Gulf International Services (GISS)

Recommendation	OUTPERFORM	Risk Rating	R-4
Share Price	QR1.476	Current Target Price	QR2.100
Implied Upside	42.3%		

NFE Drilling to Fuel Growth Spark; Reiterate Outperform/QR2.1 PT

We are updating our estimates and reiterating our Outperform rating on GISS with an unchanged target price of QR2.10. *Following the positive momentum shown in its 1Q2020 results, we think this year is well on track with GISS expected to post a 442% growth in earnings (admittedly off a modest base). Newsflow-related catalysts remain positive with GDI deploying its jackup rig "Lovanda" on March 29 as part of its 80-well drilling program for Qatar's North Field East (NFE) project. Overall, the GDI/Seadrill JV (GulfDrill) will begin to deploy six rigs in a phased manner in 2020. Moreover, on top its companywide costs optimization program, GISS is looking to restructure/ refinance GDI's $1.3bn debt pile in order to lower finance costs, extend repayments and enhance shareholder value. Besides risks of an impairment for the Msheireb rig this year, we believe the company could face some delays or slowdown in its operations and debt-restructuring program due to the ongoing COVID-19 situation. Net-net, we still believe GISS' financial performance in 2020 and beyond should please investors.*

Highlights

- **1Q2020 results show continued progress:** GISS' 1Q2020 net profit of QR8.7mn (QNB FS est.: QR5.4mn) was aided by better-than-expected profitability from aviation, drilling and catering, which more than offset losses in the insurance segment. Overall revenue of QR831.7mn (15.6% YoY, 7.6% QoQ) came in better-than-expected, up in aviation and catering and generally in-line in the drilling and insurance segments. Gross margin of 19.9% improved vs. 15.0% in 1Q2019 and 13.0% in 4Q2019 as GISS made progress in costs improvement across almost all segments. However, the insurance segment, despite posting a positive and improved gross margin, hurt overall profitability due to unrealized mark-to-market losses within its investment portfolio. On the plus side, overall finance costs declined 14.5% YoY or by QR8.7mn due to the drop in LIBOR. Overall earnings fell 65.5% YoY but increased vs. the marginal loss posted in 4Q2019, with the yearly drop mostly driven by the aforementioned unrealized mark-to-market loss of QR54mn in the insurance segment's investment book.
- **Drilling remains on track; NFE contract should boost GISS' earnings by an average of ~30% over 2020-2023.** 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. Overall, the JV will begin to utilize six rigs in a phased manner in 2020. The NFE project remains a significant catalyst for future growth in GDI and GISS.
- **Refinancing/restructuring of drilling debt to boost profitability/flexibility:** GISS is looking to capitalize on the low interest rate environment and will (subject to regulatory approvals) restructure/refinance GDI's $1.3bn debt pile. The current plan is to upstream $275mn of GDI debt into GISS, where the other three segments can contribute to payments, along with extending the tenor over ten years. Under this arrangement, the company will have a two-year grace period on repayments and a balloon payment of 20% at the end of ten years. Annual interest savings of ~QR7.4mn translates to 22% of GISS' 2019 net income. We do note given the ongoing pandemic-related restrictions and oil price volatility impacting drilling cash flow projections, we could face some delays/changes in GDI's proposed debt restructuring.
- **We expect earnings to grow from QR34mn in 2019 to QR184mn in 2020 as drilling loss declines significantly.** Aviation also contributes nicely, while continued progress in costs reduction and lower finance charges help boost earnings. *We detail our estimates on page 2.*

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 continue to rate GISS an Outperform with a TP of QR2.10.*** GISS trades at 2020 & 2021 EV/EBITDA multiples of 7.3x and 5.8x, 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%; 1Q2020: 1.0%), **quarterly earnings could be subject to significant volatility. Debt levels are high** (2019: QR4.7bn/5.3x net-debt-to-EBITDA) but still manageable in light of 2.4x interest coverage (2020e) 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	0.10	0.20	0.22
P/E (x)	80.8	14.9	7.3	6.6
EV/EBITDA (x)	8.3	7.3	5.8	4.9

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)	1.950/0.942
3-m Avg. Volume (mn)	3.2
Mkt. Cap. ($ bn/QR bn)	0.8/2.7
EV ($ bn/QR bn)	1.7/6.0
FO Limit* (%)	49.0
Current FO* (%)	8.7
Shares Outstanding (bn)	1.9
1-Year Total Return (%)	(23.9)
Fiscal Year End	December 31

Source: Bloomberg (as of July 01, 2020), *Qatar Exchange (as of July 01, 2020); Note: FO is foreign ownership

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

Summary of Segment Drivers

We expect earnings to grow from QR34mn in 2019 to QR184mn in 2020 as drilling loss declines significantly. For 2021, we now model in a net income of QR377mn, up 105%. Our projections are based on the following:

In drilling, we expect the segment to recover from a QR111mn loss in 2019 to a modest QR17mn loss in 2020 before recording earnings of QR107mn in 2021. GulfDrill should deploy 5 new rigs and one existing one (West Tucana) in a phased manner in 2020 for the NFE program. Along with its share of JV income, GDI will also record management fees for operating these rigs. The NFE program should offset decline in revenue from the existing fleet as we continue to expect pressure on rig rates given lower oil prices. Operating costs for the existing fleet, along with SG&A expenses should improve, while finance charges should benefit from lower LIBOR rates. Moreover, we expect GDI's debt to be restructured/refinanced in 4Q2020. This, according to management guidance, should lead to savings of 16bps and upstreaming of $275mn in GDI debt into GISS, which will shift proportional finance charges away from the drilling segment. We also expect the Msheireb offshore rig to be impaired by the end of this year. For 2021, GDI will benefit from all six rigs, associated with the NFE program, operating from the beginning of the year, along with continued progress on operating costs for the existing fleet and lower finance charges given the expected restructuring/refinancing. This should offset potential decline in rig rates for the existing fleet. We do note oil price volatility and COVID-19-related delays can hurt operations and debt restructuring efforts.

Aviation should also contribute nicely, with segment earnings growing from QR143mn in 2019 to QR185mn in 2020 and QR205mn in 2021. Besides its top-line enjoying a boost from the consolidation of GHC's Turkish subsidiary "RedStar" in May 2019, segment performance in 1Q2020 also benefited from overall traction in international markets, growth in domestic oil and gas operations, repricing of some contracts, etc. We note one new chopper was added in late 1Q2020/early 2Q2020 in domestic O&G bringing total fleet size to 55. While we expect positive momentum to continue, we do think ongoing COVID-19-related delays could dampen growth in international markets and our estimates reflect this.

After posting a slight profit in 2020 due to mark-to-market declines recorded in 1Q2020 in its investment book, we expect the insurance segment to jump back significantly into the green in 2021. Per our model, insurance earnings should decline from QR16mn in 2019 to QR3mn in 2020 before increasing to QR75mn in 2021. Overall performance should continue to benefit from renewal/repricing especially in the medical segment. As coronavirus-related medical claims are mostly not covered, we do not expect a significant uptick in net claims due to the ongoing pandemic.

Catering should benefit from the momentum seen in 1Q2020 and increase its net income from QR12mn in 2019 to QR21mn in 2020 and QR22mn in 2021. This segment is seeing traction in core industrial catering and manpower contracting services, along with higher occupancy in Mesaieed and Dukhan camps. Despite some near-to-medium-term challenges because of COVID-19, Amwaj expects Qatar's catering market to grow through to 2024 driven by the NFE project and the FIFA World Cup Qatar 2022.

Key Segment Details

Key Segment Details

In QR mn	2019	2020e	2021e	2022e	2023e
Revenue	**3,011**	**3,365**	**3,562**	**3,605**	**3,646**
Gulf Drilling International (GDI)	*1,164*	*1,272*	*1,405*	*1,395*	*1,390*
Gulf Helicopters Company (GHC)	*586*	*686*	*710*	*728*	*746*
Amwaj Catering Company (AHC)	*431*	*493*	*511*	*523*	*536*
Al Koot Insurance & Reinsurance (AKIR)	*830*	*913*	*936*	*959*	*974*
Net Income	**34**	**184**	**377**	**413**	**448**
Net Margin	**1%**	**5%**	**11%**	**11%**	**12%**
Drilling	*(111)*	*(17)*	*107*	*110*	*117*
Net Margin	*-10%*	*-1%*	*8%*	*8%*	*8%*
Helicopters	*143*	*185*	*205*	*227*	*241*
Net Margin	*24%*	*27%*	*29%*	*31%*	*32%*
Catering	*12*	*21*	*22*	*23*	*28*
Net Margin	*3%*	*4%*	*4%*	*4%*	*5%*
Insurance	*16*	*3*	*75*	*84*	*92*
Net Margin	*2%*	*0%*	*8%*	*9%*	*9%*
EBITDA	**714**	**794**	**890**	**919**	**944**
EBITDA Margin	**24%**	**24%**	**25%**	**25%**	**26%**
Drilling	*436*	*501*	*506*	*506*	*508*
EBITDA Margin	*37%*	*39%*	*36%*	*36%*	*37%*
Helicopters	*236*	*271*	*289*	*308*	*321*
EBITDA Margin	*40%*	*39%*	*41%*	*42%*	*43%*
Catering	*38*	*45*	*45*	*47*	*50*
EBITDA Margin	*9%*	*9%*	*9%*	*9%*	*9%*
Insurance	*(1)*	*(5)*	*67*	*76*	*83*
EBITDA Margin	*0%*	*-1%*	*7%*	*8%*	*9%*

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%	11.8%	5.9%	1.2%	1.1%
Gross Profit	1.2%	(56.2%)	(14.9%)	(10.4%)	0.5%	44.5%	1.4%	7.9%	5.6%
EBITDA	(18.9%)	(40.0%)	(17.6%)	3.5%	(4.2%)	11.2%	12.1%	3.3%	2.8%
EBIT	(33.4%)	(69.0%)	(21.8%)	10.0%	(0.9%)	53.4%	25.8%	6.8%	5.7%
PAT/EPS	(43.2%)	(91.6%)	26.9%	N/M	N/M	441.8%	104.8%	9.6%	8.4%
DPS	(81.8%)	0.0%	(100.0%)	N/A	N/A	N/A	N/A	N/A	50.0%
CFPS	25.3%	(35.1%)	(24.2%)	(39.7%)	86.9%	(39.8%)	70.0%	0.7%	3.6%
FCFPS	N/M	(59.3%)	32.4%	(41.9%)	222.5%	(55.2%)	136.4%	(0.3%)	3.3%
Operating Ratios									
Gross Margin	29.1%	17.7%	18.8%	16.0%	13.5%	17.4%	16.7%	17.8%	18.6%
Gross Margin, Excluding Depreciation & Amortization	40.7%	36.7%	38.8%	35.2%	28.7%	29.4%	27.9%	28.7%	29.3%
EBITDA Margin	35.0%	29.3%	30.0%	29.6%	23.7%	23.6%	25.0%	25.5%	25.9%
EBIT Margin	23.0%	9.9%	9.7%	10.1%	8.4%	11.5%	13.7%	14.5%	15.1%
Net Margin	19.2%	2.2%	3.5%	(3.9%)	1.1%	5.5%	10.6%	11.4%	12.3%
Finance Ratios									
Debt-Equity Ratio	1.3	1.5	1.4	1.4	1.3	1.2	1.1	1.0	0.8
Net Debt-Equity Ratio	1.1	1.1	1.1	1.2	1.1	1.0	0.7	0.5	0.4
Net Debt-to-Capital	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.3	0.3
Net Debt-to-EBITDA	2.9	4.8	5.8	5.5	5.3	4.5	3.3	2.5	1.9
Interest Coverage	12.2	2.4	1.3	1.1	1.1	2.4	3.7	4.0	4.4
Return Ratios									
ROIC	10.5%	3.2%	2.6%	3.0%	3.1%	4.7%	5.7%	5.9%	6.3%
ROE	20.4%	1.8%	2.3%	-2.8%	1.0%	4.9%	9.2%	9.2%	9.4%
ROA	7.1%	0.6%	0.8%	-1.0%	0.3%	1.7%	3.3%	3.5%	3.8%
FCF Yield	22.9%	9.3%	12.3%	7.2%	23.1%	10.4%	24.5%	24.4%	25.2%
Liquidity Ratios									
Current Ratio	0.9	1.2	1.0	1.2	1.2	1.6	1.8	1.7	1.7
Quick Ratio	0.9	1.1	1.0	1.1	1.1	1.5	1.7	1.6	1.6
Valuation									
EV/Sales	1.5	2.2	2.6	2.5	2.0	1.7	1.4	1.3	1.1
EV/EBITDA	4.4	7.4	8.8	8.5	8.3	7.3	5.8	4.9	4.3
EV/EBIT	6.7	21.7	27.3	24.8	23.3	14.8	10.5	8.6	7.3
P/E	3.4	41.0	32.3	N/M	80.8	14.9	7.3	6.6	6.1
P/CF	1.9	2.9	3.8	6.3	3.4	5.6	3.3	3.3	3.2
P/BV	0.7	0.7	0.7	0.8	0.8	0.7	0.7	0.6	0.6
Dividend Yield	6.8%	6.8%	0.0%	0.0%	0.0%	0.0%	0.0%	6.8%	10.2%
FCF Yield	22.9%	9.3%	12.3%	7.2%	23.1%	10.4%	24.5%	24.4%	25.2%

Source: Company data, QNB FS estimates

Detailed Financial Statements

Income Statement

In QR mn	2019	2020e	2021e	2022e	2023e
Revenue	3,011	3,365	3,562	3,605	3,646
COGS	2,605	2,778	2,967	2,964	2,969
Gross Profit	**406**	**587**	**595**	**642**	**677**
SG&A	207	225	223	221	219
Total Other Income	38	(70)	39	23	14
Net Finance Income (Expense)	(204)	(139)	(112)	(109)	(103)
Net Income*	**34**	**184**	**377**	**413**	**448**
EBITDA	**714**	**794**	**890**	**919**	**944**
EPS	**0.02**	**0.10**	**0.20**	**0.22**	**0.24**
DPS	**0.00**	**0.00**	**0.00**	**0.10**	**0.15**

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	1,007	1,529	2,113	2,120
Financial Investments	342	274	274	274	274
Insurance & Accounts Receivables/Prepayments	1,696	1,860	1,935	1,973	2,000
Due From Related Parties	501	786	786	786	786
Inventories & Contract Assets	225	238	254	254	254
Total Current Assets	**3,673**	**4,165**	**4,778**	**5,399**	**5,434**
Non-Current Assets					
Financial Investments	288	250	250	250	250
Equity-Accounted Investees & JVs	5	12	27	43	58
Goodwill & Intangibles	304	304	304	304	304
Right of Use & Contract Assets	76	76	76	76	76
Property, Plant & Equipment	6,421	6,220	5,976	5,744	5,524
Non-Current Assets	**7,094**	**6,860**	**6,632**	**6,416**	**6,212**
Total Assets	**10,767**	**11,025**	**11,410**	**11,816**	**11,645**
Current Liabilities					
Short-Term Debt & Bank Overdraft	825	100	39	458	442
Insurance Payables, Accounts Payable & Accruals	2,247	2,506	2,615	2,647	2,673
Contract Liabilities & Lease Liabilities	44	40	40	40	40
Due to Related Parties	33	29	29	29	29
Current Liabilities	**3,149**	**2,676**	**2,724**	**3,174**	**3,185**
Non-Current Liabilities					
EOS/Provision for Decomm. Costs	133	134	134	134	134
Contract Liabilities	51	51	51	51	51
Long-Term Debt	3,862	4,444	4,405	3,947	3,505
Non-Current Liabilities	**4,046**	**4,629**	**4,590**	**4,132**	**3,689**
Total Liabilities	**7,196**	**7,305**	**7,314**	**7,306**	**6,874**
Shareholders' Equity					
Total Shareholders' Equity	**3,571**	**3,720**	**4,097**	**4,509**	**4,771**
Liabilities & Shareholders' Equity	**10,767**	**11,025**	**11,410**	**11,816**	**11,645**

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