

## Qatar Electricity & Water Company (QEWS)

Recommendation	<b>ACCUMULATE</b>	Risk Rating	<b>R-2</b>
Share Price	<b>QR187.90</b>	Target Price	<b>QR215.00</b>
Implied Upside	<b>14.4%</b>		

### Revising Estimates Moderately Post 2Q2014 Results

*QEWS is a low-risk play deeply linked to Qatar's growth story. We retain our long-term bullish stance on QEWS with an Accumulate rating and a PT of QR215.*

#### Highlights

- Growing with Qatar:** Buoyed by significant economic and population growth, Qatar's electricity & water demand is set to grow by a CAGR of 8-10% over the next few years. State-backed QEWS (43% ownership + ~11% held by Qatar Petroleum), practically Qatar's sole power & water producer, should benefit from this growth. QEWS owns 62% and 79%, respectively, of the overall power and water desalination capacity of 8,750 MW and 328 MIGD installed in Qatar.
- Watertight contracts ensure visible earnings & cash flows.** Essentially a capacity provider, QEWS buys natural gas (primary feedstock; 67% of cash direct costs, 2012-13) from QP (supplier; 100% government-owned) through long-term take-or-pay contracts and sells power and water to Kahramaa (buyer; 100%) under long-term off-take power & water purchase agreements. Fuel cost hikes are passed through to Kahramaa. These agreements lead to stable margins and any expansion should grow revenue/EPS.
- Updating model with an average EPS upward revision of ~2% over 2014-2016.** We have tweaked our model post 2Q2014 results; while our 2014 EPS is virtually unchanged, we boost our 2015 & 2016 EPS by 1% & 5%, respectively.
- Stable operating profile and solid dividend yield should pave the way for future earnings acceleration.** Our model shows EBITDA margins remaining at industry highs of 51.6% over 2013-16. We project EPS to grow at a CAGR of 4.7% over 2013-16, including a 9.5% jump in 2016. Dividend payout has remained a solid 53% over 2007-13 and we expect this trend to continue.

#### Catalysts

- Over the longer term, significant catalysts abound.** QEWS should benefit from a new water plant, RAF A2 (36 MIGD), from 2H2015 adding ~14% to QEWS' net water capacity. Further, Facility D (2,400 MW & 130 MIGD; 60% share) should be commissioned in late 2017. We also expect contribution from the Ras Laffan Industrial Water project (36 MIGD; 60% share) later in 2017. The latter two projects are not factored into our estimates/fair value. Overall, these three projects should expand QEWS' net electricity & water capacity by 27% and 52%, respectively, in 2018. QEWS is seeking regional expansion deals and has set up a \$1bn JV (60% stake) called Nebras Power with QPI/QH to achieve this goal. The partners are in the process of valuing QEWS' existing assets in Oman & Jordan (BV: QR276.4mn) for sale to the JV. Newsflow about domestic expansion and successful regional bids could act as catalysts.

#### Recommendation, Valuation and Risks

- Recommendation and valuation: We rate QEWS an Accumulate with a price target of QR215.00.** The stock trading at a 2014 P/E of 14.6x.
- Risks:** 1) EBITDA margin erosion and 2) International expansion risks.

#### Key Financial Data and Estimates

	FY2012	FY2013	FY2014e	FY2015e
Revenue (QR mn)	2,838	2,904	2,960	3,005
Revenue Growth	N/A	2.3%	1.9%	1.5%
EPS (QR)	13.02	12.58	12.89	13.20
EPS Growth	10.2%	(3.3%)	2.4%	2.5%
P/E (x)	14.4	14.9	14.6	14.2
DPS (QR)	6.64	6.82	7.50	7.75
Dividend Payout (%)	51.0%	54.2%	58.2%	58.7%
Dividend Yield	3.5%	3.6%	4.0%	4.1%
ROE	27.7%	22.6%	21.3%	19.9%

Source: Company data, QNBFS estimates

#### Key Data

Current Market Price (QR)	187.90
Dividend Yield (%)	4.0
Bloomberg Ticker	QEWS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QEWC.QA
ISIN	QA0006929812
Sector*	Industrials
52wk High/52wk Low (QR)	208.70/132.00
3-m Average Volume ('000)	140
Mkt. Cap. (\$ bn/QR bn)	5.7/20.7
Shares Outstanding (mn)	110.0
FO Limit* (%)	25.0
Current FO* (%)	9.3
1-Year Total Return (%)	32.1
Fiscal Year End	December 31

Source: Bloomberg (as of July 17, 2014), \*Qatar Exchange (as of July 17, 2014); Note: FO is foreign ownership

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## Revising Estimates

**Updating model with an average EPS upward revision of ~2% over 2014-2016.** We have tweaked our model post 2Q2014 results; while our 2014 EPS is virtually unchanged, we increase our 2015 and 2016 EPS by 1% and 5%, respectively. While we have lowered our forecasted EBITDA margins, our earnings estimates benefit from reduced finance charges.

- **We are modeling an average of 2% top-line growth for 2014 and 2015, followed by a 7% increase in 2016.** Our revenue estimates are driven by a growth factor related to inflation with a small benefit from the startup of the new water plant in late 2015. We continue to expect QEWS' satellite stations (183 MW capacity) to go offline by end of this year. 2016 revenue should show the full impact of RAF A-2.
- **We continue to expect EBITDA margins to show modest compression driven by higher costs and lower tariffs for new plants.** For FY2014, we expect an EBITDA margin of 51.6% vs. 52.7% in 2Q2014. Our previous EBITDA margin estimate for 2014 was 53.0%. Beyond 2014, we expect margin erosion of 50bps per annum.
- **Our net income growth is around 2% for both 2014 and 2015, followed by a 9% uptick in 2016.** Lower finance charges impact our estimates positively.
- **We keep our dividend estimates unchanged.** We are expecting QR7.50 and QR7.75 in 2014 and 2015 DPS, respectively.

### Major Estimate Changes

In QR mn	2014e			2015e			2016e		
	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)
Revenue	2,960	2,960	0.0	3,005	3,005	(0.0)	3,209	3,209	(0.0)
EBITDA	1,526	1,570	(2.8)	1,534	1,578	(2.8)	1,622	1,669	(2.8)
EBITDA Margin (%)	51.6	53.0		51.1	52.5		50.6	52.0	
Net Income	1,418	1,416	0.1	1,452	1,444	0.6	1,590	1,509	5.4
Net Margin (%)	47.9	47.8		48.3	48.1		49.5	47.0	
EPS (QR)	12.89	12.87	0.1	13.20	13.13	0.6	14.45	13.72	5.4
Dividend/Share (QR)	7.50	7.50	0.0	7.75	7.75	0.0	8.00	8.00	0.0
Dividend Yield (%)	4.0	4.0		4.1	4.1		4.3	4.3	

Source: Company data, QNBFS estimates

## June 2014 Quarter Review

**Generally in-line 2Q2014 earnings with maintenance-related top-line miss offset by one-off income.** Reported net income for quarter came in at QR416.5mn (+39% QoQ, -4% YoY), just 2.1% above our estimate (QR408.0mn). Reuters consensus was at QR422.7mn but with wide divergences in the other estimates (QR389.3mn and QR470.7mn). Reported revenue was 4.5% lower than our estimate of QR815.7mn at QR779.4mn (18% QoQ, -1 YoY) with maintenance-related shutdowns at RAF B2/A1 early on in 2Q2014 impacting mostly power sales. Reported revenue was comprised of: (1) QR431.2mn in electricity revenue (+31% QoQ, -2% YoY), which was below our estimate; (2) QR299.6mn in water desalination sales (+4% QoQ, +2% YoY) also fell below our estimate but moderately; and (3) QR48.5mn in lease income (+16% QoQ, -2% YoY) that was in line with our modeled expectation. Seasonal uptick in revenue benefited margins sequentially, with the gross margin increasing to 59.9% vs. 55.3% in 1Q2014; GMs dipped below the 63.6% level posted in 2Q2013, however. EBITDA came in at QR410.5mn (+30% QoQ, -8% YoY) increasing the EBITDA margin to 52.7% vs. 47.8% in 1Q2014 (56.6% in 2Q2014). According to management, 2Q2014 profitability was helped by ~QR51mn in claims settlements. Finally, share of profits from JVs (Q Power, Mesaieed Power & RGPC) was QR102.4mn (+21% QoQ, +1% YoY) which was right in line with our estimate.

## Detailed Financial Statements

Income Statement (In QR mn)	FY2012	FY2013	FY2014e	FY2015e
<b>Revenue</b>	<b>2,838</b>	<b>2,904</b>	<b>2,960</b>	<b>3,005</b>
Cost of Sales, Excluding Depreciation	(1,080)	(1,148)	(1,214)	(1,247)
<b>Gross Profit</b>	<b>1,757</b>	<b>1,756</b>	<b>1,746</b>	<b>1,758</b>
General & Administrative Expenses	(177)	(216)	(220)	(223)
<b>EBITDA</b>	<b>1,580</b>	<b>1,540</b>	<b>1,526</b>	<b>1,534</b>
Deferred Income	7	7	7	7
Depreciation & Amortization	(473)	(458)	(460)	(499)
<b>EBIT</b>	<b>1,114</b>	<b>1,089</b>	<b>1,073</b>	<b>1,042</b>
Finance Costs	(193)	(178)	(102)	(100)
Interest Income, Dividend Income & Gain on Sale of AFS	65	92	41	42
Other & Miscellaneous Income/Expense & Share of Profits from JVs	465	389	417	428
Share of Associates	5	19	17	71
Profit Before Tax	1,457	1,412	1,446	1,481
Income Tax Expense	0	0	0	0
Profit After Tax	1,457	1,412	1,446	1,481
Minority Interest	(25)	(27)	(28)	(29)
<b>Profit for Shareholders</b>	<b>1,432</b>	<b>1,384</b>	<b>1,418</b>	<b>1,452</b>
<b>EPS (QR)</b>	<b>13.02</b>	<b>12.58</b>	<b>12.89</b>	<b>13.20</b>

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2012	FY2013	FY2014e	FY2015e
<b>Non-Current Assets</b>				
Property, Plant and Equipment	4,748	5,055	5,615	6,200
Available-for-Sale Investments	424	454	454	454
Finance Lease Receivables	1,913	1,775	1,641	1,508
JV Loans and Investments in JVs	446	721	560	426
Other Non-Current assets	263	267	479	544
<b>Total Non-Current Assets</b>	<b>7,794</b>	<b>8,272</b>	<b>8,749</b>	<b>9,131</b>
<b>Current Assets</b>				
Finance Lease Receivables & Others	126	168	168	168
Inventories	369	276	199	205
Accounts Receivables & Prepayments	572	585	730	741
Cash and Short-Term Deposits	2,690	1,726	1,746	1,647
<b>Total Current Assets</b>	<b>3,757</b>	<b>2,754</b>	<b>2,843</b>	<b>2,760</b>
<b>Total Assets</b>	<b>11,551</b>	<b>11,026</b>	<b>11,592</b>	<b>11,892</b>
<b>Equity</b>				
Equity to the Parent	5,167	6,111	6,653	7,281
Minority Interest	215	230	235	241
<b>Total Equity</b>	<b>5,382</b>	<b>6,341</b>	<b>6,889</b>	<b>7,522</b>
<b>Non-Current Liabilities</b>				
Loans and Borrowings	3,494	3,361	3,478	3,130
Deferred Income	20	14	7	0
Employees' End of Service Benefits	35	39	44	48
<b>Total Non-Current Liabilities</b>	<b>3,550</b>	<b>3,414</b>	<b>3,529</b>	<b>3,178</b>
<b>Current Liabilities</b>				
Accounts Payables & Others	874	689	605	622
Loans and Borrowings	1,455	413	392	392
Derivatives	289	169	178	178
<b>Total Current Liabilities</b>	<b>2,619</b>	<b>1,272</b>	<b>1,175</b>	<b>1,192</b>
<b>Equity and Liabilities</b>	<b>11,551</b>	<b>11,026</b>	<b>11,592</b>	<b>11,892</b>

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

<b>OUTPERFORM</b>	Greater than +20%
<b>ACCUMULATE</b>	Between +10% to +20%
<b>MARKET PERFORM</b>	Between -10% to +10%
<b>REDUCE</b>	Between -10% to -20%
<b>UNDERPERFORM</b>	Lower than -20%

### Risk Ratings

Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals

<b>R-1</b>	Significantly lower than average
<b>R-2</b>	Lower than average
<b>R-3</b>	Medium / In-line with the average
<b>R-4</b>	Above average
<b>R-5</b>	Significantly above average

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