Gulf International Services (GISS)

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	QR1.544	Current Target Price	QR1.800
Implied Upside	16.6%	Old Target Price	QR2.100

Macro Headwinds Push-Out Growth Story; Moving to Accumulate

We are reducing our estimates and lowering our rating/price target on GISS from Outperform/QR2.10 to Accumulate/QR1.80. *GISS' 2Q & 3Q2020 results were decidedly below our estimates with **(1)** its drilling business squeezed by coronavirus-related restrictions leading to rig suspensions (notably onshore GDI-4/5/7 rigs since the beginning of April) and **(2)** oil price volatility leading to another ~20% cut in rig day-rates across the fleet in July). Moreover, in our view, considering the prevailing macro environment, GDI's proposed restructuring of its $1.2bn debt pile has been put on the backburner until 2H2021. We expect another loss in FY2020 with GISS potentially writing-off its Msheireb offshore rig but forecast 2021 to be back in the green helped by the ramp-up of the North Field East (NFE) drilling program.* ***We stay longer-term positive on GISS shares but the stock remains in a "show-me" mode. Lacking a dividend-related catalyst that generally benefits Qatari companies in 4Q/early 1Q, we expect improving financial performance in 2021 and newsflow regarding the NFE expansion/debt restructuring to drive stock price performance over the next 12 months.***

Highlights

- **After a generally positive 1Q2020, COVID-19 and oil price volatility adversely influenced performance:** Overall 9M2020 top-line of QR2.3bn remained stable (up 1% YoY) but faced a downward trajectory throughout 2020 – revenue declined 13% from QR831.7mn in 1Q2020 to QR727.3mn in 2Q2020 and a further 3% down to QR707.2mn in 3Q2020. **Insurance** was a bright spot given new account additions, policy renewals and improved pricing on all major accounts in the medical segment; 9M2020 segment revenue grew 23% YoY to QR735.6mn. However, 9M2020 **drilling** revenue of QR723.3mn fell a significant 19% given the aforementioned suspensions (onshore revenue declined ~54% YoY), along with rig rate reductions from July that also contributed to a ~12% YoY fall in offshore revenue.
- **3Q2020 earnings dipped back into the red hurt by lower utilizations and day-rates in drilling.** 9M2020 earnings, however, improved 41% YoY from QR34.6mn to QR48.8mn driven by stable revenue and improved costs, especially finance costs that fell 27% due to lower interest rates.
- **We expect 2020 bottom-line at a loss of QR135.7mn vs. a net profit of QR34.0mn in 2019.** FY2020 earnings could be impacted by an impairment for the Msheireb offshore rig. Rig utilization will remain depressed. GDI-3 and Msheireb remain out of commission and Al Safliya is supposed to be off-contract for all of 2020. GDI-4/5/7 rigs are not slated to come back on-line until May-July 2021 and Rumailah/Zikreet are also not working in 4Q2020. On the positive side, we do expect the Al-Zubarah offshore rig to resume operations in late November. As far as the insurance, aviation and catering segments are concerned, we expect 4Q2020 performance to remain generally consistent with 3Q2020's reported results.
- **The NFE project remains a significant catalyst for future growth in GDI & GISS.** As expected, GDI's JV with Seadrill called as GulfDrill started deploying its jackup "Lovanda" on March 29 as part of its 80-well drilling program for Qatar's North Field East project. The second rig started work in late August. We further model in the remaining four rigs in 2021 but our rig deployment schedule projections are somewhat back-end loaded vs. management guidance.
- **We expect earnings to surface back into the green in 2021 as drilling loss declines significantly.** Other segments also contribute positively, while continued progress in costs reduction and lower finance charges help boost earnings. *We detail our estimates on page 3.*

Catalysts

- **Positive newsflow/performance on the drilling front and signs of growth in the other segments should help.** Favorable updates on debt restructuring could please equity investors.

Recommendation, Valuation and Risks

- **Recommendation and valuation:** ***We rate GISS an Accumulate with a TP of QR1.80.*** GISS trades at 2021 & 2022 EV/EBITDA multiples of 8.4x and 6.5x, respectively.
- **Risks: Geopolitical risks** cannot be modeled. **Oil price volatility and COVID-19-related delays** can hurt operations and debt restructuring efforts. Given the low level of absolute earnings, along with paper-thin net margins (2019: 1.1%; 9M2020: 2.2%), **quarterly earnings could be subject to significant volatility. Debt levels are high** (2019: QR4.7bn/5.3x net-debt-to-EBITDA) but manageable in light of 1.8x interest coverage (2021e) and GISS' attempts to restructure/refinance its leverage going forward. 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

	2019	2020e	2021e	2022e
EPS (QR)	0.02	(0.07)	0.07	0.13
P/E (x)	84.5	N/M	22.2	11.9
EV/EBITDA (x)	8.4	9.3	8.4	6.5

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)	1.820/0.942
3-m Avg. Volume (mn)	3.4
Mkt. Cap. ($ bn/QR bn)	0.8/2.9
EV ($ bn/QR bn)	1.6/5.9
FO Limit* (%)	49.0
Current FO* (%)	8.8
Shares Outstanding (bn)	1.9
1-Year Total Return (%)	(14.2)
Fiscal Year End	December 31

Source: Bloomberg (as of December 10, 2020), *Qatar Exchange (as of December 09, 2020); Note: FO is foreign ownership

Saugata Sarkar, CFA, CAIA
+974 4476 6534
saugata.sarkar@qnbfs.com.qa

Investment Themes

- **After a generally positive 1Q2020, COVID-19 and oil price volatility adversely influenced performance:** Overall 9M2020 top-line of QR2.3bn remained stable (up 1% YoY) but faced a downward trajectory throughout 2020 – revenue declined 13% from QR831.7mn in 1Q2020 to QR727.3mn in 2Q2020 and a further 3% down to QR707.2mn in 3Q2020.
    - **Insurance** was a bright spot given new account additions, policy renewals and improved pricing on all major accounts in the medical segment; 9M2020 segment revenue grew 23% YoY to QR735.6mn.
    - **Aviation** revenue grew 13% to QR490.3mn in 9M2020 with its international division reporting a growth of ~21% (traction in Turkey, along with new ST contracts in Angola, Oman and South Africa). Qatar's aviation top-line also grew ~7% given revision of rates and addition of one oil & gas chopper in early 2020. While the pandemic hurt flying hours (especially during April-May), which declined 33% YoY, aviation's fixed charge component remained unaffected and boosted segment revenue.
    - **Catering** revenue of QR317.0mn was flattish, up 1% YoY, as COVID-19 restrictions lowered number of meals served across most catering locations.
    - Finally, 9M2020 **drilling** revenue of QR723.3mn fell a significant 19%. GDI was squeezed by coronavirus-related restrictions leading to rig suspensions (notably onshore GDI-4/5/7 rigs since the beginning of April). As a result, onshore revenue declined ~54% YoY, along with rig rate reductions from July that also contributed to a ~12% YoY fall in offshore revenue.
- **Net income dipped back into the red in 3Q2020 hurt by lower utilizations and day-rates in drilling.** 9M2020 earnings, however, improved 41% YoY from QR34.6mn to QR48.8mn driven by stable revenue and improved costs, especially finance costs that declined 27% from QR181.1mn to QR131.5mn due to lower interest rates. Net income, which was depressed by unrealized mark-to-mark investment losses in the insurance segment, came in at QR8.7mn in 1Q2020. While earnings jumped markedly to QR45.3mn in 2Q2020 due to significant recoveries in previously mentioned investment losses, COVID-19-related disruptions hurt drilling and aviation setting the stage for 3Q2020's loss of QR5.2mn when drilling was impacted by further day-rate cuts.
- **We expect 2020 bottom-line at a loss of QR135.7mn vs. a net profit of QR34.0mn in 2019.** FY2020 earnings could be impacted by an impairment for the Msheireb offshore rig. Rig utilization will remain depressed. GDI-3 and Msheireb remain out of commission and Al Safliya is supposed to be off-contract for all of 2020. GDI-4/5/7 rigs are not slated to come back on-line until May-July 2021 and Rumailah/Zikreet are also not working in 4Q2020. On the positive side, we do expect the Al-Zubarah offshore rig to resume operations in late November. As far as the insurance, aviation and catering segments are concerned, we expect 4Q2020 performance to remain generally consistent with 3Q2020's reported results.
- **The NFE project remains a significant catalyst for future growth in GDI and GISS.** As expected, GDI's JV with Seadrill called as GulfDrill started deploying its jackup "Lovanda" on March 29 as part of its 80-well drilling program for Qatar's North Field East project. The second rig started work in late August. We further model in the remaining four rigs in 2021 but our rig deployment schedule projections are somewhat back-end loaded vs. management guidance.
- **GDI debt refinancing/restructuring on hold given the pandemic but we expect the process to restart next year.** We expect any future restructuring to boost profitability/flexibility and provide GDI with a grace period for repayments.
- **We expect earnings to surface back into the green in 2021 as drilling loss declines significantly.** Other segments also contribute positively, while continued progress in costs reduction and lower finance charges help boost earnings. Positive newsflow/performance on the drilling front and signs of growth in the other segments should help. Favorable updates on debt restructuring could please equity investors.
- **Risks:** Geopolitical risks cannot be modeled. Oil price volatility and COVID-19-related delays can hurt operations and debt restructuring efforts. Given the low level of absolute earnings, along with paper-thin net margins (2019: 1.1%; 9M2020: 2.2%), quarterly earnings could be subject to significant volatility. Debt levels are high (2019: QR4.7bn/5.3x net-debt-to-EBITDA) but manageable in light of 1.8x interest coverage (2021e) and GISS' attempts to restructure/refinance its leverage going forward. Further decline in rig rates/utilizations could pressure shares. GISS also faces concentration risk given its exposure to QP/affiliates.

Key Segment Details

Key Segment Details

In QR mn		2019	2020e	2021e	2022e	2023e
Revenue		**3,011**	**2,969**	**3,154**	**3,435**	**3,517**
Gulf Drilling International (GDI)		*1,164*	*912*	*998*	*1,180*	*1,199*
Gulf Helicopters Company (GHC)		*586*	*645*	*667*	*691*	*715*
Amwaj Catering Company (AHC)		*431*	*409*	*435*	*478*	*490*
Al Koot Insurance & Reinsurance (AKIR)		*830*	*1,004*	*1,054*	*1,086*	*1,113*
Net Income		**34**	**(136)**	**129**	**240**	**285**
	Net Margin	**1%**	**-5%**	**4%**	**7%**	**8%**
Drilling		*(111)*	*(390)*	*(205)*	*(125)*	*(108)*
	Net Margin	*-10%*	*-43%*	*-21%*	*-11%*	*-9%*
Helicopters		*143*	*477*	*225*	*239*	*248*
	Net Margin	*24%*	*74%*	*34%*	*35%*	*35%*
Catering		*12*	*(8)*	*18*	*23*	*30*
	Net Margin	*3%*	*-2%*	*4%*	*5%*	*6%*
Insurance		*16*	*66*	*79*	*90*	*102*
	Net Margin	*2%*	*7%*	*8%*	*8%*	*9%*
EBITDA		**714**	**627**	**646**	**759**	**805**
	EBITDA Margin	**24%**	**21%**	**20%**	**22%**	**23%**
Drilling		*436*	*269*	*222*	*303*	*322*
	EBITDA Margin	*37%*	*29%*	*22%*	*26%*	*27%*
Helicopters		*236*	*562*	*309*	*324*	*333*
	EBITDA Margin	*40%*	*87%*	*46%*	*47%*	*47%*
Catering		*38*	*14*	*41*	*46*	*53*
	EBITDA Margin	*9%*	*4%*	*9%*	*10%*	*11%*
Insurance		*(1)*	*54*	*69*	*81*	*93*
	EBITDA Margin	*0%*	*5%*	*7%*	*7%*	*8%*

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%	19.5%	(1.4%)	6.2%	8.9%	2.4%
Gross Profit	1.2%	(56.2%)	(14.9%)	(10.4%)	0.5%	(20.3%)	(8.9%)	36.0%	12.7%
EBITDA	(18.9%)	(40.0%)	(17.6%)	3.5%	(4.2%)	(12.2%)	3.0%	17.5%	6.1%
EBIT	(33.4%)	(69.0%)	(21.8%)	10.0%	(0.9%)	(17.3%)	9.0%	49.5%	13.5%
PAT/EPS	(43.2%)	(91.6%)	26.9%	N/M	N/M	(499.6%)	(195.4%)	85.7%	18.6%
DPS	(81.8%)	0.0%	(100.0%)	N/A	N/A	N/A	N/A	N/A	N/A
CFPS	25.3%	(35.1%)	(24.2%)	(39.7%)	86.9%	(51.4%)	59.5%	10.5%	9.1%
FCFPS	N/M	(59.3%)	32.4%	(41.9%)	222.5%	(50.6%)	65.2%	9.9%	10.0%
Operating Ratios									
Gross Margin	29.1%	17.7%	18.8%	16.0%	13.5%	10.9%	9.3%	11.7%	12.8%
Gross Margin, Excluding Depreciation & Amortization	40.7%	36.7%	38.8%	35.2%	28.7%	24.9%	22.5%	23.8%	24.6%
EBITDA Margin	35.0%	29.3%	30.0%	29.6%	23.7%	21.1%	20.5%	22.1%	22.9%
EBIT Margin	23.0%	9.9%	9.7%	10.1%	8.4%	7.0%	7.2%	9.9%	11.0%
Net Margin	19.2%	2.2%	3.5%	(3.9%)	1.1%	(4.6%)	4.1%	7.0%	8.1%
Finance Ratios									
Debt-Equity Ratio	1.3	1.5	1.4	1.4	1.3	1.3	1.2	1.1	1.1
Net Debt-Equity Ratio	1.1	1.1	1.1	1.2	1.1	1.1	0.9	0.7	0.6
Net Debt-to-Capital	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4
Net Debt-to-EBITDA	2.9	4.8	5.8	5.5	5.3	5.9	5.1	3.8	2.9
Interest Coverage	12.2	2.4	1.3	1.1	1.1	1.3	1.8	2.7	3.0
Return Ratios									
ROIC	10.5%	3.2%	2.6%	3.0%	3.1%	2.6%	2.9%	4.2%	4.6%
ROE	20.4%	1.8%	2.3%	-2.8%	0.9%	-4.0%	3.6%	6.3%	7.0%
ROA	7.1%	0.6%	0.8%	-1.0%	0.3%	-1.3%	1.2%	2.2%	2.6%
FCF Yield	21.9%	8.9%	11.8%	6.8%	22.1%	10.9%	18.0%	19.8%	21.8%
Liquidity Ratios									
Current Ratio	0.9	1.2	1.0	1.2	1.2	1.6	1.8	2.0	1.8
Quick Ratio	0.9	1.1	1.0	1.1	1.1	1.5	1.7	1.8	1.7
Valuation									
EV/Sales	1.6	2.2	2.7	2.6	2.0	2.0	1.7	1.4	1.2
EV/EBITDA	4.5	7.5	9.0	8.7	8.4	9.3	8.4	6.5	5.4
EV/EBIT	6.8	22.1	27.9	25.3	23.8	27.9	23.7	14.4	11.3
P/E	3.6	42.9	33.8	N/M	84.5	N/M	22.2	11.9	10.1
P/CF	2.0	3.0	4.0	6.6	3.5	7.3	4.6	4.1	3.8
P/BV	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7
Dividend Yield	6.5%	6.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
FCF Yield	21.9%	8.9%	11.8%	6.8%	22.1%	10.9%	18.0%	19.8%	21.8%

Source: Company data, QNB FS estimates

Detailed Financial Statements

Income Statement

In QR mn	2019	2020e	2021e	2022e	2023e
Revenue	**3,011**	**2,969**	**3,154**	**3,435**	**3,517**
COGS	2,605	2,646	2,860	3,034	3,065
Gross Profit	**406**	**324**	**295**	**401**	**452**
SG&A	207	200	204	209	214
Total Other Income	38	(67)	113	113	113
Net Finance Income (Expense)	(204)	(132)	(99)	(101)	(102)
Net Income*	**34**	**(136)**	**129**	**240**	**285**
EBITDA	**714**	**627**	**646**	**759**	**805**
EPS	**0.02**	**(0.07)**	**0.07**	**0.13**	**0.15**
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 (* 2019 net income has been adjusted for QR9.64mn in unrecorded bonus for GDI)

Balance Sheet

In QR mn	2019	2020e	2021e	2022e	2023e
Current Assets					
Cash & Cash Equivalents	908	832	1,081	1,503	2,000
Financial Investments	342	372	417	462	507
Insurance & Accounts Receivables/Prepayments	1,696	1,746	1,844	1,946	1,994
Due From Related Parties	501	466	466	466	466
Inventories & Contract Assets	225	259	279	296	299
Total Current Assets	3,673	3,676	4,089	4,674	5,267
Non-Current Assets					
Financial Investments	288	349	349	349	349
Equity-Accounted Investees & JVs	5	6	11	19	26
Goodwill & Intangibles	304	304	304	304	304
Right of Use & Contract Assets	76	54	54	54	54
Property, Plant & Equipment	6,421	5,885	5,580	5,289	5,005
Non-Current Assets	7,094	6,597	6,297	6,014	5,737
Total Assets	**10,767**	**10,273**	**10,386**	**10,688**	**11,004**
Current Liabilities					
Short-Term Debt & Bank Overdraft	825	144	29	10	442
Insurance Payables, Accounts Payable & Accruals	2,238	2,086	2,214	2,305	2,345
Contract Liabilities & Lease Liabilities	44	35	35	35	35
Due to Related Parties	33	26	26	26	26
Current Liabilities	**3,140**	**2,291**	**2,304**	**2,376**	**2,848**
Non-Current Liabilities					
EOS/Provision for Decomm. Costs	133	131	131	131	131
Contract Liabilities	51	36	36	36	36
Long-Term Debt	3,862	4,383	4,353	4,343	3,901
Non-Current Liabilities	**4,046**	**4,550**	**4,520**	**4,510**	**4,068**
Total Liabilities	**7,186**	**6,841**	**6,824**	**6,886**	**6,916**
Shareholders' Equity					
Total Shareholders' Equity	**3,581**	**3,432**	**3,562**	**3,802**	**4,087**
Liabilities & Shareholders' Equity	**10,767**	**10,273**	**10,386**	**10,688**	**11,004**

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

Shahan Keushgerian
Senior Research Analyst
Tel: (+974) 4476 6509
shahan.keushgerian@qnbfs.com.qa

Zaid al-Nafoosi, CMT, CFTe
Senior Research Analyst
Tel: (+974) 4476 6535
zaid.alnafoosi@qnbfs.com.qa

Mehmet Aksoy, PhD
Senior Research Analyst
Tel: (+974) 4476 6589
mehmet.aksoy@qnbfs.com.qa

QNB Financial Services Co. W.L.L.
Contact Center: (+974) 4476 6666
PO Box 24025
Doha, Qatar

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