

Qatar Electricity & Water Company (QEWS)

Recommendation	ACCUMULATE	Risk Rating	R-2
Share Price	QR187.00	Current Target Price	QR209.00
Implied Upside	11.8%	Old Target Price	QR233.00

Lowering Estimates/TP and Moving to Accumulate Rating

We are changing our rating to Accumulate from Outperform with a new price target of QR209. 3Q2018 was weaker-than-expected and the extension of the RAF B plant (for 12 years) comes at lower-than-anticipated rates. Consequently, we lower our 2018 and 2019 estimates and reduce our price target to QR209. We continue to like QEWS as a solid long-term play with a defensive business model. Our new Accumulate recommendation highlights our positive long-term thesis on the company.

Highlights

- QEWS' 3Q2018 net profit declines 31.3% YoY and 17.8% QoQ and misses our estimate** – QEWS reported a bottom-line of QR343.8mn in 3Q2018, missing our estimate of QR452.6mn (variation of -24.0%). Revenue came in at QR671.5mn in 3Q2018, which was in-line with our estimate of QR697.9mn (divergence: -3.8%); revenue for 3Q2018 represents a decrease of 18.7% YoY (-1.9% QoQ). Lower-than-expected cash gross margins of 53%, along with a decline in JV income (-36.4% YoY, -31.2% QoQ) impacted 3Q2018 results. A couple of one-offs offset each other (more details on page 2) but we were surprised by the lower rate agreement for the RAF B extension from July onward, which lowered 3Q2018 net income by QR40-50mn.
- QNBFS forecasts: 2018 Revenue/EPS decreases from QR2.7bn/QR14.47 to QR2.6bn/QR13.29 and 2019 Revenue/EPS goes from QR2.7bn/QR15.06 to QR2.6bn/QR12.42.** Beyond 2018, our forward revenue/EPS estimates decrease by an average of 5%/13%. The primary driver behind our lowered figures is the contract extension put in place for RAF B, which are now set at lower-than-expected rates as Kahramma has negotiated a new tariff structure for this fully-depreciated plant.
- We continue to like QEWS as a solid long-term play with a defensive business model.** Essentially a capacity provider, QEWS takes on insignificant demand/costs/funding risks holding secure contracted assets with long-term (~25 years) fuel agreements/PWPs and committed funding. This also leads to visible cash flows and a stable operating profile. The State of Qatar (through various entities) owns 60% of the company.
- Market leader in Qatar with international expansion gathering steam.** Essentially a monopoly, QEWS owns stakes in all domestic IWPPs/IPPs/IWPs. Moreover, the company has diversified internationally with around 14% of its net income expected to be driven by 60%-owned international JV (Nebras) in 2018. Nebras has operations in Indonesia, Jordan and Oman and is actively seeking opportunities in MENA and SE Asia.
- Despite a subdued 2019, QEWS still enjoys a solid long-term growth profile with attractive EBITDA margins and compelling dividend/FCF yields.** After falling over 2017-2019, we expect EBITDA CAGR of 4.2% over 2019-2023; FCF should grow around 4.8% over the same period driven by Facility D (Um Al Houl) and inflation-driven capacity charge increases. Despite modeled compression, QEWS should still maintain solid EBITDA margins (2019-2023 average: ~46%). We expect dividend yield to average 4.2% over 2018-2023 and FCF yield to average 7.2% over the same period (despite a dip in 2018 as QEWS invested \$252mn recently into the Facility D JV). ROEs average around 12.4% over 2019-2023.

Catalysts

- New opportunities currently not in our model:** Besides Um Al Houl, our model does not account for additional expansions domestically (like Facility E; a solar project called Siraj, etc.) which will lead to LT upside. Beyond Paiton in Indonesia, we do not have color on other Nebras projects, which could lead to growth relative to our model.

Recommendation, Valuation and Risks

- Recommendation & valuation:** *Our 1-year PT is QR209.* Shares have generated 61% in 5-year total returns, outpacing the DSM Index (30%).
- Risks: Geopolitical risks** cannot be modeled. Besides **risks in international expansion**, there is always a chance **domestic projects get delayed/shelved**. It is possible **Kahramma substantially renegotiates the terms of existing contracts** and recent discussions on K-Factors gives us pause; however, this is not an imminent risk. We note the recent lower-than-expected rates for RAF B involve a contract extension on a fully-depreciated plant. **Operational risks include availability of capacity below contracted levels**, which could lead to penalties.

Key Financial Data and Estimates

	FY2017	FY2018e	FY2019e	FY2020e
Revenue (QR mn)	3,071	2,633	2,609	2,673
Revenue Growth	-1.0%	-14.3%	-0.9%	2.4%
EPS (QR)	14.69	13.29	12.42	13.17
EPS Growth	4.8%	-9.6%	-6.5%	6.0%
P/E (x)	13.1	14.5	15.5	14.6
DPS (QR)	7.75	7.75	7.75	8.00
ROE	18.0%	13.7%	12.2%	12.3%

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

Key Data

Current Market Price (QR)	187.00
Current Dividend Yield (%)	4.0
Bloomberg Ticker	QEWS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QEWC.QA
ISIN	QA0006929812
Sector*	Industrials
52wk High/52wk Low (QR)	205.25/161.99
3-m Average Volume ('000)	34.4
Mkt. Cap. (\$ bn/QR bn)	5.6/20.6
EV (\$ bn/QR bn)	6.5/23.8
Shares Outstanding (mn)	110.0
FO Limit* (%)	49.0
Current FO* (%)	12.1
1-Year Total Return (%)	9.3
Fiscal Year End	December 31

Source: Bloomberg (as of October 24, 2018), *Qatar Exchange (as of October 23, 2018); Note: FO is foreign ownership

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3Q2018 Review

QEWS' 3Q2018 net profit declines 31.3% YoY and 17.8% QoQ and misses our estimate – QEWS reported a bottom-line of QR343.8mn in 3Q2018, missing our estimate of QR452.6mn (variation of -24.0%). Revenue came in at QR671.5mn in 3Q2018, which was in-line with our estimate of QR697.9mn (divergence: -3.8%); revenue for 3Q2018 represents a decrease of 18.7% YoY (-1.9% QoQ). Lower-than-expected cash gross margins of 53%, along with a decline in JV income (-36.4% YoY, -31.2% QoQ) impacted 3Q2018 results. A couple of one-offs offset each other but we were surprised by the lower rate agreement for the RAF B extension from July onward, which lowered 3Q2018 net income by QR40-50mn.

Key Metrics

	3Q2018	3Q2017	2Q2018	YoY	QoQ	Comments
Revenue	671.47	826.22	684.26	-18.7%	-1.9%	3Q2018 revenue lower by 18.7% YoY due to decommissioning of RAF A, impact of RAF B new tariff structure and RAF A1 (lower K-Factor)
Gross Profit	355.74	523.68	438.70	-32.1%	-18.9%	Gross profit/margin took a hit from RAF B
EBITDA	309.28	481.49	394.93	-35.8%	-21.7%	
JV Income	102.54	161.21	149.01	-36.4%	-31.2%	Um Al Houf continues to be impacted from lower K-Factors; QR57mn provision related to a JV over seawater costs
Net Income	343.83	500.82	418.17	-31.3%	-17.8%	RAF B is the major driver behind the earnings decline; QR58.8mn gain on disposal of RAF A (in other income) offsets provision booked in JV income
EPS	3.13	4.55	3.80	-31.3%	-17.8%	
Gross Margin	53.0%	63.4%	64.1%			
EBITDA Margin	46.1%	58.3%	57.7%			
Net Margin	51.2%	60.6%	61.1%			

Source: Company data, QNBFS estimates

Valuation

Valuation Metrics

Particulars	2014	2015	2016	2017	2018e	2019e	2020e	2021e	2022e	2023e
Valuation										
EV/EBITDA - Consolidated	16.2	15.3	14.6	14.9	17.6	19.1	17.7	16.4	15.3	14.2
EV/EBIT	23.2	21.5	19.7	21.1	24.6	28.1	25.6	23.4	21.6	19.8
P/E	13.8	14.1	13.7	13.1	14.5	15.5	14.6	13.7	13.0	12.3
P/CF	9.3	11.1	10.0	12.3	10.5	12.8	12.0	11.8	11.3	10.8
P/BV	3.1	2.9	2.6	2.4	2.0	1.9	1.8	1.7	1.6	1.5
Dividend Yield	3.9%	3.9%	3.9%	4.0%	4.0%	4.0%	4.2%	4.3%	4.4%	4.5%
FCF Yield	(2.3%)	4.0%	6.0%	7.8%	4.8%	6.9%	7.5%	7.6%	8.0%	8.4%

Source: Bloomberg, QNBFS estimates

In terms of multiples, QEWS seems to be in-line to expensive vs. its closest peer Saudi Electricity and expensive vs. other EM/FM peers. We point out the company benefits from a virtually risk-free business model given domestic (and international, to an extent) contracted assets with strong cash flow visibility and no fuel cost/demand/funding risks. This can be seen in QEWS' solid growth profile after 2019; FCF yield also averages around 8% as we move beyond 2018.

Relative Valuation Versus Peers

Utilities Company	Ticker	Div. Yield	P/E		P/CFPS		EV/EBITDA		FCF Yield	
			FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e	FY2018e	FY2019e
Saudi Electricity Co	SECO	4.8%	17.0x	17.7x	3.2x	3.2x	9.2x	9.0x	(20.9%)	(6.5%)
Taqa Morocco	TQM	4.6%	19.5x	18.5x	NA	NA	8.7x	8.7x	10.6%	10.7%
Abu Dhabi National Energy Co PJSC	TAQA	NA	15.1x	5.9x	NA	NA	8.2x	7.8x	33.4%	50.9%
National Central Cooling Co PJSC	TABREED	4.9%	10.3x	9.7x	NA	NA	11.2x	10.7x	9.7%	12.4%
Montauk Holdings Ltd	MNK	0.8%	nmf	nmf	NA	NA	NA	NA	NA	NA
Sembcorp Salalah Power & Water Co	SSPW	4.9%	NA	NA	NA	NA	NA	NA	NA	NA
Kenya Electricity Generating Co PLC	KEGC	NA	5.4x	4.0x	NA	NA	7.3x	6.3x	(7.5%)	(3.4%)
Lyonnaise des Eaux de Casablanca	LYD	4.9%	18.4x	17.1x	NA	NA	4.9x	4.7x	13.9%	14.9%
Severn Trent PLC	SVT	4.6%	nmf	nmf	nmf	nmf	10.9x	10.4x	2.3%	4.8%
United Utilities Group PLC	UU/	5.4%	nmf	nmf	nmf	nmf	11.5x	11.1x	6.5%	9.1%
Tata Power Co Ltd/The	TPWR	1.9%	3.8x	9.8x	4.3x	4.0x	11.0x	10.3x	17.4%	20.7%
CESC Ltd	CESC	1.4%	9.6x	8.3x	5.4x	4.9x	6.6x	6.3x	19.1%	19.7%
NTPC Ltd	NTPC	3.1%	11.4x	9.8x	7.1x	5.6x	9.8x	8.4x	(5.7%)	(1.6%)
EDP - Energias do Brasil SA	ENBR3	4.2%	10.1x	9.0x	6.2x	5.7x	6.1x	5.5x	12.3%	7.3%
Average		3.8%	12.1x	11.0x	5.2x	4.7x	8.8x	8.3x	7.6%	11.6%
Median		4.6%	10.9x	9.8x	5.4x	4.9x	9.0x	8.5x	10.1%	9.9%
Qatar Electricity & Water Co QSC	QEWS	4.0%	14.5x	15.5x	10.5x	12.8x	17.6x	19.1x	4.8%	6.9%

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/Ratios

Particulars	2014	2015	2016	2017	2018e	2019e	2020e	2021e	2022e	2023e	CAGR ('19-'23)
Growth Rates											
Revenue	(0.2%)	2.9%	4.0%	(1.0%)	(14.3%)	(0.9%)	2.4%	2.5%	2.5%	2.5%	2.5%
Gross Profit	(1.8%)	1.9%	3.6%	(3.3%)	(15.0%)	(8.4%)	4.4%	4.4%	3.4%	3.5%	3.9%
EBITDA - Consolidated	(2.5%)	5.4%	2.8%	(4.9%)	(16.6%)	(10.1%)	4.7%	4.7%	3.6%	3.6%	4.2%
EBIT	(3.5%)	7.3%	7.2%	(9.3%)	(15.7%)	(14.6%)	6.4%	6.4%	4.7%	4.7%	5.5%
PBT	11.0%	(2.0%)	2.5%	4.2%	(9.1%)	(6.5%)	6.0%	6.8%	5.7%	5.5%	6.0%
PAT/EPS	10.5%	(1.9%)	2.8%	4.8%	(9.6%)	(6.5%)	6.0%	6.8%	5.7%	5.5%	6.0%
DPS	10.0%	0.0%	0.0%	3.3%	0.0%	0.0%	3.2%	3.1%	3.0%	2.9%	3.1%
CFPS	30.7%	(16.6%)	11.7%	(19.0%)	16.7%	(17.5%)	6.9%	1.2%	4.7%	4.5%	4.3%
FCFPS	NM	NM	50.5%	31.1%	(39.1%)	45.7%	7.7%	1.4%	5.3%	5.0%	4.8%
Operating Ratios											
Gross Margin	59.5%	58.9%	58.7%	57.3%	56.8%	52.5%	53.5%	54.5%	55.0%	55.5%	
EBITDA Margin - Consolidated	51.8%	53.1%	52.5%	50.4%	49.1%	44.5%	45.5%	46.5%	47.0%	47.5%	
EBIT Margin	36.3%	37.8%	38.9%	35.7%	35.1%	30.3%	31.4%	32.6%	33.3%	34.0%	
Net Margin	52.8%	50.3%	49.7%	52.6%	55.5%	52.4%	54.2%	56.5%	58.2%	59.9%	
Finance Ratios											
Debt-Equity Ratio	0.8	0.7	0.7	0.7	0.5	0.5	0.4	0.4	0.3	0.3	
Net Debt-Equity Ratio	0.5	0.4	0.4	0.3	0.3	0.2	0.1	0.1	0.0	(0.0)	
Interest Coverage	9.7	9.4	8.1	6.1	4.1	3.4	3.7	4.1	4.6	5.1	
Return Ratios											
ROIC	8.8%	9.2%	8.5%	7.4%	5.6%	4.7%	5.0%	5.2%	5.3%	5.4%	
ROE	22.6%	20.4%	18.6%	18.0%	13.7%	12.2%	12.3%	12.4%	12.4%	12.4%	
ROA	11.8%	11.2%	10.1%	10.2%	8.4%	7.8%	8.1%	8.5%	8.8%	9.1%	
FCF Yield	-2.3%	4.0%	6.0%	7.8%	4.8%	6.9%	7.5%	7.6%	8.0%	8.4%	
Liquidity Ratios											
Current Ratio	1.2	1.5	2.1	2.3	2.0	2.2	2.2	2.4	2.6	2.8	
Quick Ratio	1.1	1.4	1.9	2.2	1.9	2.0	2.1	2.3	2.5	2.7	

Source: Bloomberg, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Revenue	3,071	2,633	2,609	2,673
Cost of Sales, Excluding Depreciation	(1,312)	(1,137)	(1,239)	(1,243)
Gross Profit	1,759	1,495	1,370	1,430
General & Administrative Expenses	(210)	(203)	(208)	(213)
EBITDA	1,549	1,293	1,162	1,217
Deferred Income	0	0	0	0
Depreciation & Amortization	(453)	(369)	(373)	(377)
EBIT	1,096	924	789	840
Finance Costs, Net	(164)	(114)	(152)	(146)
Dividend Income & Gain on Sale of AFS	95	111	122	134
Other & Miscellaneous Income/Expense & Share of Profits from JVs	613	570	635	649
Share of Associates	0	0	0	0
Profit Before Tax	1,639	1,490	1,393	1,477
Income Tax Expense	0	0	0	0
Profit After Tax (Continuing Operations)	1,639	1,490	1,393	1,477
Discontinued Operations				
Minority Interest	(23)	(29)	(27)	(29)
Profit for Shareholders	1,616	1,461	1,366	1,449
EPS (QR)	14.69	13.29	12.42	13.17

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Non-Current Assets				
Property, Plant and Equipment	5,745	5,434	5,169	4,901
Available-for-Sale Investments	702	1,384	1,384	1,384
Finance Lease Receivables	1,249	1,141	1,043	954
JV Loans and Investments in JVs	3,136	5,021	5,367	5,719
Other Non-Current assets	330	340	332	324
Total Non-Current Assets	11,161	13,321	13,296	13,282
Current Assets				
Finance Lease Receivables & Others	120	135	135	135
Inventories	231	234	255	255
Accounts Receivables & Prepayments	849	577	572	586
Cash and Short-Term Deposits	3,436	3,040	3,369	3,611
Total Current Assets	4,635	3,986	4,330	4,587
Total Assets	15,797	17,307	17,626	17,869
Equity				
Equity to the Parent	8,978	10,658	11,172	11,768
Minority Interest	250	246	241	237
Total Equity	9,228	10,903	11,413	12,005
Non-Current Liabilities				
Loans and Borrowings	4,442	4,327	4,110	3,699
Employees' End of Service Benefits	74	84	93	103
Derivatives	27	5	5	5
Total Non-Current Liabilities	4,543	4,416	4,209	3,807
Current Liabilities				
Accounts Payables & Others	586	561	577	630
Loans and Borrowings	1,424	1,423	1,423	1,423
Derivatives	15	4	4	4
Total Current Liabilities	2,026	1,988	2,004	2,057
Equity and Liabilities	15,797	17,307	17,626	17,869

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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