

Gulf Warehousing Company (GWCS)

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	QR39.95	Target Price	QR45.15
Implied Upside	13.0%		

3Q2012 Results Beat Estimates; Revising Estimates & Target Price Slightly

Gulf Warehousing reported a net profit of QR19.6mn for 3Q2012, down 11.6% QoQ from QR22.2mn in 2Q2012. The results were above our forecast of QR18.2mn. We have updated our financial model and now forecast a net income compound annual growth rates (CAGR) of 27.6% vs. our earlier estimate of 24.9% for 2011-2015. The revised estimates have led to an upward revision in our target price to QR45.15 from QR41.83 and we change our rating from Market Perform to Accumulate.

Highlights

- Upward revision in estimates.** Gulf Warehousing reported a net profit of QR19.6mn for 3Q2012, down 11.6% QoQ from QR22.2mn in 2Q2012. The QoQ decline was due to lower freight-forwarding business (Ramadan). However, financial charges, staff costs and other general expenses were lower than our estimates. We believe the management has kept a tight lid on operating expenses. Hence, we have lowered our assumptions of operating expenses and financial charges.
- Imdad – a revenue catalyst no more.** We believe Imdad is no longer an area of focus. The management will only target profitable contracts and will be less aggressive. Hence, we have revised our estimates for Imdad. The topline of Imdad is estimated to grow by 3% annually (post 2012) instead of the initial estimate of 45.1% CAGR (2011-2015). In this scenario, Imdad's revenue would reach QR37mn in 2015 vs. QR190mn previously. However, the bottom-line impact will be relatively less as Imdad is not a high margin business and has been negatively impacting earnings thus far.

Catalysts

- Focus on main competency and regional expansion.** We continue to believe GWCS represents a highly compelling longer-term growth story. The realignment of focus on logistics market is a positive sign in our view. Recently a news item appeared that the company is trying to expand in the lesser tapped markets of Africa. If things materialize, we can expect a revision in estimates for the firm.
- LVQ to provide sustainable growth until 2015.** LVQ is coming online in phases. Hence, investors can expect an improvement in earnings until 2015.

Recommendation, Valuation and Risks

- Recommendation and valuation:** *We rate GWCS an Accumulate with a price target of QR45.15 using the discounted cash flow (DCF) valuation method.* Our target price implies an upside of 13.0% from the current price.
- Risks:** 1) Increased leverage and limited visibility of capitalized interest cost; 2) Entry of new players and 3) Global economic issues.

Key Financial Data and Estimates

QR mn	FY2010	FY2011	FY2012e	FY2013e	FY2014e
Revenue	88	420	484	568	655
EPS (QR)*	1.29	1.56	2.09	2.63	3.09
P/E (x)	31.0	25.6	19.1	15.2	12.9

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

Key Data:

Bloomberg Ticker	GWCS QD
ADR/GDR Ticker	N/A
ISIN	QA000A0KD6H9
Sector*	Transportation
52wk High/52wk Low (QR)	44.75/33.50
3-m Average Volume	76,150
Mkt. Cap. (\$ bn/QR bn)	0.4/1.6
Shares Outstanding (mn)	39.6
FO Limit* (%)	24.9
Current FO* (%)	23.0
1-Year Total Return (%)	20.6
Fiscal Year End	Dec. 31

Source: Bloomberg (as of November 01, 2012), *Qatar Exchange (as of November 01, 2012); Note: FO is foreign ownership

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Executive Summary

3Q2012 Beat Estimates; Revising Estimates & Target Price

Upward revision in estimates. Gulf Warehousing reported a net profit of QR19.6mn for 3Q2012, down 11.6% QoQ from QR22.2mn in 2Q2012. The QoQ decline was due to lower freight-forwarding business (Ramadan). Revenue increased to QR124.95mn in 3Q2012 vs. QR116.42mn, which is a growth of 7.3% QoQ. Direct costs increased by 19.8% QoQ, leading to a decline in gross profit by 16.8% QoQ. Staff costs came at QR5.47mn vs. QR8.7mn; we think that there has been some reclassification of staff costs to direct costs. Financial charges (net of financing income) were QR1.82 vs. QR2.35mn in 2Q2012. The decline is surprising given the fact that total debt increased to QR671.4mn at the end of September 2012 vs. QR607.8mn at the end of June 2012. Going forward, we have assumed QR1.2mn and QR1.4mn in financial charges per month for 4Q2012 and 2013, respectively. The net profit to shareholders declined by only 11.6% QoQ after adjusting for the QR1.13mn loss of Imdad to minority shareholders in Imdad. We have lowered our assumptions of operating expenses and financial charges, as we believe management has kept a tight lid on operating expenses. However, the limited visibility on the accounting treatment of financial charges (expensed vs. capitalized) is a concern for us and can lead to some volatility in quarterly earnings going forward.

Imdad – a revenue catalyst no more. We believe Imdad is no longer an area of focus. The management will only target profitable contracts and will be less aggressive. Hence, we have revised our estimates for Imdad. The top-line of Imdad is estimated to grow by 3% annually (post 2012) instead of the initial estimate of 45.1% CAGR (2011-2015). In this scenario, revenue would reach QR37mn in 2015 vs. QR190mn previously. However, the bottom-line impact will be relatively minor as Imdad is not a high margin business and so far has been negatively impacting net income. Furthermore, in our initial estimate of QR190mn revenue in 2015, Imdad would have contributed only QR4.8mn to the bottomline after adjusting for minority interest. We believe GWCS management has done the right thing by focusing on their core competency that also offers high margins.

GWCS represents a highly compelling longer-term growth story. We estimate the combination of Logistics Village Qatar (LVQ), along with traditional revenue drivers, will drive top-line and bottom-line CAGRs of 16.5% (previously 21.8%) and 27.6% (previously 24.9%), respectively, over the next four years (2011-2015). LVQ is technically a property rental business, wherein GWCS will lease out space to clients for 5 to 10 years. A major portion of phase 1 is dedicated to internal usage. Phase 2A became operational in April 2012 and Phase 2B became operational at the end of September 2012. Other operating segments should also benefit from increased business activity.

LVQ Progress Update

Phase	WH Area (sqm)	Operational Year	Number of Clients	Status
Phase 1	82,773	2011	23	100% Rented
Phase 2A	42,000	April 2012	10	100% Rented
Phase 2B	20,000	October 2012	4	80% Rented
Phase 3	92,758	2013	1	16% Rented, starts April 2013
Phase 4	100,000	2014		Planning Stage

Source: Company data (as of September 2012)

Catalysts

Focus on main competency and regional expansion. Recently a news item appeared stating that the company is trying to expand in the lesser tapped markets of Africa. The initial negotiations are with the State of Osun in Nigeria, where a public-private partnership initiative is being discussed to create an industrial and trade hub in the State capital Oshogbo. This project will be a hub for distributing agricultural products while also providing a storage facility for imported products for a considerable length of time. If things materialize, we can expect a revision in estimates for the firm. However, we reiterate the plans are still at a very nascent stage. We await the release of more details on this front and thus, have not incorporated any potential impact from these sources in our model

LVQ should be a catalyst for growth. The LVQ project is coming online in phases We expect LVQ revenue to increase to QR183mn in 2015 from QR14mn in 2011.

Valuation

Our target price of QR45.15 per share implies an upside of 13.0% on the stock. We have arrived at the fair value of GWCS using the DCF valuation model. We account for the company's anticipated revenue growth from LVQ. We explicitly model cash flows until 2018 and use a terminal growth rate of 3.0%.

DCF Valuation

Particulars	Fair Value of Equity (QR mn)	Fair Value per Share (QR)
Cumulative PV of FCFF	407	10.27
PV of Terminal Value	1,952	49.26
PV of Cash Flows	2,359	59.53
<i>Add:</i>		
Cash Balances (Sep 2012)	101	2.56
Investments (Sep 2012)	0	0.00
<i>Less:</i>		
Debt Balances (Sep 2012)	671	16.94
Fair Value of Equity	1,790	45.15

Source: QNBFS estimates

Sensitivity Analysis

We have performed a sensitivity analysis on the WACC and terminal growth rate. The results of our sensitivity analysis are depicted below:

Sensitivity Analysis

		Terminal Growth Rate				
		1.00%	2.00%	3.00%	4.00%	5.00%
WACC	8.30%	44.20	52.42	63.74	80.33	106.98
	9.30%	38.38	44.67	52.97	64.40	81.14
	10.30%	33.81	38.80	45.15	53.53	65.06
	11.30%	30.13	34.18	39.22	45.63	54.08
	12.30%	27.10	30.47	34.56	39.64	46.11

Source: QNBFS estimates

Relative Valuation

GWCS to remain at a premium to peers. The company trades at a premium to its regional and global peers. Even with the strong growth in earnings, the company should remain at premium to peers for the next couple of years. The stock is currently trading at a P/E and P/B of 15.2x and 2.2x on our 2013 estimates.

Risks to Our Target Price

- **Increased leverage and limited visibility of interest cost capitalized:** GWCS is leveraging its balance sheet to improve its return on equity (ROE). However, increasing debt comes at the expense of greater risk to the balance sheet. An earlier-than-estimated increase in interest rates could negatively affect the bottom-line as well as potentially reduce GWCS' dividend payout ratio. Furthermore, the lack of visibility on interest cost capitalization is also a cause of concern for us.
- **Entry of new players:** GWCS is the only major logistics operator in Qatar. Although, global operators such as DHL have a presence, none of them offer warehousing facilities and have limited market shares in Qatar. This could attract other players from the region to expand their footprint in Qatar.
- **Global economic issues:** The logistics and warehousing business is highly correlated with the region's economic development. Therefore, any downturn in the Qatari or the GCC economy could affect the company's financial performance. The Qatari and the overall GCC economy could be impacted by a fall in crude oil and natural gas prices. Economic issues related to the Eurozone crisis could also adversely impact the company's performance.

Company Background

Company Description

Qatar's logistics one-stop shop. Established in 2004, Doha-based GWCS is engaged in providing a host of services such as warehousing, freight forwarding, transportation, international relocation, records management and supply chain consulting solutions to various industries. In 2011, the company acquired a 100% stake in Agility-Qatar and set up Imdad Sourcing & Logistics Group WLL (and retained a 51% stake), which is engaged in the business of trading in foodstuffs and other consumables. Post the acquisition, Agility Qatar owns an 18.1% stake in GWCS, while a Qatari institution holds 18.8%; this leaves 63.2% for the public. As of 2011, the company's top-line mix was comprised of 53.4% (logistics operations); 36.4% (freight forwarding) and 10.2% (others including Imdad). The company has five major warehouses located in key industrial areas, of which two provide frozen storage facilities. GWCS operates a fleet of more than 400 trucks and over 700 trailers, and provides freight-forwarding services and transportation services to clients. Being in the services industry, GWCS holds a number of International Organization for Standardization (ISO) certificates ranging from general management to health and safety.

Company History

A focused player in the logistics supply chain, GWCS aims to be a leading player in the GCC. The company has emerged as one of the leading 3PL services providers in Qatar. GWCS sees a QR4bn market in Qatar for third party logistics to be tapped by 2015, of which it plans to have a significant share, mainly using its association with Kuwait's Agility (an international logistics leader, especially in the emerging markets).

Agility's Global Network



Source: Agility

GWCS was listed on the Qatar Exchange (QE) in 2004, with a single warehouse and a few vehicles. Since then, the firm has grown to become the leading warehousing and logistics provider in the country. GWCS has even entered specialized logistics and warehousing services such as the storage of hazardous chemicals at Ras Laffan. LVQ, an integrated one million square-meter logistics facility, has propelled the company to grow organically and become the leading brand in Qatar's logistics market. Phase 1 of the project became fully operational in 2011 and consists of eight new warehouses, a container yard and storage facility, a fully equipped repair depot for maintaining a fleet of vehicles and a data center. Phase 2B came online in late September 2012 and phases 3 and 4 are expected to be completed in 2013 and 2014, respectively. Work on the entire project should be finished by late-2014.

Management Team

Name	Designation
Mohammed Ismail Al Emadi	Chairman
Sh. Fahed Bin Hamad Bin Jasim Al Thani	Vice Chairman
Ranjeev Menon	Group CEO
Abdulaziz Zeid Al-Taleb	Managing Director
Rajeswar Govindan	CFO

Source: Company data

Key Forecasts

Revenue

We project overall revenue to grow at a CAGR of 16.5% over 2011-2015. The key contributors will be LVQ. We expect LVQ revenue to increase to QR183mn in 2015 from QR14mn in 2011. For Imdad's top-line, we are modeling in QR37mn at the end of 2015 vs. QR43mn in 2011.

Revenue Breakdown

QR mn	FY11	FY12e	FY13e	FY14e	FY15e
Logistics Operations (incl. LVQ)	224	289	348	406	501
Freight-Forwarding Income	153	161	185	212	234
Others (Imdad)	43	34	35	36	37
Total	420	484	568	655	772

Source: Company data, QNBFS estimates

We maintain our top-line estimate from the logistics business (excluding LVQ) of QR319mn in 2015 vs. QR210 in 2011. For the freight-forwarding segment, we estimate revenue to grow to QR234mn in 2015 from QR153mn in 2011. In 9-months of 2012, LVQ generated QR54.1mn (includes internal billing). GWCS has already rented 100% of phase 2A, which became operational in April 2012. The second part or phase 2B became operational by late September 2012 and has been 80% rented out. Further, 16% of phase 3 has been leased out and is expected to become operational in April 2013; phase 3 is expected to generate QR56mn in 2015. LVQ also includes an open yard that covers an area of 400,000 square meters and accommodation buildings for 600 rooms, which should also contribute to the top-line and bottom-line growth.

Profitability

We expect gross profit and net profit to increase by CAGRs of 22.6% and 27.6%, respectively, for 2011-2015. This strong growth should augment the bottom-line to QR163.6mn in 2015. We note that our estimates are conservative relative to company guidance; the company expects net profit of QR182mn in 2015.

Capacity

Capacity additions will be driven by LVQ. The construction of LVQ will be done in four phases. Out of this, phase 1 and phase 2A and Phase 2B (144,773 square meters) have already become operational. Further, phase 3 with 92,758 square meters is expected to become operational in April 2013. The fourth and final phase is currently scheduled to be operational by 2014.

Capital Expenditures

The build-out of LVQ will drive capital expenditures (capex). LVQ is expected to be the company's largest investment. Following GWCS' plan to complete about 70% of its construction related to LVQ during 2011, 2012 and 2013, we expect a major chunk of capital expenditure during these years. Post 2014, we expect capex to largely consist of maintenance and settle between QR40mn to QR60mn per year.

Financial Position

New additions and augmented working capital cycle to boost operating cash flow. Net cash generated from operating activities will remain robust in 2012 at QR82.8mn and in 2013 at QR143.5mn (QR84.4mn in 2011). We expect ROE to improve from 9.0% in 2011 to 19.5% in 2015 as the company is leveraging its balance sheet while maintaining a high dividend payout ratio. GWCS's interest coverage ratio stood at 4.9x in 2010 and improved to 10.9x in 2011. Going forward, between 2012 and 2016 we expect the interest coverage ratio to be in the range of 6.0x to 7.0x. We estimate the total debt of the firm to peak in 2014 to QR873.0mn from QR671.48mn at the end of September 2012. We are also raising our DPS estimates for 2012 & 2013 to QR1.80 and QR2.20 from QR1.75 and QR2.00, respectively.

Detailed Financial Statements

Income Statement

Figures in QR mn	FY2010	FY2011	FY2012e	FY2013e	FY2014e	FY2015e
Revenues	88	420	484	568	655	772
Direct Costs	(55)	(305)	(338)	(389)	(450)	(514)
Gross Profit	33	114	146	179	205	258
Other Income	6	2	0	0	0	0
Valuation Gains from Investment	36	4	0	0	0	0
Staff Costs	(8)	(22)	(26)	(28)	(31)	(33)
Net Impairment Loss on Trade	(1)	(1)	(1)	(1)	(1)	(1)
G&A Expenses	(10)	(30)	(27)	(28)	(30)	(31)
Finance Costs	(4)	(6)	(10)	(17)	(21)	(30)
Net Profit to Shareholders	51	62	83	104	123	164
EPS (QR)	1.29	1.56	2.09	2.63	3.09	4.13

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

Balance Sheet

Figures in QR mn	FY2010	FY2011	FY2012e	FY2013e	FY2014e	FY2015e
Non-Current Assets						
Property, Plant and Equipment	419	666	845	978	1076	1083
Investment Properties	42	95	95	95	95	95
Intangible Assets	0	155	148	143	137	131
Available-for-Sale Investments	3	2	0	0	0	0
Total Non-Current Assets	463	918	1,089	1,216	1,308	1,310
Current Assets						
Inventories	1	10	17	21	22	23
Trade and Other Receivables	48	240	264	277	291	305
Bank Balances and cash	97	81	136	166	146	146
Total Current Assets	146	331	416	464	459	474
TOTAL ASSETS	609	1,249	1,505	1,680	1,767	1,784
EQUITY						
Share Capital	250	396	396	396	396	396
Legal Reserves	68	221	221	221	221	221
Changes in Fair Value	(0)	(1)	0	0	0	0
Retained Earnings	31	67	90	123	158	219
Attributable to Owners (Parent)	349	683	708	741	776	837
Non-Controlling Interests	0	3	2	2	2	2
Total Equity	349	687	710	743	779	839
Non-Current Liabilities						
Loans and Borrowings	189	346	615	718	758	751
Employee Benefits	2	8	11	12	14	15
Total Non-Current Liabilities	191	354	626	730	772	765
Current Liabilities						
Trade Payables and Accruals	22	108	86	87	88	89
Loans and Borrowings	30	75	57	92	115	88
Retention Payable	17	25	26	27	14	3
Total Current Liabilities	69	208	169	206	217	179
EQUITY AND LIABILITIES	609	1,249	1,505	1,680	1,767	1,784

Source: Company data, QNBFS estimates

Key Financial Data and Estimates

In QR	2010	2011	2012E	2013E
EPS	1.29	1.56	2.09	2.63
EPS Growth	419.1%	21.0%	34.2%	25.8%
P/E (x)	31.0	25.6	19.1	15.2
BVPS	8.80	17.33	17.92	18.75
P/B (x)	4.5	2.3	2.2	2.1
DPS	0.63	1.50	1.80	2.20
Dividend Payout	49.0%	96.3%	86.1%	83.6%
Dividend Yield	1.6%	3.8%	4.5%	5.5%

Source: QNBFS , Company data, Bloomberg, QE ; Note: EPS & DPS based on current number of shares

Recommendations		Risk Ratings	
<i>Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price</i>		<i>Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals</i>	
OUTPERFORM	Greater than +20%	R-1	Significantly lower than average
ACCUMULATE	Between +10% to +20%	R-2	Lower than average
MARKET PERFORM	Between -10% to +10%	R-3	Medium / In-line with the average
REDUCE	Between -10% to -20%	R-4	Above average
UNDERPERFORM	Lower than -20%	R-5	Significantly above average

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