

Qatar Gas Transport Co./Nakilat (QGTS)

Recommendation	OUTPERFORM	Risk Rating	R-3
Share Price	QR14.59	Current Target Price	QR21.00
Implied Upside	43.9%		

1Q2018 Exceeds Estimates; Maintain Outperform/QR21 TP

We maintain our estimates on QGTS post better-than-expected 1Q2018 results. Stock price has been fairly weak since mid-March as focus has shifted to several other QSE-listed names benefiting from the FOL upside catalyst. Moreover, QGTS is running the risk of being removed from the MSCI EM Index with a decision expected May 14. Nevertheless, we continue to favor Nakilat, #1 owner/operator of LNG vessels globally, as a LT play geared to Qatari LNG's dominance & anticipated growth in the LNG market. We believe the stock is attractive at current levels and reiterated our rating.

Highlights

- **QGTS' net profit declines 10% QoQ in 1Q2018, exceeding our estimate by 8%.** Nakilat reported a bottom-line figure of QR216mn in 1Q2018, which was above our forecast of QR201mn. On a YoY basis, net profit rose 13.2%. **Operating results were fairly in-line with our expectations with modestly higher gross margins and lower D&A expenses contributing to the earnings beat.** The QoQ decline in earnings was primarily due to lower other income (which had QR65mn in realized gains on investments in 4Q2017). **Operating results were actually better sequentially with adjusted EBITDA growing 4% QoQ. YoY results were positive, aided by higher gross profits and interest/dividend and other income.** (More details on Page 2).
- **Maintaining our modeled estimates which already include 2 additional conventional LNG vessels in the Maran JV.** We are comfortable with our 2018 forecasts for now. In early March, QGTS announced it added two conventional LNG ships increasing its fleet from 13 to 15 in 40%-owned Maran JV. Our estimates reflect these additional ships from March onward along with our estimates of resultant increase in debt and finance charges (at the JV level).
- **QGTS is a vital part of Qatar's LNG value chain and enjoys stable revenue/cash flow from LT (25 years/~15 years left) and fixed-rate time LNG charter contracts (take or pay)** with Qatargas and its affiliates. The availability-based take or pay contracts shields QGTS from end-demand volatility and delays in charterers' projects. 11 ships are on spot-to-medium-term charters; LPG is a spot business.
- **High leverage but debt is mostly secured by watertight charter agreements; we do not foresee any challenges in debt servicing/repayments.** QGTS has \$5.7bn in debt on its books (2017 net debt-to-EBITDA: 7.8x; 3.5x debt-to-equity/2.4x debt-to-equity excluding hedging reserve and another \$3bn in debt in JVs (2017: net debt-to-EBITDA of 7.6x and 2.5x debt-to-equity). However, out of this, only \$500mn is corporate debt with the rest being non-recourse project financing backed by charter agreements of LNG vessels. A majority of this leverage will be amortized over the remaining life of charters with last of this debt (in form of bonds) paid off by 2033. 54 of the 65 LNG ships are chartered by Qatargas with charter payments to Nakilat mostly retaining higher priority than debt service in the charterer's cash waterfall. We see no major risk of default as ~QR2bn in interest plus repayments per annum is met easily by OCF with no major refinancing expected until 2025 with \$2.7bn in bank facility balloon payments. Interestingly, while QGTS will repay all debt by 2033, LNG ships will retain another 15 years of useful life (until 2048) and can be levered for fleet growth, etc.
- **Stable profile with industry-leading EBITDA margins & attractive dividend/FCF yields.** Charter agreements result in stable revenue along with operating costs pass-through (a mixture of capped and uncapped inflation rates) leading to flattish absolute EBITDA. Nakilat's stable business profile is highlighted by its industry-leading margins (average adjusted EBITDA margin of 78.4% over 2010-2017 followed by 77.3% over 2018-2033). A significant majority of interest payments are locked at fixed rates via swaps over the length of the charters/debt at around 5.6%. Locked in charter rates with limited exposure to spot rates along with predictable and declining interest payments virtually guarantees the residual stream for shareholders as dividends. We model dividend yield of 7.2% in 2018, growing to 19.0% by 2033 with FCF yield of 16.3% growing to 36.0% over the same period.

Catalysts

- **The expansion of Qatar's LNG output from 77 MTPA to 100 MTPA is a significant driver (potentially another 30 conventional vessels).** QGTS is also considering targeting the FSRU business. Vessels have 40-years of life vs. maximum debt life of 25 years (last debt maturing 2033), creating refinancing opportunities to increase fleet size. Medium-term, the shipyard business could improve.

Recommendation, Valuation and Risks

- **Recommendation & valuation: Our 12-month target is QR21.** QGTS trades at attractive multiples vs. peers, while sporting much better EBITDA margins and FCF yields.
- **Risks: (1)** Blockade is an overhang but business impact has been limited thus far. Shipping ultimately remains the charterers' concern and comprehensive insurance policies (including war insurance) cover QGTS for political stress events under force majeure clauses for 36 months (plus 6 months in many cases). Blockage of the Strait of Hormuz/Gulf of Suez is unlikely. Charterers will also bear any costs of potential rerouting. **(2)** There is a risk existing LNG contracts get renegotiated as they are at a premium to spot (for wholly-owned fleet and some JVs). We would not rule out potential contract restructuring, with QGTS accepting slightly lower charter rates in return for increasing their lengths from 25 to 35+ years. However, bargaining power rests with Qatargas and Nakilat may have no choice but to accept significantly worse contract terms. The likelihood of this is low given investment grade-rated bonds and contagion effects for other GRE-related bond issues.

Key Financial Data and Estimates

	FY2016	FY2017	FY2018e	FY2019e
EPS (QR)	1.72	1.53	1.54	1.73
P/E (x)	8.5	9.5	9.5	8.4
DPS (QR)	1.00	1.00	1.05	1.10
Dividend Yield	6.9%	6.9%	7.2%	7.5%

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

Key Data

Current Market Price (QR)	14.59
Current Dividend Yield (%)	6.9
Bloomberg Ticker	QGTS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QGTS.QA
ISIN	QA000A0KD6L1
Sector*	Transportation
52wk High/52wk Low (QR)	19.99/13.05
3-m Average Volume ('000)	379.2
Mkt. Cap. (\$ bn/QR bn)	2.2/8.1
EV (\$ bn/QR bn)	7.1/26.0
Shares Outstanding (mn)	560.0
FO Limit* (%)	49.0
Current FO* (%)	15.9
1-Year Total Return (%)	(20.9)
Fiscal Year End	December 31

Source: Bloomberg (as of April 29, 2018), *Qatar Exchange (as of April 29, 2018); Note: FO is foreign ownership

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1Q2018 Review

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1Q2018 Actual Vs. Estimates and Comparisons

In QR mn	1Q2018	1Q2018e	4Q2017	1Q2017	A vs. E	QoQ	YoY	2018e	2017	YoY	2016	YoY
Revenue from Wholly-Owned Vessels	757.6	752.5	769.3	752.6	1%	-2%	1%	3,059.9	3,057.1	0%	3,068.6	0%
Gross Profit	593.0	581.7	588.7	581.8	2%	1%	2%	2,355.4	2,359.6	0%	2,350.6	0%
EBITDA	575.8	563.5	573.8	562.4	2%	0%	2%	2,278.2	2,281.4	0%	2,269.9	1%
EBIT	387.2	370.8	381.2	372.8	4%	2%	4%	1,508.0	1,513.4	0%	1,502.3	1%
Share of Operating Profits from Joint Ventures	84.9	83.1	62.0	83.8	2%	37%	1%	369.1	339.0	9%	553.4	-39%
Net Income to Equity	216.4	201.0	239.8	191.1	8%	-10%	13%	852.5	846.2	1%	954.2	-11%
DPS (QR)								1.05	1.00	5%	1.00	0%
Adjusted Revenue	857.4	850.2	845.6	849.7	1%	1%	1%	3,485.4	3,451.3	1%	3,677.2	-6%
Adjusted EBITDA	660.8	646.6	635.8	646.2	2%	4%	2%	2,647.3	2,620.4	1%	2,823.3	-7%
Gross Margin	78.3%	77.3%	76.5%	77.3%				77.0%	77.2%		76.6%	
EBITDA Margin	76.0%	74.9%	74.6%	74.7%				74.5%	74.6%		74.0%	
EBIT Margin	51.1%	49.3%	49.6%	49.5%				49.3%	49.5%		49.0%	
Net Margin	11.2%	11.0%	8.1%	11.1%				12.1%	11.1%		18.0%	
Adjusted EBITDA Margin	77.1%	76.0%	75.2%	76.0%				76.0%	75.9%		76.8%	

Source: Company data, QNBFS estimates

Relative Valuation

In terms of multiples, QGTS remains relatively cheaper vs. its peers along with substantially better EBITDA margins. We also point to the company substantial FCF yield resulting from limited capex requirements and significant operating cash flow.

Relative Valuation Versus Peers

Shippers Company	Ticker	Div. Yield	EBITDA Margin		P/E		P/CFPS		EV/EBITDA		FCF Yield	
			FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e
COSCO SHIPPING Energy Transportation Co Ltd	1138	5.4%	36.1%	40.4%	10.1x	7.2x	3.4x	2.8x	8.9x	7.3x	3.4%	2.4%
National Shipping Co of Saudi Arabia/The	NSCSA	5.1%	34.5%	33.2%	12.8x	11.7x	NA	NA	9.3x	8.9x	NA	NA
GasLog Partners LP	GLOP	8.8%	72.2%	72.0%	12.1x	11.3x	5.3x	5.2x	9.3x	8.6x	(26.5%)	(15.4%)
GasLog Ltd	GLOG	3.3%	70.6%	73.2%	42.1x	15.2x	4.3x	3.6x	11.2x	9.5x	(19.3%)	1.7%
Dynagas LNG Partners LP	DLNG	19.0%	72.9%	75.0%	20.4x	14.0x	5.1x	5.0x	10.6x	9.3x	(2.8%)	NA
Ship Finance International Ltd	SFL	10.5%	65.0%	67.2%	15.9x	13.5x	9.0x	8.0x	10.5x	10.1x	13.5%	20.6%
Teekay LNG Partners LP	TGP	3.1%	73.7%	76.5%	10.8x	7.3x	5.8x	4.8x	10.6x	8.4x	NA	NA
Golar LNG Ltd	GLNG	0.6%	52.1%	59.8%	nmf	43.3x	17.6x	11.7x	27.1x	18.2x	8.1%	6.3%
Tsakos Energy Navigation Ltd	TNP	5.5%	52.0%	54.1%	nmf	10.8x	2.3x	1.5x	8.5x	7.2x	45.2%	53.5%
Average		6.8%	58.8%	61.3%	17.7x	14.9x	6.6x	5.3x	11.8x	9.7x	3.1%	11.5%
Median		5.4%	65.0%	67.2%	12.8x	11.7x	5.2x	4.9x	10.5x	8.9x	3.4%	4.3%
Qatar Gas Transport Co Ltd	QGTS	6.9%	76.0%	76.2%	9.5x	8.4x	5.8x	5.4x	9.4x	8.9x	16.3%	17.5%

Note: Where coverage is not available, estimates are based on Bloomberg consensus, if available

Mean/Median calculated if more than 3 observations are present

NA: Not Applicable

nmf: Not Meaningful (typically refers to negative or exceedingly large values)

Source: Bloomberg, QNBFS Research

Detailed Financial Statements

Income Statement

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Revenue – Wholly-Owned Ships	3,057	3,060	3,063	3,066
Direct Costs	(697)	(704)	(708)	(712)
Gross Profit	2,360	2,355	2,355	2,354
Income from Marine & Agency Services	55	56	57	59
General and Administrative Expenses	(133)	(134)	(134)	(134)
EBITDA	2,281	2,278	2,279	2,279
Depreciation	(768)	(770)	(771)	(772)
EBIT	1,513	1,508	1,508	1,507
Share of Profits from Joint Ventures	339	369	419	517
Finance Costs	(1,172)	(1,127)	(1,071)	(1,006)
Interest, Dividend & Profit from Islamic Banks	64	64	64	64
Vessels Sub-Chartering & Other Income	103	39	39	39
Profit Before Tax	847	854	959	1,121
Income Tax Expense	0	0	0	0
Profit After Tax	847	854	959	1,121
Minority Interest	(1)	(1)	(1)	(2)
Profit for Equity Shareholders	846	852	957	1,120
EPS (QR)	1.53	1.54	1.73	2.02
Adjusted Net Revenue	3,451	3,485	3,539	3,641
Adjusted EBITDA	2,620	2,647	2,698	2,796

Source: Company data, QNBFS estimates

Balance Sheet

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Non-Current Assets				
Property, Plant and Equipment	22,392	21,708	21,023	20,337
Investment in Joint Venture Companies	4,144	4,268	4,394	4,523
Loans to Joint Venture Companies	99	99	99	99
Available-for-Sale Investments	109	109	109	109
Total Non-Current Assets	26,744	26,184	25,624	25,068
Current Assets				
Receivables, Inventories and Due from Joint Ventures	400	400	400	401
Cash and Bank Balances	2,775	2,835	2,634	2,536
Total Current Assets	3,175	3,235	3,035	2,937
Total Assets	29,919	29,418	28,659	28,004
Equity				
Equity Attributable to the Parent	5,922	6,393	6,941	7,625
Minority Interest	4	5	7	8
Total Equity	5,926	6,398	6,948	7,633
Non-Current Liabilities				
Borrowings	19,789	18,638	17,450	16,337
Fair Value of Interest Rate Swaps	2,478	2,323	2,168	2,014
Provision for End of Service Benefits	148	148	148	148
Total Non-Current Liabilities	22,416	21,109	19,766	18,498
Current Liabilities				
Borrowings	832	1,158	1,189	1,113
Accounts Payables/Accruals & Due to Related Parties	746	753	756	760
Total Current Liabilities	1,578	1,911	1,945	1,873
Equity and Liabilities	29,919	29,418	28,659	28,004

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

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