

Gulf International Services (GISS)

Recommendation	MARKET PERFORM	Risk Rating	R-4
Share Price	QR18.29	Current Target Price	QR19.00
Implied Upside	3.9%	Old Target Price	QR20.00

LT Growth Story Remains Buoyant; Moving to Market Perform

We are changing our rating to Market Perform and lowering our estimates for GISS. The stock appreciated 18% since our [upgrade on September 18](#) reaching QNBFS' prior price target of QR20 on October 28, 2018. However, [3Q2018 results](#) were weaker-than-expected and missed our estimates due to lower gross profits and higher-than-expected finance charges. Consequently, we lower our estimates and change our rating from Accumulate to Market Perform with a price target of QR19. We continue to expect strong overall EPS growth next year, primarily driven by drilling, albeit from a modest base. GISS' story consists of a sum of moving parts, not entirely predictable and fairly volatile. We do not expect this to change. However, we do expect the drilling segment to pull itself out of losses suffered during 2016-2018 by 2H2019 in light of increasing demand due to the proposed North Field expansion and given our assumption of high utilization of existing rigs, startup of rig utilization contracts for additional rigs (similar to the Seadrill deal announced in July) and modest cost savings. We continue to model in a resumption of dividends with QR1 in DPS (5.5% yield) expected for 2018.

Highlights

- We still expect earnings improvement in 4Q2018 barring any impairments.** We expect **4Q2018 revenue/net income of QR686.0mn/QR24.8mn** vs. our prior estimate of QR751.3mn/QR48.4mn; **for 2018, our revenue/net income** estimates decline from QR2.73bn/QR103.0mn previously to **QR2.65bn/QR64.3mn**. While the revenue forecast is down a modest 3%, earnings get slashed given GISS' razor-thin net margins. Lower GMs and higher interest expenses also drive our earnings change. We note we do not forecast any impairment; two offshore rigs, Al-Doha and Msheireb, are old and are currently not being used with GDI looking to deploy them outside of Qatar (in Asia). **Success of this strategy is yet to be seen and a year-end 2018 impairment cannot be ruled out.**
- Drilling is emerging from choppy waters and we expect a resumption of profitability from 2H2019 despite higher interest costs.** We forecast **7 offshore rigs to be deployed, in-line with current trend**; our previous assumption was 9 offshore rigs, which we have reduced by taking out the above mentioned rigs from the drilling schedule. There are no other major changes to our drilling revenue assumption. As mentioned previously, in July, GDI signed a contract with Seadrill for the utilization of Seadrill's offshore drilling rig, West Tucana; GDI will use this jackup in a rig utilization contract lasting 440 days (with options for further extensions), in which GDI will manage the rig/crew provided by Seadrill and earn a service fee. We continue to model in an additional rig under a similar arrangement in 2H2019, increasing this fleet to 3 rigs in 2020, 4 rigs in 2021 and 5 rigs in 2H2022 before gradually reducing the size of this fleet. Such contracts allow GISS to address demand growth in drilling without additional debt-driven capex. However, it is possible some of these rigs are deployed under a JV and/or are brought in-house. On the **costs** front, GISS is taking steps to streamline GDI's operations and we expect 10% savings in cash direct costs and SG&A by 2021. *Net-net, we expect GDI's loss to narrow from QR125.0mn (2018) to QR51.5mn in 2019 and turn into a QR7.3mn net profit in 2020.*
- Group earnings should grow from QR64.3mn (EPS: QR0.35) in 2018 to QR154.1mn (QR0.83) in 2019.** 82% of this growth is projected to be driven by drilling. Insurance and aviation contribute 6% and 4% to the growth, respectively, while catering is flattish.

Catalysts

- Stock price improvement depends on a resumption of confidence in company performance.** GISS stock continues to remain in a "show me" mode.

Recommendation, Valuation and Risks

- Recommendation and valuation:** *We rate GISS a Market Perform with a TP of QR19.* GISS trades at 2019 & 2020 EV/EBITDA multiples of 7.8x and 7.1x, respectively.
- Risks: Geopolitical risks** cannot be modeled. Given the low level of absolute earnings along with paper-thin net margins (9M2018: 2.0%), **quarterly earnings could be subject to significant volatility. Debt levels are relatively high** (9M2018: QR5.1bn/5.2x 2018 net-debt-to-EBITDA) but manageable in light of 1.3x 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

	2017	2018e	2019e	2020e
EPS (QR)	0.46	0.35	0.83	1.27
P/E (x)	40.0	52.9	22.1	14.4
EV/EBITDA (x)	9.8	9.2	7.8	7.1
DPS (QR)	0.00	1.00	1.25	1.50
DY (%)	0.0%	5.5%	6.8%	8.2%

Source: Company data, QNBFS 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)	21.50/15.04
3-m Avg. Volume (000)	220.6
Mkt. Cap. (\$ bn/QR bn)	0.9/3.4
EV (\$ bn/QR bn)	2.0/7.3
FO Limit* (%)	49.0
Current FO* (%)	9.0
Shares Outstanding (mn)	185.8
1-Year Total Return (%)	14.6
Fiscal Year End	December 31

Source: Bloomberg (as of November 25, 2018), *Qatar Exchange (as of November 25, 2018); Note: FO is foreign ownership

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Key Segment Details

In QR mn	2017	2018e	2019e	2020e	2021e
Revenue	2,486	2,647	2,766	2,808	2,852
<i>Gulf Drilling International (GDI)</i>	1,175	1,215	1,273	1,276	1,279
<i>Gulf Helicopters Company (GHC)</i>	532	531	544	558	572
<i>Amwaj Catering Company (AHC)</i>	453	447	459	472	486
<i>Al Koot Insurance & Reinsurance (AKIR)</i>	326	454	490	502	515
Net Income	85	64	154	236	280
<i>Net Margin</i>	3%	2%	6%	8%	10%
Drilling	(102)	(125)	(51)	7	29
<i>Net Margin</i>	-9%	-10%	-4%	1%	2%
Helicopters	145	120	124	134	144
<i>Net Margin</i>	27%	23%	23%	24%	25%
Catering	17	20	20	30	36
<i>Net Margin</i>	4%	4%	4%	6%	7%
Insurance	71	85	90	94	101
<i>Net Margin</i>	22%	19%	18%	19%	20%
EBITDA	757	774	881	948	978
<i>EBITDA Margin</i>	30%	29%	32%	34%	34%
Drilling	426	419	510	554	562
<i>EBITDA Margin</i>	36%	34%	40%	43%	44%
Helicopters	241	219	221	231	241
<i>EBITDA Margin</i>	45%	41%	41%	41%	42%
Catering	33	36	36	46	51
<i>EBITDA Margin</i>	7%	8%	8%	10%	11%
Insurance	73	86	92	96	102
<i>EBITDA Margin</i>	22%	19%	19%	19%	20%

Source: Company data, QNBFS estimates

Key Growth Rates/CAGRs

Particulars	2015	2016	2017	2018	2019	2020	2021	2022	2023	CAGR ('18-'23)
Growth Rates										
Revenue	6.6%	(28.2%)	(16.8%)	6.5%	4.5%	1.5%	1.6%	1.7%	1.5%	2.1%
Gross Profit	1.2%	(56.2%)	(14.9%)	(3.2%)	22.9%	12.6%	5.2%	5.7%	4.6%	10.0%
EBITDA	(24.1%)	(44.2%)	(1.7%)	2.3%	13.7%	7.6%	3.2%	3.6%	3.0%	6.2%
EBIT	(39.7%)	(78.2%)	34.0%	16.0%	36.0%	16.5%	6.4%	7.1%	5.6%	13.8%
PAT/EPS	(43.2%)	(91.6%)	26.9%	(24.4%)	139.8%	53.4%	18.5%	17.8%	14.1%	42.4%
DPS	(81.8%)	0.0%	(100.0%)	N/M	25.0%	20.0%	16.7%	14.3%	12.5%	17.6%
CFPS	25.3%	(35.1%)	(23.0%)	(13.1%)	37.4%	5.4%	4.0%	3.5%	3.1%	9.9%
FCFPS	N/M	(59.3%)	37.0%	9.4%	58.8%	6.0%	3.9%	3.3%	2.7%	13.2%

Source: Bloomberg, QNBFS estimates

Valuation Metrics

Particulars	2015	2016	2017	2018	2019	2020	2021	2022	2023
Valuation									
EV/Sales	1.8	2.5	3.0	2.7	2.5	2.4	2.3	2.1	1.8
EV/EBITDA	5.4	9.6	9.8	9.2	7.8	7.1	6.6	5.9	5.2
EV/EBIT	8.4	38.6	28.7	23.8	17.0	14.2	12.9	11.1	9.6
P/E	4.2	50.8	40.0	52.9	22.1	14.4	12.1	10.3	9.0
P/CF	2.3	3.6	4.7	5.3	3.9	3.7	3.6	3.4	3.3
P/BV	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.8
Dividend Yield	5.5%	5.5%	0.0%	5.5%	6.8%	8.2%	9.6%	10.9%	12.3%
FCF Yield	18.5%	7.5%	10.3%	11.3%	17.9%	19.0%	19.7%	20.4%	20.9%

Source: Bloomberg, QNBFS estimates

Detailed Financial Statements

Income Statement

In QR mn	2017	2018e	2019e	2020e	2021e
Revenue	2,486	2,647	2,766	2,808	2,852
COGS	2,035	2,211	2,229	2,204	2,217
Gross Profit	451	436	536	604	635
SG&A	244	225	228	229	230
Total Other Income	23	57	66	66	66
Net Finance Income(Expense)	(145)	(205)	(220)	(204)	(190)
Net Income	85	64	154	236	280
EBITDA	757	774	881	948	978
EPS	0.46	0.35	0.83	1.27	1.51
DPS	0.00	1.00	1.25	1.50	1.75

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

Balance Sheet

In QR mn	2017	2018e	2019e	2020e	2021e
Current Assets					
Cash & Cash Equivalents	931	964	803	730	651
HFT Investments/ST Investments	221	323	323	323	323
Insurance & Accounts Receivables/Prepayments	695	813	859	873	891
Due From Related Parties	463	457	457	457	457
Inventories	202	229	230	227	229
Total Current Assets	2,513	2,786	2,672	2,611	2,551
Non-Current Assets					
Investment Properties	-	-	-	-	-
Goodwill & Intangibles	305	304	304	304	304
Property, Plant & Equipment	7,220	6,998	6,788	6,589	6,401
Non-Current Assets	7,915	7,589	7,379	7,180	6,992
Total Assets	10,428	10,375	10,052	9,791	9,543
Current Liabilities					
Short-Term Debt	898	563	480	480	419
Insurance Payables, Accounts Payable & Accruals	1,493	1,461	1,533	1,548	1,579
Due to Related Parties	8	29	29	29	29
Current Liabilities	2,400	2,054	2,043	2,058	2,028
Non-Current Liabilities					
Employees End of Service Benefits	103	143	143	143	143
Long-Term Debt	4,248	4,440	4,159	3,879	3,659
Non-Current Liabilities	4,350	4,583	4,302	4,022	3,803
Total Liabilities	6,750	6,637	6,345	6,080	5,831
Shareholders' Equity					
Total Shareholder's Equity	3,679	3,738	3,707	3,711	3,712
Liabilities & Shareholder's Equity	10,428	10,375	10,052	9,791	9,543

Source: Company data, QNBFS estimates

Ratio Analysis

Key Metrics

Particulars	2015	2016	2017	2018	2019	2020	2021	2022	2023
Growth Rates									
Revenue	6.6%	(28.2%)	(16.8%)	6.5%	4.5%	1.5%	1.6%	1.7%	1.5%
Gross Profit	1.2%	(56.2%)	(14.9%)	(3.2%)	22.9%	12.6%	5.2%	5.7%	4.6%
EBITDA	(24.1%)	(44.2%)	(1.7%)	2.3%	13.7%	7.6%	3.2%	3.6%	3.0%
EBIT	(39.7%)	(78.2%)	34.0%	16.0%	36.0%	16.5%	6.4%	7.1%	5.6%
PAT/EPS	(43.2%)	(91.6%)	26.9%	(24.4%)	139.8%	53.4%	18.5%	17.8%	14.1%
DPS	(81.8%)	0.0%	(100.0%)	N/M	25.0%	20.0%	16.7%	14.3%	12.5%
CFPS	25.3%	(35.1%)	(23.0%)	(13.1%)	37.4%	5.4%	4.0%	3.5%	3.1%
FCFPS	N/M	(59.3%)	37.0%	9.4%	58.8%	6.0%	3.9%	3.3%	2.7%
Operating Ratios									
Gross Margin	29.1%	17.7%	18.1%	16.5%	19.4%	21.5%	22.3%	23.2%	23.9%
Gross Margin, Excluding Depreciation & Amortization	40.7%	36.7%	37.9%	34.2%	36.3%	38.2%	38.7%	39.3%	39.7%
EBITDA Margin	33.1%	25.8%	30.4%	29.2%	31.8%	33.8%	34.3%	35.0%	35.5%
EBIT Margin	21.1%	6.4%	10.4%	11.3%	14.7%	16.8%	17.7%	18.6%	19.3%
Net Margin	19.2%	2.2%	3.4%	2.4%	5.6%	8.4%	9.8%	11.4%	12.8%
Working Capital Ratios									
Inventory Days	27.4	32.5	36.3	37.7	37.7	37.7	37.7	37.7	37.7
Average Collection Period	73.8	88.2	74.4	76.0	76.0	76.0	76.0	76.0	76.0
Payable Days	70.8	75.1	88.3	76.1	72.6	70.5	70.0	69.2	68.6
Finance Ratios									
Debt-Equity Ratio	1.3	1.5	1.4	1.3	1.3	1.2	1.1	0.9	0.8
Net Debt-Equity Ratio	1.1	1.1	1.1	1.1	1.0	1.0	0.9	0.7	0.5
Net Debt-to-Capital	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.3
Net Debt-to-EBITDA	3.0	5.5	5.6	5.2	4.4	3.8	3.5	2.9	2.3
Interest Coverage	11.2	1.5	1.5	1.3	1.6	2.0	2.3	2.6	3.0
Return Ratios									
ROIC	9.7%	2.1%	2.9%	3.4%	4.9%	5.9%	6.5%	6.9%	7.3%
ROE	20.4%	1.8%	2.3%	1.7%	4.2%	6.4%	7.6%	8.2%	8.5%
ROA	7.1%	0.6%	0.8%	0.6%	1.5%	2.4%	2.9%	3.4%	3.9%
FCF Yield	18.5%	7.5%	10.3%	11.3%	17.9%	19.0%	19.7%	20.4%	20.9%
Liquidity Ratios									
Current Ratio	0.9	1.2	1.0	1.4	1.3	1.3	1.3	0.7	1.1
Quick Ratio	0.9	1.1	1.0	1.2	1.2	1.2	1.1	0.7	1.0
Valuation									
EV/Sales	1.8	2.5	3.0	2.7	2.5	2.4	2.3	2.1	1.8
EV/EBITDA	5.4	9.6	9.8	9.2	7.8	7.1	6.6	5.9	5.2
EV/EBIT	8.4	38.6	28.7	23.8	17.0	14.2	12.9	11.1	9.6
P/E	4.2	50.8	40.0	52.9	22.1	14.4	12.1	10.3	9.0
P/CF	2.3	3.6	4.7	5.3	3.9	3.7	3.6	3.4	3.3
P/BV	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.8
Dividend Yield	5.5%	5.5%	0.0%	5.5%	6.8%	8.2%	9.6%	10.9%	12.3%
FCF Yield	18.5%	7.5%	10.3%	11.3%	17.9%	19.0%	19.7%	20.4%	20.9%

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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