Gulf International Services (GISS)

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	QR2.156	Target Price	QR2.617
Implied Upside	21.4%	Old Price Target	QR2.100

Significant Earnings Beat in 2Q23; Debt Restructuring A Major Positive; Upping PT

- **We are increasing our price target to QR2.617 and maintaining our Accumulate rating.** GISS finally announced its debt restructuring and obtained a new Islamic loan of $925mn in March, replacing its previous facility. **Our calculations show an interest rate of roughly 3.5% p.a. for this new facility that could lead to roughly QR100mn in interest cost savings p.a., which translates to QR0.05/share. This loan also pushes off principal repayments until 2026 when GISS will start repaying 65% of the loan in 18 unequal annual installments with a maturity balloon payment of 35% in 2048.** GISS is currently in negotiations to refinance the remainder of its $1.1bn drilling debt on favorable terms. We will update our forecasts and publish a detailed report in the future.
- **GISS posted a net profit of QR190.7mn in 2Q2023, up significantly vs. QR25.2mn in 2Q2023, which also implies a 111.4% QoQ increase from QR90.2mn in 1Q2023.** We were expecting 2Q2023 earnings of QR79.9mn. Of the QR110.8mn beat in earnings vs. our model, QR40.3mn came from hyperinflation gains from the company's Turkish helicopter operations, which we do not model. On the operations side, gross profits from aviation surpassed our estimate by QR51.7mn mainly due to revenue upside from international operations. Moreover, drilling gross profit also exceeded our model by QR71.0mn (despite lower-than-expected revenue) as 2Q2023 profitability was boosted by lower operational costs and reversal of several crew change accruals (pertaining to 2022) that had been taken in 1Q2023. While we are not certain that the revenue momentum in aviation will continue to the same extent as in 2Q2023 and are of the view that reversal of provisions in drilling is a one-time event, we are still heartened by these set of results.
- **Our thesis on GISS seems to be playing out with debt restructuring mostly completed.** Moreover, completion of the merger of Amwaj (catering) with Shaqab/Atyab could help drive sentiment. Finally, although GDI's offshore rigs are under 2-5 year contracts, current market rates are significantly higher. Thus, if the company is able to renegotiate these contract rates, that could be a major positive for the stock. We do note that the company's GulfDrill JV was able to extend some of its rigs for an additional two years at markedly better terms.
- **Overall top-line of QR875.2mn was moderately or 4.2% higher than our estimate of QR840.3mn; significant upside in aviation along with a minor beat in insurance more than offset a slight miss in drilling.** Group revenue grew 16.7% YoY/4.6% QoQ from QR750.0mn in 2Q2022/QR836.6mn in 1Q2023. We note that impact of the catering business has been removed from the top-line and other income statement items since 1Q2023 and is being treated as a discontinued item given Amwaj's pending merger (under IFRS 5 accounting treatment).
- **2Q2023 drilling revenue of QR328.2mn (5.5% YoY,-2.7% QoQ) was moderately (3.9%) below our estimate of QR341.5mn.** Rig utilization came in at 94% in 2Q2023 vs. 96% in 1Q2023 due to lower utilization from the liftboat/barge segment. Utilization, however, grew YoY to 95% in 1H2023 as compared to 92% in 1H2022. YoY revenue grew as GDI-8 started working from mid-4Q2022 onward, while the offshore Al-Wajbah rig was under maintenance during 2Q2022. According to the company, Rumailah went off contract during end-March 2023, while its 2nd liftboat, Al-Safliya, also went off deployment in mid-May 2023 but was awarded a new contract, along with an improvement in the day rate, with Saudi Aramco. This contributed to the sequential revenue decline. Looking forward, GDI's only idle offshore rig, GDI-4, was awarded a new contract and should start operating during 3Q2023. In terms of its JV operations, all five offshore rigs under the GulfDrill JV in the North Field project, are operating with 3Q2021 being the first full quarter of contribution. **Importantly, GIS disclosed that some of the JV rigs have successfully extended for two years at significantly higher rig rates, effective after their current contracts end.**
- **Aviation revenue of QR272.2mn (16.2% YoY, 20.4% QoQ) trounced our estimate of QR231.0mn (17.9% variation).** While we had been expecting pretty much flattish revenue performance YoY/QoQ, flying activity, both domestically and internationally (especially, Turkey, along with Angola and Libya), saw substantial growth with actual flying hours up around 29% YoY in total (local up 17%, while international flying hours grew 76% YoY) in 1H2023. QoQ, momentum in Turkey helped overall flying hours grow 9%, contributing to the top-line growth. The MRO business also remained strong both YoY and QoQ.
- **2Q2023 insurance top-line of QR274.8mn (27.8% YoY, 0.7% QoQ) came in 2.6% above our estimate of QR267.8mn.** On a yearly basis, insurance segment saw significant growth from premiums from the medical insurance segment as Al Koot won new contracts, while premiums also grew in the general segment in 1H2023; quarterly top-line growth was marginal, however.
- **Catering, which is set be merged, saw its revenue decline 28.6% YoY/18.7% QoQ in 2Q2023 to QR96.7mn.** During 1H2023, the segment faced completion of WC-related contracts, non-renewal of certain catering contracts and lower occupancy levels in the accommodation segment. On a QoQ basis, manpower service business faced some declines. *Continued on next page.*

Key Financial Data and Estimates

	2022	2023e	2024e	2025e
Revenue (QR mn)	3,666	3,434	3,551	3,657
EPS (QR)	0.16	0.19	0.22	0.24
P/E	13.8	11.1	9.7	8.9
DPS	0.10	0.10	0.10	0.11
Dividend Yield	4.6%	4.6%	4.6%	5.1%

Source: Company data, QNB FS Research; Note:; These estimates do not reflect the most recent quarter

Key Data

Current Market Price (QR)	2.156
Dividend Yield (%)	4.6
Bloomberg Ticker	GISS QD
ADR/GDR Ticker	N/A
Reuters Ticker	GISS.QA
ISIN	QA000A0Q6LH4
Sector*	Industrials
52wk High/52wk Low (QR)	2.250/1.449
3-m Average Volume ('mn)	8.3
Mkt. Cap. ($ bn/QR bn)	1.1/4.0
Shares Outstanding (bn)	1.9
FO Limit* (%)	49.0
Institutional FO* (%)	10.3
1-Year Total Return (%)	5.2
Fiscal Year End	December 31

Source: Bloomberg (as of August 13, 2023), *Qatar Exchange (as of August 13, 2023); Note: FO is foreign ownership

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- **In terms of net income, relative to our model, aviation surpassed our model significantly while drilling earnings went into the green for the first time in 5 ½ years.** *Please see page 3 for details on segmental revenue/costs/earnings.*
- **Drilling reported a gross margin of 18.5% in 1H2023, up from 14.4% in 1H2022 and 2Q2023 segment earnings came in at QR1.5mn.** Overall segment net loss came in at QR13.3mn in 2Q2022 and QR23.2mn in 1Q2023. The company reported that 2Q2023 profitability was boosted by lower operational costs and reversal of several crew change accruals (pertaining to 2022) that had been taken in 1Q2023.
- **Aviation reported earnings of QR146.9mn (74.2% YoY, 79.2% QoQ) and exceeded our estimate of QR80.2mn by 83.2% driven by significant top-line growth and hyperinflation gains.** We note 2Q2023 earnings included a gain from hyperinflation of QR40.3mn and if we exclude this item, normalized 2Q2023 earnings of QR106.6mn exceeded our estimate by 32.9%. 1H2023 gross margins expanded to 43.5% vs. 42.4% in 1H2022. Moreover, besides hyperinflation gains, 1H2023 earnings were also aided by higher finance income and lower losses from currency revaluation.
- **The moderate upside in insurance top-line along with better-than-expected margins helped its bottom-line vs. our forecast** with segment earnings of QR30.0mn (vs. a loss of QR26.0mn in 2Q2022 and a profit of QR33.4mnin 1Q2023) exceeding our estimate of QR27.2mn (divergence of 10.5%). Segment revenue grew significantly YoY driving earnings. On a sequential basis, the 10.2% earnings decline was caused by higher net claims reported along with a ~9% drop in investment income from roughly QR12mn in 1Q2023 to ~QR9mn in 2Q2023.
- **Catering earnings, which was positive in 1Q2023 turned negative again in 2Q2023 with a loss of QR2.7mn.** YoY profitability in 1H2023 was aided by lower operational costs related to the manpower segment, while the QoQ earnings decline was on account of a lower top-line affected by completion of certain manpower contracts.

QNB FS 2Q2023 Estimates and Comparisons

Income Statement (In QR Millions)

	2Q2022A*	1Q2023A	2Q2023A	2Q2023e	A Vs. E	YoY	QoQ
Revenue	**750.0**	**836.6**	**875.2**	**840.3**	***4.2%***	***16.7%***	***4.6%***
Gulf Drilling International (GDI)	*311.1*	*337.4*	*328.2*	*341.5*	*-3.9%*	*5.5%*	*-2.7%*
Gulf Helicopters Company (GHC)	*234.4*	*226.2*	*272.2*	*231.0*	*17.9%*	*16.2%*	*20.4%*
Al Koot Insurance & Reinsurance (AKIR)	*214.9*	*273.0*	*274.8*	*267.8*	*2.6%*	*27.8%*	*0.7%*
COGS	**634.5**	**674.1**	**643.3**	**679.4**	***-5.3%***	***1.4%***	***-4.6%***
Gross Profit	**115.5**	**162.5**	**231.9**	**160.9**	***44.1%***	***100.8%***	***42.7%***
Gross Margin	***15.4%***	***19.4%***	***26.5%***	***19.1%***			
Net Income	**25.2**	**90.2**	**190.7**	**79.9**	***138.7%***	***655.9%***	***111.4%***
Net Margin	***3.4%***	***10.8%***	***21.8%***	***9.5%***			
Gulf Drilling International (GDI)	*(13.3)*	*(23.2)*	*1.5*	*(24.7)*	*N/M*	*N/M*	*N/M*
Net Margin	*-4.3%*	*-6.9%*	*0.4%*	*-7.2%*			
Gulf Helicopters Company (GHC)	*84.4*	*82.0*	*146.9*	*80.2*	*83.2%*	*74.2%*	*79.2%*
Net Margin	*36.0%*	*36.3%*	*54.0%*	*34.7%*			
Al Koot Insurance & Reinsurance (AKIR)	*(26.0)*	*33.4*	*30.0*	*27.2*	*10.5%*	*N/M*	*-10.2%*
Net Margin	*-12.1%*	*12.2%*	*10.9%*	*10.1%*			
Corporate/Other	*(18.5)*	*(6.8)*	*15.0*	*(2.7)*	*N/M*	*N/M*	*N/M*
EPS	**0.01**	**0.05**	**0.10**	**0.04**	***138.7%***	***655.9%***	***111.4%***

Note: Addition of 2Q2022 segment revenue does not add up to consolidated revenue given catering inter-segment revenue; *Restated to account for catering merger

Source: Company data, QNB FS Research

Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*		Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
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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