

Gulf International Services (GISS)

Recommendation	OUTPERFORM	Risk Rating	R-4
Share Price	QR16.20	Current Target Price	QR21.00
Implied Upside	29.6%	Old Target Price	QR17.00

Major Drilling Contract Win; Upgrade to Outperform with QR21 PT

We are increasing our estimates and upgrading GISS from an Accumulate to an Outperform rating; our price target also increases from QR17 to QR21. In this report, we expand upon our upgrade call initially issued in an [Alert](#) on May 2. On the back of a press release from Qatar Petroleum, GISS recently issued their own statement announcing a major contract win involving six offshore drilling rigs. This is related to the upcoming North Field Expansion (NFE) project. While we were expecting an announcement, we were positively surprised by the fact that GISS was able to secure contracts for six rigs (out of a total deal size of 8 rigs). We view this news as further validation of our bullish view on GISS and note the stock is up 17% since our prior upgrade on March 24, 2019 vs. the QSE Index's 5% gain. While all relevant details have not yet been divulged, our preliminary sense is a material uplift in earnings from 2020 onward and we consequently raise our earnings estimate by an average of 28% over 2020-2023. We upgrade GISS from Accumulate to Outperform and raise its target price from QR17 to QR21.

Highlights

- GISS has announced that QP has awarded it with contracts to provide six premium offshore jack up rigs for the North Field expansion (NFE) project. GDI intends to finalize an agreement with Seadrill to provide these required jack up rigs under the terms of their existing Strategic Cooperation Agreement. According to the deployment schedule put forth in GISS' press release: 1) the first two rigs will be contracted for a firm duration of three years and will start working from 1Q2020, 2) the third rig will start operations in 2Q2020 for a period of two years, 3) two additional rigs contracted for three years will start operations in 3Q2020 and 4) finally, a suitable rig already being deployed by Qatargas will be utilized in this drilling program from 2Q2020. Qatargas is in charge of executing this NFE project on behalf of QP; total contracts call for a drilling program of eight rigs, with the remaining two rigs awarded to US-based Northern Offshore Drilling Operations Ltd. The drilling program retains exercisable options to extend its duration if needed and is a major component of the NFE project designed to increase Qatar's LNG capacity from 77 MTPA to 110 MTPA by 2024. The scope of the project includes the drilling and completion of 80 new wells from eight wellhead platform locations.
- Financial impact: We increase our earnings estimate by an average of 28% over 2020-2023.** We increase our 2020 EPS from QR1.13 to QR1.46 (+29%) and our 2021 EPS goes from QR1.30 to QR1.72 (+32%). We have provided details of our model changes on page 2 of this report. We are assuming the five extra rigs to be deployed in a similar arrangement as the West Tucana rig currently being used under a rig utilization agreement with Seadrill. GISS could opt for another structure, such as a JV arrangement and more details should be forthcoming in the future. A rig utilization contract/JV structure should allow GISS to either avoid taking on new debt or keep the additional debt off its books, a positive given the company's relatively high level of leverage (1Q2019 debt of QR5bn with a 2018 net debt-to-EBITDA ratio of 5.5x).
- For 2019, we continue to expect a drilling recovery but remain wary of impairment charges; segment profitability, while already slated to be back in the black should now go up significantly by 2020.** As we have stated before, our 2019 drilling loss of QR88mn does not factor in any impairments; the Mshaireb rig is fairly old and is not being used with GDI looking to deploy it outside of Qatar (in Asia). Success of this strategy is uncertain and a 2019 (most likely year-end) impairment cannot be ruled out. While we were already modeling slightly positive drilling net income in 2020, this deal should firmly put GDI in the black next year.

Catalysts

- Positive newsflow on the drilling front and signs of stabilization in the other segments should continue to help the stock going forward.

Recommendation, Valuation and Risks

- Recommendation and valuation: We upgrade GISS to an Outperform with a TP of QR21.** GISS trades at 2019 & 2020 EV/EBITDA multiples of 8.4x and 6.5x, respectively.
- Risks: Geopolitical risks** cannot be modeled. Given the low level of absolute earnings along with paper-thin net margins (2018: 2.1% excluding rig impairment/PP&E write-off), **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)	0.55	1.46	1.72
P/E (x)	N/M	29.2	11.1	9.4
EV/EBITDA (x)	9.2	8.4	6.5	5.7

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)	241.8
Mkt. Cap. (\$ bn/QR bn)	0.8/3.0
EV (\$ bn/QR bn)	1.8/6.5
FO Limit* (%)	49.0
Current FO* (%)	8.6
Shares Outstanding (mn)	185.8
1-Year Total Return (%)	(2.1)
Fiscal Year End	December 31

Source: Bloomberg (as of May 1, 2019), *Qatar Exchange (as of May 1, 2019); Note: FO is foreign ownership

Saugata Sarkar, CFA, CAIA

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

Summary of Estimate Changes

We increase our earnings estimate by an average of 28% over 2020-2023 on account of this new contract. We increase our 2020 EPS from QR1.13 to QR1.46 (+29%) and our 2021 EPS goes from QR1.30 to QR1.72 (+32%). We have provided details of our model changes in the table below. We are assuming the five extra rigs to be deployed in a similar arrangement as the West Tucana rig currently being used under a rig utilization agreement with Seadrill. GISS could opt for another structure, such as a JV arrangement and more details should be forthcoming in the future. A rig utilization contract/JV structure should allow GISS to either avoid taking on new debt or keep the additional debt off its books, a positive given the company's relatively high level of leverage (1Q2019 debt of QR5bn with a 2018 net debt-to-EBITDA ratio of 5.5x).

For 2019, we continue to expect a drilling recovery but remain wary of impairment charges; segment profitability, while already slated to be back in the black should now go up significantly by 2020. As we have stated before, our 2019 drilling loss of QR88mn does not factor in any impairments; the Msheireb rig is fairly old and is not being used with GDI looking to deploy it outside of Qatar (in Asia). Success of this strategy is uncertain and a 2019 (most likely year-end) impairment cannot be ruled out. While we were already modeling slightly positive drilling net income in 2020, this deal should firmly put GDI in the black next year.

QNB FS Current Estimates Vs. Previous Estimates

In QR mn	2019			2020			2021		
	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change
Revenue	2,754.6	2,754.6	0.0%	2,927.4	2,859.3	2.4%	2,981.7	2,891.3	3.1%
Gulf Drilling International (GDI)	1,158.3	1,158.3	0.0%	1,282.8	1,214.7	5.6%	1,287.2	1,196.8	7.6%
Gulf Helicopters Company (GHC)	555.1	555.1	0.0%	568.9	568.9	0.0%	583.2	583.2	0.0%
Amwaj Catering Company (AHC)	391.6	391.6	0.0%	409.8	409.8	0.0%	428.8	428.8	0.0%
Al Koot Insurance & Reinsurance (AKIR)	649.6	649.6	0.0%	665.8	665.8	0.0%	682.5	682.5	0.0%
COGS	2,282.8	2,282.8	0.0%	2,292.5	2,292.5	0.0%	2,304.8	2,304.8	0.0%
Gross Profit	471.8	471.8	0.0%	634.9	566.8	12.0%	676.9	586.5	15.4%
SG&A	213.1	213.1	0.0%	214.2	214.2	0.0%	212.3	212.3	0.0%
Total Other Income	35.0	37.5	-6.7%	35.0	42.5	-17.6%	35.0	47.5	-26.3%
Net Finance Income (Expense)	(190.8)	(190.8)	0.0%	(184.5)	(184.5)	0.0%	(180.5)	(180.5)	0.0%
Net Income	103.0	105.5	-2.4%	271.2	210.6	28.8%	319.1	241.2	32.3%
Net Margin	3.7%	3.8%		9.3%	7.4%		10.7%	8.3%	
Gulf Drilling International (GDI)	(88.0)	(85.5)	2.9%	61.1	0.5	N/M	82.8	4.9	N/M
Net Margin	-7.6%	-7.4%		4.8%	0.0%		6.4%	0.4%	
Gulf Helicopters Company (GHC)	144.0	144.0	0.0%	152.7	152.7	0.0%	164.6	164.6	0.0%
Net Margin	25.9%	25.9%		26.8%	26.8%		28.2%	28.2%	
Amwaj Catering Company (AHC)	26.9	26.9	0.0%	31.4	31.4	0.0%	36.3	36.3	0.0%
Net Margin	6.9%	6.9%		7.7%	7.7%		8.5%	8.5%	
Al Koot Insurance & Reinsurance (AKIR)	54.4	54.4	0.0%	60.3	60.3	0.0%	69.7	69.7	0.0%
Net Margin	8.4%	8.4%		9.1%	9.1%		10.2%	10.2%	
Corporate/Other	(34.4)	(34.4)	0.0%	(34.4)	(34.4)	0.0%	(34.4)	(34.4)	0.0%
Net Margin	-1.2%	-1.2%		-1.2%	-1.2%		-1.2%	-1.2%	
EBITDA	769.9	772.4	-0.3%	929.9	869.3	7.0%	971.9	894.0	8.7%
EBITDA Margin	27.9%	28.0%		31.8%	30.4%		32.6%	30.9%	
Gulf Drilling International (GDI)	468.3	470.8	-0.5%	611.1	550.5	11.0%	628.7	550.9	14.1%
EBITDA Margin	40.4%	40.6%		47.6%	45.3%		48.8%	46.0%	
Gulf Helicopters Company (GHC)	244.8	244.8	0.0%	252.5	252.5	0.0%	263.5	263.5	0.0%
EBITDA Margin	44.1%	44.1%		44.4%	44.4%		45.2%	45.2%	
Amwaj Catering Company (AHC)	37.5	37.5	0.0%	41.8	41.8	0.0%	46.4	46.4	0.0%
EBITDA Margin	9.6%	9.6%		10.2%	10.2%		10.8%	10.8%	
Al Koot Insurance & Reinsurance (AKIR)	31.0	31.0	0.0%	36.3	36.3	0.0%	45.1	45.1	0.0%
EBITDA Margin	4.8%	4.8%		5.4%	5.4%		6.6%	6.6%	
Corporate/Other	(11.8)	(11.8)	0.0%	(11.8)	(11.8)	0.0%	(11.8)	(11.8)	0.0%
EBITDA Margin	-2.5%	-2.5%		-1.9%	-2.1%		-1.7%	-2.0%	
EPS	0.55	0.57	-2.4%	1.46	1.13	28.8%	1.72	1.30	32.3%
DPS	0.00	0.00		0.00	0.00		0.00	0.00	

Source: QNB FS estimates

Key Segment Details

Key Segment Details

In QR mn	2017	2018	2019e	2020e	2021e
Revenue	2,403	2,519	2,755	2,927	2,982
<i>Gulf Drilling International (GDI)</i>	1,112	1,142	1,158	1,283	1,287
<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)	103	271	319
Net Margin	4%	-4%	4%	9%	11%
Drilling	(102)	(264)	(88)	61	83
<i>Net Margin</i>	-9%	-23%	-8%	5%	6%
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	770	930	972
EBITDA Margin	30%	30%	28%	32%	33%
Drilling	424	398	468	611	629
<i>EBITDA Margin</i>	38%	35%	40%	48%	49%
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%	6.3%	1.9%	1.6%	1.9%
Gross Profit	1.2%	(56.2%)	(19.3%)	(11.9%)	25.2%	34.6%	6.6%	4.8%	3.2%
EBITDA	(18.9%)	(40.0%)	(17.6%)	3.5%	3.3%	20.8%	4.5%	3.2%	2.2%
EBIT	(33.4%)	(69.0%)	(21.8%)	10.0%	15.1%	55.1%	9.6%	6.7%	4.4%
PAT/EPS	(43.2%)	(91.6%)	26.9%	N/M	N/M	163.4%	17.7%	11.4%	10.5%
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%	11.1%	9.4%	3.5%	2.8%
FCFPS	N/M	(59.3%)	32.4%	(41.9%)	178.3%	14.3%	11.6%	3.2%	2.2%
Operating Ratios									
Gross Margin	29.1%	17.7%	17.8%	15.0%	17.1%	21.7%	22.7%	23.4%	23.7%
Gross Margin, Excluding Depreciation & Amortization	40.7%	36.7%	37.8%	34.1%	34.2%	37.7%	38.3%	38.7%	38.7%
EBITDA Margin	35.0%	29.3%	30.0%	29.6%	27.9%	31.8%	32.6%	33.1%	33.2%
EBIT Margin	23.0%	9.9%	9.7%	10.1%	10.7%	15.6%	16.8%	17.6%	18.0%
Net Margin	19.2%	2.2%	3.5%	(3.9%)	3.7%	9.3%	10.7%	11.7%	12.7%
Finance Ratios									
Debt-Equity Ratio	1.3	1.5	1.4	1.4	1.3	1.2	1.0	0.9	0.8
Net Debt-Equity Ratio	1.1	1.1	1.1	1.2	1.0	0.9	0.7	0.5	0.4
Net Debt-to-Capital	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.3	0.3
Net Debt-to-EBITDA	2.9	4.8	5.8	5.5	4.9	3.6	2.9	2.3	1.8
Interest Coverage	12.2	2.4	1.3	1.1	1.3	2.0	2.3	2.5	2.7
Return Ratios									
ROIC	10.5%	3.2%	2.6%	3.0%	3.5%	5.4%	5.8%	6.0%	6.4%
ROE	20.4%	1.8%	2.3%	-2.8%	2.8%	6.9%	7.5%	7.8%	8.0%
ROA	7.1%	0.6%	0.8%	-1.0%	1.0%	2.6%	3.0%	3.2%	3.6%
FCF Yield	20.9%	8.5%	11.2%	6.5%	18.2%	20.8%	23.2%	23.9%	24.4%
Liquidity Ratios									
Current Ratio	0.9	1.2	1.0	1.2	1.2	1.4	1.9	0.8	1.6
Quick Ratio	0.9	1.1	1.0	1.1	1.2	1.4	1.8	0.8	1.5
Valuation									
EV/Sales	1.7	2.4	2.9	2.7	2.4	2.1	1.9	1.6	1.5
EV/EBITDA	4.8	8.0	9.7	9.2	8.4	6.5	5.7	5.0	4.4
EV/EBIT	7.3	23.7	30.2	26.7	22.1	13.3	11.1	9.4	8.1
P/E	3.8	45.0	35.4	N/M	29.2	11.1	9.4	8.5	7.7
P/CF	2.1	3.2	4.2	6.9	3.8	3.4	3.1	3.0	2.9
P/BV	0.8	0.8	0.8	0.9	0.8	0.8	0.7	0.7	0.6
Dividend Yield	6.2%	6.2%	0.0%	0.0%	0.0%	0.0%	0.0%	3.1%	4.6%
FCF Yield	20.9%	8.5%	11.2%	6.5%	18.2%	20.8%	23.2%	23.9%	24.4%

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	2,927	2,982
COGS	1,975	2,142	2,283	2,292	2,305
Gross Profit	428	377	472	635	677
SG&A	222	214	213	214	212
Total Other Income	25	(65)	35	35	35
Net Finance Income (Expense)	(145)	(196)	(191)	(185)	(181)
Net Income	85	(98)	103	271	319
EBITDA	720	746	770	930	972
EPS	0.46	(0.53)	0.55	1.46	1.72
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	952	888	943	1,183	1,599
Financial Investments	201	289	311	311	311
Insurance & Accounts Receivables/Prepayments	725	1,007	1,273	1,334	1,364
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	3,378	3,679	4,128
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	10,436	10,524	10,771
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	3,639	3,910	4,229
Liabilities & Shareholders' Equity	10,428	10,157	10,436	10,524	10,771

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

Disclaimer and Copyright Notice: This publication has been prepared by QNB Financial Services Co. W.L.L. ("QNB FS") a wholly-owned subsidiary of Qatar National Bank (Q.P.S.C.). QNB FS is regulated by the Qatar Financial Markets Authority and the Qatar Exchange. Qatar National Bank (Q.P.S.C.) is regulated by the Qatar Central Bank. This publication expresses the views and opinions of QNB FS at a given time only. It is not an offer, promotion or recommendation to buy or sell securities or other investments, nor is it intended to constitute legal, tax, accounting, or financial advice. QNB FS accepts no liability whatsoever for any direct or indirect losses arising from use of this report. Any investment decision should depend on the individual circumstances of the investor and be based on specifically engaged investment advice. We therefore strongly advise potential investors to seek independent professional advice before making any investment decision. Although the information in this report has been obtained from sources that QNB FS believes to be reliable, we have not independently verified such information and it may not be accurate or complete. QNB FS does not make any representations or warranties as to the accuracy and completeness of the information it may contain, and declines any liability in that respect. For reports dealing with Technical Analysis, expressed opinions and/or recommendations may be different or contrary to the opinions/recommendations of QNB FS Fundamental Research as a result of depending solely on the historical technical data (price and volume). QNB FS reserves the right to amend the views and opinions expressed in this publication at any time. It may also express viewpoints or make investment decisions that differ significantly from, or even contradict, the views and opinions included in this report. This report may not be reproduced in whole or in part without permission from QNB FS.

COPYRIGHT: No part of this document may be reproduced without the explicit written permission of QNB FS.