# GISS Alert – Positive 2Q EPS Trajectory Despite Pandemic/Oil Crimping Revenue; Outperform

- **GISS' 2Q2020 net profit jumps to QR45.3mn vs. QR4.0mn in 2Q2019 and QR8.7mn in 1Q2020 –** Gulf International Services' (GISS) earnings did come in lower than our forecast of QR86.8mn. Management pointed to macro-challenges related to weak oil prices and COVID-19 affecting GISS' top-line performance, especially on the drilling side. While we had been expecting an overall slowdown given the coronavirus malaise/oil price volatility, weakness in 2Q2020 was more pronounced than our model, particularly in the drilling segment. In its press release, GISS stated that decline in rig utilizations lowered 1H2020 offshore and onshore revenue by 4% YoY and 29% YoY, respectively. This was somewhat offset by additional revenue streams (likely management fees) from the GulfDrill JV, which started deploying its first rig (out of six) called Lovanda on March 29 as part of its 80-well drilling program for Qatar's North Field East Project.
- **Overall 2Q2020 revenue came in at QR727.3mn (-3.3% YoY/-12.6% QoQ).** Reported revenue was also 13.5% lower than our estimate of QR841.2mn. Top-line was slightly better-than-expected in insurance (+24.3% YoY, +3.7% QoQ) but came in meaningfully lower vs. our estimate in drilling (-23.3% YoY, -20.1% QoQ). Continuing the trend seen in 1Q2020, GISS was able to renew additional insurance contracts with superior terms, while adding new clients in the medical segment. The aviation segment (+1.1% YoY, -16.5% QoQ) was able to hold the line YoY but witnessed lower flying hours sequentially before recovering meaningfully in June. Finally, catering (-2.7% YoY, -19.2% QoQ) felt the brunt of the lockdowns with lower meals served.
- **Relative to our model, better-than-expected profitability from insurance was more than offset by the other three segments**. Drilling, once again, was responsible for the majority of the earnings miss. Overall gross margin of 12.7% declined vs. 13.3% in 2Q2019 and 19.9% in 1Q2020 given the revenue falloff, which overshadowed ongoing costs improvements that management continues to implement and the company continues to benefit from, particularly in the drilling segment. Moreover, given the sequential gain in financial markets and some strategic portfolio reallocation, GISS was able to reverse a good chunk of its QR53mn in 1Q2020 unrealized mark-to-market investment losses (primarily in the insurance segment) by recording QR38mn in unrealized gains in 2Q2020. Finally, overall finance costs declined 27.7% YoY/8.6% QoQ due to the drop in LIBOR. *(Continued on page 2).*

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- **Drilling remains the major growth catalyst with activity related to the NFE expansion underway from late 1Q2020.** However, this segment has witnessed some slowdown given lower rig utilization rates due to COVID-19-related travel restrictions that affected the crew repatriation process.

- **Refinancing/restructuring of drilling debt pushed back to late 2020.** As we had noted previously, GISS' earlier discussed refinancing/restructuring of GDI's $1.3bn debt pile could lead to annual interest savings of ~QR7.4mn (22% of GISS' 2019 net income). However, we had foreseen, 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. GISS' press release points to this scenario with management opting to temporarily defer proceedings of the proposed new debt restructuring/refinancing exercise to the latter part of 2020. While we had already expected impact from this program to begin by 4Q2020, the current announcement could mean a modest delay vs. our original expectations.

- **We continue to expect significant growth in GISS' earnings this year.** Newsflow-related catalysts remain positive as the GDI/Seadrill JV (GulfDrill) will begin to deploy six rigs into the NFE program in a phased manner. Moreover, on top its companywide costs optimization program, GISS' proposed debt refinancing/restructuring (although pushed back somewhat) will lower finance costs, extend repayments and enhance shareholder value. In terms of risks, besides the potential 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/oil price volatility. We do see some of these risks playing out in 2Q2020 and would likely have to adjust our 2020 earnings estimate downward. However, we still believe GISS' financial performance in 2020 and beyond should please investors. **We rate GISS an Outperform with a QR2.10 price target.**



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| Recommendations<br>*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<br>*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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