

Qatar Electricity & Water Company (QEWS)

Recommendation	OUTPERFORM	Risk Rating	R-2
Share Price	QR221.00	Current Target Price	QR256.00
Implied Upside	15.8%		

In-Line 2Q2016 Operating Results; Maintain Outperform and PT

QEWS reported 2Q2016 results that were in line with our expectations. We continue rate QEWS an Outperform with an unchanged QR256 price target. Our PT continues to reflect the Umm Al Houl project beginning in 2017; this project remains on track per our latest conversation with QEWS management. We expect this 2,520 MW and 136.5 MIGD project to add about QR23 per share to QEWS' fair value. QEWS is a low-risk play deeply linked to Qatar's growth story and we retain our long-term bullish stance.

Highlights

- Seasonality boosted the top-line on a sequential basis in 2Q2016, which came in line with our model.** Overall revenue was QR798.7mn in 2Q2016 (+11% QoQ/+6% YoY), bang in-line with our estimate of QR797.8mn. Overall QoQ growth was driven by power revenue, which was up 22%, while desalinated water sales were essentially flat. On a YoY basis, water revenue was up 16% as RAF A2 (36 MIGD) came on-line in 3Q2015, while electricity sales were up 1%.
- Operating margins generally expanded and came in above our estimates.** Direct costs fell during the quarter, increasing the gross margin to 60.2% vs. 59.4% in 1Q2016 and 58.8% in 2Q2015. EBITDA came in at QR438.8mn (+16% QoQ/+10% YoY) increasing the EBITDA margin to 54.9% vs. 52.8% in 1Q2016 and 53.0% in 2Q2015. EBITDA was also in line with our estimate of QR422.1mn (+4% divergence). EBIT margin advanced to 42.0% vs. 38.4% in March 2016 and 38.9% in the year-ago quarter. QEWS continues to benefit from lower depreciation charges with RAF B being depreciated over 21 months beginning from 2016 (vs. 12 months previously).
- Underlying net income was also in line with our estimate excluding a one-time boost to earnings.** QEWS reported a net profit of QR443.8mn in 2Q2016, indicating an increase of 28% QoQ (+14% YoY), vs. our estimate of QR382.4mn. This beat in reported earnings was entirely driven by QR42mn in settlement from Kahramaa for RAF A1; excluding this item, net income would have been QR401.8mn, which was in-line with our estimate of QR382.4mn (+5% divergence).

Catalysts

- New projects on the horizon:** QEWS should benefit from two new 100%-owned water plants, RAF A2 (36 MIGD) from 3Q2015 and RAF A3 (36 MIGD) from Sep.2016 (fully functional by 2017), adding ~28% to QEWS' net water capacity. Further, Umm Al Houl (Facility D) should be on-line in 2018 after its initial phase in 2017. Overall, these three projects should expand QEWS' net electricity & water capacity by 28% and 60%, respectively, in 2018. QEWS should also start construction of its 500-MW-solar power JV with QP by 1Q2017. Newsflow regarding domestic expansion could act as catalysts.

Recommendation, Valuation and Risks

- Recommendation and valuation:** *We rate QEWS an Outperform with a price target of QR256.00.* The stock trading at a 2016 P/E of 14.7x.
- Risks:** **Volatile oil prices are a major risk to regional equities.** Decrease in tariff rates could negatively impact QEWS' business model.

Key Financial Data and Estimates

	FY2014	FY2015	FY2016e	FY2017e
Revenue (QR mn)	2,898	2,983	3,256	3,507
Revenue Growth	(0.2%)	2.9%	9.2%	7.7%
EPS (QR)	13.91	13.64	15.00	16.61
EPS Growth	10.5%	(1.9%)	9.9%	10.7%
P/E (x)	15.9x	16.2x	14.7x	13.3x
DPS (QR)	7.50	7.50	7.75	8.00
Dividend Payout	53.9%	55.0%	51.7%	48.2%
Dividend Yield	3.4%	3.4%	3.5%	3.6%
ROE	22.6%	20.4%	20.4%	20.2%

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

Key Data

Current Market Price (QR)	221.00
Dividend Yield – 2016 (%)	3.5
Bloomberg Ticker	QEWS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QEWQ.QA
ISIN	QA0006929812
Sector*	Industrials
52wk High/52wk Low (QR)	228.80/175.10
3-m Average Volume ('000)	26.0
Mkt. Cap. (\$ bn/QR bn)	6.7/24.3
Shares Outstanding (mn)	110.0
FO Limit* (%)	25.0
Current FO* (%)	11.8
1-Year Total Return (%)	3.7
Fiscal Year End	December 31

Source: Bloomberg (as of July 18, 2016). *Qatar Exchange (as of July 17, 2016); Note: FO is foreign ownership

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Comparisons and Actual Versus Estimates

Income Statement (In QR mn)	2Q2015	1Q2016	2Q2016	2Q2016e	A Vs. E	QoQ	YoY
Revenue	753	718	799	798	0%	11%	6%
Cost of Sales, Excluding Depreciation	(310)	(291)	(318)	(329)	-3%	9%	2%
Gross Profit	443	427	481	469	2%	13%	9%
General & Administrative Expenses	(44)	(47)	(42)	(47)	-11%	-12%	-5%
EBITDA	399	379	439	422	4%	16%	10%
Deferred Income	2	2	2	2	0%	0%	0%
Depreciation & Amortization	(108)	(105)	(105)	(124)	-15%	0%	-2%
EBIT	293	276	335	300	12%	22%	14%
Finance Costs, Net	(20)	(32)	(33)	(32)	4%	2%	62%
Dividend Income & Gain on Sale of AFS	3	31	3	1	225%	-90%	-3%
Other & Miscellaneous Income/Expense & Share of Profits from JVs	113	81	147	122	20%	80%	30%
Share of Associates	11	-	-				-100%
Profit Before Tax	400	356	452	392	15%	27%	13%
Income Tax Expense							
Profit After Tax (Continuing Operations)	400	356	452	392	15%	27%	13%
Discontinued Operations							
Minority Interest	(9)	(9)	(9)	(9)	-9%	0%	-8%
Profit for Shareholders	391	347	444	382	16%	28%	14%
EPS (QR)	3.55	3.16	4.03	3.48	16%	28%	14%

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Revenue	2,983	3,256	3,507	3,566
Cost of Sales, Excluding Depreciation	(1,225)	(1,342)	(1,463)	(1,505)
Gross Profit	1,757	1,915	2,045	2,061
General & Administrative Expenses	(173)	(192)	(207)	(210)
EBITDA	1,584	1,723	1,838	1,851
Deferred Income	7	7	0	0
Depreciation & Amortization	(463)	(435)	(468)	(405)
EBIT	1,128	1,294	1,370	1,446
Finance Costs, Net	(102)	(136)	(138)	(137)
Dividend Income & Gain on Sale of AFS	20	21	23	28
Other & Miscellaneous Income/Expense & Share of Profits from JVs	474	507	612	808
Share of Associates	16	0	0	0
Profit Before Tax	1,536	1,686	1,867	2,146
Income Tax Expense	0	0	0	0
Profit After Tax (Continuing Operations)	1,536	1,686	1,867	2,146
Discontinued Operations				
Minority Interest	(35)	(36)	(40)	(46)
Profit for Shareholders	1,501	1,649	1,827	2,099
EPS (QR)	13.64	15.00	16.61	19.08

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2015	FY2016e	FY2017e	FY2018e
Non-Current Assets				
Property, Plant and Equipment	5,714	6,267	6,799	6,562
Available-for-Sale Investments	344	367	367	367
Finance Lease Receivables	1,491	1,376	1,262	1,147
JV Loans and Investments in JVs	2,627	3,016	3,450	3,932
Other Non-Current assets	311	302	295	287
Total Non-Current Assets	10,487	11,329	12,173	12,296
Current Assets				
Finance Lease Receivables & Others	146	135	135	135
Inventories	178	287	313	322
Accounts Receivables & Prepayments	888	803	865	879
Cash and Short-Term Deposits	1,751	1,926	2,361	3,025
Total Current Assets	2,963	3,150	3,673	4,361
Total Assets	13,450	14,479	15,846	16,657
Equity				
Equity to the Parent	7,346	8,084	9,058	10,278
Minority Interest	256	270	285	302
Total Equity	7,602	8,354	9,343	10,580
Non-Current Liabilities				
Loans and Borrowings	3,791	4,149	4,471	4,024
Deferred Income	0	0	0	0
Employees' End of Service Benefits	49	52	56	59
Derivatives	20	36	36	36
Total Non-Current Liabilities	3,860	4,238	4,564	4,120
Current Liabilities				
Accounts Payables & Others	756	570	621	639
Loans and Borrowings	1,124	1,210	1,210	1,210
Derivatives	107	107	107	107
Total Current Liabilities	1,988	1,887	1,939	1,957
Equity and Liabilities	13,450	14,479	15,846	16,657

Source: Company data, QNBFS estimate

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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