

# QGTS Alert – In-Line Operations With Lower Depreciation Leads To Modest 1Q2023 Beat; Accumulate

- **QGTS beats our 1Q2023 earnings estimate on lower-than-expected depreciation expense:** Nakilat's 1Q2023 net income of QR395.5mn increased 3.6% YoY and 30.2% QoQ, beating our estimate of QR374.2mn by 5.7%.
  - **Revenue from wholly-owned ships** of QR878.8mn (0.6% YoY, -2.1% QoQ) was bang in-line with our estimate of QR882.0mn (variation of -0.4%).
  - **Adjusted revenue** (wholly-owned ships + marine & agency services + JV income) of QR1.06bn (1.9% YoY, -2.8% QoQ) was also in-line with our estimate of QR1.07bn (again a -0.4% variance).
  - **EBITDA** of QR676.3mn (-0.5% YoY, 2.7% QoQ) was 0.6% ahead of our forecast of QR672.6mn given slightly lower-than-expected **cash operating costs** of the wholly-owned fleet (cash gross margins rose to 77.9% vs. our model of 77.4% and 78.9%/76.6% in 1Q2022/4Q2022) and growth in **income from marine & agency services** (22.4% YoY, -12.3% QoQ; 22.1% ahead of our model); **G&A** expenses of QR21.5mn (4.6% YoY, -51.4% QoQ; in-line with our estimate of QR21.2mn) fell significantly sequentially, as expected, from its 4Q2022 high that included expenses related to several COVID-19-related postponed projects concerning IT infrastructure, maintenance, travel, conferences, etc.
  - **Adjusted EBITDA** (EBITDA + JV income) of QR847.9mn (1.1% YoY, 0.9% QoQ) was right in-line with our estimate of QR847.5mn, with slightly lower-than-expected JV income offsetting the modest upside seen in EBITDA.
  - **Depreciation** of QR200.2mn (-7.9% YoY, -30.2% QoQ) was 9.5% below our forecast of QR221.2mn. Depreciation fell given completion of a 5-year dry-dock cycle in 2022 and the beginning of a new one in 2023. We had expected depreciation to fall but underestimated the extent of its decline.
  - **JV income** of QR171.6mn (7.9% YoY, -5.6% QoQ) was 1.9% below our estimate of QR174.9mn. Overall, JV income continues its buoyant trend due to improving shipyard performance (which posted a net profit of QR91.2mn in 2022 after posting net losses of QR36.2mn and QR25.5mn in 2021 and 2020, respectively), along with addition of the 3<sup>rd</sup>/4<sup>th</sup> LNG vessels in Nakilat's Global Shipping JV in Oct. 2021/Jan. 2022.
  - Finally, **finance costs** of QR308.3mn (18.6% YoY, 4.7% QoQ) was 3.5% ahead of our estimate of QR297.9mn. Interest costs increased due to gains in LIBOR rates on the unhedged portion (~ 30%) of QGTS' debt, offset by scheduled repayment of loans. However, net finance charges were in line with our model as **interest, dividend & other income** of QR56.4mn (176.7% YoY, 25.7% QoQ) came in 22.6% above our forecast of QR46.0mn driven by higher rates on term deposits and increase in dividend income on investment securities.
- **2023 could be a watershed year for Nakilat if it is selected as one of the ship owners involved in Qatar's massive LNG expansion program.** We remind investors that QatarEnergy is expanding Qatar's LNG capacity from 77 MTPA to 110 MTPA (first production: 4Q2025) and further to 126 MTPA a couple of years later. To cater to this expansion, back in April/June 2020, QatarEnergy signed major LNG shipbuilding capacity agreements with Chinese and South Korean companies to build 100+ LNG vessels worth +QR70bn at that time. Furthermore, in 1Q2021, QatarEnergy issued an invitation to tender package to ship owners for the chartering of LNG carriers in relation to this project; QatarEnergy intends to assign selected ship owners from this tender to the shipyards' construction slots reserved in China and South Korea. So far, newsflow indicates several ship charter agreements have been awarded already. *Considering Nakilat's strategic importance (Nakilat ships ~75-80% of Qatar's current LNG exports) and impressive track record in Qatar's existing LNG shipping value chain, we expect QGTS to be a major beneficiary and secure a meaningful share of new contracts. We also estimate that every incremental vessel (@100%) adds ~1% to QGTS' target price (for details, please see our [report](#)) and an award of 20-30 ships could significantly increase our price target and estimates. Given typical lead-times for LNG ship construction, we should expect to hear about final ship owner selections in 2023. We do expect QGTS shares to come under pressure in the unlikely scenario that the company does not secure a meaningful portion of the new LNG shipping contracts.*
- **We stay bullish on Nakilat, which is the best avenue for equity investors to participate in the LT growth expected in Qatar's LNG sector.** Irrespective of the volatility of the LNG shipping market, Nakilat's business should remain relatively unaffected given the LT nature of its charters. Nakilat's fleet continues to provide QGTS with stable, contractually sustainable cash flow that allow for a healthy residual income stream for equity investors after providing for debt service. Moreover, the 40-year life of Nakilat's vessels vs. maximum debt life of 25 years (last debt maturing 2033), could allow for value-enhancement. *We stay Accumulate on QGTS with a price target of QR4.100.*

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Income Statement							
In QR mn Except Otherwise Noted	1Q2022	4Q2022	1Q2023	1Q2023e	A Vs. E	YoY	QoQ
Revenue from Wholly-Owned Vessels	873.928	897.228	878.760	881.980	-0.4%	0.6%	-2.1%
Operating Costs	(184.165)	(209.905)	(194.195)	(199.057)	-2.4%	5.4%	-7.5%
<b>Gross Profit</b>	<b>689.763</b>	<b>687.323</b>	<b>684.565</b>	<b>682.923</b>	<b>0.2%</b>	<b>-0.8%</b>	<b>-0.4%</b>
<i>Gross Margin</i>	<i>78.9%</i>	<i>76.6%</i>	<i>77.9%</i>	<i>77.4%</i>			
Income from Marine and Agency Services	10.785	15.055	13.197	10.812	22.1%	22.4%	-12.3%
General and Administrative Expenses	(20.535)	(44.186)	(21.470)	(21.151)	1.5%	4.6%	-51.4%
<b>EBITDA</b>	<b>680.013</b>	<b>658.192</b>	<b>676.292</b>	<b>672.584</b>	<b>0.6%</b>	<b>-0.5%</b>	<b>2.7%</b>
Depreciation of Property and Equipment	(217.404)	(286.648)	(200.170)	(221.230)	-9.5%	-7.9%	-30.2%
<b>EBIT</b>	<b>462.609</b>	<b>371.544</b>	<b>476.122</b>	<b>451.354</b>	<b>5.5%</b>	<b>2.9%</b>	<b>28.1%</b>
<i>EBIT Margin</i>	<i>52.9%</i>	<i>41.4%</i>	<i>54.2%</i>	<i>51.2%</i>			
Share of Operating Profits from Joint Ventures	158.949	181.745	171.582	174.930	-1.9%	7.9%	-5.6%
Finance Costs	(259.967)	(294.593)	(308.343)	(297.878)	3.5%	18.6%	4.7%
Interest, Dividend income & Profit from Islamic Banks	20.373	44.865	56.382	45.987	22.6%	176.7%	25.7%
<b>Profit Before Tax</b>	<b>381.964</b>	<b>303.561</b>	<b>395.743</b>	<b>374.392</b>	<b>5.7%</b>	<b>3.6%</b>	<b>30.4%</b>
<b>Profit After Tax</b>	<b>381.964</b>	<b>303.561</b>	<b>395.743</b>	<b>374.392</b>	<b>5.7%</b>	<b>3.6%</b>	<b>30.4%</b>
Minority Interest	(0.129)	0.240	(0.255)	(0.145)	75.7%	97.7%	-206.3%
<b>Net Income to Equity</b>	<b>381.835</b>	<b>303.801</b>	<b>395.488</b>	<b>374.247</b>	<b>5.7%</b>	<b>3.6%</b>	<b>30.2%</b>
<i>Net Profit Margin</i>	<i>43.7%</i>	<i>33.9%</i>	<i>45.0%</i>	<i>42.4%</i>			
EPS (QR)	0.07	0.05	0.07	0.07	5.7%	3.6%	30.2%
<b>Adjusted EBITDA</b>	<b>838.962</b>	<b>839.937</b>	<b>847.874</b>	<b>847.514</b>	<b>0.0%</b>	<b>1.1%</b>	<b>0.9%</b>

<b>Adjusted Revenue</b>	<b>1,043.662</b>	<b>1,094.028</b>	<b>1,063.539</b>	<b>1,067.722</b>	<b>-0.4%</b>	<b>1.9%</b>	<b>-2.8%</b>
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Particulars	1Q2022	4Q2022	1Q2023	1Q2023e
Adj. EBITDA Margin	80.4%	76.8%	79.7%	79.4%
Gross Margin	78.9%	76.6%	77.9%	77.4%
EBIT Margin	52.9%	41.4%	54.2%	51.2%
G & A % of Sales	2.3%	4.9%	2.4%	2.4%
Depreciation & Amortization % of Sales	24.9%	31.9%	22.8%	25.1%

Recommendations	
<i>Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price</i>	
<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	
<i>Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals</i>	
<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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