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Gulf International Services QSC

Company:	**Gulf International Services**
Conference Title:	**Gulf International Services (GISS) Q1-22 Results Conference Call**
Speakers from GISS:	**Sami Mathlouthi, Assistant Manager, Privatized Companies Affairs, QatarEnergy** **Rashid Al-Mohannadi, Sr. Financial Management Analyst, QatarEnergy** **Riaz Khan, Investor Relations Officer, QatarEnergy**
Moderator:	**Bobby Sarkar, Head of Research – QNB Financial Services**
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Conference Time:	**1:30 pm Doha Time**

Operator:	Good day, and welcome to the Gulf International Services Company's Second-Quarter Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Bobby Sarkar. Please go ahead.
Bobby Sakar [QNB FS]:	Thanks so much. Hi. Hello, everyone. This is Bobby Sarkar, Head of Research at QNB Financial Services. I wanted to welcome everyone to Gulf International Services Second Quarter 2020 Results Conference Call. So on this call from Qatar Energy's Privatised Companies Affairs Group, we have Sami Mathlouthi, who is the Assistant Manager in Financial Operations. We have Rashid Al-Mohannadi, who is a Senior Financial Management Analyst. And Riaz Khan, who is the Investor Relations Officer. So we will conduct this conference with the management reviewing the company's results, followed by a Q&A. I would like to turn the call over now to Riaz. Please go ahead.
Riaz Khan [GIS]:	Thank you Bobby. Good afternoon and thank you all for joining us. Before we go into the business and performance updates of GIS, I would like to mention that this call is purely for the investors of GIS and no media representatives should be attending this call. Moreover, please note that this call is subject to GIS's disclaimer statements as detailed on slide no. 2 of the IR deck. Moving on to the call, on 11th of August, GIS published its results for the six-month period ended 30th of June 2022, and today in this call, we will go through these results and provide you an update on key financial and operational highlights. We have structured our call as follows: ▪ At first, I will provide you a quick insight on GIS's ownership structure, competitive advantages, overall governance & BOD structure by covering slides 5 till 8, and slides 29 & 30; ▪ Secondly, Sami will brief you on GIS's key operational & financial performance matrix. ▪ Later, I will provide you with insights on the segmental performance. ▪ And finally, we will open the floor for the Q&A session. To start with, as detailed on slide no. 6 of the IR deck, the ownership structure of GIS comprises of QatarEnergy with 10% stake being the Parent shareholder, whereas GRSIA with 22.3% stake is the largest shareholder.

	As detailed on slide no. 5, QatarEnergy provides most of the head office functions through a service-level agreement. The operations of GIS's subsidiaries are independently managed by their respective Board of Directors, along with the senior management team. The BOD structure is detailed on slide no. 7 of the IR Presentation. In terms of competitive advantages, as detailed on slide no. 8, all of the GIS's group companies are strategically placed having significant market share in their respective business sectors within Qatar. • For eg. drilling business is the only Qatari on-shore drilling service provider and have more than 50% market share in the off-shore drilling service in Qatar. • Similarly, the aviation business of GIS is a sole provider of helicopter services in Qatar's Oil & Gas service sector and being one of the largest operator in the MENA region. • In terms of insurance business, it is one of the leading medical insurance providers in Qatar. • This is supported by an experienced senior leadership having expertise in the relevant business segments. In terms of the Governance structure of GIS, you may refer to slides 29 & 30 of the IR deck, which covers various aspects of GIS's code of corporate governance in detail. I will now hand over to Sami.
Sami Mathlouthi [GIS]:	Thank you Riaz. Good afternoon and thank you all for joining us. Starting with the business updates, Within the drilling segment: 1. new contracts are won in KSA & Maldives for liftboats within the drilling segment. These liftboats remained operational throughout the second quarter of 2022; 2. Also, the segment had successfully renewed contracts for certain offshore rigs with extended term ranging from 2 to 5 years; 3. This was in addition to continued positive impacts on segment's performance for the first half of 2022, from new rig day-rates for the offshore fleet applied starting from mid of last year and redeployment of two previously suspended onshore rigs during the third quarter 2021. Aviation segment continues to witness improved set of performance with better flying activity within both domestic and international operations. Also, contributions from MRO & international business continue to support the segment performance. During the second quarter of 2022, international operations witnessed further growth from Angola's contract revision with better terms on account of better asset utilization. An aircraft was mobilized to the Angolan fleet from the Qatari fleet to cover the additional flying hours as per the new contract. Also, another aircraft was mobilized to the Turkish fleet from Qatar to meet the upcoming increased demand from the market. Within the insurance segment expansion on the general line of business was noted. However, medical insurance business witnessed loss of certain contracts.

The catering segment improved its performance on the back of realizations from the new contract won during last year. Additionally, certain contracts have been renewed within manpower segments, with broader scope improving overall service volumes for the segment.

In terms of Group's financial performance, as detailed on slide 12, the Group's total revenue for the first six months of 2022 improved by 21% compared to the same period of last year, to reach QR 1.7 billion. Revenue growth from the aviation, drilling and catering segments led to an overall increase in the Group revenue. This was partially offset by a negative growth in revenue from the insurance segment.

For the current six-month period, the Group averaged an EBITDA of QR 398 million, with an increase of 63% versus the same period of last year. The Group reported a net profit for the current financial period amounting to QR 168 million, as compared to a net loss of QR 0.8 million for the same period of last year.

When analyzing the profitability in more detail, as reflected on slide 14, the main contributor towards the growth in the bottom-line profitability was mainly linked to Group revenue. This was partially offset by higher direct costs, G&A expenses and net finance cost. Also, foreign currency revaluation losses from Gulf Helicopter's Turkish subsidiary contributed negatively towards the year-on-year movement in net earnings. Additionally, decline in investment income from the insurance segment also adversely affected 1H-22 profitability versus 1H-21.

Moving on to quarter-on-quarter performance, revenue for the second quarter of 2022 increased by 8% compared to the first quarter of 2022, mainly on account of better revenue reported from the insurance, aviation and catering segments, which was slightly offset by negative movement in the topline from the drilling segment.

Net profit for the second quarter slightly inched higher by 1% compared to the first quarter. Minimal growth in the Group net profit was reported as the negative movements in profitability from insurance, drilling and catering segments, predominantly offset the aviation segment's continued growth in bottom-line profitability.

On overall basis, our base case strategy will continue to focus on market development by focusing on building our market share, reducing operating costs and continue to improve utilization of assets.

I will now hand over to Riaz, to cover the segmental performance.

Riaz Khan [GIS]:	Thank you Sami. I will start with Drilling segment, where you may refer to slides 16 till 18. Drilling segment reported a revenue of QR 632 million for the six-month period ended 30 June 2022, up by 43% compared to the first six months of last year. This revenue growth has largely been linked to the new rig day-rates implemented for the offshore fleet since the mid of last year (July'21). Also, redeployment of the two onshore suspended rigs, i.e. GDI-5 and GDI-7, during the third quarter of 2021, positively contributed to the topline performance. Moreover, full deployment of Gulfdrill JV's fleet since mid-last year, had a positive impact on the segment revenue for the first six months of current year, on account of comparatively higher management fees. The segment reported a net loss of QR 23 million for the six-month period ended 30 June 2022, compared to a net loss of QR 132 million for 1H-21. Reduction in losses was mainly attributed to growth in segmental revenue. Moving on to the Aviation segment, as detailed on slides 19 till 21. Here the segment reported a total revenue of QR 441 million for the six-month period ended 30 June 2022, with an increase of 31% compared to 1H-21. The increase was mainly attributed to higher flying activity recorded within both domestic and international operations, coupled with growth in revenue noted across the international locations, mainly from Turkey & Angola. Also, continuous growth within MRO business segment contributed positively to the segment topline. The segmental net profit reached QR 163 million, representing an increase of 47% compared to 1H-21, mainly on account of higher segmental revenue, despite the impacts of currency devaluation from Turkish subsidiary. Moving on to insurance segment, as discussed on slides 22 till 24. Revenue within the insurance segment for six-month period ended 30 June 2022, decreased by 13% as compared to 1H-21, to reach QR 417 million. Decline in revenue was mainly linked to loss of two insurance contracts within medical line of business. This decline was partially offset by growth in premiums from the general insurance line of business, on account of new contracts and renewals of existing contracts. On the contrary, segment net earnings increased by 7% as compared to 1H-21, to reach QR 35 million. The growth in bottom line profitability was mainly supported by an overall decline in claims, which decreased by 48% on a year-on-year basis. On the contrary, negative performance of the segment's investment portfolio due to volatilities in capital markets weighed on the segment's profitability. Finally, moving on to the catering segment, as discussed on slides 25 till 27. The segment reported a revenue of QR 249 million, an increase of 44% as compared to 1H-21. Revenue increase was mainly due to the growth in revenue within the manpower segment, on the back of realizations from a new contract won during last year. Additionally, certain contracts have been renewed within manpower segment, with broader scope improving overall service volumes for the segment.

	The segment reported a net loss of QR 1 million for the six-month period ended 30 June 2022, compared to a net loss of QR 9 million for 1H-21, mainly due to higher revenues and better margins. Now, I think we can open the floor for the Q&A Session.
Operator:	Thank you. Ladies and gentlemen, if you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that is Star one for your questions today. We will post a brief moment. Our first question today comes from Mohammed Adel from AFII. Please go ahead. Your line is open.
Mohamed Adel [AFII]:	Thanks for the presentation. Thanks for taking my question. So I have a couple of questions. My first question is on the drilling segment, how many rigs are currently deployed? And I'm not sure if I heard right, did you say that the offshore rates were increased? And also for the drilling segment, now the drilling segment was increasing utilization, it's still loss-making. So like if we want to draw like a map to taking the drilling segment to profitability again, how long this will take and what - will it be through increasing the rates or for example, the offshore rates only take them for the second quarter? I'm trying to figure out how the drilling segment would go profitability again. And for the aviation sector, how much of the revenue is coming from Turkey? Because of Turkey's current situation, I think this is the main risk for the aviation sector. Thank you.
Sami Mathlouthi [GIS]:	Thank you, Mohammed, for the question. I will start with the drilling segment. The number of rigs deployed, at this stage, we have in total seven offshore rigs, eight onshore rigs, and we have two lift boats, and one accommodation barge. This is the total fleet of GDI. So out of this, seven offshore rigs are totally deployed. In the onshore side of the business, we have in total eight rigs, so out of the eight, six are contracted, we have one which is under contract, and it will start soon in Q3 2022. And we have another rig that is still under discussion, and it is expected to commence operation, probably in Q4 2022. So this is the situation with the existing fleet. In terms of your second question which is the increase of offshore rates, there is no increase of offshore rates. In the press release we announced that the rates increased in mid-July 2021, that was for the offshore fleet, and the increase was based on the change of the formula to the OPI. The formula is effective until the latest of 30th of June 2022 or the expiry of the contract. Some of the contracts were expired before 30 June and have been renewed for a period of two to five years starting from Q2 2022. And we have three offshore contracts which are still under the OPI formula where the rate is standing at $74,000 and some of them will expire end of 2022 out of which two rigs will be expiring in the first half of 2023. Your question relating to the profitability of the drilling segment despite the increase in the utilization, you are correct in some extent, however as you can see from the press release, revenue has increased tremendously in the drilling segment, EBITDA has increased as well compared to the last period. We are starting to see some recovery from the losses that we have seen in the previous quarters and with the deployment of the remaining two onshore rigs where one is expected in Q3 2022 and the last one in Q4 2022 and with the full operation of all the rigs, we can we are expecting a positive result for the drilling business. We have to bear in mind that some of the rigs haven't started operation completely in the beginning of the year 2022 and we had one rig as well which has been under maintenance in Q2 2022 where we have lost around 45 working days. Things are on the positive side. We are seeing some improvement at the top line with around 43% increase in revenues quarter-on-quarter basis.

	About your question, what needs to be done at GDI to be a profitable business? There are three components that affect profitability. So it's basically the top-line side, we are working on that to make sure that we have full utilization of the rigs, this will increase the top-line side in addition to maintaining or securing better rates. So this will help to improve the profitability. The second component is the direct cost. We are very lean; we are controlling our costs as part of our KPI's. In the region, GDI is among the leanest companies in terms of direct costs. The third component that we are working on as well, which is the debt structure, and as you know, a huge part of the generated cash flows are used to service the debt, the Business is generating positive cash flows. If we reduce the interest cost the profitability will improve.
Mohamed Adel [AFII]:	Thank you. If I may follow up, you said that there are some rigs already contracts have ended on offshore and a new contract has been put in place. And there is another, I think three rigs, you said will be the contract will end at the end of this year. I mean, the rigs are already now in new contracts at the same rate or at the same formula or the formula has changed? And if you can disclose this, so you said that the rate is 74K for the offshore, what is the rate for the onshore rigs? Thank you very much.
Sami Mathlouthi [GIS]:	For the three rigs that are remaining under OPI, they are not all due for renewal in 2022, only one rig will be due for renewal at the end of 2022 and the two other rigs will be due in 2023. For the rigs, which have been renewed, we cannot provide you with a specific rate. It's ranging from \$70k to \$74k and it's in line with the market prices or the market rates that we are seeing in the region. In terms of onshore, I think your second question was on the onshore, so the onshore is in the range of \$18,000 to \$27000 per day. And again, this is in line with the rates we are seeing in the region. Do you have questions on drilling?
Mohamed:	No. I'm done on the drilling. We can go to the aviation question.
Sami Mathlouthi [GIS]:	For aviation, we have ten aircrafts in Turkey. So the contribution in terms of revenue, is around QR98 million around QR 21 million is the contribution towards Net profit.
Mohamed Adel [AFII]:	Okay. Thank you very much. If I may, just one last follow-up, so we saw something happened in the banks that has subsidiaries in Turkey that they had to do some kind of hyperinflation accounting treatment. Will you be doing this? Did the auditors tell you anything? Was there a discussion with the auditor about it? Thank you.
Sami Mathlouthi [GIS]:	Thank you, Mohammed. Well, the impact of inflation, is already reflected, it's already taken into account. So as you know, so it is a requirement of IAS 29. Any country where the inflation rate has reached more than 100% on three consecutive years, is obliged to apply the IAS 29. So this has been accounted for and you will see that the impact has been in place in the P&L of GIS with an impact of around QR 7.9 million. It's on the face of the P&L. And this is the impact for the first half year 2022. There is another impact that is related to the devaluation of the existing balance sheet items. That impact is around QR 29 million and this has been included as part of the retained earnings. We will still continue to monitor the Turkish business, at every closing we will have to calculate the impact of the inflation until Turkey will be removed from that list of hyper inflationary economies.
Mohamed Adel [AFII]:	Thank you very much. Thank you. I appreciate it. Thank you.
Operator:	Thank you. We come to our next question now, which is from Nikhil Puttani of CBFS. Please go ahead.

Nikhil Pattani [CBFS]:	Yeah. Thank you, sir. I mean, thank you for the detailed information that has been provided on the drilling segment. Just wanted to understand a little bit more so in the drilling in terms of the revenues. Now, the way it looks like, suppose we compare the first quarter in a previous presentation that you have given in the second half, it looks like the average revenue per rig under the offshore model, there has been a decline where, actually, I mean, there was an increase while there was a decline in the offshore rates - onshore rates. So is that true? Second, in terms of your merger with Al-Shaqab, I mean, under your catering business, just I suppose you can just give a highlight about what exactly is happening currently, how it is you're planning to go about it, what likely contribution that you could be seeing in terms of a merger for this particular division? And thirdly, in terms of your Forex, I mean, you did mention that there has been a QR7 million on your profit and other things, so it looks like it is more on CPI basis. So just wanted to understand what exactly you're seeing for the third quarter, I mean, given that 40 days have passed? I mean, how do you foresee it going forward in third quarter on that particular aspect? Thank you.
Sami Mathlouthi [GIS]:	Okay. For your first question, I think in terms of the revenue from the offshore, the only decline that we have seen in half-year 2022 is relating to one of the offshore rigs, which went for a big maintenance scale. And this has affected the utilization of the offshore revenue, so that's around 45 days. This is the only reason that explains the drop in the revenue. For your second question, in terms of the merger with Shaqab, , we have announced already to the market that we are in discussion with Shaqab which is a leading catering company. We are still in the stage of evaluating the opportuinity. We have advisors working with us. We appointed the valuator from both sides and as you know due diligence process will take some time. In addition to the financial aspect of the merger we are discussing the legal part, the structure and other aspects relating to the combined entity. That's on the Al-Shaqab side. In terms of Forex, as you know, the CPI index, will be calculated at the closing of each period. At the moment, the first closing where we have applied this inflationary IAS-29 accounting policy was on half-year 2022 because Turkey joined the list of hyperinflationary economies in May 2022. We will collect the CPI index from the central bank in the next closing which will be in 30th of September 2022. And based on that, we can recalculate the impact of inflation as per IAS 29.
Nikhil Pattani [CBFS]:	Thank you. Just wanted to check in terms, again, in terms of Shaqab how the deal will be going through, will it be an all-share swap deal? I believe that's what they didn't mention. So any indications where exactly we could be ending up in terms of equity dilution in that case, how it will be going through for GIS?
Sami Mathlouthi [GIS]:	Look, at this stage, as I mentioned in the beginning, it's too early to mention or to disclose to the market. Discussion is still ongoing all parties. And it's only once the due diligence and evaluation and discussion about structure have been completed and agreed between all the parties, only at that time we will be able to disclose the structure, the shareholding of each party and whether there will be any dilution or not. But at this stage, it's too early.
Nikhil Pattani [CBFS]:	Okay. Thank you, sir. Thanks a lot. Thanks for the comment.
Operator:	Thank you. We now move to a question from Lee Beswick of QNB. Please go ahead.

Lee Beswick [QNB]:	Hello. Can we just talk about the accounting for a second? Now, you acquired the 50% of GDI you didn't own in 2014 when jack-up rates were double what they are today. The book value of most of that is in the QR5.5 billion in property and equipment, we know that. We know that book value is wrong. We know that you need to write it down because it's pretty clear, from the P&L, that you need to write it down. It is cash flow positive but there's no profit. If you write it down to its true value, which I don't know what the number is, but it's probably QR2.5 to QR3 billion, you probably need to take QR2.5, QR3 billion off your equity, which effectively wipes out all of your equity, which means the company needs recapitalizing. We've talked about this in the past. Everyone knows it needs to happen. We can all see the accounts. So I suppose the question is, when is it going to happen, who's going to recapitalize the company, and when are we going to move forward from this situation? Because otherwise, you're never ever going to make a profit. Over.
Sami Mathlouthi [GIS]:	Well, I think impairment is one side of the equation, and we can discuss that but profitability is linked to the impairment in itself. Profitability is linked to utilization and is linked to the payment of debt on those rigs. We have around $1.2 billion of debt where we are paying, an average, of 3.5% interest on those debts. This is having a huge impact on the profitability of the business. In terms of impairment, impairment is not based on the value of the rig itself as today, it's based on the expected cash flows that will be generated by those rigs in the future. And the calculation was based on the Future expected cash flows which is agreed by all the auditors since 2014. But accounting-wise, impairment is not calculated on the value of the rig itself.
Lee Beswick [QNB]:	Yeah. I agree is on the future expected cash flow, that is - I completely agree with that. The purchase was made at a time when rigs' prices were double what they are today. It's not that they're 10% more, 10% less, it was double what they are today. There was no sign whatsoever that rig prices are going to recover to the levels that they were when you made the acquisition. There's no sign at all given the current situation with lack of drilling for oil around the world. Therefore, there is a material change in the future expected cash flows of this company from when you made the acquisition in 2014. And therefore it's not very difficult, and I'm sure if I - if we saw the assumptions that the auditors made, I'm sure we could drive a truck through those assumptions because they are obviously going to be different today versus 2014. So I don't see why we're still talking about it. I don't see why you haven't written it down. I honestly don't understand. Unless you're saying that rig prices are going to double from where they are today, which they may do, it's possible.
Sami Mathlouthi [GIS]:	Impairment are assessed on a yearly basis and at the end of each closing by the auditor. And for the information at the end of 2020, we already impaired a rig by around $56 million Before that, I think some impairment has been made. What I can confirm is that the assessment of impairment is there. But if you are saying that the acquisition has been done during the peak cycle, which is normal, this business is cyclical, and the acquisition has been done during that time, it does not mean that we will need always to impair the rigs based on the value of the rig in 2014. The business is cyclical and now we are seeing the oil prices slightly returning back to the levels of 2014 and this will have an impact on the day rates as well as on the rig values.
Lee Beswick:	Okay. Thanks.
Operator:	Thank you. We currently have no further questions in the queue.
Bobby Sakar:	Great. If there are no further questions, we can wrap up the call for today. I want to thank Sami, I want to thank Riaz for taking the time to talk to investors. And we will pick this up next quarter. Thank you so much.
Riaz Khan:	Thank you. Thank you, everyone.
Operator:	Thank you. This concludes today's call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.