

Gulf International Services (GISS)

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	QR15.82	Current Target Price	QR17.00
Implied Upside	7.5%		

A Decent 1Q2019 Beat; Maintain Estimates & Reiterate Accumulate

After two weak quarters in a row, GISS posted a positive set of results in 1Q2019. We were expecting a return to profitability in 1Q2019 and GISS did not disappoint. Importantly, we think 2Q and 3Q should continue to show earnings momentum. We remain buyers of GISS and continue to believe the risk-reward for the stock is biased toward the positive. For 2019, we still expect healthy EBITDA growth and the company should post a bottom-line of QR105mn; we want to highlight our earnings estimate does not include potential rig impairments and a rig impairment cannot be ruled out, which could, once again, wipe out the entire yearly net income. Our overall thesis remains the same – GISS' story consists of a sum of moving parts, not entirely predictable and fairly volatile. We do not expect this to change. However, we do expect drilling to pull itself out of losses suffered during 2016-19 by 2020 in light of demand due to the proposed North Field expansion and given our assumption of high fleet utilization & modest cost savings. **GISS stock has appreciated 15% (vs. QE Index's 5%) since our March 24 upgrade.**

Highlights

- As expected, GISS posted a decent beat in 1Q2019 with QR25.3mn in earnings – GISS reported a net profit of QR25.3mn (+167.1% YoY) in 1Q2019 as compared to a net profit of QR9.5mn in 1Q2018 and net loss of QR137.7mn (net profit of QR4.5mn, excluding impairments) in 4Q2018, beating our estimate of QR15.0mn. 1Q2019 revenue came in at QR719.2mn, which represents an increase of 17.6% YoY (+28.9% QoQ), 8.4% ahead of our forecast of QR663.6mn. Revenue for the insurance segment reported the highest increase. EBITDA came in at QR188.2mn and EPS increased to QR0.14 in 1Q2019 from QR0.05 in 1Q2018 (loss of QR0.74 in 4Q2018).
- Segment performance was generally in-line with our preview. Insurance top-line improved significantly YoY given new wins/regaining of lost accounts in the energy/medical segments. However, insurance profitability remained flat YoY due to higher net claims and reinsurance costs. The drilling segment reported marginal revenue growth, primarily driven by the West Tucana rig contracted to Qatargas via a deal with Seadrill. GISS stated that GDI's operating profit surged more than 50% YoY due to increased revenue along with costs optimization. However, drilling net loss came in flat primarily due to increased finance costs. Aviation revenue increased moderately YoY due to international growth along with stable domestic trends. International growth along with G&A savings resulted in a significant growth in segment net income. Catering hiked its net income YoY due to COGS /G&A reduction despite revenue decline due to demobilization of major contracts and reduction in camps' occupancy.
- Our estimates remain unchanged and we continue to expect a drilling recovery in 2019 but remain wary of impairment charges; segment profitability still expected by 2020. We continue to model 7 offshore rigs, in-line with current trend as we do not expect any contribution from the Msheireb rig. We still model the West Tucana rig to be deployed in a rig utilization contract and expect another rig to be used in a JV from 2H2019 (by 2021, we expect two additional JV rigs). Further, we model 7 onshore rigs in 1H2019 as GDI-3 remains stacked. Net-net, our GDI segment net loss decreases from a loss of QR264mn (QR168mn loss, ex. impairment of QR96mn) in 2018 to a loss of QR85mn in 2019. We want to point out again our 2019 drilling loss of QR85mn does not factor in any impairments; the Msheireb rig is old and is currently not being used with GDI looking to deploy it outside of Qatar (in Asia). Success of this strategy is uncertain and a 2019 (most probably year-end) impairment cannot be ruled out. We expect GDI to go back in the black in 2020. We also point to insurance revenue growth (as seen in 1Q19) given the startup of new medical insurance contracts with QP/Qatargas/others in 2019; however, segment income could be hurt by high loss ratios in medical insurance.

Catalysts

- GISS stock continues to remain in a "show me" mode.

Recommendation, Valuation and Risks

- Recommendation and valuation:** We rate GISS an Accumulate with a TP of QR17. GISS trades at 2019 & 2020 EV/EBITDA multiples of 8.3x and 6.9x, respectively.
- Risks: Geopolitical risks** cannot be modeled. Given the low level of earnings along with paper-thin net margins (2018: 2.1% ex. rig impairment/PP&E write-off; 1Q2019: 3.5%), quarterly earnings could be subject to significant volatility. Debt levels are high (2018: QR5.0bn/5.5x 2018 net-debt-to-EBITDA) but still manageable in light of 1.1x interest coverage and expected reduction in leverage going forward, in our view. Further decline in rig rates/ utilizations could pressure shares. GISS also faces concentration risk given its exposure to QP/affiliates.

Key Financial Data and Estimates

	2018	2019e	2020e	2021e
EPS (QR)	(0.53)	0.57	1.15	1.35
P/E (x)	N/M	27.9	13.8	11.7
EV/EBITDA (x)	9.1	8.3	6.9	6.2

Source: Company data, QNB FS estimates; Note: All data based on current number of shares

Key Data

Bloomberg Ticker	GISS QD
ADR/GDR Ticker	N/A
Reuters Ticker	GISS.QA
ISIN	QA000A0Q6LH4
Sector	Industrials
52wk High/52wk Low (QR)	21.50/13.50
3-m Avg. Volume (000)	222.8
Mkt. Cap. (\$ bn/QR bn)	0.8/2.9
EV (\$ bn/QR bn)	1.8/6.4
FO Limit* (%)	49.0
Current FO* (%)	8.6
Shares Outstanding (mn)	185.8
1-Year Total Return (%)	(15.4)
Fiscal Year End	December 31

Source: Bloomberg (as of April 30, 2019), *Qatar Exchange (as of April 29, 2019); Note: FO is foreign ownership

Saugata Sarkar, CFA, CAIA

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

Key Segment Details

Key Segment Details

In QR mn	2017	2018	2019e	2020e	2021e
Revenue	2,403	2,519	2,755	2,859	2,891
<i>Gulf Drilling International (GDI)</i>	1,112	1,142	1,158	1,215	1,197
<i>Gulf Helicopters Company (GHC)</i>	530	542	555	569	583
<i>Amwaj Catering Company (AHC)</i>	436	403	392	410	429
<i>Al Koot Insurance & Reinsurance (AKIR)</i>	326	433	650	666	682
Net Income	85	(98)	105	213	251
Net Margin	4%	-4%	4%	7%	9%
Drilling	(102)	(264)	(85)	1	5
<i>Net Margin</i>	-9%	-23%	-7%	0%	0%
Helicopters	145	141	144	153	165
<i>Net Margin</i>	27%	26%	26%	27%	28%
Catering	17	24	27	31	36
<i>Net Margin</i>	4%	6%	7%	8%	8%
Insurance	71	53	54	60	70
<i>Net Margin</i>	22%	12%	8%	9%	10%
EBITDA	720	746	772	872	904
EBITDA Margin	30%	30%	28%	30%	31%
Drilling	424	398	471	550	551
<i>EBITDA Margin</i>	38%	35%	41%	45%	46%
Helicopters	239	243	245	253	263
<i>EBITDA Margin</i>	45%	45%	44%	44%	45%
Catering	29	35	37	42	46
<i>EBITDA Margin</i>	7%	9%	10%	10%	11%
Insurance	56	38	31	36	45
<i>EBITDA Margin</i>	17%	9%	5%	5%	7%

Source: Company data, QNB FS estimates

Ratio Analysis

Key Metrics

Particulars	2015	2016	2017	2018	2019	2020	2021	2022	2023
Growth Rates									
Revenue	6.6%	(28.2%)	(19.6%)	4.8%	9.3%	3.8%	1.1%	1.6%	1.9%
Gross Profit	1.2%	(56.2%)	(19.3%)	(11.9%)	25.2%	20.1%	3.5%	5.5%	3.6%
EBITDA	(18.9%)	(40.0%)	(17.6%)	3.5%	3.6%	12.9%	3.7%	5.1%	3.8%
EBIT	(33.4%)	(69.0%)	(21.8%)	10.0%	16.0%	34.2%	8.6%	11.2%	8.0%
PAT/EPS	(43.2%)	(91.6%)	26.9%	N/M	N/M	102.0%	17.9%	20.4%	17.2%
DPS	(81.8%)	0.0%	(100.0%)	N/A	N/A	N/A	N/A	N/A	50.0%
CFPS	25.3%	(35.1%)	(24.2%)	(39.7%)	83.6%	5.5%	6.5%	4.4%	4.6%
FCFPS	N/M	(59.3%)	32.4%	(41.9%)	178.3%	6.1%	7.6%	4.5%	4.7%
Operating Ratios									
Gross Margin	29.1%	17.7%	17.8%	15.0%	17.1%	19.8%	20.3%	21.1%	21.4%
Gross Margin, Excluding Depreciation & Amortization	40.7%	36.7%	37.8%	34.1%	34.2%	36.2%	36.4%	36.9%	36.9%
EBITDA Margin	35.0%	29.3%	30.0%	29.6%	28.0%	30.5%	31.3%	32.4%	33.0%
EBIT Margin	23.0%	9.9%	9.7%	10.1%	10.8%	13.9%	14.9%	16.3%	17.3%
Net Margin	19.2%	2.2%	3.5%	(3.9%)	3.8%	7.5%	8.7%	10.3%	11.8%
Finance Ratios									
Debt-Equity Ratio	1.3	1.5	1.4	1.4	1.3	1.2	1.1	1.0	0.8
Net Debt-Equity Ratio	1.1	1.1	1.1	1.2	1.0	0.9	0.7	0.6	0.4
Net Debt-to-Capital	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.3
Net Debt-to-EBITDA	2.9	4.8	5.8	5.5	4.9	3.9	3.2	2.6	2.0
Interest Coverage	12.2	2.4	1.3	1.1	1.3	1.8	2.0	2.2	2.5
Return Ratios									
ROIC	10.5%	3.2%	2.6%	3.0%	3.5%	4.7%	5.1%	5.5%	6.1%
ROE	20.4%	1.8%	2.3%	-2.8%	2.9%	5.5%	6.1%	6.9%	7.6%
ROA	7.1%	0.6%	0.8%	-1.0%	1.0%	2.0%	2.4%	2.8%	3.3%
FCF Yield	21.4%	8.7%	11.5%	6.7%	18.6%	19.7%	21.2%	22.2%	23.2%
Liquidity Ratios									
Current Ratio	0.9	1.2	1.0	1.2	1.2	1.4	1.8	0.8	1.5
Quick Ratio	0.9	1.1	1.0	1.1	1.2	1.3	1.7	0.8	1.4
Valuation									
EV/Sales	1.7	2.3	2.9	2.7	2.3	2.1	1.9	1.7	1.5
EV/EBITDA	4.8	8.0	9.6	9.1	8.3	6.9	6.2	5.3	4.7
EV/EBIT	7.2	23.5	29.9	26.5	21.7	15.1	12.9	10.6	8.9
P/E	3.7	43.9	34.6	N/M	27.9	13.8	11.7	9.7	8.3
P/CF	2.0	3.1	4.1	6.8	3.7	3.5	3.3	3.1	3.0
P/BV	0.7	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.6
Dividend Yield	6.3%	6.3%	0.0%	0.0%	0.0%	0.0%	0.0%	3.2%	4.7%
FCF Yield	21.4%	8.7%	11.5%	6.7%	18.6%	19.7%	21.2%	22.2%	23.2%

Source: Company data, QNB FS estimates

Detailed Financial Statements

Income Statement

In QR mn	2017	2018	2019e	2020e	2021e
Revenue	2,403	2,519	2,755	2,859	2,891
COGS	1,975	2,142	2,283	2,292	2,305
Gross Profit	428	377	472	567	586
SG&A	222	214	213	214	212
Total Other Income	25	(65)	38	45	58
Net Finance Income (Expense)	(145)	(196)	(191)	(185)	(181)
Net Income	85	(98)	105	213	251
EBITDA	720	746	772	872	904
EPS	0.46	(0.53)	0.57	1.15	1.35
DPS	0.00	0.00	0.00	0.00	0.00

Source: Company data, QNB FS estimates; Note: EPS based on current number of shares

Balance Sheet

In QR mn	2017	2018	2019e	2020e	2021e
Current Assets					
Cash & Cash Equivalents	950	888	945	1,148	1,503
Financial Investments	201	289	311	311	311
Insurance & Accounts Receivables/Prepayments	725	1,007	1,273	1,313	1,336
Due From Related Parties	434	477	611	611	611
Inventories	202	216	223	223	225
Contract Assets		19	18	18	18
Total Current Assets	2,513	2,897	3,380	3,624	4,004
Non-Current Assets					
Financial Investments	391	226	250	250	250
Equity-Accounted Investees	-	1	1	1	1
Goodwill & Intangibles	305	304	304	304	304
Contract Assets		9	9	9	9
Property, Plant & Equipment	7,220	6,720	6,494	6,280	6,079
Non-Current Assets	7,915	7,260	7,058	6,844	6,643
Total Assets	10,428	10,157	10,439	10,468	10,648
Current Liabilities					
Short-Term Debt	898	935	800	600	239
Bank Overdraft		1	1	1	1
Insurance Payables, Accounts Payable & Accruals	1,493	1,424	1,861	1,877	1,906
Contract Liabilities		37	28	28	28
Due to Related Parties	8	28	31	31	31
Current Liabilities	2,400	2,426	2,722	2,539	2,206
Non-Current Liabilities					
EOS/Provision for Decomm. Costs	103	122	123	123	123
Contract Liabilities		16	16	16	16
Long-Term Debt	4,248	4,062	3,937	3,936	4,197
Non-Current Liabilities	4,350	4,199	4,076	4,075	4,336
Total Liabilities	6,750	6,625	6,797	6,614	6,542
Shareholders' Equity					
Total Shareholders' Equity	3,679	3,532	3,641	3,854	4,105
Liabilities & Shareholders' Equity	10,428	10,157	10,439	10,468	10,648

Source: Company data, QNB FS 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

Saugata Sarkar, CFA, CAIA

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Mehmet Aksoy, PhD

Senior Research Analyst

Tel: (+974) 4476 6589

mehmet.aksoy@qnbfs.com.qa

Shahan Keushgerian

Senior Research Analyst

Tel: (+974) 4476 6509

shahan.keushgerian@qnbfs.com.qa

QNB Financial Services Co. W.L.L.

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

Zaid al-Nafoosi, CMT, CFTe

Senior Research Analyst

Tel: (+974) 4476 6535

zaid.alnafoosi@qnbfs.com.qa

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