

Qatar Electricity & Water Company (QEWS)

Recommendation	ACCUMULATE	Risk Rating	R-2
Share Price	QR217.60	Current Target Price	QR256.00
Implied Upside	17.6%	Old Target Price	QR229.00

Raising TP & Maintaining Accumulate Rating

We are raising our target price to reflect Facility D project beginning in 2017. 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. We retain our long-term bullish stance on QEWS with an Accumulate rating.

Highlights

- **Seasonality boosted revenue and net income on a sequential basis in 2Q2015.** QEWS reported a 2Q2015 bottom-line of QR391mn (+13% QoQ, -6% YoY) versus our estimate of QR423mn and Reuters mean estimate of QR429mn. The company generated revenue of QR753mn (+13% QoQ, flattish YoY excluding the impact of satellite stations but down 3% otherwise), which was only 4% shy of our estimate of QR787mn. Reported revenue was impacted by discontinuation of satellite stations by YE2014 (already reflected in our model) and a lower tariff regime for RAF A, which is subjected a new two-year PWPA from 2015 onward.
- **Operating margins generally softened and came in below our estimates.** Direct costs expanded during the quarter, lowering the gross margin to 58.8% vs. 60.8% in 1Q2015/2Q2014; EBITDA came in at QR399mn (+10% QoQ, -1% YoY) lowering the EBITDA margin to 53.0% vs. 54.4% in 1Q2015 and 53.6% in 2Q2014. EBIT margins advanced to 38.9% vs. 38.8% in March 2015 and 38.4% in the year-ago quarter benefiting from lower depreciation charges given RAF A has been fully depreciated as of YE2014.
- **Net income grew sequentially but declined vs. 2Q2014 given one-offs.** The second quarter of 2014 benefited from QR44mn in claims settlement; however, in 2Q2015, QEWS recorded a gain from sale of less than QR1mn from the IPO of Phoenix Power (running the Sur Power plant in Oman) that reduced the company's stake to 9.75% from 15%. In 2Q2015, QEWS had to forego around QR7mn in net income that it recorded last year from its satellite stations; however, the impact of the new RAF A tariff regime was a wash on net income with lower revenue being offset by reduced depreciation expenses.
- **Updating our model and factoring in Facility D:** QEWS owns 60% of this \$3bn, 2,520 MW and 136.5 MIGD project, which is likely to be funded by 85% debt. We expect contribution to begin through Phase I in 2017, followed by full operations in 2018. Consequently, we raise our 2017 and 2018 net income estimates by 4% and 10%, respectively.

Catalysts

- **New projects on the horizon:** QEWS should benefit from two new 100%-owned water plants, RAF A2 (36 MIGD) from this month and RAF A3 (36 MIGD) from September 2016 (fully operational by 2017), adding ~28% to QEWS' net water capacity. Further, Facility D should be fully contributing 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. Moreover, QEWS is seeking regional expansion through a \$1bn JV (60% stake), Nebras Power, with QP/QH.

Recommendation, Valuation and Risks

- **Recommendation and valuation:** *We rate QEWS an Accumulate with a revised price target of QR256.00.* The stock trading at a 2016 P/E of 14.8x.
- **Risks: Declining oil prices are a major risk to regional equities.** We note these further specific risks: 1) EBITDA margin erosion & 2) Foreign expansion risks.

Key Financial Data and Estimates

	FY2013	FY2014	FY2015e	FY2016e
Revenue (QR mn)	2,904	2,989	3,076	3,370
Revenue Growth	2.3%	2.9%	2.9%	9.5%
EPS (QR)	12.58	13.91	14.06	14.68
EPS Growth	-3.3%	10.5%	1.1%	4.4%
P/E (x)	17.3	15.6	15.5	14.8
DPS (QR)	6.82	7.50	7.75	8.00
Dividend Payout	54.2%	53.9%	55.1%	54.5%
Dividend Yield	3.1%	3.4%	3.6%	3.7%
ROE	22.6%	22.6%	20.8%	19.7%

Source: Company data, QNBFS estimates

Key Data

Current Market Price (QR)	217.60
Dividend Yield (%)	3.6
Bloomberg Ticker	QEWS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QEWQ.QA
ISIN	QA0006929812
Sector*	Industrials
52wk High/52wk Low (QR)	228.00/162.00
3-m Average Volume ('000)	35.4
Mkt. Cap. (\$ bn/QR bn)	6.6/23.9
Shares Outstanding (mn)	110.0
FO Limit* (%)	25.0
Current FO* (%)	10.3
1-Year Total Return (%)	24.2
Fiscal Year End	December 31

Source: Bloomberg (as of August 04, 2014), *Qatar Exchange (as of August 03, 2015); Note: FO is foreign ownership

Saugata Sarkar

+974 4476 6534

saugata.sarkar@qnbfs.com.qa

Revising Estimates

We are revising our estimates to account for Facility D. Major divergence is seen in 2018, when Facility D is fully operational with earnings increasing 10% vs. our prior estimate. Facility D should impact 2017 earnings as well given that Phase I should be operational that year. We do note that Facility D will not impact QEWS' revenue as it is a joint venture and will be accounted for using the equity method. Before 2017, our changes reflect model tweaks incorporating 2Q2015 results; we do note that we now expect RAF A3 to commence operations in August 2015 vs. our prior expectation of July 2015.

Estimate Changes

QR mn Except per Share Values	Current Estimates				Previous Estimates				Change in %			
	2015e	2016e	2017e	2018e	2015e	2016e	2017e	2018e	2015e	2016e	2017e	2018e
Revenue	3,076	3,370	3,619	3,676	3,116	3,412	3,649	3,706	(1.3)	(1.2)	(0.8)	(0.8)
EBITDA	1,606	1,736	1,839	1,850	1,569	1,701	1,801	1,810	2.4	2.1	2.1	2.2
Net Income	1,546	1,615	1,798	2,006	1,516	1,606	1,724	1,819	2.0	0.6	4.3	10.3
EPS	14.06	14.68	16.35	18.24	13.79	14.60	15.67	16.53	2.0	0.6	4.3	10.3
DPS	7.75	8.00	8.50	9.00	7.75	8.00	8.25	8.50	0.0	0.0	3.0	5.9

Source: Company data, QNBFS estimates

Slight Top-Line Underperformance Leads to a 7% Miss in 2Q2015 earnings

Seasonality boosted revenue and net income on a sequential basis. QEWS reported a 2Q2015 bottom-line of QR391mn (+13% QoQ, -6% YoY) versus our estimate of QR423mn and Reuters mean estimate of QR429mn.

- **The company generated revenue of QR753mn (+13% QoQ, flattish YoY excluding the impact of satellite stations but down 3% otherwise), which was only 4% shy of our estimate of QR787mn.** Reported revenue was impacted by discontinuation of satellite stations by YE2014 (already reflected in our model) and a lower tariff regime for RAF A, which is subjected a new two-year PWPA from 2015 onward. The satellite stations made up about 2% of QEWS' power capacity, while RAF A makes up roughly 6% and 17% of the company's power and water capacity, respectively. We note that 2Q2014 revenue did feel some impact, mostly in power sales, from maintenance-related shutdowns at RAF B2/A1 early during the quarter.
- **Operating margins generally softened and came in below our estimates.** Direct costs expanded during the quarter, lowering the gross margin to 58.8% vs. 60.8% in 1Q2015/2Q2014; EBITDA came in at QR399mn (+10% QoQ, -1% YoY) lowering the EBITDA margin to 53.0% vs. 54.4% in 1Q2015 and 53.6% in 2Q2014. EBIT margins advanced to 38.9% vs. 38.8% in March 2015 and 38.4% in the year-ago quarter benefiting from lower depreciation charges given RAF A has been fully depreciated as of YE2014.
- **Net income grew sequentially but declined vs. 2Q2014 given one-offs.** The second quarter of 2014 benefited from QR44mn in claims settlement; however, in 2Q2015, QEWS recorded a gain from sale of less than QR1mn from the IPO of Phoenix Power (running the Sur Power plant in Oman) that reduced the company's stake to 9.75% from 15%. In 2Q2015, QEWS had to forego around QR7mn in net income that it recorded last year from its satellite stations; however, the impact of the new RAF A tariff regime was a wash on net income with lower revenue being offset by reduced depreciation expenses.

Key Financial Data and Estimates

QR mn Except per Share Values	2Q2015	QoQ	YoY	2Q2015e	Actual Vs. Estimate	1Q2015	2Q2014
Revenue	753	12.9	(0.2)	787	(4.3)	667	755
Gross Profit	443	9.2	(3.5)	484	(8.6)	406	459
Gross Margin (%)	58.8			61.5		60.8	60.8
EBITDA	399	10.0	(1.3)	429	(7.0)	363	404
EBITDA Margin (%)	53.0			54.5		54.4	53.6
EBIT	293	13.3	1.1	325	(9.9)	259	290
EBIT Margin (%)	38.9			41.3		38.8	38.4
Net Income	391	13.0	(6.1)	423	(7.5)	346	417
Net Margin (%)	51.9			53.7		51.9	55.2

Source: Company data, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	FY2013	FY2014	FY2015e	FY2016e
Revenue	2,904	2,989	3,076	3,370
Cost of Sales, Excluding Depreciation	(1,148)	(1,227)	(1,268)	(1,406)
Gross Profit	1,756	1,762	1,808	1,963
General & Administrative Expenses	(215)	(225)	(202)	(228)
EBITDA	1,541	1,537	1,606	1,736
Deferred Income	7	7	7	0
Depreciation & Amortization	(459)	(461)	(457)	(515)
EBIT	1,089	1,083	1,156	1,221
Finance Costs	(178)	(108)	(99)	(114)
Interest Income, Dividend Income & Gain on Sale of AFS	92	41	41	44
Other & Miscellaneous Income/Expense & Share of Profits from JVs	389	523	436	457
Share of Associates	19	28	50	47
Profit Before Tax	1,412	1,567	1,585	1,654
Income Tax Expense	0	0	0	0
Profit After Tax	1,412	1,567	1,585	1,654
Minority Interest	(27)	(37)	(38)	(40)
Profit for Shareholders	1,384	1,530	1,546	1,615
EPS (QR)	12.58	13.91	14.06	14.68

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2013	FY2014	FY2015e	FY2016e
Non-Current Assets				
Property, Plant and Equipment	5,055	5,328	6,207	6,459
Available-for-Sale Investments	454	485	421	421
Finance Lease Receivables	1,775	1,637	1,523	1,408
JV Loans and Investments in JVs	721	2,567	2,637	2,834
Other Non-Current assets	267	424	428	430
Total Non-Current Assets	8,272	10,442	11,216	11,552
Current Assets				
Finance Lease Receivables & Others	168	138	144	144
Inventories	276	195	188	208
Accounts Receivables & Prepayments	585	552	632	692
Cash and Short-Term Deposits	1,726	1,622	2,229	2,747
Total Current Assets	2,754	2,507	3,193	3,792
Total Assets	11,026	12,949	14,409	15,344
Equity				
Equity to the Parent	6,111	6,782	7,448	8,210
Minority Interest	230	243	257	271
Total Equity	6,341	7,025	7,705	8,481
Non-Current Liabilities				
Loans and Borrowings	3,361	3,674	4,528	4,622
Deferred Income	14	7	0	0
Employees' End of Service Benefits	39	44	48	52
Total Non-Current Liabilities	3,414	3,725	4,576	4,674
Current Liabilities				
Accounts Payables & Others	689	603	636	697
Loans and Borrowings	413	1,425	1,342	1,342
Derivatives	169	171	150	150
Total Current Liabilities	1,272	2,199	2,127	2,189
Equity and Liabilities	11,026	12,949	14,409	15,344

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

Contacts

Saugata Sarkar

Head of Research

Tel: (+974) 4476 6534

saugata.sarkar@qnbfs.com.qa

Sahbi Kasraoui

Head of HNI

Tel: (+974) 4476 6544

sahbi.alkasraoui@qnbfs.com.qa

QNB Financial Services SPC

Contact Center: (+974) 4476 6666

PO Box 24025

Doha, Qatar

Disclaimer and Copyright Notice: This publication has been prepared by QNB Financial Services SPC ("QNBFS") a wholly-owned subsidiary of QNB SAQ ("QNB"). QNBFS is regulated by the Qatar Financial Markets Authority and the Qatar Exchange QNB SAQ is regulated by the Qatar Central Bank. This publication expresses the views and opinions of QNBFS at a given time only. It is not an offer, promotion or recommendation to buy or sell securities or other investments, nor is it intended to constitute legal, tax, accounting, or financial advice. QNBFS accepts no liability whatsoever for any direct or indirect losses arising from use of this report. Any investment decision should depend on the individual circumstances of the investor and be based on specifically engaged investment advice. We therefore strongly advise potential investors to seek independent professional advice before making any investment decision. Although the information in this report has been obtained from sources that QNBFS believes to be reliable, we have not independently verified such information and it may not be accurate or complete. QNBFS does not make any representations or warranties as to the accuracy and completeness of the information it may contain, and declines any liability in that respect. For reports dealing with Technical Analysis, expressed opinions and/or recommendations may be different or contrary to the opinions/recommendations of QNBFS Fundamental Research as a result of depending solely on the historical technical data (price and volume). QNBFS reserves the right to amend the views and opinions expressed in this publication at any time. It may also express viewpoints or make investment decisions that differ significantly from, or even contradict, the views and opinions included in this report. This report may not be reproduced in whole or in part without permission from QNBFS

COPYRIGHT: No part of this document may be reproduced without the explicit written permission of QNBFS.