

Qatar Gas Transport Co./Nakilat (QGTS)

Recommendation	OUTPERFORM	Risk Rating	R-3
Share Price	QR15.91	Current Target Price	QR21.00
Implied Upside	32.0%		

Strong 2Q2018 Prompts Estimates Revision; Retain Outperform

Nakilat modestly beats our 2Q2018 estimates; increasing forecasts but maintaining price target of QR21 and Outperform rating. We are optimistic about QGTS' 2H2018 operating performance and raise our 2018 & 2019 earnings by 5% and 6%, respectively. Nakilat management will conduct its first ever public investor conference call on July 16 and we believe the reinvigorated focus on transparency and investor engagement as spearheaded by QGTS' new CFO, Hani Abuaker, should be a positive for the stock. We continue to favor Nakilat, #1 owner/operator of LNG vessels globally, as a LT play geared to Qatari LNG's dominance and growth. We believe the stock is attractive at current levels.

Highlights

- **QGTS' bottom line rises 5% YoY/QoQ in 2Q2018, modestly better than our estimate (divergence of 5%):** Nakilat's net profit rose 4.8% YoY (5.2% QoQ) to QR227.7mn in 2Q2018, vs. our estimate of QR216.0mn (variation of 5.4%). Wholly-owned ship business was in-line with gross profits lower by 0.6% vs. our forecast. The beat vs. our earnings estimate came primarily from higher-than-expected JV income (likely due to impact of the 2 conventional LNG vessels added in March in the 40%-owned Maran JV) and lower depreciation. JV income of QR106.8mn (4.9% YoY/25.7% QoQ) was 16.9% better than our forecast and was at the highest level seen since 4Q2016. Going forward, we envision a further boost to the quarterly run-rate of JV income given the addition of a 55% stake in a FSRU vessel.
- **Management guidance is bullish for 2H2018.** In its earnings presentation, Nakilat has provided a general outlook (another first for the company) for the 2nd half. Management expects JV income to improve given full impact of the 2 additional LNG vessels and inclusion of a FSRU. Moreover, Nakilat expects JV income to benefit from higher utilization of its shipyard given dry dock activities and marine & offshore projects. Finally, QGTS expects growth in its marine services segment at Ras Laffan & Mesaieed ports due to increased port calls post the blockade.
- **Raising EPS estimates by 5.4% and 6.5% for 2018 and 2019, respectively.** Thus far, QGTS' reported net income for 1H2018 has exceeded our expectations by 6.5%, primarily due to better-than-estimated JV income followed by modestly higher wholly-owned fleet gross profit and lower depreciation. Our adjusted revenue forecasts increase by a more modest 1.2% and 1.7%, respectively, for 2018 and 2019, while adjusted EBITDA ticks up by 0.6% and 1.0% over the same period.

Catalysts

- **Expansion of Qatar's LNG output from 77 MTPA to 100 MTPA is a significant driver (potentially another 30 conventional vessels).** QGTS is also targeting FSRUs with one vessel already added to the fleet. Ships have 40-years of life vs. maximum debt life of 25 years (last debt maturing 2033), creating refinancing opportunities to increase fleet size. Medium-term, the shipyard business could further improve.

Recommendation, Valuation and Risks

- **Recommendation & valuation: Our 12-months target is QR21.** QGTS trades at attractive multiples vs. peers despite having higher EBITDA margins & FCF yields.
- **Risks: (1)** Blockade is an overhang but business impact has been limited thus far. Shipping ultimately remains the charterers' concern and comprehensive insurance policies (including war insurance) cover QGTS for political stress events under force majeure clauses for 36 months (plus 6 months in many cases). Blockage of the Strait of Hormuz/Gulf of Suez is unlikely. Charterers will also bear any costs of potential rerouting. **(2)** There is a risk existing LNG contracts get renegotiated as they are at a premium to spot (for wholly-owned fleet and some JVs). We would not rule out potential contract restructuring, with QGTS accepting slightly lower charter rates in return for increasing their lengths from 25 to 35+ years. However, bargaining power rests with Qatargas and Nakilat may have no choice but to accept markedly worse contract terms. The likelihood of this is low given investment grade-rated bonds and contagion in other GRE-related bond issues.

Key Financial Data and Estimates

	FY2016	FY2017	FY2018e	FY2019e
EPS (QR)	1.72	1.53	1.62	1.84
P/E (x)	9.2	10.4	9.8	8.6
DPS (QR)	1.00	1.00	1.05	1.10

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

Key Data

Current Market Price (QR)	15.91
Current Dividend Yield (%)	6.3
Bloomberg Ticker	QGTS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QGTS.QA
ISIN	QA000A0KD6L1
Sector*	Transportation
52wk High/52wk Low (QR)	18.83/13.05
3-m Average Volume ('000)	1,414.3
Mkt. Cap. (\$ bn/QR bn)	2.4/8.8
EV (\$ bn/QR bn)	7.3/26.7
Shares Outstanding (mn)	560.0
FO Limit* (%)	49.0
Current FO* (%)	14.8
1-Year Total Return (%)	(7.1)
Fiscal Year End	December 31

Source: Bloomberg (as of July 15, 2018), *Qatar Exchange (as of July 15, 2018); Note: FO is foreign ownership

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2Q2018 Review

Nakilat's bottom line rises 5% YoY/QoQ in 2Q2018, modestly better than our estimate (divergence of 5%): QGTS' net profit rose 4.8% YoY (5.2% QoQ) to QR227.7mn in 2Q2018, vs. our estimate of QR216.0mn (variation of 5.4%). Wholly-owned ship business was in-line with gross profits lower by 0.6% vs. our forecast. The beat vs. our earnings estimate came primarily from higher-than-expected JV income (likely due to impact of the 2 conventional LNG vessels added in March in the 40%-owned Maran JV) and lower depreciation. JV income of QR106.8mn (4.9% YoY/25.7% QoQ) was 16.9% better than our forecast and was at the highest level seen since 4Q2016. Going forward, we envision a further boost to the quarterly run-rate of JV income given the addition of a 55% stake in a FSRU vessel.

1Q2018 Actual Vs. Estimates and Comparisons

In QR mn	2Q2018	2Q2018e	2Q2017	1Q2018	A vs. E	YoY	QoQ	2018e	2017	YoY	2016	YoY
Revenue from Wholly-Owned Vessels	768.9	766.0	764.4	757.6	0.4%	0.6%	1.5%	3,059.9	3,057.1	0.1%	3,068.6	-0.4%
Gross Profit	593.9	597.5	595.3	593.0	-0.6%	-0.2%	0.2%	2,365.9	2,359.6	0.3%	2,350.6	0.4%
EBITDA	573.0	578.6	573.7	575.8	-1.0%	-0.1%	-0.5%	2,288.7	2,281.4	0.3%	2,269.9	0.5%
EBIT	384.9	387.1	381.7	387.2	-0.6%	0.8%	-0.6%	1,533.9	1,513.4	1.4%	1,502.3	0.7%
Share of Operating Profits from Joint Ventures	106.8	91.4	101.8	84.9	16.9%	4.9%	25.7%	389.3	339.0	14.8%	553.4	-38.7%
Net Income to Equity	227.7	216.0	217.2	216.4	5.4%	4.8%	5.2%	898.1	846.2	6.1%	954.2	-11.3%
EPS (QR)	0.41	0.39	0.39	0.39	5.4%	4.8%	5.2%	1.62	1.53	6.1%	1.72	-11.3%
DPS (QR)								1.05	1.00	5.0%	1.00	0.0%
Adjusted Revenue	888.3	871.9	879.7	857.4	1.9%	1.0%	3.6%	3,505.6	3,451.3	1.6%	3,677.2	-6.1%
Adjusted EBITDA	679.8	669.9	675.5	660.8	1.5%	0.6%	2.9%	2,678.0	2,620.4	2.2%	2,823.3	-7.2%
Gross Margin	77.2%	78.0%	77.9%	78.3%				77.3%	77.2%		76.6%	
EBITDA Margin	74.5%	75.5%	75.1%	76.0%				74.8%	74.6%		74.0%	
EBIT Margin	50.1%	50.5%	49.9%	51.1%				50.1%	49.5%		49.0%	
Net Margin	29.6%	28.2%	28.4%	28.6%				29.4%	27.7%		31.1%	
Adjusted EBITDA Margin	76.5%	76.8%	76.8%	77.1%				76.4%	75.9%		76.8%	

Source: Company data, QNBFS estimates

Relative Valuation

In terms of multiples, QGTS remains relatively cheaper vs. its peers along with substantially better EBITDA margins. We also point to the company substantial FCF yield resulting from limited capex requirements and significant operating cash flow.

Relative Valuation Versus Peers

Shippers Company	Ticker	Div. Yield	EBITDA Margin		P/E		P/CFPS		EV/EBITDA		FCF Yield	
			FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e
COSCO SHIPPING Energy Transportation Co Ltd	1138	1.7%	35.3%	38.1%	12.1x	7.9x	3.4x	2.8x	8.7x	7.2x	4.9%	3.4%
National Shipping Co of Saudi Arabia/The	NSCSA	5.1%	33.9%	33.2%	16.6x	11.6x	NA	NA	10.1x	9.1x	NA	NA
GasLog Partners LP	GLOP	8.9%	71.6%	71.8%	12.8x	12.1x	5.4x	5.2x	9.4x	8.6x	(26.6%)	(15.4%)
GasLog Ltd	GLOG	3.2%	68.6%	70.1%	61.6x	18.7x	5.4x	4.0x	13.1x	11.1x	(20.3%)	0.6%
Dynagas LNG Partners LP	DLNG	16.4%	71.5%	74.5%	58.6x	18.3x	5.8x	5.1x	11.2x	10.0x	(2.7%)	(95.1%)
Ship Finance International Ltd	SFL	9.6%	68.3%	67.0%	13.9x	11.7x	8.6x	7.5x	10.2x	9.4x	(17.0%)	14.7%
Teekay LNG Partners LP	TGP	3.4%	79.0%	81.9%	14.2x	7.5x	6.5x	4.7x	11.1x	8.8x	(38.1%)	11.6%
Golar LNG Ltd	GLNG	0.7%	46.0%	60.6%	nmf	47.4x	24.2x	12.8x	34.3x	18.0x	7.1%	7.7%
Tsakos Energy Navigation Ltd	TNP	5.8%	46.2%	54.3%	nmf	15.3x	3.1x	1.8x	9.8x	7.2x	46.1%	56.3%
Average		6.1%	57.8%	61.3%	27.1x	16.7x	7.8x	5.5x	13.1x	9.9x	(5.8%)	(2.0%)
Median		5.1%	68.3%	67.0%	14.2x	12.1x	5.6x	4.9x	10.2x	9.1x	(9.9%)	5.5%
Qatar Gas Transport Co Ltd	QGTS	6.3%	76.4%	76.7%	9.8x	8.6x	7.8x	5.8x	9.6x	9.0x	12.2%	16.5%

Note: Where coverage is not available, estimates are based on Bloomberg consensus, if available

Mean/Median calculated if more than 3 observations are present

NA: Not Applicable

nmf: Not Meaningful (typically refers to negative or exceedingly large values)

Source: Bloomberg, QNBFS Research

Key Forecasts: Profitability and Growth Metrics

ROIC should increase over time given pay down of debt and lower interest expenses. This is despite profitability margins coming down for the 100%-owned ship fleet as we expect costs to outpace flattish top-line of wholly-owned vessels. Growth of operating metrics remains flattish with profitability already at elevated levels. ROE levels remain healthy.

Ratio Analysis

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2033
Growth Ratios (In %)												
Revenue - Wholly Owned	0.7%	(0.4%)	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Revenue - Adjusted	2.0%	(6.1%)	1.6%	2.0%	1.4%	(0.7%)	1.3%	1.2%	1.2%	1.3%	1.3%	1.3%
Gross Profit	0.1%	0.4%	0.3%	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)
EBITDA	(1.1%)	0.5%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBITDA -Adjusted	1.1%	(7.2%)	2.2%	2.4%	1.7%	(1.1%)	1.6%	1.4%	1.5%	1.5%	1.6%	1.6%
EBIT	(6.5%)	0.7%	1.4%	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)
EPS	(2.9%)	(11.3%)	6.1%	13.5%	11.2%	3.0%	9.1%	8.2%	7.8%	7.9%	6.1%	5.3%
CFPS	(9.9%)	16.7%	(13.3%)	33.4%	8.3%	2.6%	5.7%	5.3%	5.2%	5.4%	4.6%	4.2%
FCFPS	(4.9%)	22.0%	(17.8%)	35.2%	8.6%	2.7%	5.9%	5.5%	5.4%	5.6%	4.7%	4.3%
DPS	(20.0%)	0.0%	5.0%	4.8%	4.5%	4.3%	4.2%	4.0%	3.8%	28.7%	6.1%	5.3%
Operating Ratios (In %)												
Gross Margin	76.6%	77.2%	77.3%	77.2%	77.1%	77.0%	76.9%	76.8%	76.7%	76.6%	76.1%	75.8%
EBITDA Margin	74.0%	74.6%	74.8%	74.7%	74.7%	74.6%	74.6%	74.5%	74.4%	74.4%	74.1%	73.9%
Adj. EBITDA Margin	76.8%	75.9%	76.4%	76.7%	77.0%	76.7%	76.9%	77.1%	77.2%	77.4%	78.4%	79.0%
EBIT Margin	49.0%	49.5%	50.1%	50.1%	50.0%	49.9%	49.9%	49.8%	49.8%	49.7%	49.4%	49.2%
Net Margin	31.1%	27.7%	29.4%	33.3%	37.0%	38.0%	41.5%	44.8%	48.3%	52.1%	72.5%	85.0%
Finance Ratios												
Net Debt-to-EBITDA	8.3	7.8	7.5	7.0	6.5	6.1	5.5	5.0	4.4	3.8	0.7	-1.3
Debt-Equity Ratio	4.1	3.5	2.7	2.4	2.1	1.8	1.5	1.3	1.1	0.9	0.2	0.0
Net Debt-Equity Ratio	3.6	3.0	2.4	2.1	1.8	1.5	1.3	1.1	0.9	0.7	0.1	-0.1
Interest Coverage	1.3	1.3	1.3	1.4	1.5	1.6	1.7	1.8	2.0	2.2	5.3	35.9
EBITDA Interest Coverage	1.9	1.9	2.0	2.1	2.2	2.4	2.6	2.8	3.0	3.3	8.0	54.0
Return Ratios (In %)												
ROIC	5.6%	5.7%	5.7%	5.8%	5.9%	6.0%	6.1%	6.2%	6.3%	6.4%	7.0%	7.3%
ROAE	19.7%	15.1%	13.7%	13.6%	14.0%	13.3%	13.5%	13.5%	13.4%	13.3%	13.2%	12.9%
ROAA	3.1%	2.8%	3.0%	3.5%	4.0%	4.2%	4.6%	5.1%	5.6%	6.2%	9.6%	11.9%
Liquidity Ratios												
Current Ratio	2.0	2.0	1.7	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.4	4.2
Quick Ratio	2.0	2.0	1.7	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.4	4.2
Valuation												
EV/EBITDA-Adjusted	9.8	10.1	9.6	9.0	8.5	8.2	7.6	7.1	6.5	5.9	3.3	1.7
EV/EBIT	18.4	17.5	16.8	16.2	15.4	14.7	13.9	13.1	12.3	11.4	6.8	3.8
P/E	9.2	10.4	9.8	8.6	7.8	7.5	6.9	6.4	5.9	5.5	3.9	3.3
P/CF	7.8	6.7	7.8	5.8	5.4	5.2	4.9	4.7	4.5	4.2	3.3	2.9
P/B	1.7	1.5	1.2	1.1	1.0	1.0	0.9	0.8	0.8	0.7	0.5	0.4
Dividend Yield	6.3%	6.3%	6.6%	6.9%	7.2%	7.5%	7.9%	8.2%	8.5%	10.9%	15.3%	18.0%
FCF Yield	12.2%	14.9%	12.2%	16.5%	18.0%	18.5%	19.5%	20.6%	21.7%	23.0%	29.6%	33.6%

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Revenue – Wholly-Owned Ships	3,057	3,060	3,063	3,066
Direct Costs	(697)	(694)	(697)	(701)
Gross Profit	2,360	2,366	2,365	2,365
Income from Marine & Agency Services	55	56	57	59
General and Administrative Expenses	(133)	(134)	(134)	(134)
EBITDA	2,281	2,289	2,289	2,289
Depreciation	(768)	(755)	(755)	(756)
EBIT	1,513	1,534	1,534	1,533
Share of Profits from Joint Ventures	339	389	454	502
Finance Costs	(1,172)	(1,149)	(1,093)	(1,026)
Interest, Dividend & Profit from Islamic Banks	64	86	86	86
Vessels Sub-Chartering & Other Income	103	39	39	39
Profit Before Tax	847	899	1,020	1,134
Income Tax Expense	0	0	0	0
Profit After Tax	847	899	1,020	1,134
Minority Interest	(1)	(1)	(1)	(2)
Profit for Equity Shareholders	846	898	1,019	1,133
EPS (QR)	1.53	1.62	1.84	2.05
Adjusted Net Revenue	3,451	3,506	3,575	3,626
Adjusted EBITDA	2,620	2,678	2,743	2,791

Source: Company data, QNBFS estimates

Balance Sheet

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Non-Current Assets				
Property, Plant and Equipment	22,392	21,696	20,998	20,300
Investment in Joint Venture Companies	4,144	4,499	4,635	4,761
Loans to Joint Venture Companies	99	87	87	87
Available-for-Sale Investments	109	119	119	119
Total Non-Current Assets	26,744	26,400	25,839	25,267
Current Assets				
Receivables, Inventories and Due from Joint Ventures	400	552	552	553
Cash and Bank Balances	2,775	2,704	2,556	2,474
Total Current Assets	3,175	3,256	3,108	3,027
Total Assets	29,919	29,656	28,947	28,294
Equity				
Equity Attributable to the Parent	5,922	7,216	7,784	8,438
Minority Interest	4	5	7	8
Total Equity	5,926	7,221	7,790	8,446
Non-Current Liabilities				
Borrowings	19,789	18,638	17,450	16,337
Fair Value of Interest Rate Swaps	2,478	1,738	1,614	1,490
Provision for End of Service Benefits	148	129	129	129
Total Non-Current Liabilities	22,416	20,505	19,193	17,955
Current Liabilities				
Borrowings	832	1,158	1,189	1,113
Accounts Payables/Accruals & Due to Related Parties	746	772	776	779
Total Current Liabilities	1,578	1,930	1,964	1,892
Equity and Liabilities	29,919	29,656	28,947	28,294

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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