

Qatar Aluminum Manufacturing

Target Price: QAR 1.35
Upside/ (Downside): 9.0%

Recommendation

Hold

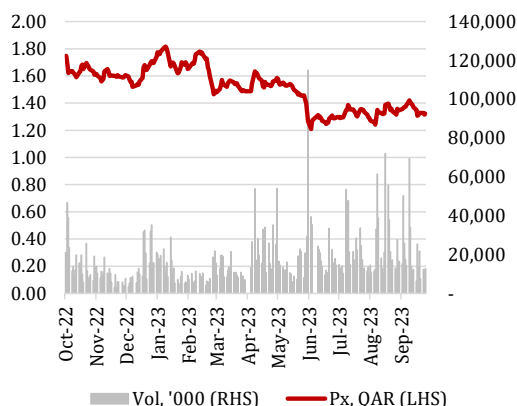
Bloomberg Ticker	QAMC QD
Current Market Price (QAR)	1.24
52wk High / Low (QAR)	1.83/1.20
12m Average Vol. (000)	16,606.3
Mkt. Cap. (USD/QAR mn)	1,834/6,897
Shares Outstanding (mn)	5,580.12
Free Float (%)	49%
3m Avg Daily Turnover (QAR'000)	29,113.7
6m Avg Daily Turnover (QAR'000)	29,200.1
P/E'23e (x)	16.5
EV/EBITDA'23e (x)	1.1
Dividend Yield '23e (%)	6.7%

Price Performance:

1 month (%)	(8.3)
3 month (%)	(4.8)
12 month (%)	(29.2)

Source: Bloomberg, valued as of 23 Oct 2023

Price-Volume Performance



Source: Bloomberg

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- **QAMCO's JV Qatalum continues to operate at full capacity and sells over 95% of its produce, despite a weak operating environment, which suggests it enjoys a largely resilient demand.**
- **The company's revenue has come under pressure as its average realization moves in close tandem with LME aluminum prices which have been in a downward trend since 3Q 2022.**
- **A weak global economic growth outlook due to the elevated interest rate environment and the persisting weakness in China is expected to keep aluminum prices suppressed in the near future, which, in turn, will constrain the JV's top and bottom-line growth.**

We reviewed our coverage of Qatar Aluminum Manufacturing Company (QAMCO) and reduced our target price to QAR 1.35 (previously, QAR 1.77), as the weak demand and prices of aluminum clouds the outlook for the company's growth prospects for an extended period. At the current market price, our target price gives an upside of 9.0% and accordingly, we assign a **Hold** rating (previously, Accumulate) to the stock. Currently, the stock trades at FY'23e P/E of 15.1x and EV/EBITDA of 3.9x, similar to the 12 months (12m) blended forward 3-year daily average P/E of 15.0x but well below the 12m blended forward 3-year daily average EV/EBITDA of 7.3x.

Investment Thesis

Earnings to remain subdued over our forecast period as recovery in aluminum prices is expected to be long-drawn

i) With Qatalum consistently operating at over 100% capacity and no capacity addition planned, except for some de-bottlenecking, production, and sales are expected to be range-bound.

ii) Aluminum prices are estimated to end 2023 significantly lower than 2022 levels and remain suppressed over the next few years. We expect a similar performance in the JV's realizations and hence estimate QAMCO's earnings to post -3% CAGR during FY 2022-2027e (vs. +3% CAGR estimated previously).

iii) Hit primarily by a weak top line, the JV's gross and operating margin is estimated to contract by around 6 pp and 9 pp, respectively in FY 2023. However, based on the forecasts of aluminum prices recovering from next year onwards, the company's cost optimization and efficiency improvement efforts, we estimate margins to stabilize and expand gradually.

iv). QAMCO, with its strong cash position, is expected to easily fund its part of the JV's ~QAR 1.1bn planned capex while continuing to dole out healthy dividends.

Year	FY20	FY21	FY22	FY23e	FY24e	FY25e
Share of results from joint venture (QAR mn)	101.5	831.9	899.8	401.7	439.6	552.9
Net income (QAR mn)	94.7	834.5	919.1	458.2	545.8	640.8
Operating margin	89.6%	98.7%	99.0%	98.0%	98.0%	98.0%
Net profit margin	93.3%	100.3%	102.1%	114.1%	124.1%	115.9%
RoE	1.7%	13.8%	13.9%	6.7%	8.1%	9.4%
FCF (QAR/share)	0.02	0.15	0.16	0.06	0.08	0.10
DPS (QAR/share)	0.04	0.08	0.09	0.09	0.09	0.10
P/E (x)	57.0x	12.0x	9.2x	15.1x	12.6x	10.8x
P/B (x)	0.9x	1.6x	1.2x	1.0x	1.0x	1.0x

Source: Company Reports, U Capital Research

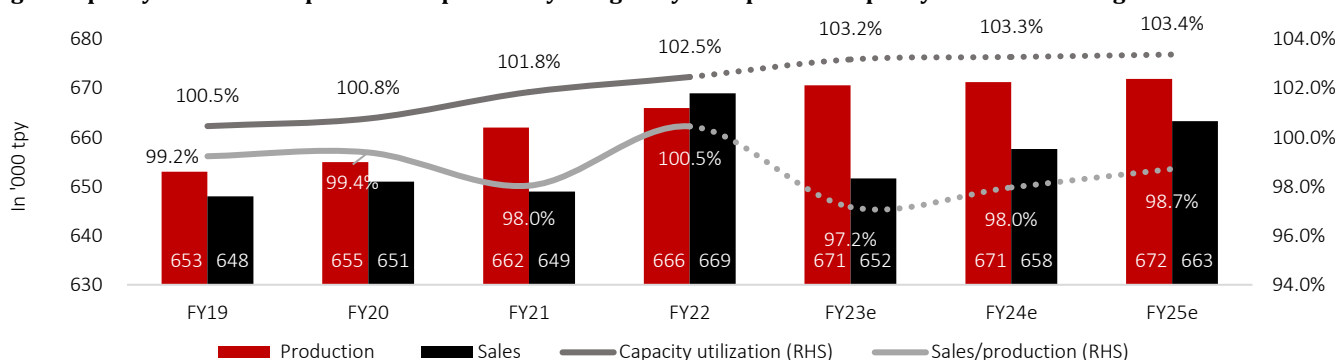
*P/E, P/B, and dividend yield from 2023 onwards are based on current price

Investment thesis

Qatalum's revenue is unlikely to reach FY 2022 levels over our forecast period despite operating at full capacity...

Qatar Aluminium Limited (Qatalum), the 50% JV of Qatar Aluminium Manufacturing Company (QAMCO), registered a 24.8% YoY decline in its revenue during 1H 2023, closely tracking a 24.1% YoY decline in the average LME aluminum price over the same period. The company's sales volume, on the other hand, fell only slightly by 1.6% during 1H 2023 to 317k MT, accounting for ~94% of the total production as compared to around 98% of the total production in 1H 2022. Qatalum's production, meanwhile, edged up 1.8% YoY during the first half of 2023, with the JV continuing to operate at around 103% capacity for a fourth consecutive quarter in 2Q 2023.

Fig. 1: Capacity utilization expected to improve only marginally with planned capacity de-bottlenecking



Source: Company Reports, U Capital Research

Qatalum's plant, located in Qatar's Mesaieed Industrial City, has consistently operated at over 100% before, during, and after the COVID-19 pandemic, with its sales averaging between 95% and 100% of the production. We believe this is largely owing to the company's widespread sales covering Asia, Europe, and America, with Qatalum benefitting from its access to the global sales network of its 50% JV partner Hydro Aluminum through an agreement, under which Hydro is responsible for 100% offtake and marketing of the JV's products.

In its latest update, the IMF has largely maintained the World's GDP growth estimate for 2023 and 2024, which indicates that while being weak, global economic conditions are not deteriorating. Against this backdrop, we remain confident that by leveraging its diverse customer base and Hydro's sales network, QAMCO's JV will continue to operate with similar production and sales metrics as highlighted above. Also, the company intends to spend around QAR 1.1bn in capital expenditures (capex) over the next five years till FY 2027 on various aspects like improving plant reliability and efficiency, capacity de-bottlenecking, investment on health, safety, and environment (HSE), cost optimization, etc., we opine this will not lead to a significant rise in capacity. Hence, we have kept Qatalum's capacity constant, which leads to almost flat production and sales estimates over our forecast period.

Fig. 2: QAMCO's JV plans to spend around QAR 1.1bn during 2023-2027 as capex on various parameters

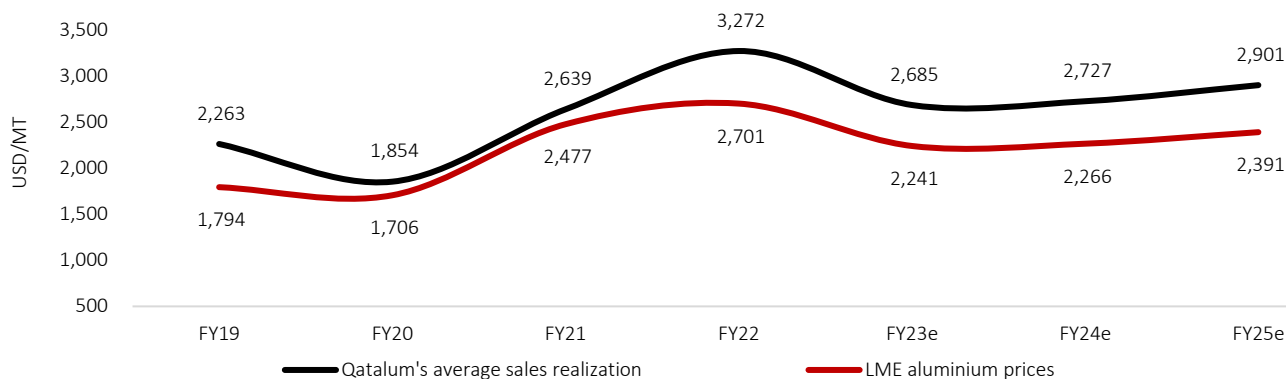
Planned capex (QAR mn)	2023	2024	2025	2026	2027
Pot relining	72	19	31	79	133
Operational capex, < \$5mn	25	17	-	-	-
Capex on other projects, < \$5mn	41	96	85	75	62
Other capex, > \$5mn	107	30	-	-	-
Maintenance and/or replacement capex on turbines, flue walls, rotor refurbishments, networks, and others	47	49	51	48	31
Total	292	211	167	202	226

Source: Company Reports, U Capital Research

...primarily owing to an unfavorable outlook for global aluminum prices

With Qatalum operating at over 100% capacity and its sales/production averaging in the 95-100% range for the last several years, the company has little scope to grow its sales, which is visible in its 1% sales volume CAGR during FY 2019-2022. In contrast, JV's revenue recorded a 14% CAGR during this period, with the average LME prices clocking a 15% CAGR. This clearly shows the close correlation between Qatalum's sales realization and LME prices.

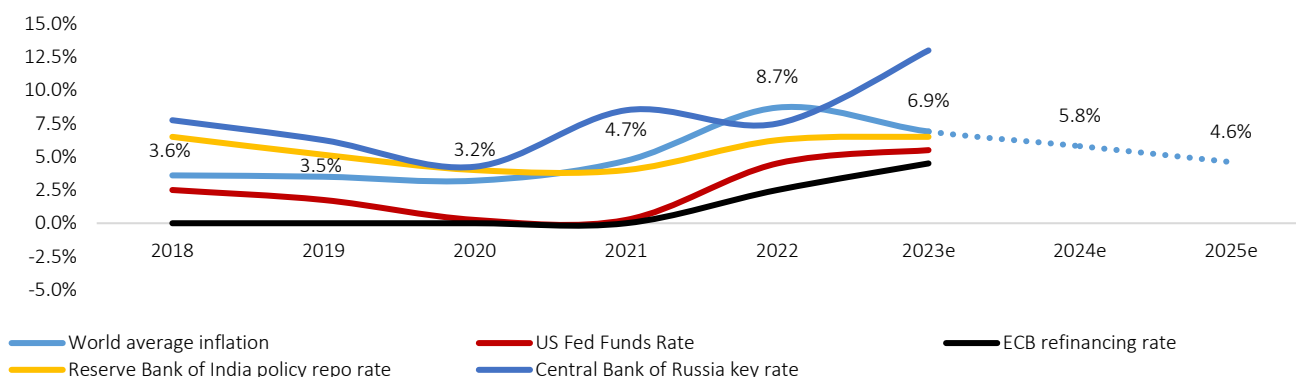
Fig. 3: Qatalum's average sales realization generally moves in sync with LME aluminum prices



Source: Bloomberg, Company Reports, U Capital Research

Over the last five quarters since 3Q 2022, LME aluminum prices have registered a consistent YoY decline and their outlook has also deteriorated. Some of the factors weighing on the global prices of aluminum are: i) a slowdown in global economic growth; ii) rising interest rates to tame inflation, which is dampening industrial and consumer demand; iii) supply-demand balance tilted towards supply currently, with the London Metal Exchange (LME) warehouses reportedly witnessing a rise in Russian aluminum inventory as its offtake reduced due to Ukraine-war related sanctions, and a restart of production by aluminum smelters in China. The research firm BMI, a unit of Fitch Solutions, estimates that production of aluminum from China will grow 2.2% YoY in 2023 to reach 41.3mn tons after rising 4.0% YoY in 2022; and iv) a struggling Chinese economy with a problematic real estate sector. While the realty sector is one of the major users of aluminum, where it is used in window and door frames, shower enclosures, partitioning, etc., China is the World's largest producer and consumer of silvery-white metal. BMI estimates that in 2023, China alone will account for nearly 63% of the global aluminum demand.

Fig. 4: Several major countries have raised their key interest rates since 2021 multiple times to tame inflation



Source: Global-rates.com, U Capital Research; FY 2023 interest rates are the most recent policy rates of the respective countries

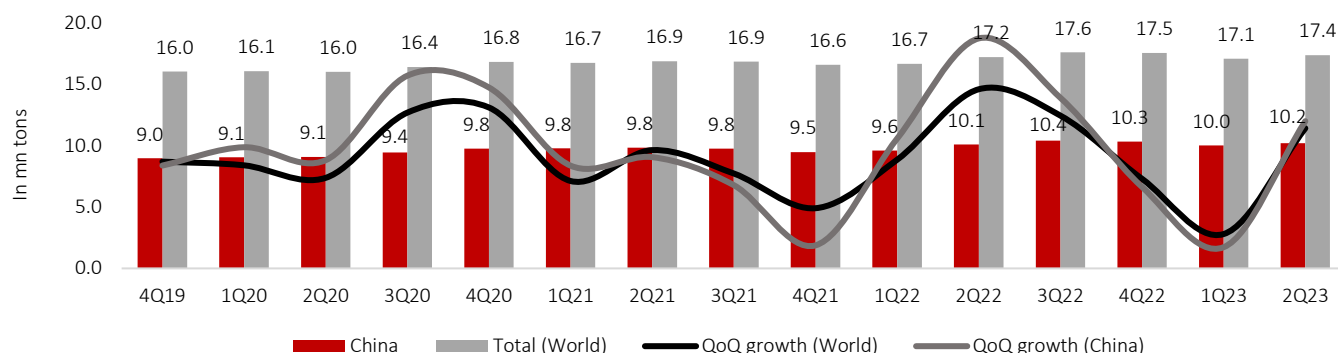
Fig. 5: The IMF upheld the global economic growth estimate for FY'23 but lowered it for FY'24 marginally in its latest update

			IMF Jul'23 estimates		IMF Oct'23 estimates	
Real GDP growth (YoY)	2021	2022	2023	2024	2023	2024
World	6.3%	3.5%	3.0%	3.0%	3.0%	2.9%

US	5.9%	2.1%	1.8%	1.0%	2.1%	1.5%
Germany	2.6%	1.8%	-0.3%	1.3%	-0.5%	0.9%
China	8.4%	3.0%	5.2%	4.5%	5.0%	4.2%
India	9.1%	7.2%	6.1%	6.3%	6.3%	6.3%
Brazil	5.0%	2.9%	2.1%	1.2%	3.1%	1.5%
Saudi Arabia	3.9%	8.7%	1.9%	2.8%	0.8%	4.0%

Source: IMF, U Capital Research

Fig. 6: After falling in 1Q23, global and China's aluminum production rose in 2Q23. Our back-of-the-envelope calculation shows, based on Jul'23 and Aug'23 data, that aluminum production might rise to reach 3Q22 levels in 3Q23

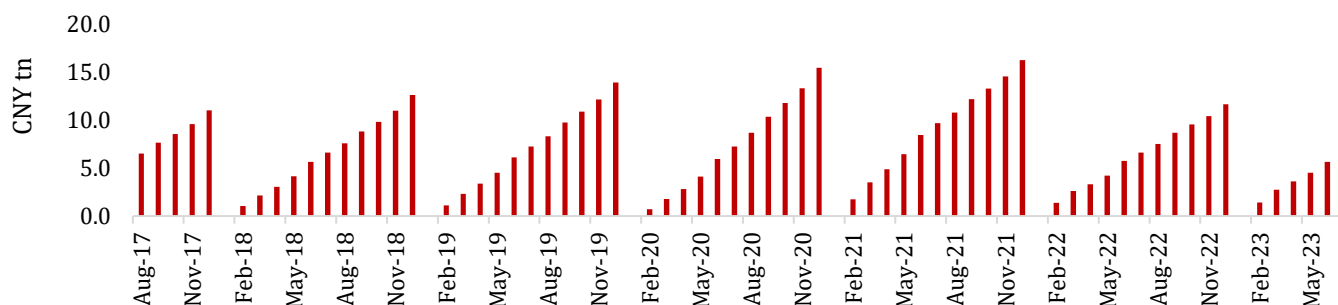


Source: IAI, U Capital Research

Real estate is an important sector for China as it contributes around 25-30% of its GDP. However, the country's property sector is grappling with serious issues wherein it witnessed some of its high-profile builders like Country Garden and Evergrande defaulting on debt repayment and filing for bankruptcy, respectively earlier this year. As the crisis in China's housing sector continues, it is likely to keep the demand for aluminum suppressed in China and globally in the foreseeable future. This fact is corroborated by the downward revision of forecasted aluminum prices. For instance, our analysis showed that Bloomberg forecasted aluminum prices for 2023-2026 on 15 October 2023 was lower by around 3-4% than the respective prices for the same periods on 01 October, and between 7% and 10% considering the prices around mid-June 2023.

Fig. 7: China's property market is undergoing a significant slowdown

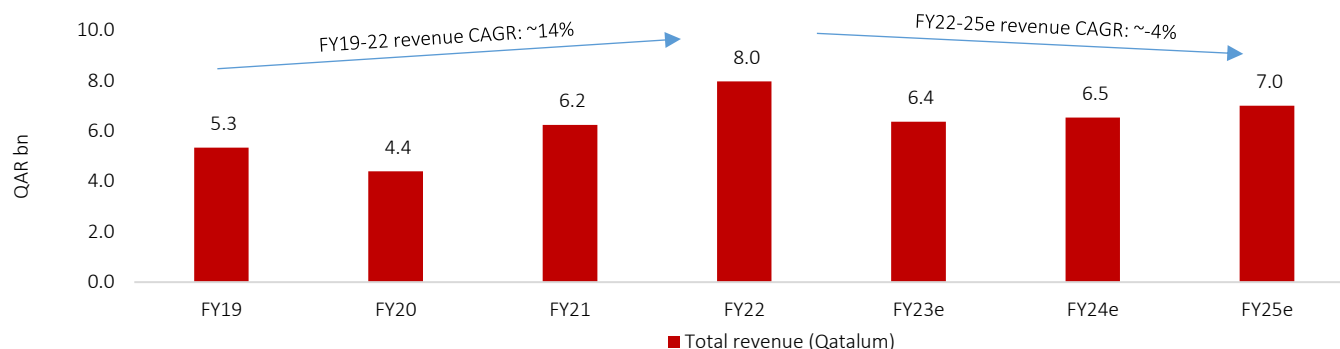
China home sales



Source: Bloomberg, U Capital Research

Thus, based on the lower global aluminum price expectations, we revised our FY 2023 average realization for the JV lower by about 6%-7% given the close correlation between them. Accordingly, our FY 2023 revenue estimate for Qatalum is less by c. 5% from our earlier estimate. Also, our FY 2022-2027 revenue CAGR forecast now stands flat vs. ~1% revenue CAGR estimated previously.

Fig. 8: Top line is estimated to grow from FY24 onwards, but recovery is expected to be slow

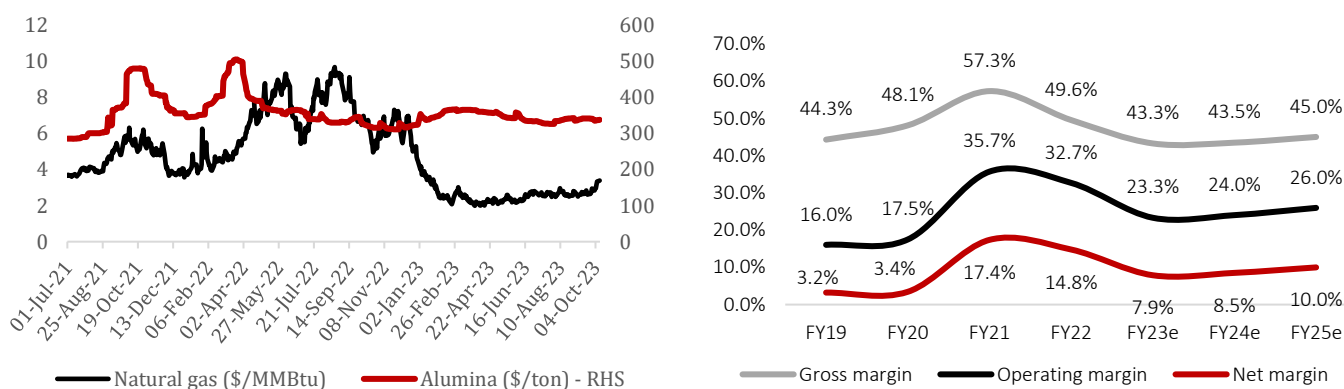


Source: Company Reports, U Capital Research

Gross and operating margins are likely to shrink in FY 2023 owing to the under-pressure revenue but could stabilize next year driven by a rebound in sales

Raw material and energy costs form a major portion of total costs for aluminum smelters. Cumulatively these costs have largely ranged between 50% and 55% of Qatalum's revenue over the past 4-5 years. Alumina is the principal raw material in aluminum production and with a decline in aluminum prices, alumina prices have also corrected. Qatalum uses natural gas in its production process which it secures from QatarEnergy at competitive prices through a long-term agreement. Thus, aided by lower raw material prices and relatively stable energy costs, Qatalum's cumulative feedstock & energy costs fell 11% YoY during 1H 2023, though, a relatively faster decline in revenue took a toll on the gross margin which contracted c. 8 percent points (pp) YoY to 45.5% during 1H 2023. In FY 2023, while we expect direct costs to continue falling YoY during the remaining quarters amid lower alumina prices, under pressure revenue is estimated to drag gross margin by about 6 pp for the current year to ~43%. Consequently, the operating margin is estimated to shrink by nearly 9 pp to ~23% in FY 2023, with the major operating costs expected to remain largely stable YoY on an absolute basis.

Fig. 9: Lower raw material prices, along with the company's cost optimization initiatives are likely to help margins stabilize by next year



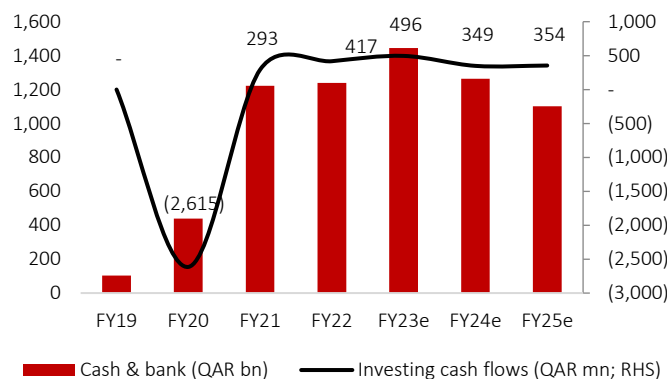
Source: Company Reports, U Capital Research

Source: Company Reports, U Capital Research

While remaining below FY 2022 levels, aluminum prices are estimated to gradually improve from FY 2024 onwards, which we believe could be a result of the stabilization of aluminum demand amid steady global economic growth and relatively fewer interest rate increases. An improvement in aluminum prices could lead to higher premiums for Qatalum's average realization over LME prices as improved market conditions lead to higher sales of value-added products like extrusion ingots, which carry higher margins over standard products. Further, backed by the JV's consistent investment over the next five years in cost optimization, improving asset reliability and integrity, and enhancing operational efficiency, we expect margins to bottom out this year and move in an upward trajectory.

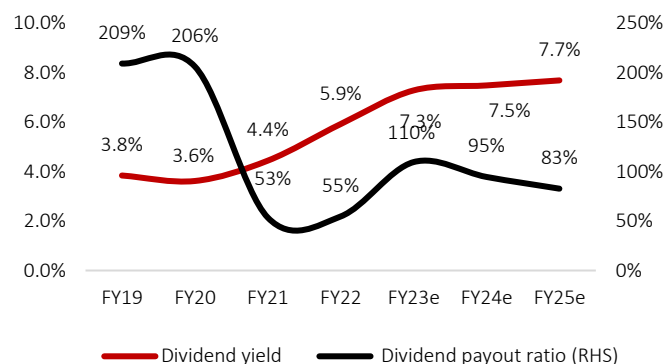
Further, given QAMCO's strong cash position (~QAR 1.2bn) as of 1H 2023-end, we believe the JV will easily fund its targeted ~QAR 1.1bn capex program. The company should also witness increased cash flows with a projected improvement in profitability, which will aid it in maintaining its healthy dividend payout. The company's most recent dividend at the current market price offers an attractive yield of 6.7%.

Fig. 10: Backed by the strong cash position...



Source: Company Reports, U Capital Research

Fig. 11: ...QAMCO is estimated to maintain its dividend payouts



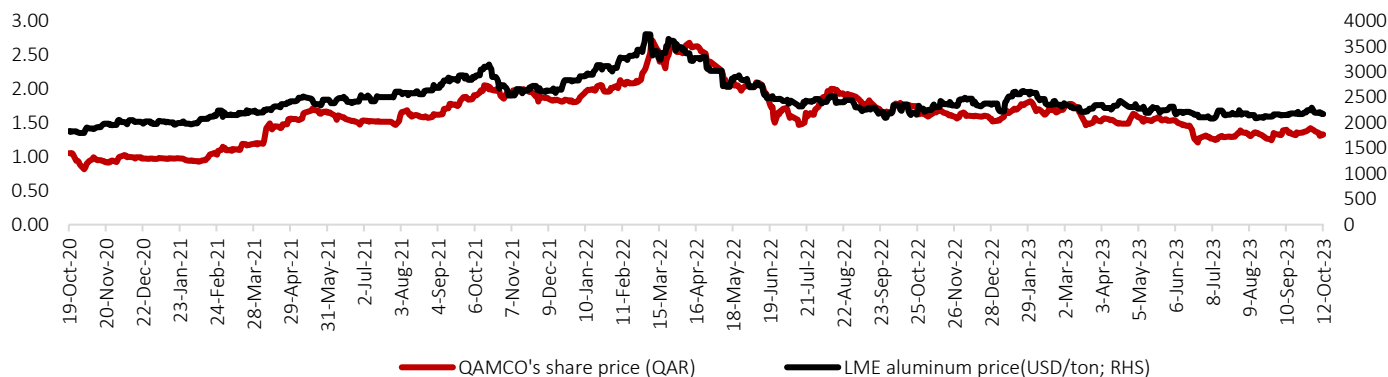
Source: Company Reports, U Capital Research

Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using P/E).

We revised our target price for the company to QAR 1.35 (previously, SAR 1.77), as we expect revenue and earnings of the JV and QAMCO to get hit significantly this year by the weak aluminum prices, and unlikely to reach the FY 2022 earnings level by the end of our explicit forecast period in FY 2027. At the current market price, our target price gives an upside of 9.0% and accordingly, we assign a **Hold** rating (previously, Accumulate) to the stock. Currently, the stock trades at FY'23e P/E of 15.1x and EV/EBITDA of 3.9x, similar to the 12 months (12m) blended forward 3-year daily average P/E of 15.0x but well below the 12m blended forward 3-year daily average EV/EBITDA of 7.3x.

Fig. 12: QAMCO stock price closely mirrors LME aluminum price movements



Source: Bloomberg, U Capital Research

Risks

Key downside risks:

- If the global aluminum prices remain suppressed for a longer than the estimated period or recover at a lesser than forecasted pace either due to weak demand or supply rising at a faster rate.
- The sales/production ratio falls below our estimated range resulting from further deterioration in demand.

- iii) Any decrease in forecasted cash flows in case the company goes for organic or inorganic expansion which currently is not modeled in our assumptions.

Key upside risks:

- i) A faster-than-expected increase in revenue and earnings emanating from better-than-estimated aluminum prices, if the global economy expands at a faster than currently estimated pace.
- ii) Better-than-projected margins and cash flows resulting from the improvement in efficiencies or cost management brought by the company's capex plan for the next 4-5 years.

Valuation

	QAMCO
(Currency)	QAR
DCF (50% weight)	
PV of Free Cash Flows (mn)	
Year 1	345
Year 2	380
Year 3	429
Year 4	443
Year 5	449
Terminal Value	7,642
PV of Terminal Value	4,858
Less: Debt	-
Less: Minority interest	-
Less: Employee retirement benefits	-
Add: Cash & bank balances	1,240
Add: Investments	-
Equity value (mn)	8,144
Outstanding Shares (mn)	5,580.1
Assumptions	
Risk Free Rate (%)	5.4%
Adjusted Beta	1.11
Risk Premium (%)	5.4%
Cost of Equity (Ke) (%)	11.4%
WACC (%)	11.4%
Target Price	1.46
P/E based Relative Valuation (50% weight)	
Target P/E multiple (x)	15.0
EPS FY23e	0.08
Target Price	1.24
Weighted Average Target Price	1.35
Current Market Price	1.24
Upside/(Downside), %	9.0%
Recommendation	Hold

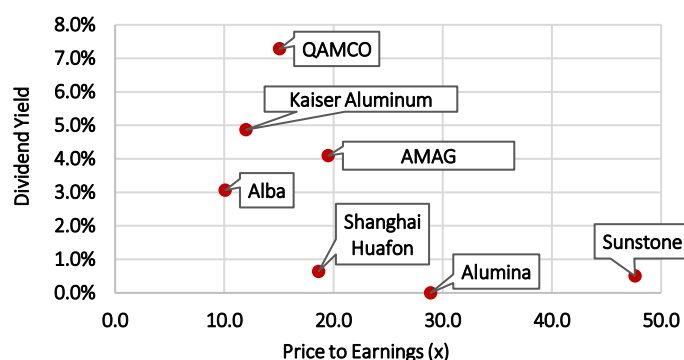
Source: Company Financials, Bloomberg, U Capital Research

Peer Group Valuation

Name	Mkt Cap (SAR mn)	Last Px (LC)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBIT DA'23e, (x)	P/E'23e, (x)	ROE'23 e, (%)	Div Yield' 23e, (%)	FCF Yield TTM (%)
Aluminum smelters										
QAMCO	6,897.0	1.24	-8	-5	-19	3.9	15.1	6.7%	7.3%	12.7%
Alba	15,242.2	1.11	1	1	2	6.8	10.1	8.3%	3.1%	18.0%
Alumina Ltd	5,217.4	0.78	-23	-42	-49	150.8	28.9	-3.0%	0.0%	9.4%
Shanghai Huafo Aluminum	7,792.4	15.65	0	9	5	15.8	18.6	20.4%	0.6%	5.8%
Sunstone Development Co Ltd	4,288.1	15.900	-13	-9	-39	13.1	47.6	2.8%	0.5%	-5.0%
Kaiser Aluminum Corp	3,713.0	63.570	-14	-20	-16	10.0	12.0	6.6%	4.9%	-19.8%
AMAG Austria Metall	3,888.7	28.500	-7	-10	-18	8.0	19.5	7.7%	4.1%	0.8%
Average						29.8	21.7	7.1%	2.9%	3.1%
Median						10.0	18.6	6.7%	3.1%	5.8%

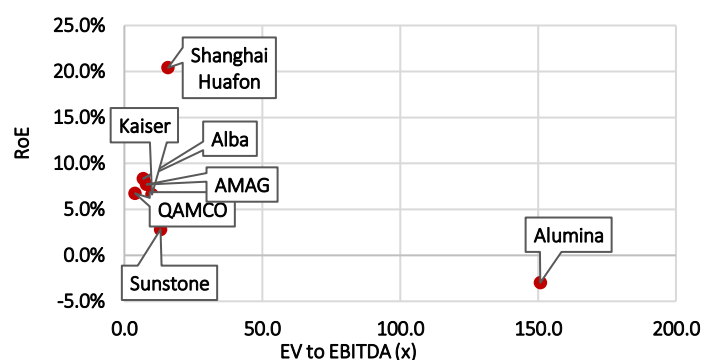
Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 23 October 2023

Fig. 13: Aluminum smelters – P/E & Dividend Yield



Source: Bloomberg, U Capital Research; As of 23 Oct 2023

Fig. 14: Aluminum smelters – RoE & EV to EBITDA



Key financials

In QAR mn, except stated otherwise	FY20	FY21	FY22	FY23e	FY24e	FY25e
Income Statement						
Share of results from joint venture	101	832	900	402	440	553
General and administrative expenses	(11)	(11)	(9)	(8)	(9)	(11)
Operating profit	91	821	890	394	431	542
Finance income	2	12	26	64	114	98
Other Income	1	2	3	1	1	1
Net income for equity shareholders	95	835	919	458	546	641
Balance Sheet						
Other receivables	1	10	18	2	2	2
Cash, deposits and other bank balances	440	1,222	1,239	1,445	1,263	1,101
Investments in associates and joint ventures	5,357	5,215	5,670	5,373	5,573	5,831
Total assets	5,797	6,446	6,926	6,820	6,838	6,935
Other payables	38	66	100	51	53	55
Due to related parties	5	7	3	2	2	2
Total liabilities	42	73	103	52	54	56
Share capital	5,580	5,580	5,580	5,580	5,580	5,580
Retained earnings	175	793	1,241	1,184	1,199	1,293
Equity Attributable to Shareholders	5,755	6,373	6,823	6,768	6,784	6,878
Cash Flow Statement						
Net cash generated from operating activities	(9)	(18)	(39)	(83)	(19)	(24)
Net cash generated from investing activities	293	417	496	349	354	392
Net cash (used in) provided by financing activities	(56)	(195)	(446)	(502)	(516)	(530)
Cash and cash equivalents at the end of the period	233	437	447	210	28	(134)
Key Ratios						
Operating margin (%)	89.6%	98.7%	99.0%	98.0%	98.0%	98.0%
Net margin (%)	93.3%	100.3%	102.1%	114.1%	124.1%	115.9%
ROA	1.6%	13.6%	13.7%	6.7%	8.0%	9.3%
ROE	1.7%	13.8%	13.9%	6.7%	8.1%	9.4%
Current Ratio (x)	10.4x	16.9x	12.2x	27.7x	23.3x	19.7x
EPS	0.02	0.15	0.16	0.08	0.10	0.11
BVPS	1.03	1.14	1.22	1.21	1.22	1.23
DPS	0.04	0.08	0.09	0.09	0.09	0.10
Dividend Payout Ratio	206.2%	53.5%	54.6%	109.6%	94.6%	82.7%
Dividend Yield (%)	3.6%	4.4%	5.9%	7.3%	7.5%	7.7%
P/E (x)	57.0x	12.0x	9.2x	15.1x	12.6x	10.8x
P/BV (x)	0.9x	1.6x	1.2x	1.0x	1.0x	1.0x
Price as at period end*	0.97	1.80	1.52	1.24	1.24	1.24


Source: Company Reports, U Capital Research; *Current market price is used for forecast periods

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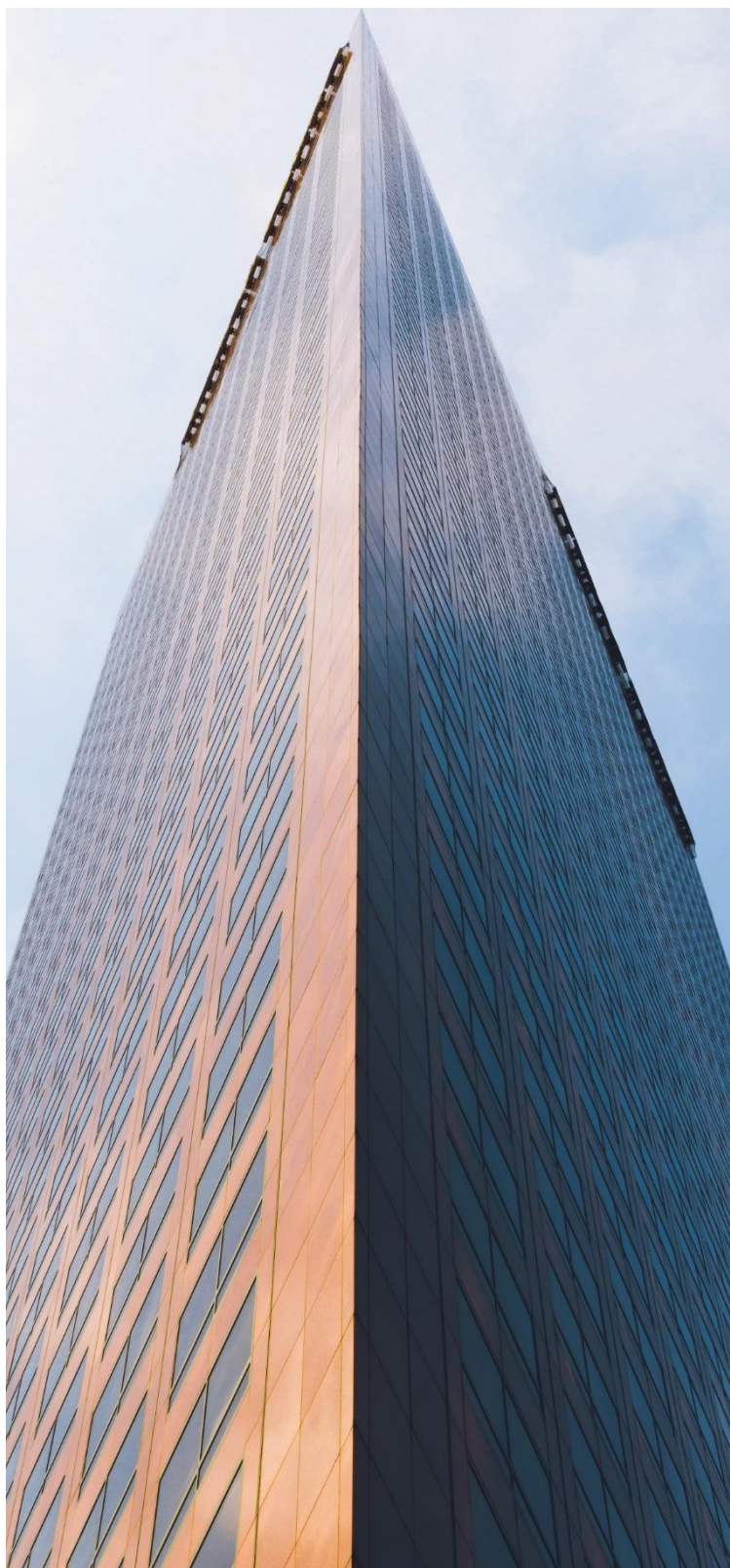
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Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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