Qatar Gas Transport Co./Nakilat (QGTS)

Recommendation	ACCUMULATE	Risk Rating	R-3
Share Price	QR18.83	Current Target Price	QR21.00
Implied Upside	11.5%	Old Target Price	QR25.00

Look Past the Leverage; Reiterate Accumulate Rating

We like Nakilat, #1 owner/operator of LNG vessels globally, as a LT play geared to Qatar's dominance & anticipated growth in the LNG market. *While QGTS stock has gained 35% (vs. QSE Index's 22%) since we put out our tactical buy idea on December 3, and "easy gains" probably have already been made, we believe there is upside, albeit LT in nature. We maintain our Accumulate. We note 4Q2017 results are unlikely to be a strong catalyst but a dividend boost beyond our flat QR1/share estimate for 2017 (5.3%) could drive upside.*

Highlights

- **4Q2017 preview: Net income should post modest QoQ & YoY growth.** While wholly-owned ship revenue could remain flat, we expect a moderate pickup in JV income to drive adjusted revenue/net income QoQ. We remain optimistic despite the softness in the shipyard businesses, Nakilat's other JVs have stemmed some of the declines seen in 9M2017. The yearly decline in adjusted revenue/adjusted EBITDA is driven by an one-off hedging gain of QR108.9mn at QGTS' Teekay JV in 4Q2016. **We model flat DPS of QR1 (2017) but would not rule out a modest increase/decrease.**
- **Nakilat is a critical part of Qatar's LNG value chain with LNG driving a majority of government revenue.** Qatar is the #1 LNG exporter globally (2016 market share: 30.1%) and the 2nd largest gas exporter (after Russia) once pipeline flows are included. Acting as Qatar's floating pipeline, Nakilat is responsible for owning ships that provide transport for 87% of Qatar's LNG volumes. With a total effective LNG shipping capacity of +9mn cubic meters, QGTS owns 15% of the global LNG shipping capacity. Apart from 63 (25 wholly-owned, 38 in JVs) LNG vessels, QGTS jointly owns 4 LPG vessels.
- **QGTS enjoys stable revenue/cash flows from LT (25 years/~15 years left) and fixed-rate time LNG charter contracts (take or pay)** with Qatargas, RasGas (now part of Qatargas) and their affiliates. The availability-based take or pay nature of the contracts shields QGTS from end-demand volatility and delays in charters' projects. Only one-to-two LNG ships are on a spot basis; LPG is a spot business.
- **High leverage but debt is mostly secured by watertight charter agreements; we do not foresee any challenges in debt servicing/repayments.** QGTS has $5.8bn in debt on its books (2017 net debt-to-EBITDA: 7.8x; 3.9x debt-to-equity/2.5x debt-to-equity excluding 3Q2017 hedging reserve and another $3.1bn in debt in JVs (2016: net debt-to-EBITDA of 7.1x and 2.8x debt-to-equity). However, out of this $8.9bn in debt, only $500mn is corporate debt with the rest being non-recourse project financing backed by charter agreements of 63 LNG vessels, and will be amortized over the remaining life of charters with last of this debt (in form of bonds) paid off by 2033. 54 of the 63 LNG ships are chartered by Qatargas with charter payments to Nakilat mostly retaining higher priority than debt service in the charterer's cash waterfall. We see no major risk of default as ~QR2bn in interest plus repayments per annum is met easily by OCF with no major refinancing expected until 2025 with $2.7bn in bank facility balloon payments. Interestingly, while QGTS will repay all debt by 2033, LNG ships will retain another 15 years of useful life (until 2048) and can be relevered for fleet growth, etc.
- **Blockade is an overhang but impact limited thus far:** Shipping ultimately remains the charters' concern and comprehensive insurance policies (including war insurance) cover QGTS for political stress events under force majeure clauses for 36 months (plus 6 months in many cases). Blockage of the Strait of Hormuz/Gulf of Suez is unlikely. Charterers will bear any costs of potential rerouting.
- **Stable profile with industry-leading EBITDA margins & attractive dividend/FCF yields.** Charter agreements result in stable revenue along with operating costs pass-through (a mixture of capped and uncapped inflation rates) leading to flattish absolute EBITDA. Nakilat's stable business profile is highlighted by its industry-leading margins (average adjusted EBITDA margin of 80.1% over 2010-2017 followed by 79.3% over 2018-2033). A significant majority of interest payments are locked at fixed rates via swaps over the length of the charters/debt at around 5.6%. Locked in charter rates with minimal exposure to spot rates along with predictable and declining interest payments virtually guarantees the residual stream for shareholders as dividends. We model dividend yield of 5.6% in 2018, growing to 14.5% by 2033 with FCF yield of 12.3% growing to 27.7% over the same period.

Catalysts

- **The expansion of Qatar's LNG output from 77 MTPA to 100 MTPA is a significant driver (potentially another 30 conventional vessels**). QGTS is also considering targeting the FSRU business. Vessels have 40-years of life vs. maximum debt life of 25 years (last debt maturing 2033), creating refinancing opportunities to increase fleet size. Medium-term, the shipyard business could improve.

Recommendation, Valuation and Risks

- **Recommendation & valuation:** ***Our 12-month target is QR21.*** Our new target reflects a higher CoE and other model changes. QGTS stock declined 19% from beginning 2017 after its dividend cut leading up to the blockade which further hurt the stock. While the stock has recovered from its lows, we believe it retains LT upside. Shares have generated 56% in total returns over five years (MSCI EM: 36%).
- **Risks:** Geopolitical risks cannot be modeled. There is a risk existing LNG contracts get renegotiated as they are at a premium to spot (for wholly-owned fleet and some JVs). We would not rule out potential contract restructuring, with QGTS accepting slightly lower charter rates in return for increasing their lengths from 25 to 35+ years. However, bargaining power rests with Qatargas and Nakilat may have no choice but to accept significantly worse contract terms. The likelihood of this is low given investment grade-rated bonds and contagion effects for other GRE-related bond issues.

Key Financial Data and Estimates

	FY2015	FY2016	FY2017e	FY2018e
EPS (QR)	1.77	1.72	1.47	1.62
P/E (x)	10.6	10.9	12.8	11.6
DPS (QR)	1.25	1.00	1.00	1.05
Dividend Yield	6.6%	5.3%	5.3%	5.6%

Source: Company data, QNBFS estimates; Note: All data based on current number of shares

Key Data

Current Market Price (QR)	18.83
Current Dividend Yield (%)	5.3
Bloomberg Ticker	QGTS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QGTS.QA
ISIN	QA000A0KD6L1
Sector*	Transportation
52wk High/52wk Low (QR)	24.90/13.05
3-m Average Volume ('000)	429.4
Mkt. Cap. ($ bn/QR bn)	2.9/10.4
Shares Outstanding (mn)	560.0
FO Limit* (%)	49.0
Current FO* (%)	16.1
1-Year Total Return (%)	(18.8)
Fiscal Year End	December 31

Source: Bloomberg (as of January 29, 2018), *Qatar Exchange (as of January 29, 2018); Note: FO is foreign ownership

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4Q2017 and 2017 Preview

Net income should post modest QoQ & YoY growth. While wholly-owned ship revenue could remain flat, we expect a moderate pickup in JV income to drive adjusted revenue/net income QoQ. We remain optimistic despite the softness in the shipyard businesses, Nakilat's other JVs have stemmed some of the declines seen in 9M2017. The yearly decline in adjusted revenue/adjusted EBITDA is driven by an one-off hedging gain of QR108.9mn at QGTS' Teekay JV in 4Q2016. We model flat DPS of QR1 (2017) but would not rule out a modest increase/decrease.

4Q2017 and 2017 Key Metrics

In QR mn	4Q2017e	3Q2017	4Q2016	QoQ	YoY	2017e	2016	YoY
Revenue from Wholly-Owned Vessels	774.6	770.9	766.3	0%	1%	3,062.4	3,068.6	0%
Gross Profit	595.6	593.7	566.2	0%	5%	2,366.4	2,350.6	1%
EBITDA	575.5	571.5	540.6	1%	6%	2,283.1	2,269.9	1%
EBIT	381.3	377.8	297.8	1%	28%	1,513.6	1,502.3	1%
Share of Operating Profits from Joint Ventures	99.7	91.4	183.0	9%	-45%	376.7	553.4	-32%
Net Income to Equity	209.7	198.1	206.4	6%	2%	816.0	954.2	-14%
DPS (QR)						1.00	1.00	0%
Adjusted Revenue	898.4	887.2	970.5	1%	-7%	3,532.7	3,710.4	-5%
Adjusted EBITDA	700.3	687.9	747.0	2%	-6%	2,760.9	2,910.8	-5%
Gross Margin	76.9%	77.0%	73.9%			77.3%	76.6%	
EBITDA Margin	74.3%	74.1%	70.5%			74.6%	74.0%	
EBIT Margin	49.2%	49.0%	38.9%			49.4%	49.0%	
Net Margin	12.9%	11.9%	23.9%			12.3%	18.0%	
Adjusted EBITDA Margin	78.0%	77.5%	77.0%			78.2%	78.4%	

Source: Company data, QNBFS estimates

Valuation

We think the stock is worth QR21 without accounting for any upside from the North Field expansion. Our other assumptions include:

- We use a cost of equity of 11.6% with a beta of 0.88 and a market risk premium of 8%.
- We explicitly model operations of JV companies along with QGTS' wholly-owned fleet. We forecast charter rates, operating costs, EBITDA and capex for joint ventures instead of just forecasting dividends received from JVs.
- We run our DCF in two stages. In the first stage, we model our cash flows until 2033, when the existing charter agreements (25-year terms) are expected to run out.
- Beyond 2033, we expect QGTS' LNG fleet to be renewed for another 10 years at significantly lower charter rates while continuing to grow operating expenses.
- We do not consider a terminal value in our calculations and expect the fleet to be sold off by the end of 2043 (with around 5 years of remaining useful life).
- We note the company will have paid off all its debt by 2033 but this does not factor into our DCF as we calculate free cash flow to the firm and deduct all of QGTS' current debt to arrive at our equity value. In this respect, our DCF analysis is fairly conservative as it penalizes the company for its high leverage (which is normal in this industry) that will realistically not be paid off until much later.

Discounted Cash Flow Valuation

Particulars	2018	2019	2020	2021	2022	2025	2030	2033	2034	2035	2040	2043
EBIT	1,508	1,508	1,507	1,507	1,506	1,504	1,502	1,501	566	565	561	558
Taxes (Social & Sports Fund Contribution)	(23)	(25)	(28)	(30)	(32)	(41)	(55)	(63)	(26)	(27)	(28)	(29)
Depreciation and Amortization	772	773	773	774	775	777	781	784	784	785	789	791
Changes in Working Capital	10	5	5	5	5	5	5	5	118	1	1	1
Capital Expenditures	(86)	(86)	(86)	(86)	(86)	(86)	(87)	(87)	(87)	(87)	(87)	(87)
Net Free Cash Flow from JVs	923	942	1,060	1,048	1,056	1,113	1,175	1,214	774	695	695	695
Free Cash Flow to Firm	3,104	3,117	3,231	3,217	3,223	3,273	3,322	3,353	2,128	1,933	1,931	1,929
PV of FCFF	2,920	2,758	2,689	2,519	2,374	2,007	1,500	1,261	753	643	473	394
Cumulative PV of FCFF	**2,920**	**5,678**	**8,367**	**10,886**	**13,261**	**19,649**	**28,104**	**32,117**	**32,869**	**33,512**	**36,197**	**37,455**

PV of Cash Flows	**37,455**
Add:	
Cash Balances	3,057
Cash Balances (JVs)	1,356
PV of BV of Fleet	1,449
Loans to JVs	173
AFS	104
Less:	
Debt Balances	21,026
Debt Balances (JVs)	11,001
Minority Interest	4
Fair Value of Equity	**11,563**
Fair Value of Equity (per Share)	**21.00**

Source: Company data, QNBFS estimates

Valuation Metrics

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2033
Valuation												
EV/EBITDA-Adjusted	10.0	10.2	9.7	9.3	8.7	8.2	7.8	7.2	6.8	6.3	3.9	2.4
EV/EBIT	19.5	18.6	18.1	17.5	16.8	16.0	15.3	14.5	13.7	12.9	8.4	5.4
P/E	10.9	12.8	11.6	10.5	9.2	8.6	8.0	7.3	6.9	6.4	4.8	4.1
P/CF	9.3	6.5	7.6	7.0	6.2	5.9	5.7	5.4	5.1	4.9	3.9	3.5
P/B	2.0	1.9	1.8	1.6	1.5	1.4	1.3	1.2	1.1	1.0	0.7	0.6
Dividend Yield	5.3%	5.3%	5.6%	5.8%	6.1%	7.0%	7.5%	8.2%	8.8%	9.4%	12.6%	14.5%
FCF Yield	10.3%	15.3%	12.3%	13.4%	15.3%	16.0%	16.7%	17.8%	18.7%	19.6%	24.6%	27.7%

Source: Bloomberg, QNBFS estimates

In terms of multiples, despite its recent run-up, QGTS remains relatively cheaper than its peers along with substantially better EBITDA margins. We also point to the company substantial FCF yield resulting from limited capex requirements and significant operating cash flow.

Relative Valuation Versus Peers

Shippers		*Div.*	EBITDA Margin		P/E		P/CFPS		EV/EBITDA		FCF Yield	
Company	**Ticker**	***Yield***	**FY2017e**	**FY2018e**	**FY2017e**	**FY2018e**	**FY2017e**	**FY2018e**	**FY2017e**	**FY2018e**	**FY2017e**	**FY2018e**
COSCO SHIPPING Energy Transportation Co Ltd	1138	*4.8%*	*36.6%*	*36.2%*	NA	NA	NA	NA	NA	NA	*NA*	*NA*
National Shipping Co of Saudi Arabia/The	NSCSA	*8.3%*	*33.7%*	*35.5%*	14.7x	11.5x	NA	NA	10.3x	9.0x	*NA*	*NA*
GasLog Partners LP	GLOP	*8.3%*	*74.1%*	*72.6%*	11.3x	11.2x	6.1x	6.2x	10.1x	8.7x	*2.8%*	*(3.8%)*
GasLog Ltd	GLOG	*2.7%*	*68.8%*	*69.4%*	nmf	38.6x	7.0x	6.1x	13.6x	11.6x	*8.4%*	*(11.8%)*
Dynagas LNG Partners LP	DLNG	*14.4%*	*73.1%*	*74.9%*	15.6x	20.8x	6.7x	7.7x	11.1x	11.1x	*6.2%*	*13.3%*
Ship Finance International Ltd	SFL	*10.3%*	*65.8%*	*64.5%*	14.6x	16.5x	8.8x	9.2x	9.9x	10.2x	*15.8%*	*14.3%*
Teekay LNG Partners LP	TGP	*2.8%*	*69.7%*	*74.0%*	19.0x	11.1x	9.1x	6.0x	14.3x	10.8x	*(4.4%)*	*(31.2%)*
Golar LNG Ltd	GLNG	*0.7%*	*NA*	*NA*	nmf	nmf	nmf	18.6x	nmf	24.2x	*(15.3%)*	*9.5%*
Tsakos Energy Navigation Ltd	TNP	*5.0%*	*nmf*	*54.2%*	nmf	22.9x	1.9x	1.9x	8.8x	7.8x	*32.4%*	*55.6%*
Average		***6.4%***	***60.3%***	***60.2%***	**15.0x**	**18.9x**	**6.6x**	**7.9x**	**11.1x**	**11.7x**	***6.5%***	***6.5%***
Median		***5.0%***	***68.8%***	***67.0%***	**14.7x**	**16.5x**	**6.8x**	**6.2x**	**10.3x**	**10.5x**	***6.2%***	***9.5%***
Qatar Gas Transport Co Ltd	**QGTS**	***5.3%***	***78.2%***	***78.2%***	**12.8x**	**11.6x**	**6.5x**	**7.6x**	**10.2x**	**9.7x**	***15.3%***	***12.3%***

Note: Where coverage is not available, estimates are based on Bloomberg consensus, if available
Mean/Median calculated if more than 3 observations are present
NA: Not Applicable
nmf: Not Meaningful (typically refers to negative or exceedingly large values)
Source: Bloomberg, QNBFS Research

Key Growth Rates/CAGRs

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2033	CAGR
Growth Ratios (In %)													'17-'33
Revenue - Wholly Owned	0.7%	(0.2%)	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Revenue - Adjusted	2.0%	(4.8%)	1.4%	1.1%	2.2%	0.6%	0.6%	1.9%	0.9%	0.9%	1.0%	1.0%	1.1%
Gross Profit	0.1%	0.7%	(0.2%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	0.0%
EBITDA	(1.1%)	0.6%	(0.1%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBITDA -Adjusted	1.4%	(5.1%)	1.5%	1.3%	2.7%	0.6%	0.7%	2.2%	1.0%	1.1%	1.1%	1.1%	1.2%
EBIT	(6.5%)	0.8%	(0.4%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.1%)
EPS	(2.9%)	(14.5%)	10.3%	10.1%	14.4%	7.1%	6.8%	10.0%	6.7%	6.8%	5.4%	4.8%	7.3%
CFPS	(9.9%)	42.4%	(14.4%)	8.4%	13.0%	4.6%	4.5%	6.2%	4.6%	4.8%	4.1%	3.8%	3.9%
FCFPS	(4.9%)	48.2%	(19.4%)	8.9%	13.8%	4.9%	4.7%	6.5%	4.8%	5.0%	4.3%	3.9%	3.8%
DPS	(20.0%)	0.0%	5.0%	4.8%	4.5%	14.4%	6.8%	10.0%	6.7%	6.8%	5.4%	4.8%	6.5%

Source: Bloomberg, QNBFS estimates

Company Overview

Company Description

Qatar's LNG carrier/floating pipeline: Nakilat is responsible for owing and providing transport for 87% of Qatar's LNG volumes; it is also engaged in LPG transport. With a total effective LNG shipping capacity in excess of 9mn cubic meters, QGTS owns 15% of the global LNG shipping capacity. Apart from 63 (25 wholly-owned, 38 through JVs) LNG ships, QGTS also jointly owns 4 vessels for transporting LPG. Nakilat enjoys stable revenue and cash flows due to long-term (25 years/~15 years left) and fixed-rate time LNG charter contracts (take or pay) with Qatargas, RasGas (now part of Qatargas) and their affiliates. LPG is basically a spot- business.

A state-of-the-art fleet: QGTS has invested around $11bn to own 58 state-of-the-art LNG carriers, 25 of which are wholly-owned. Of these vessels, 45 are of the Q-Max and Q-Flex type, which have the largest capacity in the world. An April 2014 deal added a further3 JV-held LNG vessels bringing the count to 61 and more recently, in August 2015, Nakilat added another 2 JV LNG ships to grow its LNG fleet size to 63. As previously mentioned, QGTS also jointly owns four LPG ships (along with Milaha). As of 2016, the company achieved LNG fleet utilization of 86%, with reliability at 99.43% and delivered 272 cargoes to 16 countries and 31 different terminals.

History

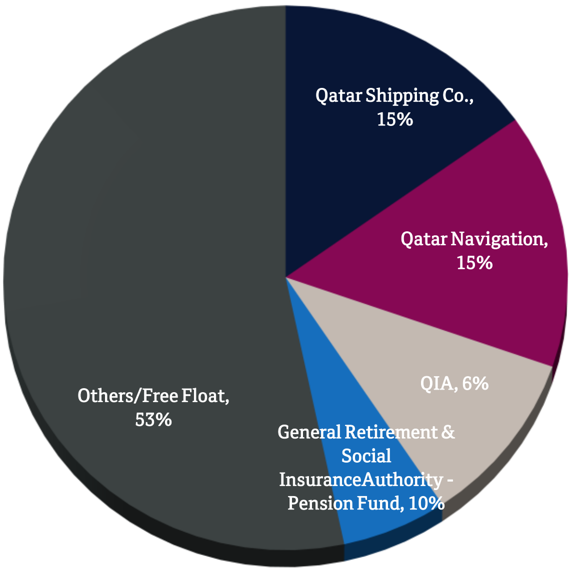
Nakilat was formed in 2004 to capture the LNG shipping services value-chain (mid-stream). The State of Qatar owns/controls both upstream (gas extraction/LNG production) and downstream (LNG sales) segments of the value chain (directly/via affiliates). QGTS went public at QR10/sh. in April 2005 (paid 50/50 in two cash calls in 2005 and 2007). IPO proceeds of $1.5bn along with $500mn in corporate debt provided the equity capital needed to finance Nakilat's fleet. QGTS acts as a securitization of Qatar's fixed-rate LNG shipping contracts funded mostly via debt (interest mostly fixed) virtually guaranteeing the residual stream for equity as dividends.

QGTS addresses the need for shipping large quantities of Qatari LNG produced for export across the globe. QGTS has also entered into related segments, including shipyard management and building of high-value ships. Moreover, Nakilat provides maintenance and docking services for vessels besides operating harbor vessels at the Ras Laffan Port.

Ownership

Overall, given QGTS' critical position, the State of Qatar owns almost 23% through various stakes. Milaha (Qatar Navigation or QNNS) owns a ~30% stake through Qatar Navigation and Qatar Shipping. Around 10% is owned by the civil pension fund and 6% is owned by the QIA. QP owns roughly 1% directly and another 2% is owned by the military pension fund. Qatar Fuel (QFLS) also has a 2% stake in QGTS. We note Milaha is 8.6% owned by QP and QP and the civil pension fund together own around 35% of QFLS.

Shareholders



Source: Company data

Business Overview

Qatar has the 3rd largest reserves of gas (858 tcfe) globally after Russia and Iran. Most of this comes from the giant North Field, the largest non-associated gas field discovered to-date. Qatar operates 14 trains for processing gas into LNG (including six mega-trains). The country is the top LNG exporter in the world (84% of the gas traded in 2016 was exported as LNG, while 16% was through the Dolphin pipeline). According to BP, LNG accounted for 32% of the global gas trade in 2016 with Qatar holding a 30.1% market share.

Qatar reached 77 MTPA in LNG capacity in late 2010 and plans are underway to increase output to 100 MTPA in 5-7 years. Back in 2005, Qatar imposed a moratorium on new North Field projects, which was removed last year, setting up this increase in LNG output.

QGTS has three different kinds of LNG ships – Q-Max, Q-Flex and Conventional. Exclusively built for QGTS, Q-Flex and Q-Max ships consume 40% less energy than conventional vessels. The higher capacity of these vessels (50%-80% vs. conventional) as well as new technical features (such as membrane containment systems, re-liquefaction systems and advanced propulsion technology) has reduced transportation costs by 20-30%. A majority of these ships have been chartered to RasGas and Qatargas to deliver LNG mainly to the Japan, South Korea, India, UK, Taiwan and China. QGTS also owns 4 Very Large Gas Carriers for LPG transportation.

QGTS is gradually moving ship management and operations in-house – 18 ships managed internally; 15 more to go. Nakilat's LNG vessels are operated and managed through a strategic alliance with Shell International Trading and Shipping Co. (STASCO). QGTS entered into a master services agreement with STASCO in 2006, under which the latter agreed to provide a number of key shipping services, including initial handling of the technical management of the wholly-owned LNG vessels. This agreement had a provision for STASCO to gradually hand over the management of these vessels to QGTS. We have held the view that while benefiting from STASCO's operating expertise, this agreement should allow Nakilat to develop the expertise to manage and operate its LNG fleet. In this regard, QGTS has already transitioned 18 ships into its in-house program. These 18 vessels include 10 wholly-owned LNG vessels, 4 Nakilat/OSG jointly-owned Q-Flex LNG carriers and 4 LPG carriers. QGTS intends to bring the management/operations of the remaining 15 wholly-owned vessels in-house over a period of time via a fleet transition agreement signed in 2016.

Fleet

Type	Number	% Share	Capacity	Charterers
Wholly-Owned	**25**			
Q-Max	14	100%	263,000m^3 – 266,000m^3	Qatargas
Q-Flex	11	100%	210,000m^3 – 217,000m^3	Qatargas
Joint Ventures	**38**			
Q-Flex	20	20-60%	210,000m^3 – 217,000m^3	Qatargas
Conventional	18		145,000m^3 – 170,000m^3	Qatargas, Shell, BG, Cheniere
Total LNG	**63**			
LPG VLGCC	4	50%		Spot
Total LPG	**4**			

Source: Company data

State-of-the-art shipyard should be a LT asset. QGTS owns an economic interest, along with full operational and management responsibilities, in the $3bn Erhama Bin Jaber Al Jalahma shipyard, which was financed by QP. Nakilat operates the shipyard via two JVs – Nakilat Keppel Offshore & Marine, which specializes in ship repair and offshore fabrication, and Nakilat Damen Shipyards Qatar, focusing on ship building. While the shipyard segment has been soft lately, we expect it to resume its growth in the future.

Major Subsidiary/Joint Ventures

LNG Subsidiary	Ownership	Number of Vessels	Vessel Type	Product	Chartered to
Nakilat Inc.	100%	25	Q-Max/Q-Flex	LNG	Qatargas
LNG/LPG Joint Ventures	**Ownership**	**Number of Vessels**	**Vessel Type**	**Product**	**Chartered to**
Maran Nakilat Co. Ltd.	40%	13	Conventional	LNG	Qatargas, Shell, BG, Cheniere
J5 Nakilat No.1 to No.8 Ltd Companies	40%	8	Q-Flex	LNG	Qatargas
Peninsula LNG Transport No.4 Ltd.	30%	1	Conventional	LNG	Qatargas
Teekay Nakilat Corp.	30%	3	Conventional	LNG	Qatargas
Teekay Nakilat (III) Corp.	60%	4	Q-Flex	LNG	Qatargas
OSG Nakilat Corp.	50.1%	4	Q-Flex	LNG	Qatargas
Pronav	45%	4	Q-Flex	LNG	Qatargas
India LNG Transport Co. (No.3) Ltd.	20%	1	Conventional	LNG	Qatargas
Gulf LPG Transport Co.	50%	4	VLGCs	LPG	Spot - Various
Shipyard Joint Ventures	**Ownership**	**Operations**	**Highlights (as of 2016 Annual Report)**		
Nakilat-Keppel Offshore & Marine Ltd. (N-KOM)	80%	Ship repairs	Completed more than 600 marine & offshore projects since inception in 2011		
Nakilat Damen Shipyards Qatar Ltd. (NDSQ)	70%	Ship building	Delivered 35 vessels & has 5 vessels under construction; 23 yacht refit & minor repair projects		

Source: Company data

SWOT Analysis

Strengths:

- **Largest player in the global LNG shipping market:** Nakilat is basically a monopoly/preferred player for Qatar.
- **QGTS has a relatively young fleet**, which besides conventional carriers, also consists of Q-Max and Q-Flex vessels. These "Q" vessels were built specifically for Nakilat and are the largest LNG carriers capable of holding ~50-80% more capacity, while consuming less energy than conventional LNG carriers.
- **25-year watertight contracts with comprehensive insurance policies** (including war insurance) cover Nakilat for political stress events under force majeure clauses for a period of 36 months (plus 6 months in many cases).

Weaknesses:

- **Majority of QGTS' fleet is tied into LT charter agreements giving Nakilat no room to revise prices upward.** However, stable charter agreements have proved to be a significant benefit given historical premiums enjoyed vs. spot rates. Stable charter agreements also help minimize operational and cash flow volatility.

Opportunities:

- **The expansion of Qatar's LNG output from 77 MTPA to 100 MTPA allows for significant growth (another 30 conventional vessels).** This upside is not included in our model.
- **Potentially targeting the FSRU business:** QGTS recently signed a MoU with Höegh LNG to explore the potential for entering the Floating Storage and Regasification Unit (FSRU) business as part of its diversification strategy.
- **Current fleet will be debt free by 2033, creating opportunities for refinancing to increase fleet size.** LNG vessels have 40-years of useful life vs. maximum debt term of 25 years (last debt maturing 2033).

Threats:

- **Customer concentration is a potential issue with 54 of the 63 LNG vessels charted by Qatargas/RasGas.** Customer/supplier concentration is a weakness but we have not seen any major revisions to contract terms in the past. However, bargaining power ultimately rests with Qatargas and Nakilat may have no choice but to accept significant revision to contract terms. The likelihood of this is low given investment grade-rated bonds and contagion effects for other GRE-related bond issues.
- **High leverage could impede operations but probability of a credit event is low.** Finance charges account for around 42% of total expenses (2016-2017e). Thus, any stoppage of operations that fall outside of acceptable terms of the charters could impair QGTS' ability to service its debt. While leverage is high, payments to Nakilat retain waterfall priority in Qatargas/RasGas. We note debt repayments/servicing is secured by charters leading to the investment grade rating for Nakilat's bonds. Charterers could renegotiate terms but this is unlikely given outstanding bonds which can have knock on effect for GRE support of a variety of Qatari issuers. We believe there is no major risk of default – QR2bn in interest plus repayments per annum is met easily by OCF and major refinancing is only likely by 2025.
- **Oversupply in the LNG markets could crimp growth; however, market could reach balance by 2020 or even earlier considering growth seen from China.** LNG supply has outpaced demand in recent years primarily driven by new exports from Australia. In the medium-term, growth from the US and Australia is further expected to boost supply. However, the market is expected to come back into balance and even potentially go into an undersupplied scenario around 2020, which should intersect nicely with the expected ~30% increase in Qatar's LNG output from 77 MTPA to 100 MTPA. Increasing demand from Asia, continued adoption of cleaner sources of energy and delays in investments should help the market rebalance itself. Demand from China (LNG imports expected up 35% YoY in 2017 to 37 MTPA) could be a significant driver given its major environmental protection initiatives aimed at shifting millions of households from coal to natural gas for heating as well converting several industrial/chemicals producers from coal to gas feedstock.
- **LNG tankers remain plentiful but Nakilat's current/potential business is/should be LT-charter based.** By the end of last year, there were around 465 vessels globally and there is substantial growth in deliveries expected in 2018. There are around 110 deliveries expected by 2022 with a peak in 2018, with around 40% not yet tied to charters. We note QGTS current business is primarily based on LT charters signed by Qatargas and we expect any future contracts (due to the expansion of the North Field) to be of a similar nature, albeit at lower rates.
- **LPG spot business/shipyard operations remain soft but may have reached a trough.**

Key Forecasts: Revenue and Income

100% of QGTS' top-line is driven by revenue from its 25 wholly-owned LNG vessels, which are under long-term charters with Qatargas. Below we show the net income split by major segments. The JV businesses drop as a proportion of net income in 2017 because of a one-time hedging gain posted in 2016. Income contribution from the wholly-owned fleet accelerates in 2021 as we assume lower charter rates for Nakilat's 40%-owned Maran JV (13 conventional ships), which is the only joint venture with exposure to non-Qatari charterers.

Net Income Split

Net Income Mix	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2033
Wholly-Owned Fleet	33%	42%	43%	44%	44%	47%	48%	48%	50%	51%	55%	57%
JV Business	58%	46%	47%	46%	47%	45%	44%	45%	44%	43%	40%	38%
Marine & Agency Services	6%	7%	6%	6%	5%	5%	5%	4%	4%	4%	3%	3%
Vessel Sub-Chartering & Other Income	3%	5%	4%	4%	3%	3%	3%	3%	3%	2%	2%	2%

Source: Company data, QNBFS estimates

Key Forecasts: Profitability and Growth Metrics

ROIC should increase over time given pay down of debt and lower interest expenses. This is despite profitability margins coming down as we expect costs to outpace flattish top-line of wholly-owned vessels. Growth of operating metrics remains flattish with profitability already at elevated levels. ROE levels remain healthy.

Ratio Analysis

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2033
Growth Ratios (In %)												
Revenue - Wholly Owned	0.7%	(0.2%)	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Revenue - Adjusted	2.0%	(4.8%)	1.4%	1.1%	2.2%	0.6%	0.6%	1.9%	0.9%	0.9%	1.0%	1.0%
Gross Profit	0.1%	0.7%	(0.2%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)
EBITDA	(1.1%)	0.6%	(0.1%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBITDA -Adjusted	1.4%	(5.1%)	1.5%	1.3%	2.7%	0.6%	0.7%	2.2%	1.0%	1.1%	1.1%	1.1%
EBIT	(6.5%)	0.8%	(0.4%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)
EPS	(2.9%)	(14.5%)	10.3%	10.1%	14.4%	7.1%	6.8%	10.0%	6.7%	6.8%	5.4%	4.8%
CFPS	(9.9%)	42.4%	(14.4%)	8.4%	13.0%	4.6%	4.5%	6.2%	4.6%	4.8%	4.1%	3.8%
FCFPS	(4.9%)	48.2%	(19.4%)	8.9%	13.8%	4.9%	4.7%	6.5%	4.8%	5.0%	4.3%	3.9%
DPS	(20.0%)	0.0%	5.0%	4.8%	4.5%	14.4%	6.8%	10.0%	6.7%	6.8%	5.4%	4.8%
Operating Ratios (In %)												
Gross Margin	76.6%	77.3%	77.1%	77.0%	76.9%	76.8%	76.7%	76.6%	76.5%	76.4%	75.9%	75.6%
EBITDA Margin	74.0%	74.6%	74.4%	74.3%	74.3%	74.2%	74.1%	74.1%	74.0%	73.9%	73.7%	73.5%
Adj. EBITDA Margin	78.4%	78.2%	78.2%	78.4%	78.8%	78.8%	78.8%	79.1%	79.2%	79.3%	79.8%	80.1%
EBIT Margin	49.0%	49.4%	49.2%	49.1%	49.1%	49.0%	48.9%	48.9%	48.8%	48.8%	48.5%	48.3%
Net Margin	31.1%	26.6%	29.4%	32.3%	36.9%	39.5%	42.2%	46.3%	49.4%	52.7%	70.5%	81.4%
Finance Ratios												
Net Debt-to-EBITDA	8.3	7.8	7.4	7.0	6.5	6.0	5.6	5.0	4.5	4.0	1.0	-1.0
Debt-Equity Ratio	4.1	3.7	3.3	2.9	2.5	2.2	1.9	1.6	1.4	1.1	0.3	0.0
Net Debt-Equity Ratio	3.6	3.2	2.9	2.5	2.2	1.9	1.6	1.3	1.1	0.9	0.2	-0.1
Interest Coverage	1.3	1.3	1.3	1.4	1.5	1.6	1.7	1.8	2.0	2.2	5.3	36.1
EBITDA Interest Coverage	1.9	1.9	2.0	2.1	2.3	2.4	2.6	2.8	3.1	3.4	8.1	55.0
Return Ratios (In %)												
ROCE	5.6%	5.8%	5.9%	6.0%	6.2%	6.3%	6.5%	6.6%	6.8%	7.0%	8.1%	8.6%
ROIC	1.5%	1.0%	1.2%	1.5%	2.0%	2.0%	2.2%	2.5%	2.8%	3.0%	4.7%	5.8%
ROE	18.1%	14.7%	15.2%	15.7%	16.6%	16.4%	16.2%	16.5%	16.4%	16.2%	15.3%	14.5%
ROA	3.1%	2.7%	3.0%	3.4%	4.0%	4.4%	4.8%	5.4%	5.8%	6.4%	9.6%	11.8%
Liquidity Ratios												
Current Ratio	2.0	1.8	1.5	1.4	1.4	1.4	1.3	1.3	1.2	1.1	1.0	2.5
Quick Ratio	2.0	1.8	1.5	1.4	1.4	1.4	1.3	1.3	1.2	1.1	1.0	2.4

Source: Company data, QNBFS estimates

Key Forecasts: Debt Schedule

We see no major risk of default as ~QR2bn in interest plus repayments per annum is met easily by OCF with no major refinancing expected until 2025 with $2.7bn in bank facility balloon payments. Interestingly, while QGTS will repay all debt by 2033, LNG ships will retain another 15 years of useful life (until 2048) and can be relevered for fleet growth, etc.

Debt Schedule for Wholly-Owned Fleet

In QR Million	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2030	2033
Loan 1	1,821	1,821	1,821	1,517	1,214	910	607	303	-			
Repayment/Issuance	-	-	-	(303)	(303)	(303)	(303)	(303)	(303)			
Senior Bank Facilities	12,571	12,209	11,822	11,410	10,970	10,500	9,998	9,463	8,892	-		
Repayment/Issuance	(339)	(362)	(386)	(412)	(440)	(470)	(501)	(535)	(571)	(8,892)		
Subordinated Bank Facilities	1,430	1,391	1,349	1,304	1,255	1,203	1,148	1,089	1,025	-	-	-
Repayment/Issuance	(37)	(39)	(42)	(45)	(48)	(52)	(55)	(59)	(63)	(1,025)	-	-
Loan 2												
Repayment/Issuance	-											
Senior Bonds - Series "A"	3,095	3,095	3,095	3,095	3,095	2,974	2,731	2,488	2,246	2,003	789	-
Repayment/Issuance	-	-	-	-	-	(121)	(243)	(243)	(243)	(243)	(243)	(303)
Subordinated bonds Series "A"	927	895	861	825	787	746	703	657	608	555	240	-
Repayment/Issuance	(30)	(32)	(34)	(36)	(38)	(41)	(43)	(46)	(49)	(52)	(71)	(84)
KEXIM Facility	633	475	317	158	-	-	-	-	-			
Repayment/Issuance	(158)	(158)	(158)	(158)	(158)							
KSURE Covered Facility	997	784	570	356	142	-	-	-	-			
Repayment/Issuance	(214)	(214)	(214)	(214)	(214)	(142)						
New Loans/Refinancings										8,815	3,305	-
Issuance/repayment										(1,102)	(1,102)	(1,101)
Less: Insurance Costs of Bonds	(24)	(22)	(21)	(20)	(18)	(17)	(15)	(14)	(13)	(11)	(4)	-
Less: Costs of Islamic Financing	(10)	(9)	(7)	(6)	(5)	(3)	(2)	(0)	-			
Less: Transaction Costs of Refinancing	(21)	(19)	(16)	(14)	(12)	(9)	(7)	(5)	(2)	-		
Total	**21,420**	**20,620**	**19,790**	**18,626**	**17,429**	**16,304**	**15,163**	**13,981**	**12,755**	**11,362**	**4,330**	**-**
Total Repayments/Issuances	**(773)**	**(800)**	**(829)**	**(1,164)**	**(1,197)**	**(1,125)**	**(1,141)**	**(1,182)**	**(1,226)**	**(1,393)**	**(1,414)**	**(1,487)**
Interest	**(1,188)**	**(1,174)**	**(1,129)**	**(1,073)**	**(1,007)**	**(942)**	**(879)**	**(814)**	**(747)**	**(674)**	**(281)**	**(42)**
Repayments + Interest Payments	**(1,961)**	**(1,974)**	**(1,958)**	**(2,237)**	**(2,204)**	**(2,067)**	**(2,020)**	**(1,996)**	**(1,973)**	**(2,067)**	**(1,696)**	**(1,529)**

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement

Income Statement (In QR mn)	FY2016	FY2017e	FY2018e	FY2019e
Revenue – Wholly-Owned Ships	3,069	3,062	3,065	3,068
Income from Marine & Agency Services	55	55	56	57
Share of Profits from Joint Ventures	553	377	421	457
Vessels Sub-Chartering & Other Income	33	39	39	39
Adjusted Net Revenue	**3,710**	**3,533**	**3,581**	**3,621**
Direct Costs	(718)	(696)	(703)	(706)
Gross Profit	**2,992**	**2,837**	**2,878**	**2,914**
General and Administrative Expenses	(136)	(138)	(138)	(138)
Interest, Dividend & Profit from Islamic Banks	54	62	62	62
Adjusted EBITDA	**2,911**	**2,761**	**2,802**	**2,838**
Depreciation	(768)	(770)	(772)	(773)
EBIT	**2,143**	**1,991**	**2,030**	**2,066**
Finance Costs	(1,188)	(1,174)	(1,129)	(1,073)
Gain/(Loss) on Derivatives from Joint Ventures	0	0	0	0
Profit Before Tax	955	817	901	993
Income Tax Expense	0	0	0	0
Profit After Tax	955	817	901	993
Minority Interest	(1)	(1)	(1)	(1)
Profit for Equity Shareholders	**954**	**816**	**900**	**991**
EPS (QR)	**1.72**	**1.47**	**1.62**	**1.79**

Source: Company data, QNBFS estimates

Balance Sheet

Balance Sheet (In QR mn)	FY2016	FY2017e	FY2018e	FY2019e
Non-Current Assets				
Property, Plant and Equipment	23,161	22,398	21,712	21,025
Investment in Joint Venture Companies	4,018	4,206	4,417	4,599
Loans to Joint Venture Companies	135	125	125	125
Available-for-Sale Investments	134	104	104	104
Total Non-Current Assets	**27,448**	**26,833**	**26,358**	**25,854**
Current Assets				
Receivables, Inventories and Due from Joint Ventures	380	458	458	458
Cash and Bank Balances	2,493	2,865	2,868	2,623
Total Current Assets	**2,873**	**3,322**	**3,326**	**3,082**
Total Assets	**30,321**	**30,156**	**29,684**	**28,935**
Equity				
Equity Attributable to the Parent	5,260	5,568	5,915	6,324
Minority Interest	4	5	6	8
Total Equity	**5,264**	**5,574**	**5,921**	**6,332**
Non-Current Liabilities				
Borrowings	20,616	19,790	18,626	17,429
Fair Value of Interest Rate Swaps	2,819	2,793	2,793	2,793
Provision for End of Service Benefits	188	158	158	158
Total Non-Current Liabilities	**23,624**	**22,741**	**21,577**	**20,380**
Current Liabilities				
Borrowings	804	829	1,164	1,197
Accounts Payables/Accruals & Due to Related Parties	630	1,011	1,021	1,026
Total Current Liabilities	**1,433**	**1,841**	**2,185**	**2,224**
Equity and Liabilities	**30,321**	**30,156**	**29,684**	**28,935**

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*	
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

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