Qatar Electricity and Water Co (QEWC.QA)

OVERWEIGHT

CMP	**QAR 102.10**
Target	**QAR 128.04**
Upside	**25.4%**

MSCI GCC Index	428.12
Doha Securities Market	7,017.43

Key Stock Data

Sector	Power and Utilities
Reuters Code	QEWC.QA
Bloomberg Code	QEWS QD Equity
Net Out. Shares (bn)	0.100
Market Cap (QAR bn)	10.210
Market Cap (USD bn)	2.807
Avg. 12m Vol. (mn)	0.072
Volatility (30 day)	15.572
Volatility (180 day)	27.113

Stock Performance (%)

52 week high / low (QAR) 114.20 / 70.40

	1M	3M	12M
Absolute (%)	5.3	3.8	29.4
Relative (%)	3.1	9.0	-8.9

Shareholding Pattern	(%)
Government	42.00
Public	58.00

Qatar Electricity and DSM 20 Index

Quarterly Result Update

- **Qatar Electricity and Water Co. (QEWC) reported revenues of QAR 2,651 million during FY09, up 16.6% YoY. The top-line was 1.5% below our estimate.**
- **Net profit increased 21.8% to QAR 922 million during FY09, 2.2% lower than our estimate.**
- **We have maintained our revenue estimate, but revised the profitability estimate upward by 1.9% for 2010.**
- **We are reiterating our OVERWEIGHT recommendation on QEWC, with a revised DCF target price of QAR 128.04, implying an upside of 25.4%.**

Overview

QAR Million	2008A	2009A	2010E	2011E	2012E
Sales	2,273	2,651	4,424	5,066	5,527
EBITDA	1,129	1,362	2,252	2,556	2,761
EBITDA Margin	49.7%	51.4%	50.9%	50.5%	50.0%
Net Profit	757	922	1,783	1,966	2,107
Net Profit Margin	33.3%	34.8%	40.3%	38.8%	38.1%
Adjusted EPS (QAR)	7.57	9.22	17.83	19.66	21.07
Total Assets	13,588	18,048	20,176	22,206	23,733
RoAE	30.2%	37.6%	42.4%	37.3%	34.0%

Revenues

During FY09, Qatar Electricity & Water Co's (QEWC) revenues jumped 16.6% to QAR 2,651 million from QAR 2,273 million in FY08, driven by improved performance across segments. Revenue from sale of electricity increased 11.4% to QAR 1,515 million, and that from water desalination plants rose 18.1% to QAR 931 million. In addition, income from plant lease was up 65.0% to QAR 204 million. On the non-operating side, interest income almost tripled to QAR 73 million, and dividend income jumped 121.5% to QAR 17 million. Similarly, the share of income from joint ventures was up 25.8% to QAR 50 million, and share of profit of associated companies was up 52.6% to QAR 47 million. Miscellaneous income increased 49.3% to QAR 15 million.

Expenses

Cost of sales (CoS) increased 15.7% to QAR 1,129 million from QAR 975 million in FY08. Meanwhile, as a percentage of revenues, CoS was down 34 bps to 42.6% during the year. General & administrative expenses slipped 4.6% to QAR 161 million from QAR 168 million. The company also reported a 10.1% increase in depreciation charges, which stood at QAR 409 million compared to QAR 371 million last year. Overall, total operating expenses increased 12.1% to QAR 1,698 million, despite contracting 259 bps to 64.0% as a percentage of revenues. Finance costs were up 40.1% YoY to QAR 194 million on higher leverage.

Liquidated Damages

Liquidated damages to Kahramaa increased almost four-fold to QAR 81 million during FY09 compared to QAR 21 million last year. This was partially offset by a nearly three-fold increase in the share of liquidated damages for Mesaieed Power Company to QAR 58 million.

Profitability

During FY09, QEWC's gross profit margin increased marginally to 57.4% from 57.1% YoY, as the increase in CoS was more than compensated by the growth in revenues. Similarly, operating margin rose to 35.9% from 33.4% in FY08. Net profit jumped 21.8% to QAR 922 million from QAR 757 million in FY08, driven by top-line growth and higher non-operating income. Net profit margin increased 148 bps to 34.8% during FY09. Adjusted earnings per share (EPS) increased to QAR 9.22 from QAR 7.57 in FY08.

Peer Comparison

We have considered Saudi Electricity Co (SECO) for a peer comparison of companies in the power & utilities sector in the GCC.

	SECO		QEWC	
(USD Million)	**2008**	**2009**	**2008**	**2009**
Sales	5,940	6,359	625	729
YoY change	6.9%	7.0%	18.0%	16.6%
EBITDA	2,032	2,225	310	374
YoY change	0.8%	9.5%	9.2%	20.6%
Net Profit	294	310	208	253
YoY change	-21.9%	5.5%	23.3%	21.8%
Total Assets	38,748	44,273	3,735	4,961
YoY change	6.5%	14.3%	47.9%	32.8%
Shareholders' Equity	12,940	13,108	359	987
YoY change	1.1%	1.3%	-64.7%	174.5%
Ratios:				
Total Assets Turnover Ratio (x)	0.16	0.15	0.20	0.17
EBITDA Margin	34.2%	35.0%	49.7%	51.4%
Net Profit Margin	5.0%	4.9%	33.3%	34.8%
RoAE	2.3%	2.4%	30.2%	37.6%
RoAA	0.8%	0.7%	6.6%	5.8%
Market Indicators:				
Adj. EPS (USD)	0.07	0.07	2.08	2.53
P/E (x)	46.14	43.75	13.49	11.08
Adj. BVPS (USD)	3.11	3.15	3.59	9.87
P/BV (x)	1.05	1.04	7.81	2.84
Current Market Capitalisation (USD Million)	13,582	13,582	2,807	2,807

Source: Zawya, QEWC's financial statements

Risks and Concerns to Valuation:

- Our revenue and net profit estimates for QEWC factor in the timely completion of the company's capacity expansion plans. Any delay in the scheduled completion of these projects may require a change to our estimates and may call for a relook at our rating.

Valuation Methodology:

We have used the DCF valuation method to arrive at the fair value of QEWC, as explained below:

Assumptions:

(i) Risk free Rate (Rf) of 3.39%, equivalent to 12-months average yield on a 10-year US T-bill;
(ii) Levered Beta of 1.80;
(iii) Terminal growth rate of 2.0%

Based on the above and using the Capital Asset Pricing Model (CAPM), we have arrived at a Cost of Equity of 15.09% and a WACC of 7.85%.

DCF Calculation

DCF Valuation (FCFF Model)

(QAR Million)	2010E	2011E	2012E	2013E	2014E
NOPAT	**1,754**	**1,986**	**2,145**	**2,131**	**2,118**
Add: Depreciation and Amortisation	499	571	616	651	690
Less: Capex	2,924	2,353	1,468	1,142	1,264
Less: Change in Net Working Capital	-175	-95	-20	59	60
Operating Free Cash Flows to Firm (OFCFF)	**-496**	**299**	**1,313**	**1,582**	**1,485**
Free Cash Flow to Firm (FCFF)	**-287**	**561**	**1,550**	**1,827**	**1,745**
WACC (Ko)	**7.85%**	**7.85%**	**7.85%**	**7.85%**	**7.85%**
Present Value / Discount Factor	0.9272	0.8598	0.7972	0.7392	0.6854
Long-Term Growth Rate (g)					**2.00%**
Terminal Multiple [(1 + g) / (WACC - g)]					17.44
Nominal Terminal Value [(FCFF * (1 + g)) / (WACC - g)]					**30,436**
Present Value of Free Cash Flows	**-266**	**482**	**1,236**	**1,350**	**1,196**

Calculation of Equity Value and Fair Value Per Share		
NPV of Free Cash Flows (during Explicit Forecast Period)		**3,998**
Terminal Value:		
Residual Cash Flow (FCFF of 2014E)		1,745
WACC	7.85%	
Long-Term/Terminal Growth Rate (g)	2.00%	
Divided by Capitalisation Rate (WACC - g)		5.85%
Equals Nominal Terminal Value		30,436
Implied Multiple of 2014E EBITDA		10.84
Times PV/Discount Factor		0.69
Present Value of Terminal/Residual Value		**20,816**
Enterprise Value		**24,859**
Implied Multiple of 2014E EBITDA		8.85
Less: Market Value of Long-term Debts		12,055
Less: Market Value of Preferred Shares		0
Add: Surplus Cash and Investments		0
Equity Value		**12,804**
Net shares outstanding (Million)		100
Fair Value Per Share (QAR)		**128.04**

** figures in QAR Million unless specified*

Sensitivity Analysis

The following tables present a sensitivity analysis and indicate the probable nominal terminal value, discounted terminal value and enterprise value, given different growth rate and WACC assumptions. The shaded areas represent the most probable outcomes.

Sensitivity Analysis of Nominal Terminal Value (QAR Million)					
	Long-Term Growth Rate				
Discount Factor	1.00%	1.50%	**2.00%**	2.50%	3.00%
5.85%	36,355	40,736	46,256	53,424	63,110
6.85%	30,138	33,119	36,715	41,137	46,709
7.85%	25,737	27,902	**30,436**	33,445	37,074
8.85%	22,458	24,104	25,992	28,177	30,735
9.85%	19,919	21,217	21,217	24,342	26,247

Sensitivity Analysis of Discounted Terminal Value (QAR Million)					
	Long-Term Growth Rate				
Discount Factor	1.00%	1.50%	**2.00%**	2.50%	3.00%
5.85%	25,850	28,966	32,891	37,988	44,875
6.85%	20,254	22,258	24,674	27,646	31,391
7.85%	16,356	17,732	**20,861**	21,255	23,562
8.85%	13,503	14,494	15,628	16,942	18,480
9.85%	11,338	12,076	12,909	13,855	14,939

Sensitivity Analysis of Enterprise Value (QAR Million)					
	Long-Term Growth Rate				
Discount Factor	1.00%	1.50%	**2.00%**	2.50%	3.00%
5.85%	29,918	33,033	36,958	42,055	48,942
6.85%	24,136	26,140	28,556	31,529	35,273
7.85%	20,064	21,439	**24,859**	24,962	27,269
8.85%	17,045	18,035	19,170	20,484	22,022
9.85%	14,723	15,461	16,294	17,240	18,324

Investment Opinion

Energy consumption in the GCC has been following an upward trajectory due to the rising population and the unprecedented spike in construction activities and industrial projects over the last few years. Strong growth in investments across various sectors has led to a significant increase in the demand for power. In order to enable the requisite supply to meet this high demand, more than 60,000 MW of capacity, which is around 80% of the current total, is expected to come online between 2008 and 2015. The demand for power in Qatar has grown in tandem with the robust economic growth and high investments into infrastructure development. In addition, the rising population and higher government and private spending contributed to the demand, thereby necessitating new investments in the power sector. According to BMI, Qatar's primary energy demand is expected to grow at 30.1% over 2007-2012. In order to meet this demand, investments to the tune of USD 7.48 billion are being planned to expand capacity to approximately 7,900 MW by 2010. At the same time, water production is expected to reach 275 million imperial gallons per day (MIGD) by 2015. In an effort to efficiently utilise the electricity generated by GCC countries , the set-up of a power grid connecting all the member nations is currently underway. The first phase of the power grid, linking Saudi Arabia, Kuwait, Qatar, and Bahrain, was completed in December 2009 at a cost of USD 1.6 billion. Work on connecting the UAE and Oman is currently underway and the grid is expected to be complete by 2012.

We continue to hold an optimistic outlook on QEWC's stock in view of the positive fundamentals and expectations of healthy performance following the completion of ongoing development projects. Healthy top-line (up 16.6%) and bottom-line (up 21.8%) performance during 2009 reconfirms our positive outlook on the company's fundamentals. The company is the largest power generation player in Qatar with approximately 68% share of the total capacity, along with ownership of most of the water desalination plants. The strong government backing, as highighed in our previous report, will contine to benefit the company. The Qatari government has contracted its power-generating assets to the company for a period of 20-25 years, which makes it the largest beneficiary of investments into the sector. The company's strong portfolio of development projects, including major ones like Mesaieed A Power Station (2,000 MW) and Ras Laffan C (2,730 MW) have been progressing as planned. Going forward, the company's top-line and bottom-line performance is expected to benefit from the planned capacity expansions. Moreover, the company has been focusing on increasing the share of profit from its desalination units as well. In this direction, the company entered into a strategic partnership with Qatar National Cement Co. for the supply of limestone, an essential raw material for desalination units.

We had updated Qatar Electricity & Water Co. on January 25, 2009 with an OVERWEIGHT recommendation (target price of QAR 127.36 and an upside of 31.3%). Currently, the company's stock is trading at a P/E multiple of 5.73x and 5.19x on 2010E and 2011E earnings, and at a P/BV multiple of 2.12x and 1.78x on 2010E and 2010E BVPS, respectively. Meanwhile, the stock has gained 4.3% since the beginning of this year as against a loss of 2.2% posted by the Qatar Exchange's DSM 20 Index. Considering the above factors, we have arrived at a price target of QAR 128.04, which is higher than the price target assigned in the previous update report and represents an upside of 25.4%.

Financial Statements

Consolidated Income Statement					
(QAR Million)	**2008A**	**2009A**	**2010E**	**2011E**	**2012E**
Revenue	**2,273**	**2,651**	**4,424**	**5,066**	**5,527**
Cost of sales	-975	-1,129	-1,895	-2,182	-2,394
Gross Profit	**1,298**	**1,522**	**2,529**	**2,884**	**3,132**
General and administrative expenses	-168	-161	-277	-327	-371
Depreciation	-371	-409	-499	-571	-616
Operating profit	**758**	**953**	**1,754**	**1,986**	**2,145**
EBITDA	**1,129**	**1,362**	**2,252**	**2,556**	**2,761**
Deferred income	26	7	7	7	7
Liquidated damages to KAHRAMAA	-21	-81	0	0	0
Finance costs	-138	-194	-233	-257	-283
Interest income	26	73	107	65	60
Dividend income	8	17	18	18	19
Miscellaneous income	10	15	21	24	26
Share of income from joint venture	40	50	57	66	72
Share of profits of associate companies	31	47	53	58	62
Share of liquidated damages of Mesaieed Power Company Limited	19	58	0	0	0
Loss on sale of property, plant and equipment	-2	0	0	0	0
Net profit for the year	**757**	**922**	**1,783**	**1,966**	**2,107**
Adjusted EPS	**7.57**	**9.22**	**17.83**	**19.66**	**21.07**

Consolidated Balance Sheet					
(QAR Million)	**2008A**	**2009A**	**2010E**	**2011E**	**2012E**
ASSETS					
Current Assets					
Inventories	286	274	483	538	581
Trade receivable and prepayments	413	432	661	757	856
Bank Balances and Cash	1,615	2,307	1,380	1,238	1,315
Finance lease receivables	25	27	31	34	36
Total Current Assets	**2,338**	**3,041**	**2,555**	**2,567**	**2,789**
Non-Current Assets					
Property, plant and equipment	9,334	10,664	13,089	14,871	15,723
Investments in associates	205	247	281	309	329
Available for sale investments	232	275	323	366	403
Lease receivable	1,479	3,821	3,928	4,093	4,488
Total Non-Current Assets	**11,249**	**15,007**	**17,621**	**19,639**	**20,944**
Total Assets	**13,588**	**18,048**	**20,176**	**22,206**	**23,733**
LIABILITIES AND EQUITY					
Liabilities					
Current Liabilities					
Trade payable and accruals	925	1,103	1,719	1,968	2,132
Current portion of bank borrowings	740	668	594	703	728
Current portion of other term liabilities	66	106	40	26	27
Derivatives	2,967	1,202	1,202	1,202	1,202
Deferred income	7	7	7	7	7
Total Current Liabilities	**4,704**	**3,086**	**3,562**	**3,907**	**4,095**
Non-Current Liabilities					
Long term portion of bank borrowings	6,920	10,823	11,279	12,080	12,502
Long term portion of other term liabilities	564	458	417	391	365
Deferred income	48	41	34	27	20
Employees' end of service benefits	44	51	60	70	82
Total Non-Current Liabilities	**7,576**	**11,373**	**11,790**	**12,569**	**12,969**
Total Liabilities	**12,280**	**14,458**	**15,352**	**16,476**	**17,065**
Equity					
Share capital	1,000	1,000	1,000	1,000	1,000
Legal reserve	500	500	500	500	500
General reserve	2,286	2,708	3,343	4,044	4,794
Cumulative changes in fair value	-2,929	-1,118	-1,118	-1,118	-1,118
Retained earnings	450	500	1,099	1,305	1,492
Total Equity	**1,308**	**3,590**	**4,824**	**5,730**	**6,668**
Total Liabilities and Equity	**13,588**	**18,048**	**20,176**	**22,206**	**23,733**

Consolidated Cash Flow Statement					
(QAR Million)	**2008A**	**2009A**	**2010E**	**2011E**	**2012E**
Cash Flows from Operating Activities:					
Profit for the period	757	922	1,783	1,966	2,107
Adjustments for:					
Depreciation	371	409	499	571	616
Finance costs	138	194	233	257	283
Provision for slow-moving stocks	18	24	37	36	33
Provision for employees' end of service benefits	10	9	10	12	14
Share of profit from associate companies	-31	-47	-53	-58	-62
Deferred income recognised	-26	-7	-7	-7	-7
Interest income	-26	-73	-107	-65	-60
Dividend income	-8	-17	-18	-18	-19
Loss on retirement of property, plant and equipment	2	0	0	0	0
Operating profit before working capital changes	**1,206**	**1,424**	**2,378**	**2,694**	**2,906**
Working capital changes:					
Lease receivable	-91	-33	-108	-165	-395
Inventories	114	-12	-209	-55	-43
Accounts receivable and prepayments	-90	-19	-229	-133	-124
Accounts payable and accruals	421	167	569	249	164
Cash from operations	**1,560**	**1,527**	**2,402**	**2,590**	**2,508**
Interest paid	-138	-194	-233	-257	-283
Employees' end of service benefits paid	-2	-1	-2	-2	-2
Payment of directors' fees	-12	0	0	0	0
Net cash from (used in) operating activities	**1,408**	**1,331**	**2,167**	**2,331**	**2,222**
Cash flows from investing activities					
Purchase of property, plant and equipment	-3,864	-4,050	-2,924	-2,353	-1,468
Dividends from other investment	8	17	18	18	19
Dividends received from associates	27	23	26	29	31
Interest received	26	73	107	65	60
Purchase of available-for-sale investments	-8	-17	-48	-43	-37
Net cash (used in) investing activities	**-3,811**	**-3,954**	**-2,821**	**-2,284**	**-1,395**
Cash flows from financing activities					
Dividends paid	-400	-450	-548	-1,060	-1,169
Net changes in bank borrowings and other term liabilities	3,763	3,765	275	871	420
Net cash from financing activities	**3,363**	**3,315**	**-273**	**-189**	**-749**
Net increase/(decrease) in cash and bank balances	**961**	**692**	**-927**	**-143**	**78**
Bank balances and cash at the beginning of period	654	1,615	2,307	1,380	1,238
Bank balances and cash at the end of period	**1,615**	**2,307**	**1,380**	**1,238**	**1,315**

Financial Ratios

	2008A	2009A	2010E	2011E	2012E
Liquidity Ratios:					
Current Ratio (x)	0.50	0.99	0.72	0.66	0.68
Quick Ratio (x)	0.44	0.90	0.58	0.52	0.54
Inventory Conversion Period (Days)	132	91	73	85	85
Average Collection Period (Days)	59	58	45	51	53
Length of Operating Cycle (Days)	191	149	118	136	139
Average Payment Period (Days)	269	328	272	308	313
Length of Cash Cycle (Days)	-79	-179	-154	-172	-174
Activity Ratios:					
Inventory Turnover Ratio (x)	2.77	4.03	5.00	4.27	4.28
Debtors Turnover Ratio (x)	6.18	6.27	8.09	7.15	6.85
Creditors' Turnover Ratio (x)	1.35	1.11	1.34	1.18	1.17
Total Assets Turnover Ratio (x)	0.20	0.17	0.23	0.24	0.24
Net Fixed Assets Turnover Ratio (x)	0.29	0.27	0.37	0.36	0.36
Working Capital Turnover Ratio (x)	-2.44	-2.20	-8.42	-4.32	-4.18
Equity Turnover Ratio (x)	0.91	1.08	1.05	0.96	0.89
Profitability Ratios:					
Gross Profit Margin (GPM)	57.1%	57.4%	57.2%	56.9%	56.7%
EBITDA Margin	49.7%	51.4%	50.9%	50.5%	50.0%
Operating Profit Margin (OPM)	33.4%	35.9%	39.6%	39.2%	38.8%
Net Profit Margin (NPM)	33.3%	34.8%	40.3%	38.8%	38.1%
Return on Average Equity (RoAE)	30.2%	37.6%	42.4%	37.3%	34.0%
Return on Average Assets (RoAA)	6.6%	5.8%	9.3%	9.3%	9.2%
Leverage Ratios:					
Debt to Equity (D/E) Ratio (x)	6.34	3.36	2.56	2.30	2.04
Shareholders' Equity to Total Assets Ratio (x)	0.10	0.20	0.24	0.26	0.28
Total Liabilities to Total Assets Ratio (x)	0.90	0.80	0.76	0.74	0.72
Current Liabilities to Equity Ratio (x)	3.60	0.86	0.74	0.68	0.61
Growth Rates:					
YoY Growth in Revenue	18.0%	16.6%	66.9%	14.5%	9.1%
YoY Growth in Operating Profit	13.6%	25.7%	84.0%	13.2%	8.0%
YoY Growth in EBITDA	9.2%	20.6%	65.4%	13.5%	8.0%
YoY Growth in Net Profit	23.3%	21.8%	93.4%	10.3%	7.1%
YoY Growth in Total Assets	47.9%	32.8%	11.8%	10.1%	6.9%
YoY Growth in Shareholders' Equity	-64.7%	174.5%	34.4%	18.8%	16.4%
Ratios used for Valuation:					
EPS (QAR)	7.57	9.22	17.83	19.66	21.07
BVPS (QAR)	13.08	35.90	48.24	57.30	66.68
P/E Ratio (x)	13.49	11.08	5.73	5.19	4.85
P/BV Ratio (x)	7.81	2.84	2.12	1.78	1.53
Current Market Price (QAR)*	102.10	102.10	102.10	102.10	102.10

** CMP as on February 24, 2010*