

Qatar Electricity & Water Company (QEWS)

Recommendation	OUTPERFORM	Risk Rating	R-2
Share Price	QR190.00	Current Target Price	QR233.00
Implied Upside	22.6%	Old Target Price	QR223.00

Updating Model and Raising PT/Rating to QR233/Outperform

We are upgrading QEWS from an Accumulate to an Outperform. Although 2Q2018 was admittedly weaker-than-expected and the stock has drifted down after touching its YTD high of QR205.25, which was fueled by strong 1Q2018 results/FOL hike, we continue to believe there is long-term upside in the name. While QEWS essentially reported in-line 1H2018 results vs. our model, our previous 2018 estimates were too conservative prompting us to revisit our model. Our forecasts for 2018 revenue/EPS go from QR2.5bn/QR13.32 to QR2.7bn/QR14.47. Beyond 2018, our forward revenue/EPS estimates increase by an average of 4%. We also raise our 12-month price target from QR223 to QR233 and increase QEWS' rating from Accumulate to Outperform.

Highlights

- **QEWS reported 2Q2018 revenue/EPS of QR684mn/QR3.80 missing our estimates of QR746mn/QR4.41 by 8%.** Net income of QR418mn declined 9% YoY but increased 6% QoQ benefitting from seasonality. 2Q2018 revenue of QR684mn (-16% YoY, +4% QoQ) also showed a similar trend with the yearly fall in revenue mostly prompted by the decommissioning of an older plant (RAF A) last year (see page 2 for more details).
- **QNBFS forecasts: 2018 Revenue/EPS increases from QR2.5bn/QR13.32 to QR2.7bn/QR14.47 and 2019 Revenue/EPS goes from QR2.6bn/QR14.36 to QR2.7bn/QR15.06.** Beyond 2018, our forward revenue/EPS estimates increase by an average of 4%. While QEWS essentially reported in-line 1H2018 results vs. our model, our previous 2018 estimates were too conservative prompting us to revisit our model.
- **We 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/PWPAs 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 13% 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.
- **Solid growth profile with industry leading EBITDA margins and attractive dividend/FCF yields.** We expect EBITDA CAGR of 1.7% over 2019-2023 and FCF to grow around 4.5% over the same period driven by Facility D (Um Al Houli) and inflation-driven capacity charge increases. Despite modeled compression, QEWS should maintain above-average EBITDA margins (avg.: ~52%). We expect dividend yield to average 4.6% over 2018-2023 and FCF yield to average 8.7% over the same period (despite a dip in 2018 as QEWS invested \$251.2mn recently into the Facility D JV). ROEs remain healthy.

Catalysts

- **New opportunities currently not in our model:** Besides Um Al Houli, 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 QR233. Shares have generated 54% in 5-year total returns, outpacing the DSM Index (25%) & the MSCI EM Index (32%).
- **Risks: Geopolitical risks** cannot be modeled. Besides risks in international expansion, there is always a chance domestic projects get delayed/shelved. It is possible Kahramaa substantially renegotiates the terms of existing contracts and recent discussions on K-Factors gives us pause; however, this is not an imminent risk. **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	2,698	2,747	2,809
Revenue Growth	-1.0%	-12.1%	1.8%	2.3%
EPS (QR)	14.69	14.47	15.06	15.51
EPS Growth	4.8%	-1.5%	4.1%	3.0%
P/E (x)	12.9	13.1	12.6	12.3
DPS (QR)	7.75	7.75	8.00	8.50
ROE	4.1%	4.1%	4.2%	4.5%

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

Key Data

Current Market Price (QR)	190.00
Current Dividend Yield (%)	4.1
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)	97.0
Mkt. Cap. (\$ bn/QR bn)	5.7/20.9
EV (\$ bn/QR bn)	6.5/23.6
Shares Outstanding (mn)	110.0
FO Limit* (%)	49.0
Current FO* (%)	12.0
1-Year Total Return (%)	4.0
Fiscal Year End	December 31

Source: Bloomberg (as of July 31, 2018), *Qatar Exchange (as of July 31, 2018); Note: FO is foreign ownership

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2Q2018 Review

QEWS reported 2Q2018 revenue/EPS of QR684mn/QR3.80 missing our estimates of QR746mn/QR4.41 by 8%. Net income of QR418mn declined 9% YoY but increased 6% QoQ benefitting from seasonality. 2Q2018 revenue of QR684mn (-16% YoY, +4% QoQ) also showed a similar trend with the yearly fall in revenue mostly prompted by the decommissioning of an older plant (RAF A) last year

Key Metrics

	2Q2018	2Q2017	1Q2018	YoY	QoQ	Comments
Revenue	684.26	817.95	659.89	-16.3%	3.7%	2Q2018 revenue lower by 14% YoY due to decommissioning of RAF A; modest impact of RAF B (no capacity charges along but almost offset by lower depreciation expenses) and RAF A1 (lower K-Factor)
Gross Profit	438.70	502.09	393.02	-12.6%	11.6%	Benefits from lack of RAF A and higher seasonal availability of power/water
EBITDA	394.93	456.08	344.75	-13.4%	14.6%	
JV Income	149.01	158.16	131.09	-5.8%	13.7%	Um Al Houll lower YoY due to lower K-Factor; modest YoY declines in Nebras (higher interest charges) and RGPC
Net Income	418.17	460.32	394.38	-9.2%	6.0%	YoY decline with fall in revenue/JV income somewhat offset by improved margins; QoQ growth in revenue/margins due to seasonality
EPS	3.80	4.18	3.59	-9.2%	6.0%	
Gross Margin	64.1%	61.4%	59.6%			
EBITDA Margin	57.7%	55.8%	52.2%			
Net Margin	61.1%	56.3%	59.8%			

Source: Company data, QNBFS estimates

Valuation

Valuation Metrics

Particulars	2014	2015	2016	2017	2018e	2019e	2020e	2021e	2022e	2023e
Valuation										
EV/Sales	8.3	8.0	7.6	7.5	8.4	7.9	7.4	6.9	6.4	5.9
EV/EBITDA - Consolidated	16.1	15.1	14.5	14.8	15.8	15.0	14.1	13.2	12.3	11.4
EV/EBIT	23.0	21.3	19.5	20.9	21.3	20.2	18.9	17.7	16.4	15.2
P/E	13.7	13.9	13.6	12.9	13.1	12.6	12.3	11.8	11.4	11.0
P/CF	9.4	11.3	10.1	12.5	9.7	10.8	10.0	9.7	9.4	9.2
P/BV	3.1	2.8	2.5	2.3	2.2	2.0	1.8	1.7	1.6	1.5
Dividend Yield	3.9%	3.9%	3.9%	4.1%	4.1%	4.2%	4.5%	4.7%	5.0%	5.3%
FCF Yield	(2.3%)	3.9%	5.9%	7.7%	5.6%	8.4%	9.2%	9.4%	9.7%	10.0%

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. However, we point to the company's attractive dividend yield and strong FCF yield. We also note 2018 is a down year (12.1% decline in revenue; 1.5% decline in net income) for QEWS given the expiration of a key project (RAF A) which inflates multiples. We further 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 2018; FCF yield also averages more than 9% 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	3.6%	19.3x	20.2x	4.2x	4.2x	10.0x	9.8x	(1.7%)	(5.0%)
Taqa Morocco	TQM	4.7%	19.3x	18.3x	NA	NA	8.7x	8.6x	10.7%	11.0%
Abu Dhabi National Energy Co PJSC	TAQA	NA	9.3x	4.8x	NA	NA	8.2x	7.7x	32.7%	48.9%
National Central Cooling Co PJSC	TABREED	4.3%	12.1x	10.7x	NA	NA	11.6x	10.9x	8.5%	8.8%
Montauk Holdings Ltd	MNK	0.6%	NA	nmf	NA	NA	NA	NA	NA	NA
Sembcorp Salalah Power & Water Co	SSPW	4.6%	NA	NA	NA	NA	NA	NA	NA	NA
Kenya Electricity Generating Co Ltd	KEGC	NA	4.7x	3.1x	NA	NA	6.5x	5.8x	(8.3%)	(3.8%)
Lyonnaise des Eaux de Casablanca	LYD	4.5%	20.1x	18.8x	NA	NA	5.5x	5.3x	12.6%	13.6%
Severn Trent PLC	SVT	4.5%	nmf	nmf	nmf	42.0x	11.1x	10.5x	3.1%	5.3%
United Utilities Group PLC	UU/	5.5%	nmf	nmf	nmf	nmf	11.4x	10.8x	6.7%	9.4%
Tata Power Co Ltd/The	TPWR	1.8%	3.8x	10.3x	4.7x	4.3x	11.2x	10.4x	14.8%	21.8%
CESC Ltd	CESC	1.3%	10.4x	9.0x	5.8x	5.3x	6.9x	6.6x	17.9%	18.4%
NTPC Ltd	NTPC	3.2%	10.8x	9.4x	6.2x	5.3x	9.3x	7.9x	(6.2%)	0.5%
EDP - Energias do Brasil SA	ENBR3	4.4%	9.8x	8.8x	5.9x	5.4x	5.9x	5.3x	10.0%	7.4%
Average		3.6%	12.0x	11.3x	5.4x	11.1x	8.8x	8.3x	8.4%	11.4%
Median		4.4%	10.6x	9.9x	5.8x	5.3x	9.0x	8.3x	9.2%	9.1%
Qatar Electricity & Water Co QSC	QEWS	4.1%	13.1x	12.6x	9.7x	10.8x	15.8x	15.0x	5.6%	8.4%

Key Growth Rates/CAGRs

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%)	(12.1%)	1.8%	2.3%	2.3%	2.3%	2.4%	2.3%
Gross Profit	(1.8%)	1.9%	3.6%	(3.3%)	(7.2%)	1.4%	1.8%	1.9%	1.9%	1.9%	1.9%
EBITDA - Consolidated	(2.5%)	5.4%	2.8%	(4.9%)	(7.7%)	1.2%	1.7%	1.7%	1.7%	1.8%	1.7%
EBIT	(3.5%)	7.3%	7.2%	(9.3%)	(3.0%)	1.2%	1.9%	1.9%	2.0%	2.0%	1.9%
PBT	11.0%	(2.0%)	2.5%	4.2%	(1.1%)	4.0%	3.0%	3.7%	3.7%	3.3%	3.4%
PAT/EPS	10.5%	(1.9%)	2.8%	4.8%	(1.5%)	4.1%	3.0%	3.7%	3.7%	3.3%	3.4%
DPS	10.0%	0.0%	0.0%	3.3%	0.0%	3.2%	6.3%	5.9%	5.6%	5.3%	5.7%
CFPS	30.7%	(16.6%)	11.7%	(19.0%)	28.5%	(9.9%)	8.5%	2.7%	2.8%	2.5%	4.1%
FCFPS	NM	NM	50.5%	31.1%	(27.7%)	50.7%	9.3%	3.0%	3.0%	2.7%	4.5%

Source: Bloomberg, QNBFS estimates

Detailed Financial Statements

Income Statement (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Revenue	3,071	2,698	2,747	2,809
Cost of Sales, Excluding Depreciation	(1,312)	(1,066)	(1,092)	(1,123)
Gross Profit	1,759	1,632	1,655	1,685
General & Administrative Expenses	(210)	(203)	(209)	(215)
EBITDA	1,549	1,429	1,446	1,470
Deferred Income	0	0	0	0
Depreciation & Amortization	(453)	(366)	(370)	(374)
EBIT	1,096	1,063	1,076	1,096
Finance Costs, Net	(164)	(186)	(174)	(171)
Dividend Income & Gain on Sale of AFS	95	106	117	129
Other & Miscellaneous Income/Expense & Share of Profits from JVs	613	637	667	682
Share of Associates	0	0	0	0
Profit Before Tax	1,639	1,621	1,686	1,736
Income Tax Expense	0	0	0	0
Profit After Tax (Continuing Operations)	1,639	1,621	1,686	1,736
Discontinued Operations				
Minority Interest	(23)	(29)	(30)	(30)
Profit for Shareholders	1,616	1,592	1,657	1,706
EPS (QR)	14.69	14.47	15.06	15.51

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2017	FY2018e	FY2019e	FY2020e
Non-Current Assets				
Property, Plant and Equipment	5,745	5,454	5,192	4,926
Available-for-Sale Investments	702	1,075	1,075	1,075
Finance Lease Receivables	1,249	1,141	1,043	954
JV Loans and Investments in JVs	3,136	4,252	4,532	4,707
Other Non-Current assets	330	337	329	321
Total Non-Current Assets	11,161	12,259	12,171	11,982
Current Assets				
Finance Lease Receivables & Others	120	130	130	130
Inventories	231	219	224	231
Accounts Receivables & Prepayments	852	591	602	616
Cash and Short-Term Deposits	3,436	3,227	3,875	4,462
Total Current Assets	4,639	4,167	4,831	5,439
Total Assets	15,800	16,426	17,002	17,420
Equity				
Equity to the Parent	8,978	9,717	10,521	11,347
Minority Interest	250	246	241	236
Total Equity	9,228	9,963	10,762	11,584
Non-Current Liabilities				
Loans and Borrowings	4,442	4,351	4,134	3,720
Employees' End of Service Benefits	74	84	93	103
Derivatives	27	9	9	9
Total Non-Current Liabilities	4,543	4,444	4,236	3,833
Current Liabilities				
Accounts Payables & Others	590	584	568	569
Loans and Borrowings	1,424	1,420	1,420	1,420
Derivatives	15	15	15	15
Total Current Liabilities	2,029	2,019	2,003	2,004
Equity and Liabilities	15,800	16,426	17,002	17,420

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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