

QGTS Alert – In-Line 2Q2023 Earnings As JV Income Offsets Depreciation; Stay Accumulate

- **QGTS reports in-line 2Q2023 earnings with upside in JV income offset by higher-than-expected depreciation charges:** Nakilat's 2Q2023 net income of QR378.9mn increased 8.9% YoY but declined 4.2% QoQ, coming right in-line with our estimate of QR380.6mn (-0.5% difference).
 - **Wholly-owned ship revenue** of QR886.6mn (-0.1% YoY, 0.9% QoQ) was also bang in-line with our estimate of QR887.4mn (variation of -0.1%).
 - **Adjusted revenue** (wholly-owned ships + marine & agency services + JV income) of QR1.11bn (4.4% YoY, 4.7% QoQ) was moderately ahead of our estimate of QR1.07bn (4.3% variance) with upside coming from a significant beat on the JV income front.
 - **EBITDA** of QR672.1mn (-3.8% YoY, -0.6% QoQ) was 1.6% shy of our forecast of QR683.3mn given slightly higher-than-expected **cash operating costs** of the wholly-owned fleet (cash gross margins fell to 77.2% vs. our model of 78.0% and 79.8%/77.9% in 2Q2022/1Q2023). Moreover, **G&A expenses** of QR27.8mn (17.1% YoY, 29.3% QoQ) was 25.0% ahead of our estimate of QR22.2mn; management attributed the increase in 1H2023 G&A to increase in planned activities this year. However, **income from marine & agency services** of QR15.2mn (4.6% YoY, 15.0% QoQ) came in 13.5% ahead of our model of QR13.4mn. **Adjusted EBITDA** (EBITDA + JV income) of QR883.5mn (2.4% YoY, 4.2% QoQ) was 3.9% ahead of our estimate of QR850.2mn, with significantly higher-than-expected JV income offsetting the modest downside seen in EBITDA.
 - **Depreciation** of QR249.8mn (12.5% YoY, 24.8% QoQ) was 18.2% above our forecast of QR211.3mn. Management attributed 1H2023 depreciation (QR449.9mn, up 2.4% vs. QR439.4mn in 1H2022) growth to higher depreciable value of the new dry-dock cycle and accounting of the initial dry-dock component. We remind investors that QGTS completed a 5-year dry-dock cycle in 2022 and started a new one in 2023, which led 4Q2022 depreciation to shoot up to QR286.6mn, followed by a decline to QR200.2mn in 1Q2023. Depreciation has remained erratic vs. our model for the past three quarters and we will seek further guidance from management in this regard.
 - **JV income** of QR211.4mn (28.9% YoY, 23.2% QoQ) was 26.7% above our estimate of QR166.9mn. Overall, JV income continues its buoyant trend due to improving shipyard performance (which posted a net profit of QR91.2mn in 2022 after posting net losses of QR36.2mn and QR25.5mn in 2021 and 2020, respectively), along with addition of the 3rd/4th LNG vessels in Nakilat's Global Shipping JV in Oct. 2021/Jan. 2022. Management has also previously alluded to improving performance from its 60%-owned ship fabrication JV, QFAB, which could have impacted 2Q2023 positively.
 - Finally, **finance costs** of QR312.0mn (1.9% YoY, 1.2% QoQ) was in-line with our estimate of QR315.8mn (-1.2% divergence). Interest costs increased due to gains in LIBOR rates on the unhedged portion (~ 30%) of QGTS' debt, offset by scheduled repayment of loans. Moreover, net finance charges were also in-line as **interest, dividend & other income** of QR57.4mn (332.9% YoY, 1.8% QoQ) was only 0.6% shy of our model of QR57.7mn.
- **2023 could be a watershed year for Nakilat if it is selected as one of the ship owners involved in Qatar's massive LNG expansion program.** We remind investors that QatarEnergy is expanding Qatar's LNG capacity from 77 MTPA to 110 MTPA (first production: 4Q2025) and further to 126 MTPA a couple of years later. To cater to this expansion, back in April/June 2020, QatarEnergy signed major LNG shipbuilding capacity agreements with Chinese and South Korean companies to build 100+ LNG vessels worth +QR70bn at that time. Furthermore, in 1Q2021, QatarEnergy issued an invitation to tender package to ship owners for the chartering of LNG carriers in relation to this project; QatarEnergy intends to assign selected ship owners from this tender to the shipyards' construction slots reserved in China and South Korea. So far, newsflow/industry chatter indicate several ship charter agreements have been awarded already. *Considering Nakilat's strategic importance, (QGTS ships ~75-80% of Qatar's current LNG exports) and impressive track record in Qatar's existing LNG shipping value chain, we expect QGTS to be a major beneficiary and secure a meaningful share of new contracts. We also estimate that every incremental vessel (@100%) adds ~1% to QGTS' target price (for details, please see our [report](#)) and an award of 20-25 ships could markedly boost our price target and estimates. Given typical lead-times for LNG ship construction, we should expect to hear about final ship owner selections in 2023. We do expect QGTS shares to come under pressure in the unlikely scenario that the company does not secure a meaningful portion of the new LNG shipping contracts.*
- **QGTS remains the best avenue for equity investors to participate in the LT growth in Qatar's LNG sector.** Irrespective of the volatility of the LNG shipping market, Nakilat's business should remain relatively unaffected given its LT charters. Nakilat's fleet continues to provide QGTS with stable, contractually sustainable cash flow that allow for a healthy residual income stream for equity investors after providing for debt service. Moreover, the 40-year life of Nakilat's vessels vs. maximum debt life of 25 years (last debt maturing 2033), could allow for value-enhancement. *We stay Accumulate with a price target of QR4.100. While we do not expect major changes to our 2023 earnings estimate of QR1,563.3mn (up 8.6%), we will tweak our model and revisit our price target in the near future.*

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Income Statement							
In QR mn Except Otherwise Noted	2Q2022	1Q2023	2Q2023	2Q2023e	A Vs. E	YoY	QoQ
Revenue from Wholly-Owned Vessels	887.345	878.760	886.621	887.369	-0.1%	-0.1%	0.9%
Operating Costs	(179.265)	(194.195)	(201.980)	(195.221)	3.5%	12.7%	4.0%
Gross Profit	708.080	684.565	684.641	692.148	-1.1%	-3.3%	0.0%
<i>Gross Margin</i>	<i>79.8%</i>	<i>77.9%</i>	<i>77.2%</i>	<i>78.0%</i>			
Income from Marine and Agency Services	14.504	13.197	15.172	13.362	13.5%	4.6%	15.0%
General and Administrative Expenses	(23.689)	(21.470)	(27.751)	(22.204)	25.0%	17.1%	29.3%
EBITDA	698.895	676.292	672.062	683.305	-1.6%	-3.8%	-0.6%
Depreciation of Property and Equipment	(222.006)	(200.170)	(249.770)	(211.253)	18.2%	12.5%	24.8%
EBIT	476.889	476.122	422.292	472.052	-10.5%	-11.4%	-11.3%
<i>EBIT Margin</i>	<i>53.7%</i>	<i>54.2%</i>	<i>47.6%</i>	<i>53.2%</i>			
Share of Operating Profits from Joint Ventures	163.991	171.582	211.405	166.863	26.7%	28.9%	23.2%
Finance Costs	(306.002)	(308.343)	(311.966)	(315.774)	-1.2%	1.9%	1.2%
Interest, Dividend income & Profit from Islamic Banks	13.260	56.382	57.409	57.741	-0.6%	332.9%	1.8%
Profit Before Tax	348.138	395.743	379.140	380.882	-0.5%	8.9%	-4.2%
Profit After Tax	348.138	395.743	379.140	380.882	-0.5%	8.9%	-4.2%
Minority Interest	(0.332)	(0.255)	(0.244)	(0.245)	-0.6%	-26.5%	-4.3%
Net Income to Equity	347.806	395.488	378.896	380.637	-0.5%	8.9%	-4.2%
<i>Net Profit Margin</i>	<i>39.2%</i>	<i>45.0%</i>	<i>42.7%</i>	<i>42.9%</i>			
EPS (QR)	0.06	0.07	0.07	0.07	-0.5%	8.9%	-4.2%
Adjusted EBITDA	862.886	847.874	883.467	850.169	3.9%	2.4%	4.2%

Adjusted Revenue	1,065.840	1,063.539	1,113.198	1,067.594	4.3%	4.4%	4.7%
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Particulars	2Q2022	1Q2023	2Q2023	2Q2023e
Adj. EBITDA Margin	81.0%	79.7%	79.4%	79.6%
Gross Margin	79.8%	77.9%	77.2%	78.0%
EBIT Margin	53.7%	54.2%	47.6%	53.2%
G & A % of Sales	2.7%	2.4%	3.1%	2.5%
Depreciation & Amortization % of Sales	25.0%	22.8%	28.2%	23.8%
Minority Interest % of PAT	0.10%	0.06%	0.06%	0.06%

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