

Gulf International Services (GISS)

Recommendation	MARKET PERFORM	Risk Rating	R-4
Share Price	QR16.65	Current Target Price	QR19.00
Implied Upside	14.1%		

4Q2018 Preview: Impairments Could Bite; Market Perform

Potential rig impairment (s) could mask sequential operating earnings growth in 4Q2018. GISS stock has drifted down 9% since we changed our rating to [Market Perform](#) vs. a 5% increase in the QSE Index. Our view on the upcoming results remains unchanged – results should show growth YoY/QoQ, on an operating basis, but net income could get impacted if we see any rig impairments. We continue to model in a resumption of dividends with QR1 in DPS (6% yield) expected for 2018. However, a loss could easily eliminate the dividend and further pressure the stock. While 2018 results are important, we continue to look beyond and point to our expectation of solid earnings growth in 2019 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 stay Market Perform for now and could potentially revisit our rating after results announcement.

Highlights

- **We still expect QoQ earnings improvement in 4Q2018 barring any impairments.** We expect 4Q2018 revenue/net income of QR686.0mn/QR24.8mn. Our detailed forecasts are in Page 2. **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.** We continue to model in a resumption of dividends with QR1 in DPS expected for 2018. However, a loss could easily eliminate the dividend. Given its razor-thin margins, GISS is subject to significant quarterly earnings volatility.
- **Looking beyond 2018, drilling is emerging from choppy waters and we expect a resumption of profitability from 2H2019 despite higher interest costs.** We continue to model 7 offshore rigs to be deployed, in-line with current trend. As we have pointed out 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 NI should grow from QR64.3mn (EPS: QR0.35) in 2018 to QR154.1mn (QR0.83) in 2019.** 82% of this growth is to be driven by drilling. Insurance and aviation contribute 6% and 4%, respectively, while catering is flattish. Again, there are no impairment charges in our model.

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 7.5x and 6.8x, 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)	36.4	48.1	20.1	13.1
EV/EBITDA (x)	9.4	8.8	7.5	6.8
DPS (QR)	0.00	1.00	1.25	1.50
DY	0.0%	6.0%	7.5%	9.0%

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)	21.50/16.10
3-m Avg. Volume (000)	179.8
Mkt. Cap. (\$ bn/QR bn)	0.8/3.1
EV (\$ bn/QR bn)	1.9/7.0
FO Limit* (%)	49.0
Current FO* (%)	8.5
Shares Outstanding (mn)	185.8
1-Year Total Return (%)	(8.6)
Fiscal Year End	December 31

Source: Bloomberg (as of February 5, 2019), *Qatar Exchange (as of February 5, 2019); Note: FO is foreign ownership

Saugata Sarkar, CFA, CAIA

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

4Q2018 Preview

QNB FS Estimates and Comparisons

In QR mn	4Q2018e	4Q2017A	3Q2018A	YoY	QoQ	2018e	2017	YoY
Revenue	686.0	609.9	650.7	12.5%	5.4%	2,647.1	2,485.9	6.5%
Gross Profit	124.5	159.0	90.2	-21.7%	38.0%	436.3	450.8	-3.2%
EBITDA	211.9	193.8	184.4	9.3%	14.9%	774.2	756.7	2.3%
EBIT	91.7	110.6	67.3	-17.1%	36.3%	298.5	257.4	16.0%
Net Income	24.8	62.8	5.2	-60.5%	375.3%	64.3	85.0	-24.4%
EPS (QR)	0.13	0.34	0.03	-60.5%	375.3%	0.35	0.46	-24.4%
DPS (in QR)						1.00	0.00	
Gross Margin	18.2%	26.1%	13.9%			16.5%	18.1%	
EBITDA Margin	30.9%	31.8%	28.3%			29.2%	30.4%	
EBIT Margin	13.4%	18.1%	10.3%			11.3%	10.4%	

Source: Company data, QNB FS estimates

Key Metrics

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, QNB FS estimates

Valuation Metrics

Particulars	2015	2016	2017	2018	2019	2020	2021	2022	2023
Valuation									
EV/Sales	1.7	2.4	2.9	2.6	2.4	2.3	2.2	2.0	1.7
EV/EBITDA	5.1	9.2	9.4	8.8	7.5	6.8	6.3	5.6	4.9
EV/EBIT	8.1	37.0	27.5	22.8	16.3	13.5	12.3	10.5	9.0
P/E	3.9	46.2	36.4	48.1	20.1	13.1	11.0	9.4	8.2
P/CF	2.1	3.3	4.2	4.9	3.5	3.4	3.2	3.1	3.0
P/BV	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7
Dividend Yield	6.0%	6.0%	0.0%	6.0%	7.5%	9.0%	10.5%	12.0%	13.5%
FCF Yield	20.3%	8.3%	11.3%	12.4%	19.7%	20.8%	21.6%	22.4%	23.0%

Source: Bloomberg, QNB FS estimates

Key Segment Details

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
Net Margin	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
EBITDA Margin	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, QNB FS 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%
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	20.3%	8.3%	11.3%	12.4%	19.7%	20.8%	21.6%	22.4%	23.0%
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	1.7	2.4	2.9	2.6	2.4	2.3	2.2	2.0	1.7
EV/EBITDA	5.1	9.2	9.4	8.8	7.5	6.8	6.3	5.6	4.9
EV/EBIT	8.1	37.0	27.5	22.8	16.3	13.5	12.3	10.5	9.0
P/E	3.9	46.2	36.4	48.1	20.1	13.1	11.0	9.4	8.2
P/CF	2.1	3.3	4.2	4.9	3.5	3.4	3.2	3.1	3.0
P/BV	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7
Dividend Yield	6.0%	6.0%	0.0%	6.0%	7.5%	9.0%	10.5%	12.0%	13.5%
FCF Yield	20.3%	8.3%	11.3%	12.4%	19.7%	20.8%	21.6%	22.4%	23.0%

Source: Company data, QNB FS 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, QNB FS 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, QNB FS 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, 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

Mehmet Aksoy, PhD

Senior Research Analyst

Tel: (+974) 4476 6589

mehmet.aksoy@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

QNB Financial Services Co. W.L.L.

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

Disclaimer and Copyright Notice: This publication has been prepared by QNB Financial Services Co. W.L.L. ("QNB FS") a wholly-owned subsidiary of Qatar National Bank (Q.P.S.C.). QNB FS is regulated by the Qatar Financial Markets Authority and the Qatar Exchange. Qatar National Bank (Q.P.S.C.) is regulated by the Qatar Central Bank. This publication expresses the views and opinions of QNB FS at a given time only. It is not an offer, promotion or recommendation to buy or sell securities or other investments, nor is it intended to constitute legal, tax, accounting, or financial advice. QNB FS accepts no liability whatsoever for any direct or indirect losses arising from use of this report. Any investment decision should depend on the individual circumstances of the investor and be based on specifically engaged investment advice. We therefore strongly advise potential investors to seek independent professional advice before making any investment decision. Although the information in this report has been obtained from sources that QNB FS believes to be reliable, we have not independently verified such information and it may not be accurate or complete. QNB FS does not make any representations or warranties as to the accuracy and completeness of the information it may contain, and declines any liability in that respect. For reports dealing with Technical Analysis, expressed opinions and/or recommendations may be different or contrary to the opinions/recommendations of QNB FS Fundamental Research as a result of depending solely on the historical technical data (price and volume). QNB FS reserves the right to amend the views and opinions expressed in this publication at any time. It may also express viewpoints or make investment decisions that differ significantly from, or even contradict, the views and opinions included in this report. This report may not be reproduced in whole or in part without permission from QNB FS.

COPYRIGHT: No part of this document may be reproduced without the explicit written permission of QNB FS.