazakhstan and BUE Turkmenistan.** In addition, Topaz Marine commands more than a 50% market share in Azerbaijan and Kazakhstan.

Number of Vessels, by Region



Source: Company Data; Note: Includes vessels under construction

2010 Fleet Mix by Region

Region	Currently Operating	Under Construction	Total
MENA	32	5	37
Kazakhstan	36	2	38
Azerbaijan	14	3	17
Turkmenistan	8	0	8
Total	**90**	**10**	**100**

Source: Company Data

2010 Fleet Mix by Vessel

Region	Currently Operating	Under Construction	Total
AHTS/AHTSV	32	4	36
PSV/MPSV	17	2	19
ERRV	3	0	3
Crew Boat	7	2	8
Specialized Barges	23	2	25
Others	8	0	8
Total	**90**	**10**	**100**

Source: Company Data

Vessel Descriptions

Type of Vessel	Description
Anchor Handling Tug Supply Vessels (AHTSV)	AHTSVs are used to tow oil rigs and anchor them. They can also serve as Emergency Response and Rescue Vessels (ERRVs). These vessels differ from Platform Supply Vessels (PSVs) as they have 1) winches for towing and anchor handling; 2) an open stern to allow the decking of anchors and 3) more power to allow towing. The machinery is specifically designed for anchor handling and towing operations. The reference load used in the design and testing of the towing winch is twice the static bollard pull (pulling force required to be sustained for towing under test conditions).
Platform Supply Vessels (PSV)	PSVs are used primarily for transportation of goods and personnel to and from offshore oil platforms and other offshore structures. These ships (ranging 20-100 meters in length) are used to carry cargo like drilling mud, pulverized cement, diesel fuel and chemicals used in the drilling process. Certain vessels are customized for operational support like being fitted with fire-fighting equipment, oil containment equipment, specialized tools, etc.
Emergency Response and Rescue Vessels (ERRV)	An ERRV has the following characteristics: 1) highly maneuverable; 2) powerful and fast to reach and recover emergency points; 3) at least two methods of recovering persons (including those injured) from the sea; 4) appropriate medical facilities on board; 5) constructed so that fast daughter craft launches and personnel recovery areas are in full view from the bridge and 5) at least 2 remotely controlled 360° searchlights.
Crew Boats	Crew boats are small vessels, which can be used for commercial purposes like fishing, ferrying passengers and patrolling or for personal purposes.
Specialized Barges	A barge is a flat-bottomed boat (used in shallow waters) built mainly for transport of heavy goods. Some barges are not self-propelled and need to be towed or pushed by towboats. A jack-up rig is a type of specialized barge that can stand still on the seafloor with the support of legs that can be lowered or raised and used for servicing other offshore structures like offshore wind turbines, long bridges and drilling platforms.

Source: Industry reports

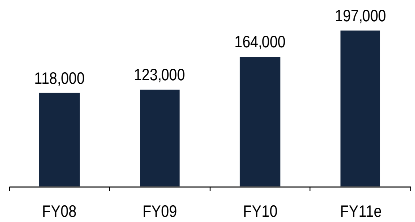
Engineering: Significant expertise in oil and gas despite recent troubles. RNSS' Topaz Engineering division is involved in executing oil and gas projects, including modules for floating production storage and offloading, LNG loading modules and jackets. This segment, earlier grouped into four sub-segments, has been more recently restructured into two:

- **Oil and Gas Engineering** comprises 1) Fabrication and Construction and 2) Maintenance Services.
- **Marine Engineering** is now focused on 1) Ship Building and 2) Marine Repair.

Adyard Abu Dhabi and Nico International are the key units of the engineering division. While Adyard operates from Abu Dhabi, Nico International runs operations in Dubai, Fujairah, Salalah, Bautino and Baku. Overall, the company has 35 years of experience in delivering large-scale and complex projects for blue-chip customers in the MENA region and more recently in the Caspian.

Contract services: Leading player in Oman. This segment provides facilities management, facilities establishment, contract catering, operations and maintenance services to large-scale projects, including those in harsh, remote or beleaguered environments serving a broad client base and controls 67% and 46% of the contract services market in Oman and Norway, respectively. Other countries in which the contract services segment operates include Angola (18% market share), Afghanistan (10%), Iraq (10%) and the UAE (5%).

Meals Served per Day



Source: Company Data

Key Competencies in Contract Services Segment

Segment	Activities
Catering	Oil & Gas sector, Universities, Schools, Hospitals, Military & Guards, Commerce & Industry
Facilities Management	Facilities Management & Facilities Establishment – Build, Own, Operate: Camps, Dining Facilities (DFACs) and Life Support Accommodation (LSA), Permanent Accommodation for Contractors (PACs)
O&M	Operations and Maintenance
Support Services	Cleaning, Laundry, Accommodation Services, Leisure Services; Property & Estate Services, Event Management

Source: Company Data

- **PAC is a concept developed by PDO under which RNSS builds, owns and operates accommodation facilities for PDO's contractors** along with provisioning of recreational, medical and other facilities. The contracts entered with PDO for Marmul and Bahja in 2010, which will be valid until 2044, provides earnings visibility for the long-term.

PAC Capacity in Oman

PACs as of 2010	Year opened	Extensions	# of Rooms
Nimr	2000	2008-112 2009- 82 2010- 40	530
Fahud	2000	2008-112 2010-112	640
Qarn Alam	2002	2005-100 2006- 50 2008-112	725
Marmul	2010		728
Bahja	2010		448

Source: Company Data

Other segments: Marginal contributors. RNSS is also engaged in education & training (ET) and media communications. The ET segment provides training solutions in energy, construction, retail and hospitality sectors. Under media communications, the company provides a gamut of services including advertising, IT solutions, publishing, media representation, media distribution & communications logistics, public relations, and event management.

Key Forecasts

Revenue

We expect a 6.5% CAGR in total revenue during 2010-2016, driven mainly by the marine segment. We forecast the company's revenue by projecting the revenue of its three diverse segments individually.

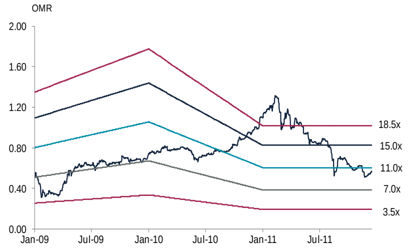
- **The marine segment will remain Renaissance's growth engine.** We expect the marine segment revenue to post a 9.1% CAGR over 2010-2016 on the back of expansion in the marine fleet and expectations of an increase in freight rates. Considering its young fleet, RNSS is well positioned to command higher freight rates and better utilization of its vessels on account of an increase in offshore E&P activity in the Caspian and Middle East regions. Nevertheless our forecasts remain conservative given: 1) we assume a marginal 2% growth per annum in day rates; 2) our estimate of fleet expansion remains somewhat modest versus other analysts with our model showing a back-end loaded fleet growth and 3) our fleet utilization remains at the low end of management's guidance of 85-95% (utilization was 80% at the end of Q3 2011).
- **Stable growth expectations for the contract services division should provide support.** We are modeling for top-line to stabilize at a CAGR of 6.6% over our forecast period. This follows a ~30% YoY growth in revenue in 2010 with the company entering new markets (the UAE and Afghanistan) and bagging new contracts. Moreover, this segment is expected to grow 15% in 2011 given the improving occupancy at the company's latest PAC facilities in Marmul and Bahja.
- **The engineering services segment is likely to remain a laggard.** With an order backlog of OMR33.4mn (59% and 33% of YTD and 2012 sales, respectively), there remains a pressing need for RNSS to focus on competitive tendering and winning new contracts. After a roughly 16% decline in 2010 revenue, we are forecasting a 14% increase in 2011. Overall, we project revenue of the engineering segment to grow at a CAGR of 3.4% during 2010-2016. Going forward, we will continue to monitor this segment for any significant changes in its growth outlook.

Revenue mix should shift toward the marine segment. The company's sales mix for 2010 was well balanced with contributions of marine, contract services and engineering segments at 36.8%, 33.2% and 25.9%, respectively. Considering our expectations for healthy revenue growth in the marine segment, we project it to dominate with a 42.5% share of consolidated revenue by 2016, followed by the contract services segment at 33.4%. However, the engineering segment's contribution is expected to fall to 21.6%.

Profitability

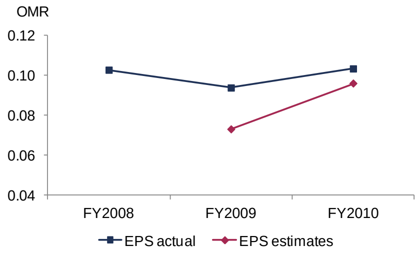
We expect operating profit (EBIT) to grow at a 7.4% CAGR during 2010-2016, outpacing revenue growth. Given the weak profitability performance YTD, especially in the engineering segment, and a spate of bad news, we have adopted a conservative approach in forecasting margins. Operating margins are expected to decline to 14.2% in 2011 (vs. 19.2% in 2010). After this year, an increased focus on cost optimization and a shift toward the higher-margin marine segment will result in a decline in operating expenses as a percentage of revenue. Consequently, operating margins are expected to improve gradually over our forecast period, reaching 20.2% by 2016.

1 Year Forward P/E Band



Source: Bloomberg

Earnings Surprise



Source: Bloomberg; Note: EPS estimates for RNSS is N/A for 2008

- **The marine segment should remain the major contributor to operating profit.** Though we expect the marine business to drive overall revenue growth, we forecast operating margin contraction in 2011 to ~32% (in line with YTD performance) as compared to ~ 38% in 2010 due to subdued profitability thus far this year. Our forward forecasts for operating margins remain conservative and we do not forecast a yearly improvement until 2014 (34%). We believe that 2010 will likely remain the high water mark year in terms of operating margins.
- **We forecast improvement in contract services margins post 2011.** We are modeling a ~300bps contraction in the segment's operating margins in 2011 considering increased cost pressures due to changes in Oman's labor laws and rising food prices. The management has informed us that major clients have agreed to absorb around 80% of the additional costs related to the pay hikes of Omani employees. Thus, we expect margins to steadily recover as these costs are passed on and reach 13% and 14% by 2012 and 2013, respectively.
- **We forecast operating break-even in the engineering services segment in 2013.** Reeling under operating losses, limited visibility on earnings and ongoing restructuring activities, we forecast the engineering services segment to post an operating loss of OMR5.6mn in 2011. RNSS remains confident of achieving break-even in 2012 but we choose to remain somewhat cautious. Profitability will be affected by certain committed projects (in oil and gas engineering) that have little-to-no margins and have to be delivered by 2012. In our view, improvement in this segment will depend on securing significant contract wins at profitable spreads. Moreover, we would like to see evidence that RNSS disclosed restructuring initiatives of lowering its engineering headcount by more than 100 personnel will bear fruit and yield annualized cost savings of at least USD6.3mn (including USD2.5mn in corporate overhead). We expect this segment to turn profitable only in 2013 with an operating margin of 1%, which we steadily increase to 3% by 2016.

Lower operating margins coupled with higher finance costs, restructuring costs and one-time charges will result in a slight net loss in 2011. According to the Chairman's report for Q3 2011, the company expects one-time charges of USD38mn (USD30mn related to the engineering services segment and USD8mn related the postponed London listing of Topaz) in 2011. Excluding these charges, the company could have reported an OMR13mn net profit for 2011. Going forward, we expect the net profit margin to recover to 6.7% in 2012, reaching 10.3% by 2016.

Capital Expenditures

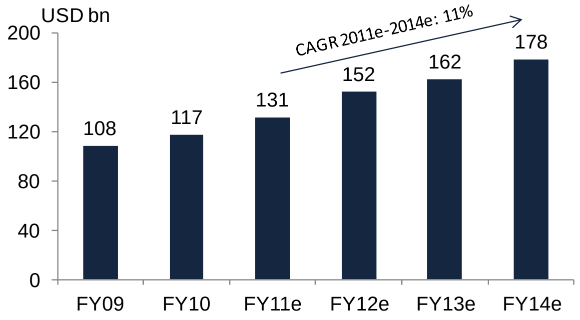
Capex should be subdued as compared to initial plans. At the beginning of 2011, RNSS had announced plans to infuse capital investments of USD2.3-2.6bn over 2011-2013. However, given the postponement of the Topaz IPO, the capex plans are likely to be pared down significantly. Currently, we are forecasting less than USD1bn in capex in the company's marine segment over 2011-2016.

Financial Position

Net debt-to-equity ratio should decline in the medium-term. Total loans (term loans and bank overdraft) have grown by 22% YTD to OMR352mn. As a result, the net debt-to-equity ratio stood at 1.9x as of September 2011 as compared to 1.5x in 2010. RNSS is on track to raise around OMR144mn in debt to refinance roughly OMR97mn in upcoming repayments along with ~OMR48mn for spending on vessels under construction and for capex on new vessels. With further vessel additions planned for the marine division, we expect RNSS to take up additional debt until 2013. Post 2013, positive free cash flow given a decline in capex will facilitate a reduction in the net debt-to-equity ratio to 1.1x by 2016.

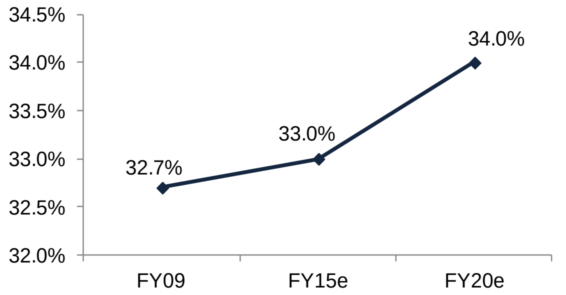
Marine and Engineering: Macro data

Global Offshore Capex



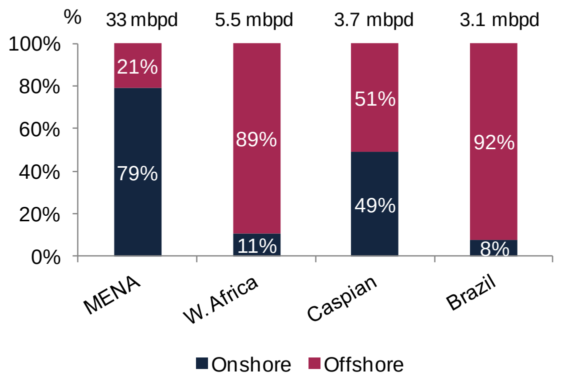
Source: Company Data

Offshore Oil Production as % of Global Oil Production



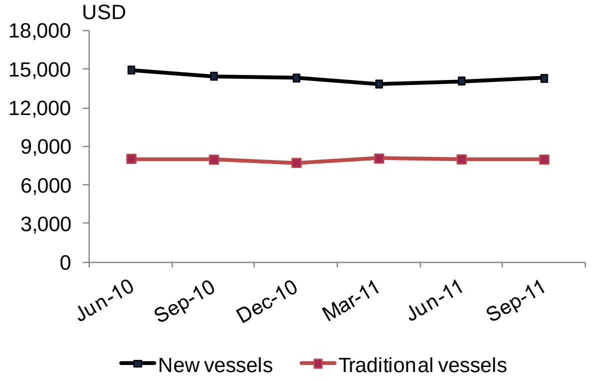
Source: Company Data

Oil Production Forecast In 2015



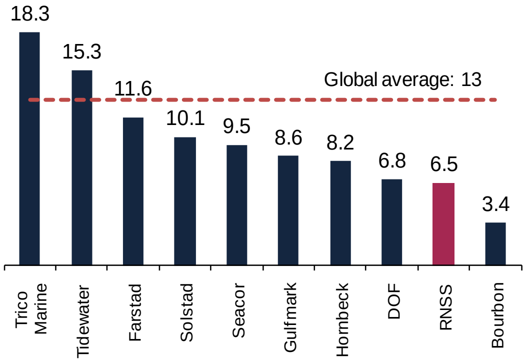
Source: Company Data

Day Rates for Vessels



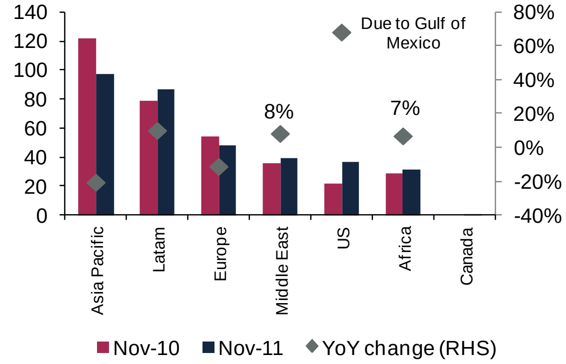
Source: Tidewater

Average Fleet Age



Source: Company Data

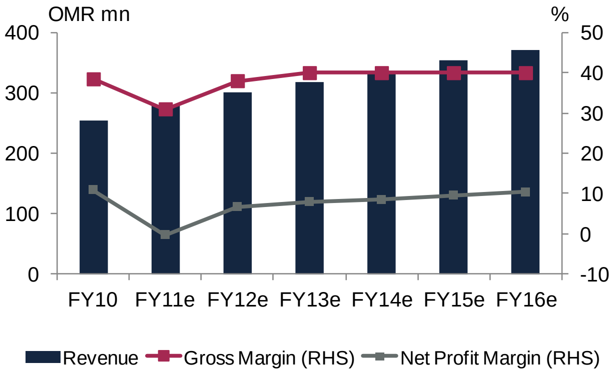
Global Offshore Rotary Rig Count



Source: Baker Hughes, November 2011

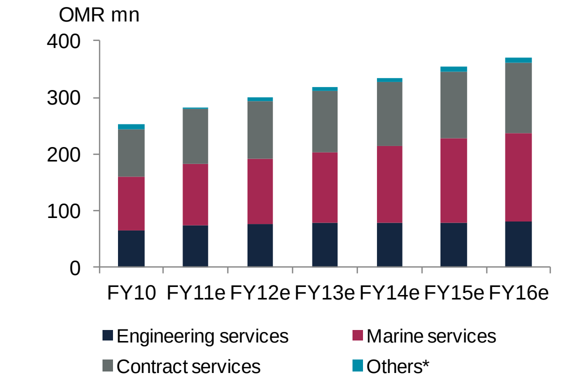
Financial Analysis: Revenue, Returns and Capex

Revenue and Margins



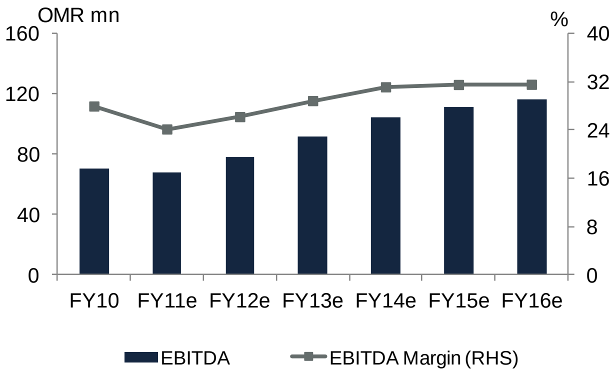
Source: Company Data, QNBFS Estimates

Revenue Distribution by Business



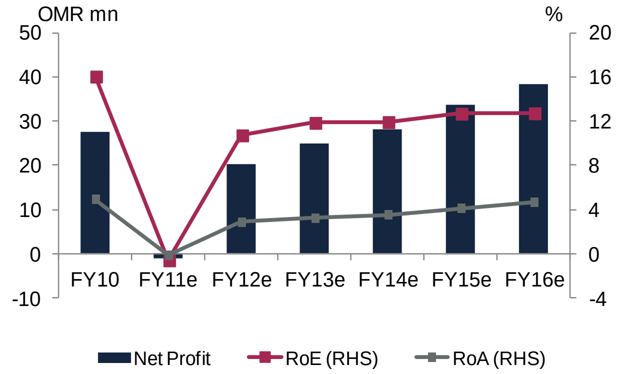
Source: Company Data, QNBFS Estimates; Note: * Others consist of Education and Training, Media Communication and Adjustments

EBITDA and EBITDA Margins



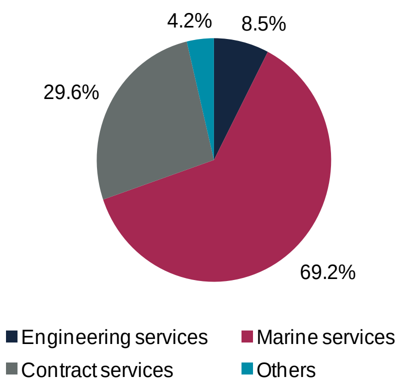
Source: Company Data, QNBFS Estimates

Profitability



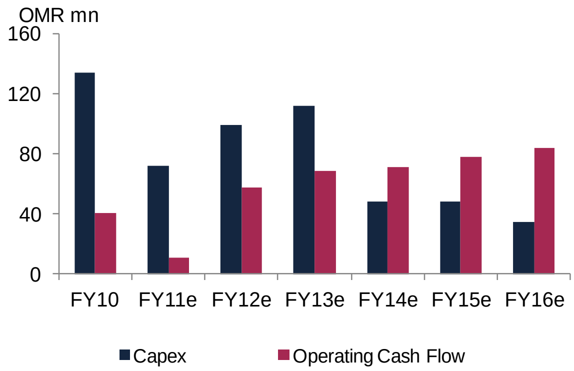
Source: Company Data, QNBFS Estimates

Profit from Operations – 2010



Source: Company Data

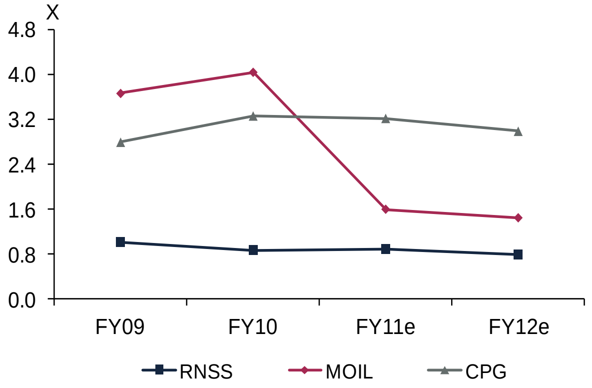
Capex and Operating Cash Flow



Source: Company Data

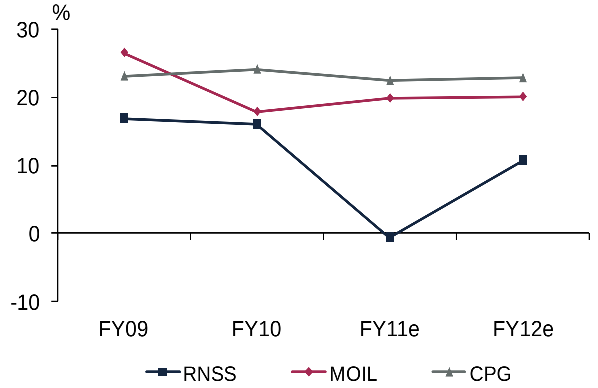
Peer Trend Analysis

P/B



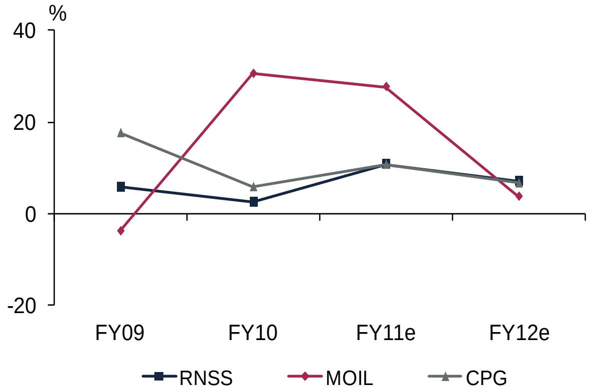
Source: Bloomberg, QNBFS Estimates

ROE



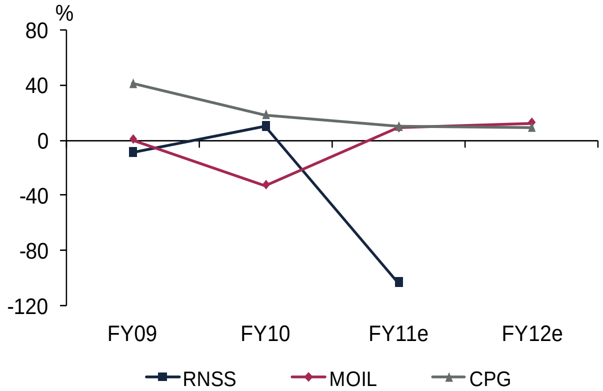
Source: Bloomberg, QNBFS Estimates

Revenue Growth



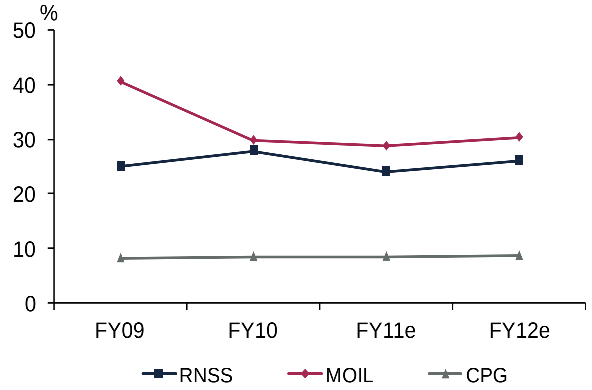
Source: Bloomberg, QNBFS Estimates

EPS Growth



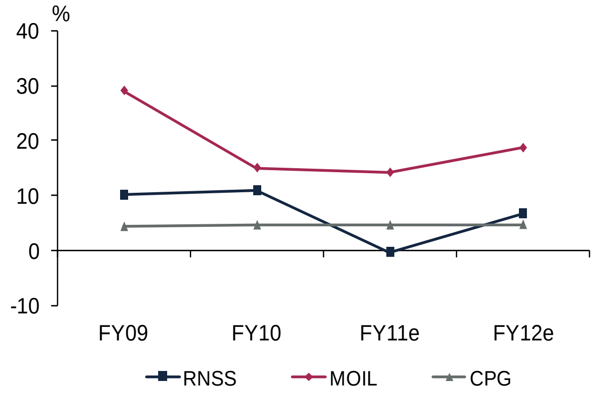
Source: Bloomberg, QNBFS Estimates; Note: We expect negative EPS for RNSS in FY11e, hence EPS growth for FY12e is N/M.

EBITDA Margin



Source: Bloomberg, QNBFS Estimates

Net Profit Margin



Source: Bloomberg, QNBFS Estimates

Detailed Financial Statements

Income Statement

Figures in OMR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
Revenue	248	253	205	281	300	318
Operating expenses	(153)	(156)	(137)	(194)	(186)	(191)
Gross profit	**94**	**97**	**68**	**87**	**114**	**127**
General and admin. exp.	(33)	(27)	(21)	(19)	(36)	(36)
EBITDA	**62**	**71**	**47**	**68**	**78**	**92**
Depreciation & amortization	(21)	(22)	(21)	(28)	(31)	(35)
EBIT	**41**	**49**	**26**	**40**	**48**	**56**
Net finance costs	(8)	(10)	(13)	(17)	(20)	(22)
Other income/ expense	(0)	0	(2)	(17)	0	0
Profit before tax	**33**	**39**	**11**	**6**	**28**	**35**
Income tax expense	(4)	(7)	(6)	(6)	(4)	(6)
Profit after tax	**29**	**32**	**5**	**1**	**24**	**29**
Minority interest	(3)	(5)	(2)	(2)	(3)	(4)
Profit for shareholders	**25**	**28**	**3**	**(1)**	**20**	**25**
EPS (OMR)	0.09	0.10	0.01	(0.00)	0.08	0.09

Source: Company Data, QNBFS Estimates

Balance Sheet

Figures in OMR mn	FY2009	FY2010	Q3 2011	FY2011e	FY2012e	FY2013e
Non-current Assets						
Property, plant and equipment	283	392	433	436	504	581
Intangible assets	34	39	39	39	39	39
Other long term assets	3	2	2	2	2	2
Total Non-current Assets	**319**	**433**	**474**	**477**	**545**	**622**
Current Assets						
Inventories	11	13	23	24	23	24
Trade receivables	87	94	110	111	107	105
Trading investments	0	0	0	0	0	0
Cash and short term deposits	31	22	29	40	33	25
Total Current Assets	**129**	**130**	**163**	**175**	**163**	**153**
TOTAL ASSETS	**448**	**562**	**637**	**652**	**708**	**775**
EQUITY						
Share capital	28	28	28	28	28	28
Share premium and reserves	28	28	26	28	28	28
Retained earnings and other	92	116	116	112	132	154
Equity attributable to the parent	148	172	171	168	188	211
Minority interest	20	24	25	25	27	29
Total Equity	**168**	**196**	**196**	**193**	**215**	**240**
Non-current Liabilities						
Term loans & borrowings	150	229	261	295	305	320
Payables & advances	18	10	11	10	10	10
Employees benefits	5	6	6	6	7	8
Total Non-Current Liabilities	**173**	**244**	**278**	**311**	**322**	**338**
Current Liabilities						
Trade and other payables	65	62	71	72	69	71
Term loans & borrowings	42	60	92	76	102	127
Total Current Liabilities	**107**	**122**	**163**	**148**	**171**	**198**
Total Liabilities	**280**	**366**	**441**	**459**	**493**	**536**
EQUITY AND LIABILITIES	**448**	**562**	**637**	**652**	**708**	**775**

Source: Company Data, QNBFS Estimates

Cash Flow Statement

Figures in OMR mn	FY2009	FY2010	2011 9M	FY2011e	FY2012e	FY2013e
OPERATING ACTIVITIES						
Profit to equity holders	25	28	3	1	24	29
Adjustments for:						
Depreciation	21	22	21	28	31	35
Amortization	0.03	0.01	0.01	0.01	0.01	0.01
Staff terminal benefits	1	1	1	1	1	1
Changes in working capital	(1)	(10)	(24)	(19)	2.7	4
Net cash from operating activities	**46**	**41**	**1**	**10**	**58**	**69**
Net cash used in investing activities	**(71)**	**(140)**	**(55)**	**(72)**	**(99)**	**(112)**
Net cash used in financing activities	**40**	**91**	**51**	**79**	**34**	**36**
Net decrease/increase in cash equivalents	**15**	**(8)**	**(3)**	**17**	**(7)**	**(8)**
Cash equivalents at beginning of the year	**12**	**27**	**19**	**19**	**36**	**29**
Cash equivalents at end of the year	**27**	**19**	**16**	**36**	**29**	**22**

Source: Company Data, QNBFS Estimates

Growth Rates

Figures in percentage	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Revenue	5.7	2.4	10.7	7.0	5.9
Gross Profit	13.5	3.3	(10.8)	31.1	11.5
EBITDA	12.2	14.5	(4.4)	16.1	16.7
EBIT	8.6	20.2	(18.4)	20.5	17.3
PBT	(1.9)	18.6	(83.4)	334.7	23.8
PAT	5.0	10.2	(103.5)	N/M	23.8
EPS	5.0	10.2	(103.5)	N/M	23.8

Source: Company Data, QNBFS Estimates

Key Ratios

Key Ratios	FY2009	FY2010	FY2011e	FY2012e	FY2013e
Operating Ratios (%)					
Gross Margin	38.1	38.5	31.0	38.0	40.0
EBITDA Margin	24.9	27.9	24.1	26.2	28.8
EBIT Margin	16.4	19.2	14.2	16.0	17.7
Net Margin	10.1	10.9	(0.3)	6.7	7.9
Working Capital Ratios (Days)					
Inventory days	26.3	31.1	45.0	45.0	45.0
Average collection period	128.0	135.1	145.0	130.0	120.0
Payable days	154.3	146.1	135.0	135.0	135.0
Finance Ratios					
Debt -Equity Ratio	1.3	1.7	2.2	2.2	2.1
Net Debt-Equity Ratio	1.1	1.5	2.0	2.0	2.0
Interest Coverage	5.2	4.7	2.4	2.4	2.6
Return Ratios (%)					
ROCE	24.1	24.9	20.7	22.3	23.5
Incremental ROCE	10.8	29.9	N/M	36.7	33.1
ROE	16.9	16.0	(0.6)	10.7	11.9
ROA	5.6	4.9	(0.1)	2.9	3.2
Liquidity Ratios					
Current Ratio	1.2	1.1	1.2	1.0	0.8
Quick Ratio	1.1	1.0	1.0	0.8	0.7
Valuations					
EV/Sales	1.3	1.7	1.8	1.8	1.9
EV/EBITDA	5.4	6.2	7.5	7.0	6.5
EV/EBIT	8.2	9.0	12.7	11.5	10.7
P/E	6.0	5.4	N/M	7.5	6.0
P/BV	1.0	0.9	0.9	0.8	0.7

Source: Company Data, QNBFS Estimates

Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

Contacts

Ahmed M. Shehada	**Keith Whitney**	**Saugata Sarkar**	**Sahbi Kasraoui**
Head of Trading	Head of Sales	Head of Research	Manager – HNWI
Tel: (+974) 4476 6535	Tel: (+974) 4476 6533	Tel: (+974) 4476 6534	Tel: (+974) 4476 6544
ahmed.shehada@qnb.com.qa	keith.whitney@qnb.com.qa	saugata.sarkar@qnb.com.qa	sahbi.alkasraoui@qnb.com.qa

QNB Financial Services SPC

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

QNB
Financial Services