

Gulf International Services (GISS)

Recommendation	OUTPERFORM	Risk Rating	R-3
Share Price	QR90.90	Target Price	QR120.00
Implied Upside	32.0%		

Growth Story Remains Intact; Reiterate Outperform

Revising price target to QR120 from QR136 but maintaining Outperform recommendation. After doubling in 2013, GISS' stock shot up another 168% in 2014 to reach a high of QR131 in early November 2014. Since then, the stock has plummeted in tandem with the precipitous decline in crude prices along with most regional equities. While GISS has recovered from the QR67 level seen in mid-December, the stock remains susceptible to bearish investor sentiment. **However, much of the company's drilling business remains secured through existing contracts with just two offshore rigs (Al-Rayyan and Leshat) and two onshore rigs (GDI-5 and GDI-6) up for renewal in 2015 and 2016.** Consequently, all remaining offshore rigs, except one, in a total fleet of 10 (9 currently in operation) are already secured by announced contracts with disclosed attractive rig rates that were fixed before the decline in oil prices. These contracts are mostly five years in duration with the earliest ending in 2Q2017. Net-net, factoring in lower renewal rates for the aforementioned two offshore rigs and two onshore rigs, we have adjusted our model and reduced our price target.

Highlights

- Factoring in lower rates for rig renewals:** Given the expected weak outlook for crude prices, we have lowered our day rate estimates for rig renewals. **(1)** For offshore, we have renewed the Al-Rayyan rig from 2Q2015 and the Leshat rig from 1Q2016 at a 20% discount to existing contracted rates. **(2)** For onshore, we have renewed GDI-5/6 at around ~\$30k/d from 1Q2016 vs. recent renewals (from 2Q2014) of GDI-1-4 land rigs at 2x these rates or at ~\$60k/d.
- Majority of fleet still enjoying high contracted rates.** As mentioned in our October 21 report, GISS has inked four major deals with Qatar Petroleum since mid-June. **(1)** On June 11, GDI announced a five-year contract for two onshore rigs, GDI-7 and GDI-8, with a disclosed value of QR1.1bn (~\$302mn) implying an average rate of almost \$83k/rig versus \$30.4k/rig for the existing land fleet as of 2013. We expect GDI-7 to be deployed in 3Q2015 followed by GDI-8 in 4Q2015. **(2)** On June 16, GDI announced a QR1.275bn (~\$350mn), five-year contract for the Dukhan jack-up offshore rig. When commencing operations in 4Q2014, this rig will garner around \$190k/d, or a ~35% premium to Al-Jassra and a ~60% premium to the 2013 blended offshore rate (seven rigs). **(3)** On July 10, GDI announced a five-year, QR1.6bn contract extension for GDI 1-4 land rigs with effect from 2Q2014. At around ~\$60k/d/rig, deal extension terms implied 2x existing land rig rates. **(4)** Finally, on July 20, GDI announced a QR1.2bn (~\$330mn) five-year contract to supply a 4th jack-up rig, Halul, to QP. Halul will become GDI's 10th overall offshore rig and will command a day rate of ~\$180k once it is deployed around mid-2016. All four deals have been signed with QP. In total, these four contracts add ~QR5.2bn in revenue, or roughly QR1bn in incremental top-line per year for five years vs. QR912mn posted by all of GDI (at ~70% stake) in 2013.

Catalysts

- 2014 dividends/results are near-term catalysts:** GISS' board will hold an earlier-than-usual meeting on January 7 to discuss 2014's proposed dividend distribution. 2014 results release in February could also provide momentum.

Recommendation, Valuation and Risks

- Recommendation and valuation: We maintain our Outperform rating on GISS with a revised price target of QR120.00.** The stock is currently trading at 2015 and 2016 P/E multiples of 14.4x and 12.4x, respectively.
- Risks: Declining oil prices remain a substantial risk to regional equity prices.** GISS also faces concentration risk, as most of its businesses are dependent on QP/affiliates.

Key Financial Data and Estimates

	2013	2014e	2015e	2016e
EPS (QR)	3.64	5.94	6.30	7.34
P/E (x)	25.0	15.3	14.4	12.4

Source: Company data, QNBFS 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)	131.00/52.8
3-m Avg. Volume (000)	572.1
Mkt. Cap. (\$ bn/QR bn)	4.6/16.9
FO Limit* (%)	25.0
Current FO* (%)	12.6
Shares Outstanding (mn)	185.8
1-Year Total Return (%)	70.6
Fiscal Year End	December 31

Source: Bloomberg (as of January 06, 2015), *Qatar Exchange (as of January 06, 2015); Note: FO is foreign ownership

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4Q2014 Results Preview

We expect significant growth on a YoY basis given the consolidation and buy-out of GDI. Drilling revenue should also benefit sequentially given the deployment of Dukhan in late October. Our estimates do not adjust for any potential one-offs that could occur during the quarter.

Quarterly Comparisons

In QR mn	1Q/13	2Q/13	3Q/13	4Q/13	1Q/14	2Q/14	3Q/14	4Q/14	QoQ	YoY
Revenue	553	567	575	607	617	979	1,116	1,183	6%	95%
Gulf Drilling International (GDI)*						346	522	556	6%	
GDI – 100% Ownership	247	297	342	417	374	474	522	556	6%	33%
Gulf Helicopters Co. (GHC)	149	159	155	155	153	167	159	165	3%	6%
Amwaj Catering Co. (ACS)	241	233	239	263	272	276	267	275	3%	5%
Al Koot Insur. & Reins. (AKIR)	162	175	181	189	192	189	167	187	12%	(1%)
COGS	445	448	460	465	508	718	755	808	7%	74%
Gross Profit	108	119	115	143	108	260	361	375	4%	163%
Gross Margin %	19.5%	21.0%	19.9%	23.5%	17.6%	26.6%	32.4%	31.7%		
SG&A	23	19	26	26	27	56	59	69	17%	162%
SG&A %	4.2%	3.3%	4.4%	4.3%	4.4%	5.7%	5.3%	5.8%		
Total Other Income	9	6	5	19	31	49	27	25	(7%)	34%
Net Finance Income (Expense)	1	1	1	(0)	2	(5)	(12)	(10)	(18%)	3,251%
Income from JVs	41	51	71	83	74	26	0	1		(99%)
Net Income	136	157	166	218	189	275	318	322	1%	48%
Net Margin %	24.6%	27.8%	28.9%	35.9%	30.6%	28.1%	28.5%	27.2%		
EPS (QR)	0.73	0.85	0.89	1.17	1.01	1.48	1.71	1.73	1%	48%
EBITDA	163	183	191	245	213	363	444	454	2%	86%
EBITDA Margin %	29.5%	32.3%	33.3%	40.3%	34.6%	37.1%	39.8%	38.3%		

Source: Company data, QNBFS estimates; Note: EPS based on current number of shares, *GDI results consolidated from May 1, 2014

Detailed Financial Statements

Income Statement

In QR mn	2013	2014e	2015e	2016e
Revenue	2,302	3,894	4,887	5,267
Gulf Drilling International (GDI)*		1,425	2,367	2,621
Gulf Helicopters Company (GHC)	619	644	710	775
Amwaj Catering Company (ACS)	976	1,090	1,060	1,092
Al Koot Insurance & Reinsurance (AKIR)	707	735	750	780
COGS	1,818	2,790	3,445	3,606
Gross Profit	484	1,105	1,442	1,661
SG&A	94	211	287	306
Total Other Income	39	133	40	40
Net Finance Income (Expense)	3	(24)	(26)	(31)
Income from JVs	245	101	1	1
Net Income	677	1,103	1,170	1,365
EBITDA	782	1,474	1,728	1,981
DPS (QR)	1.60	2.25	2.50	2.75

Source: Company data, QNBFS estimates; Note: EPS based on current number of shares, *GDI results consolidated from May 1, 2014

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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