

Gulf International Services (GISS)

Recommendation	OUTPERFROM	Risk Rating	R-3
Share Price	QR57.20	Current Target Price	QR81.00
Implied Upside	41.6%	Old Target Price	QR93.00

Revising Estimates and Price Target

We are lowering our price target to QR81 factoring in recent 3Q2015 results and other model changes. The stock is down more than 41% this year vs. a ~12% decline in the QSE Index. While weakness in oil prices and the negative impact of the unprecedented lowering of contracted rig rates continues to weigh on the stock price, we see long-term value in the company. At the current stock price, the market is pricing in roughly another 30% haircut in drilling revenue (QR3.4bn) and a +40% decline in drilling EBITDA (QR2.6bn) over the next five years. While the investment case is compelling, the stock suffers from a lack of catalysts. We continue to believe recovery in GISS stock remains hinged on improvement in oil prices and a resumption of confidence in company performance.

Highlights

- Adjusting estimates post 3Q2015 results:** GISS posted 3Q2015 results that were generally in line with our estimates (see page 3). Factoring in these results along with other model changes, we are reducing our revenue estimates by 4% for 2015. For 2015, we are projecting lower top-line figures across all segments but primarily driven by the helicopter division followed by drilling. Our 2015-18e revenue estimates have also come down by 6% on an average with net income reduced by around 2% over the same period.
- Our drilling day rate expectations continue to call for around 15% declines across the board in offshore and onshore.** However, it seems that rate reductions went into effect after 2Q2015 rather than in the 2nd quarter itself. On the onshore side, we have lowered rates by 15% vs. 10% previously. There is risk that rates drop below our assumed levels and/or rigs are idled or taken off contract. However, we believe that the stock is pricing in close to a worst-case scenario for the drilling segment (see page 2).

Catalysts

- While the investment case is compelling, recovery in GISS stock remains hinged on improvement in oil prices and a resumption of confidence in company performance.** 2015 dividend yield is also attractive at 8.7%.

Recommendation, Valuation and Risks

- Recommendation and valuation:** *We rate GISS an Outperform with a revised price target of QR81.00.* Our current price target is 13% lower than our previous target of QR93.00. The stock is currently trading at 2015 and 2016 P/E multiples of 9.7x and 8.8x, respectively. While our price target provides compelling upside, the stock remains in a “show me” mode.
- Risks: Declining/volatile oil prices remain a substantial risk to regional equity prices.** Further decline in rig rates could pressure the stock. GISS also faces concentration risk given its exposure to QP/affiliates.

Key Financial Data and Estimates

	2014	2015e	2016e	2017e
EPS (QR)	6.14	5.93	6.47	6.90
P/E (x)	9.3	9.7	8.8	8.3
P/B	2.5	2.5	2.3	2.2
EV/EBITDA	8.4	9.1	8.2	7.7
DPS (QR)	5.50	5.00	5.25	5.50
Dividend Yield (%)	9.6	8.7	9.2	9.6

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)	124.40/53.60
3-m Avg. Volume (000)	427.4
Mkt. Cap. (\$ bn/QR bn)	2.9/10.6
FO Limit* (%)	25.0
Current FO* (%)	9.2
Shares Outstanding (mn)	185.8
1-Year Total Return (%)	(50.7)
Fiscal Year End	December 31

Source: Bloomberg (as of November 18, 2015), *Qatar Exchange (as of November 18, 2015); Note: FO is foreign ownership

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Major Estimate Changes

For 2015, we are projecting lower top-line figures across all segments but primarily driven by the helicopter division followed by drilling. Our 2015-18e revenue estimates have also come down by 6% on an average with net income reduced by around 2% over the same period.

We expect GISS to pay QR5 in DPS for 2015 vs. QR5.50 for 2014. This translates into a 84.4% payout ratio vs. a 89.6% payout in 2014 (excluding the one-time gain recorded for the acquisition of GDI). With no major growth capex requirements beyond spending on the Halul offshore rig in 2016 and expanding the helicopter fleet, GISS management can maintain its 2014 DPS going forward. However, we assume a slightly more conservative approach to dividends given the overall subdued commodity price environment. For 2016, we project a moderate 5% growth in DPS to QR5.25 followed by a similar increase back to QR5.50 in 2017.

Major Estimate Changes

In QR mn	2015e			2016e			2017e			2018e			15-18 Avg %
	New	Old	(%)	New	Old	(%)	New	Old	(%)	New	Old	(%)	
Revenue	4,317	4,509	(4)	4,609	4,884	(6)	4,779	5,067	(6)	4,823	5,163	(7)	(6)
EBITDA	1,680	1,725	(3)	1,862	1,872	(1)	1,967	1,944	1	2,002	1,984	1	(0)
EBITDA Margin (%)	38.9	38.2		40.4	38.3		41.2	38.4		41.5	38.4		
Net Income	1,101	1,159	(5)	1,203	1,241	(3)	1,282	1,288	(0)	1,305	1,319	(1)	(2)
Net Margin (%)	25.5	25.7		26.1	25.4		26.8	25.4		27.1	25.5		
EPS (QR)	5.93	6.24	(5)	6.47	6.68	(3)	6.90	6.93	(0)	7.02	7.10	(1)	(2)

Source: Company data, QNBFS estimates

Sensitivity to Further Drilling Segment Weakness

At the current stock price, the market is pricing in roughly another 30% haircut in drilling revenue (QR3.4bn) and a +40% decline in drilling EBITDA (QR2.6bn) over the next five years. We show the results of our sensitivity analysis below. There is risk that rates drop below our assumed levels and/or rigs are idled or taken off contract. However, we believe that the stock is pricing in close to a worst-case scenario for the drilling segment as we can see from the downside case below.

Scenario Analysis

GISS Price Target	Drilling						
	Change Vs. Base Case						
	Revenue	Direct Costs	Revenue	Gross Margin	EBITDA Margin	EBIT Margin	
	2016-2020		CAGR 2015-2020	Average 2016-2020			
Upside	92.00	10%	-5%	5%	68%	58%	38%
Base	81.00	0%	0%	3%	65%	55%	36%
Dow nside	55.00	-30%	15%	-5%	57%	46%	27%

Source: QNBFS estimates

Recent Results

GISS posts in-line results in 3Q2015. GISS registered QR216.9mn net profit in 3Q2015, in-line with our estimate of QR208.7mn (positive 3.9% variation). Overall net profit, down 13.1% on a sequential basis (-30.4% YoY), was majorly impacted by a 10.2% QoQ drop in 3Q2015 revenue to QR973.9mn. Drilling revenue was also in-line with our estimate and should improve sequentially in 4Q2015 given the deployment of GDI-7/8.

Quarterly Comparisons

In QR '000 Except Otherwise Noted	3Q2014	2Q2015	3Q2015	3Q2015e	Actual Vs. Estimate	YoY	QoQ
Total Revenue	1,116,132	1,084,555	973,933	1,036,193	-6%	-13%	-10%
Insurance	167,359	168,386	166,642	164,968	1%	0%	-1%
Aviation	159,476	164,417	151,156	171,915	-12%	-5%	-8%
Catering	266,831	249,079	221,049	248,883	-11%	-17%	-11%
Drilling	522,466	502,673	435,086	450,426	-3%	-17%	-13%
COGS	760,661	783,419	687,981	746,959	-8%	-10%	-12%
Insurance	151,441	173,611	135,648	149,278	-9%	-10%	-22%
Aviation	96,824	100,771	114,280	105,539	8%	18%	13%
Catering	236,885	226,569	202,439	226,391	-11%	-15%	-11%
Drilling	275,511	282,468	235,614	265,752	-11%	-14%	-17%
Gross Profit	355,471	301,136	285,952	289,234	-1%	-20%	-5%
GM %	31.8%	27.8%	29.4%	27.9%			
Insurance GM %	9.5%	-3.1%	18.6%	9.5%			
Aviation GM %	39.3%	38.7%	24.4%	38.6%			
Catering GM %	11.2%	9.0%	8.4%	9.0%			
Drilling GM %	47.3%	43.8%	45.8%	41.0%			
Gross Profit Contribution							
Insurance	4.5%	-1.7%	10.8%	5.4%			
Aviation	17.6%	21.1%	12.9%	22.9%			
Catering	8.4%	7.5%	6.5%	7.8%			
Drilling	69.5%	73.1%	69.8%	63.8%			
Net Income	311,701	249,689	216,864	208,740	4%	-30%	-13%
NM %	27.9%	23.0%	22.3%	20.1%			
Insurance	33,299	11,985	30,403	4,907	520%	-9%	154%
Insurance NM %	19.9%	7.1%	18.2%	3.0%			
Aviation	58,423	57,270	49,699	60,020	-17%	-15%	-13%
Aviation NM %	36.6%	34.8%	32.9%	34.9%			
Catering	19,327	33,277	18,876	21,174	-11%	-2%	-43%
Catering NM %	7.2%	13.4%	8.5%	8.5%			
Drilling	205,696	159,460	128,505	135,071	-5%	-38%	-19%
Drilling NM %	39.4%	31.7%	29.5%	30.0%			
Unallocated (Plug)	(5,044)	(12,303)	(10,619)	(12,432)	-15%	111%	-14%
EPS (QR)	1.68	1.34	1.17	1.12	4%	-30%	-13%
EBITDA	444,053	391,936	356,355	355,380	0%	-20%	-9%
EBITDA Margin %	39.8%	36.1%	36.6%	34.3%			

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement

In QR mn	FY2014	FY2015e	FY2016e	FY2017e	FY2018e
Revenue	3,906	4,317	4,609	4,779	4,823
Gulf Drilling International (GDI)*	1,473	1,980	2,246	2,330	2,285
Gulf Helicopters Company (GHC)	644	649	676	720	766
Amwaj Catering Company (ACS)	1,056	998	998	1,023	1,049
Al Koot Insurance & Reinsurance (AKIR)	733	689	689	706	724
COGS	2,710	2,946	3,108	3,188	3,210
Gross Profit	1,196	1,370	1,501	1,591	1,614
SG&A	217	247	272	280	279
Total Other Income	89	35	35	35	35
Net Finance Income (Expense)	(27)	(57)	(62)	(64)	(65)
One-Offs/Non-Recurring Items	269	0	0	0	0
Income from JVs	100	0	0	0	0
Net Income	1,410	1,101	1,203	1,282	1,305
Net Income (Clean)	1,140	1,101	1,203	1,282	1,305
EBITDA	1,818	1,680	1,862	1,967	2,002
EBITDA (Clean)	1,549	1,680	1,862	1,967	2,002
DPS (QR)	5.50	5.00	5.25	5.50	5.75

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

Balance Sheet

In QR mn	FY2014	FY2015e	FY2016e	FY2017e	FY2018e
Current Assets					
Cash & Cash Equivalents	1,087	1,657	1,789	2,297	2,804
Investments Held for Trading	218	241	241	241	241
Insurance Contract Receivables & A/R	946	1,078	1,132	1,173	1,188
Due From Related Parties	634	584	584	584	584
Inventories	203	218	229	236	237
Total Current Assets	3,089	3,778	3,975	4,531	5,055
Non-Current Assets					
Available for Sale Investments	300	301	301	301	301
Held to Maturity Investments	85	86	86	86	86
Investment in Joint Ventures	-	-	-	-	-
Investment Properties	1	1	1	1	1
Goodwill	313	313	313	313	313
Property, Plant & Equipment	7,037	7,595	7,944	7,833	7,709
Non-Current Assets	7,738	8,296	8,645	8,534	8,409
Total Assets	10,826	12,075	12,620	13,065	13,464
Current Liabilities					
Short-Term Debt	909	1,378	1,378	1,378	1,378
Insurance Payables & Accounts Payable	1,719	1,855	1,905	1,954	1,982
Due to Related Parties	11	24	24	24	24
Current Liabilities	2,638	3,257	3,307	3,356	3,384
Non-Current Liabilities					
Employees End of Service Benefits	64	73	73	73	73
Long-Term Debt	3,946	4,488	4,710	4,799	4,888
Non-Current Liabilities	4,010	4,561	4,783	4,872	4,961
Total Liabilities	6,649	7,818	8,089	8,229	8,345
Shareholders' Equity					
Total Shareholder's Equity	4,178	4,257	4,530	4,836	5,119
Liabilities & Shareholder's Equity	10,826	12,075	12,620	13,065	13,464

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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