Nakilat (QGTC) 3Q18 Results

Earnings Call Transcript

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NAKILAT ناقلات

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Executives:

1) Hani Abuaker – Chief Financial Officer
2) Fotios Zeritis – Head of Investor Relations

Questions by:

1) Bobby Sarkar – Qatar National Bank
2) Philip Kanaan – QInvest
3) Shabbir Kagalwala – Al Rayan Investments
4) Nikhil Arora – Franklin Templeton Investments

Operator

Good day and welcome to Nakilat's 3Q18 Financial Results Conference Call. Today's conference is being recorded. Today's presentation will be hosted by CFO, Hani Abuaker, Fotios Zeritis and Bobby Sarkar. At this time, I would like to turn the conference over to Bobby Sarkar.

Please, go ahead, sir.

Bobby Sarkar

Hello everyone. This is Bobby Sarkar, Head of Research at QNB Financial Services. I want to welcome everyone to Qatar Gas Transport Company Nakilat's third quarter 2018 conference call.

On this call, we have Hani Abuaker, who's Nakilat's CFO and Fotios Zeritis who's Nakilat's Head of Investor Relations. We will conduct this conference with first management reviewing the company's third quarter results and 9 months' results followed by a question and answer session. I will now turn the call over now to Fotios Zeritis. Thank you.

Fotios Zeritis

Good afternoon and thank you for joining Nakilat's third quarter 2018 conference call. For your convenience, the transcript of this call and presentation will be available on the Investor Relations section of our website.

Please, now turn to slide 2 of the presentation. Many of our remarks contain forward-looking statements and page 3, has the table of contents of the entire presentation as well as page 4, has the glossary.

In addition, some of our remarks contain non-IFRS financial measures such as EBITDA. A reconciliation of these is included in the notes of this presentation.

I will now hand over to Mr. Hani Abuaker, CFO of Nakilat.

Hani Abuaker

Thank you, Fotios. Good afternoon to all of you. Thank you for joining our third quarter earnings call. I'll begin with the financial highlights of the quarter or the 9 months of this year. Fotios will update you on current trends of LNG shipping market and outlook, following which, I will then take you through Nakilat’s business outlook as well as key investment highlights and then we will open the floor for questions.

Turning to slide 6 and 7. This has been very successful 9 months of 2018 for Nakilat in terms of executing our strategy of growth and efficiency. Our profitability increased by 8.5% in the first 9 months of the year due to the acquisition of 2 LNG carriers and 1 FSRU. Further factors also contributed to this higher profitability, which are: higher level of Shipyard’s activities, increased interest income from bank deposits and dividends from investments in shares of listed companies.

On a unit basis, we can see our G&A decreased by 7.2% in the first 9 months of 2018 compared to the same period in 2017, while total operating expenses were slightly less by 0.4% year on year.

Furthermore, Nakilat’s EBITDA was up 2.5% Year-on-Year at QAR2.1Bn

Turning to slide 8 and 9, we see a strong and healthy balance sheet with cash and bank balances stood at QAR2.8Bn as well as total assets at QAR30Bn. The investment in JV increased mainly due to share of operating profits, hedging gain & investment in new JV.

As you can see, we have already reduced Nakilat’s net borrowings by ~13.3% over the last 5 years while at the same time, we have acquired additional 11 LNG carriers and 1 FSRU.

Now, let me hand back to Fotios to take you through an overview of LNG shipping market.

Fotios Zeritis

Thank you, Hani. Slide 9 shows clearly the improvement of short-term LNG shipping market. Due to LNG shipping's seasonality nature, usually the third quarter is considered by many market participants as the holiday period but this year is a "*no holiday for 3Q*", with rising rates across all trading basis.

In the third quarter of 2018, LNG shipping spot market significantly improved, with average rates for the second-generation LNG carriers (DFDEs) reached at ~$82,000 per day in comparison with ~$43,000 per day in 3Q17, which translate an impressive increase of 93%. For the first-generation LNG carriers (Steams), the increased was approximately 65% from ~$30,000 per day in the third quarter of 2017 to ~$49,000 per day this quarter.

This spot market rate improvement is driven by many factors. However, the main factor is an impressive increase of Chinese LNG demand by ~48% YoY, which made China the 2nd largest global LNG importer. Other important factors are the rising global liquefaction capacity, and a firming LNG price in the East hemisphere.

Along with increased spot market activity, there has been a notable pick up in inquiries about multi-month and multi-year shipping requirements. We believe this recent increase in tender activity is an acknowledgement by charterers that as rising demand for LNG absorbs available shipping capacity. Charterers need to secure shipping tonnage in order to ensure that they have access to it, when required by their shipping needs.

Turning to slide 12, we observe that the incremental LNG fleet growth reached approximately at 7.8% (in terms of number of ships, 38 new LNGCs and 5 LNGCs scrapped). Please, note that we exclude FSRUs and vessels smaller than 65,000cbm.

Until October, there are 464 vessels in operation and 98 vessels on-order which implies an increase of 21% of total LNG fleet in terms of number of ships. The average age of LNG fleet is relatively young, 11 years old and only 4.7% older than 35 years old.

In addition, there are 29 FSRUs in operations and 12 FSRUs on order.

The promising fundamentals of LNG shipping market has boosted the confidence of LNG shipowner and as a result, their newbuild contract (incl. FSRUs) activity has impressively increased by 215%, from 13 newbuild contracts in 2017 to 41 newbuild contracts in the first 9 months of 2018.

During the third quarter of 2018, the 87% of the LNG fleet is chartered for longer than 3 months, the 9% is available on the short-term market, and only 4% of the LNG fleet is lay-up.

Turning to slide 13, the LNG shipping balance is expected to be much tighter by 2022 due to a very high increase in LNG production of approximately 64mts (Post-FID) or approximately 118mts (Post-FID & FEED+FERC).

As a result of the tighter market, it will rise global fleet's annualized utilizations with corresponding improvements in earnings and vessel values.

In short-term, the rising spot market is driven by increased global liquefaction capacity, US exports, and high LNG demand from Asia. The LNG shipping market is entering its busiest period (Q4) on the back of a very strong Q3.

As a final note of market, both LNG demand outlook and LNG shipping macro remain robust and incremental vessel capacity will be needed to meet future demand.

At this time, I'd like to turn the conference over to Hani to discuss Nakilat's business outlook.

Hani Abuaker

Thank you Fotios for the update and I am sure there are a lot of analysts who are going to ask you a lot of questions afterward. However, I will start with page 15. I would like to illustrate to you that we are committed to continue to meet Nakilat's objectives. Nakilat's JV LNG fleet is expected to have a full positive impact on our financials with the addition of the 2 LNGCs and 1 FSRU.

Furthermore, we anticipate the momentum to continue with higher utilization of shipyard activities and rise of marine activities due to the increased port calls post blockade.

In addition, we continue to be focused on our business portfolio in terms of growth and diversification. The stronger LNG shipping market improves the sentiment of owners and creates an attractive investment environment in order to capture new global LNG shipping business opportunities.

Moving on to slide 17, I would like to re-emphasize on the Nakilat's investment story that we provide an attractive risk-adjusted return for our shareholders. We are the world's largest LNG shipping owner by capacity. Nakilat has fixed long-term rate contracts with first class charterers that secures both strong balance sheet and solid steady cash-flow in order to exploit future business opportunities for expansion in a growing LNG shipping market.

With that, I'd like to ask the operator to open the call for questions.

Operator

Thank you. Ladies and gentlemen, at this time if you wish to ask a question over the phone, please dial star followed by the digit 1 on your telephone keypad. Please, ensure that the mute function is switched off to allow your signal to reach our equipment. And if you find that your question has already been answered, you may remove yourself from the queue by pressing star 2. Once again, please press star 1 to ask a question.

We will pause for just a moment to allow everyone to signal.

Bobby Sarkar

Hi Hani. Hi Fotios, this is Bobby Sarkar again. Let me just get the ball rolling and ask you a couple of quesions, if I could please. Could you discuss a little bit as to the reason behind the decline in JV income in the third quarter versus the second quarter of this year given the strengthening spot rates, what was the reason that JV income declined slightly? Also, just discuss a little bit in terms of what we are seeing for finance charges. I see there is another increase this quarter versus the second quarter and the third quarter of last year. It is my belief that, you know, close to 75% of your debt is hedged. So, what is driving this sequential growth in finance charges which is somewhat significant on a percentage basis? Thank you.

Hani Abuaker

Okay, the first question about the joint venture income; as we said, our shipyard's activities increased potentially over the last 6 months or maybe some of the spill over that we saw in the end of the quarter that maybe made the difference between April and June compared to July and September.

I think that it is the major contributor to the difference between both. Regarding financing charges; as you know, we have a corporate loan facility that is not fully hedged. Basically, the increased US interest rate is why it was higher compared to the quarter before. So, I hope I did answer your questions.

Bobby Sarkar

Okay, Thank you

Operator

As a reminder, ladies and gentlemen, if you wish to ask a question over the phone, please press star 1. Okay, we will now take our first question from Philip Kanaan from QInvest. Please go ahead, your line is open.

Philip Kanaan

Yes, thank you for the presentation. I have two questions, one is a bit outdated. The first question is why did depreciation basically strike up in 2016 versus 2015, is it because the salvage value of the vessels went down because of the shipping market? And do you expect any further depreciation impairments, some other impairments in the future?

And the second question is, are there any discussions with Qatar Gas regarding the new capacity that might come online? Are there any initial discussions? I know it might be very early stage, but is Nakilat in the loop of any expansions?

Fotios Zeritis

I will take the Qatar's LNG expansion question. It was an expected and interesting question. When the expansion will be completed by 2024. Qatar's LNG production capacity will reach around 110 million tons per year, roughly it is an increase of 43% from current capacity. What we can tell you is that we have always discussions with our charterers about LNG issues and LNG shipping business but right now, we cannot disclose further about this thing.

Philip Kanaan

Yeah, because that was one thing – if the government and QatarGas would give the same kind of lucrative deal they have right now, given especially the spot rates where they are right now.

Hani Abuaker

Yes, but that it is something that belongs to them to decide and to communicate at the right time for sure whether it is Nakilat or potentially any other shipping companies. We will leave it up to them to comment on this one. However, we, as any other shipping company, are always in discussion with the charterers who are located either in Qatar or abroad to secure LNG business of any capacity.

I will answer your question about the depreciation, the increased charges. Basically, the reason of that increased charges is not impairment, it is more about our adjusted scrap value of vessels.

Basically, we changed the accounting estimate to be more conservative because back in 2015 the scrap value at the end of the life of the vessel had changed. So, we decided to be more conservative and reflect what are the current market dynamics of demolition LNG shipping space.

Regarding impairment, we don't see any impairment very soon. We must understand why we do an impairment.

An impairment will be in a case where your economic expected value is not being achieved based on the original assumption. However, Nakilat's contracts are fixed long term based on a specific rate of return. As per IFRS, it does not constitute that we should have any sort of impairment.

Our vessels are generating the expected return since the beginning of their contracts.

We are not impacted by any kind of spot market fluctuation as much compared to most of our fleet. Yes, we have exposure to spot LPG market fluctuations and we have short-term contracts of 1 or 2 years. Nevertheless, we do not foresee any sort of impairment because we believe these 4 LPG vessels, as per our economic models, still deliver what was expected from them since we bought them back in the days.

Philip Kanaan

Okay, fair enough. I mean these valuations are purely I guess driven by the global prices and where the charterer rates are and what independent valuations put them on, is it more of market demand?

Hani Abuaker

Please, let me just elaborate more. On an annual basis, we have been asked that question by our external auditors where we review impairment tests and we look at the book value of our vessels.

In addition, we look at the generating potential cash flow of vessels over their depreciable life and we discount all of that based on the expected rate of return. Whether we see any discrepancy or at least if we see any sort of indication of impairments, we will take that decision right away.

However, we haven't seen that. Again, the reason behind that is our vessels are depreciated over time and our economic models show that there is still a rate of return that we are generating, based on what we are expecting since entering this business opportunity. There was nothing that signaled any deterioration in the way that our vessels are performing. So, we don't see any sort of impairment in the near future.

Philip Kanaan

Okay, fair enough, final question. How much of the JV is spot, how much is long term, approximate figure?

Hani Abuaker

Currently, if we look at all our vessels, some of the LNGCs are being fixed on short-term charter contracts (1-3 years contracts). However, most of the 65 vessels are chartered on medium to long term contracts, 7 to 10 years on average, and about 15 to 25 years long term contract as well as Nakilat's FSRU which is close to 15 years contract.

Philip Kanaan

LPG?

Hani Abuaker

The nature of the LPG shipping is different, it goes into a contract term of around between 1 and 3 years contracts. However, we haven't disclosed a specific number of years. We charter them on a time charter contract. So, basically our minimum is 1 year, to ensure that we always have these vessels being chartered. In addition, the nature of the contract could be reflected by the current market and the previous months performance and finally, some of our LPG's have fixed rate contracts.

So, we have a mix of both kind of chartering for the LPG vessels. However, they are still exposed to the LPG Baltic rate.

Philip Kanaan

Okay, thank you.

Hani Abuaker

Welcome, thanks.

Operator

Thank you. As a reminder, ladies and gentlemen, please press star 1 to ask a question. We will now take our next question from Shabbir Kagalwala from Al Rayan Investment.

Please go ahead, your line is open.

Shabbir Kagalwala

Gentlemen, thank you for the call, I had a few questions. You mentioned about that the rate, LNG rates have been good in the past quarter. Just wanted to know how is Nakilat benefitting or what steps Nakilat is taking to benefit from this rate hike if any. And how much of the JV vessels are up for renewal in the current one year or so?

Fotios Zeritis

Okay, regarding the market, we can see that the rates have started to increase and this helps the attitude of the market. So, there are business opportunities that we can look into in the short term and long term. Also, it is pushing the market value of newbuilds.

You can see that that the price of a LNGC newbuild were around $183 million 6 months ago. Now, you can see that the newbuild LNGC is about $185 million and shipyards are trying to push it up to the range of $190 million.

Obviously, this rising LNG shipping market pushes the prices of the existing fleet to a higher level. But we cannot see this clearly in the existing LNG fleet because there is no enough liquidity of sales and purchases transactions in the existing LNG vessel market. But in the long run, eventually the values of the existing vessels will go up with the continuation of this rising momentum.

Also, we had discussions with ship brokers about the valuation of the existing fleet and they started to notice this upward trend. However, in order for us to have a clear picture, we need to see the current rising momentum of LNG shipping market continue in the coming months to be sure for this fleet value increase.

Hani Abuaker

I will add to what Fotios said and elaborate more on what does this mean for Nakilat. Basically a strong market demand on fundamentals is very good for us. That means that potentially we can have more future business opportunities in 2019 and 2020 and going forward because we want to make sure that the market continues to have that strong fundamentals. This will allow us to acquire more capacity potentially worldwide, which was the case earlier this year when we partnered with our joint venture partner Maran for 2 vessels.

So, yes, it means more potential business for us because we have enough capital to deploy. We have the size, we have the capabilities to raise required debt and to finance these assets.

Having good fundamentals in the market and the LNG shipping market specifically will always help us in securing these assets.

Shabbir Kagalwala

Right, and in terms of renewals, how much of the fleets are up for renewal for the next one year or so?

Hani Abuaker

I just answered this question earlier, but I will repeat again. For the LPG vessels, the nature of the LPG vessels is different. We currently have only 4 vessels out of our 70 vessels, usually these vessels are chartered between 1 and 3 years. However, chartering these vessels is possible always.

Again, what we are looking for is the market fundamentals, is the LPG Baltic index rate strong enough, so we can generate more profitable income out of these vessels or not. So, yes, chartering LPG vessels between 1 and 3 years is always easy and doable. Therefore, chartering LPG's for 1 or 5 years is indifferent due to the LPG market economics. The LPG is based on Baltic index rates ,which change almost on a daily base.

The Baltic rate was not as good over the last 2 to 3 years. However, before that, it was at record high. So, currently our vessels continue to be chartered the same way since we bought them in 2008. We usually charter them for a period between 1 and 3 years.

And that charter rate could be in 2 elements. Some of them are chartered on a fixed rate, and some on reset rate which is based on the previous months' performance on the Baltic rate. And the remaining LNGs, we can say that most of them are chartered between 7 to 25 years which is what we have seen and maybe 1 or 3 on around 3 to 5 years contracts.

Shabbir Kagalwala

Okay. And in the start of the year, you did conduct expansion into FSRUs, are there more vessels to come in that category as of now or what is the plan for that segment?

Hani Abuaker

As we have said in our press release, the fact that we got into the FSRU business opens a completely new horizon for potential future opportunities. So, yes, we will continue to look for business opportunities if ever exist in this segment.

Shabbir Kagalwala

And you mentioned you are looking for acquiring vessels, will that have an impact on the dividend?

Hani Abuaker

Okay. As we have highlighted before in our previous conference call that we don't think the acquisition of FSRU or a couple of LNGs will have any sort of impact on our dividend over the next 1 or 2 years.

If you can see our profit is now around QAR 650 million and maybe it will head to QAR 820 million or 860 million,

And I mean we still pay QAR 554 million in dividends. So, we can maintain our current level of growth with the current profit that we are generating. As you can see, over the last 5 to 6 years, we have added almost 11 LNG vessels as well as 1 FSRU and we continue to pay the dividends and we never cut those dividends. We can use our internal generated money and our capabilities with our world class charter contracts to finance potential acquisitions.

Shabbir Kagalwala

All right. Thank you, gentlemen. Thanks for answering the question.

Hani Abuaker

Thank you.

Operator

Thank you. As a reminder, it is star 1 to ask a question over the phone. We will now take our next question from Nikhil Arora from Franklin Templeton Investments. Please go ahead, your line is open.

Nikhil Arora

Thank you, gentlemen so much for the call today. I have just a comment if you can please confirm. So, just elaborating on your last statement on the dividend. I think it is safe to assume that if there is any kind of expansion opportunity, then most likely it is going to be in the format of a joint venture rather than let's say taking any new asset on your own balance sheet, which might affect the dividend, and is that true?

Hani Abuaker

No, absolutely not. Recently, we acquired assets like the 2 vessels with our joint ventures which were 50-50 ownership, or we might also acquire one vessel by ourselve. So, I don't foresee that based on what we have been doing over the years. I don't think our annual or regular growth that we are going to have over the next 1 or 2 years have any impact on the dividend. By saying that, I would like to have some cautions is that if we have like a one in a lifetime opportunity where we must acquire a massive number of vessels where we must go above and beyond what we expect, and this is the best thing, we might. However, we currently don't see the possibility of a dividend cut because of our normal growth that we have been seeing over the last years.

Therefore, whether it is a joint venture or whether Nakilat acquiring vessels by itself, we don't foresee, and we don't see it over the next couple of 2 years or even further, assuming it is a normal business or business as usual. However, if things change and we have an opportunity that has a massive potential that we really need, and this is the best interest of our shareholders, we might consider, and it is not something that we will do, but we might consider. However, again I want to emphasize, dividend is something that Nakilat believes that it is valuable and based on its risk profile and the future cash flow which is linked back to back with world class charterers, we strongly believe that this dividend level shall be be sustained.

Nikhil Arora

All right, thank you for that.

Hani Abuaker

I hope I answered your question.

Nikhil Arora

Yeah, it does, thanks. I have like two more questions on the operation side. So, number one is that administrative cost which are lower this quarter and highlighted in your slide show; is this like a sustainable level of G&A expenses that we should expect going forward as well? And how much of this is a result of say taking vessels from Shell's management to your own internal management?

And number two, can you just, you know, remind us again of the shipyard operations; is that still loss making and if yes, then how much on a quarterly basis?

Hani Abuaker

Firstly, I would like to answer on your G&A question. We are maturing as a shipping company over the years, and we are actually always implementing a lot of continuous improvement measures within the organization to ensure that we truly emphasize on our vision to be a global leader. So, basically, we are continuously looking for sustainable and continuous improvement measures in the way we do business, the way we utilize our internal resources, and the way we exploit and take advantage of economies of scale which is what we just talked about earlier, taking over the vessels from STASCO, because it allows us to really utilize our own G&A and potentially allocate more resources efficiently between our operation and the number of G&A resources needed.

So, yes, we think that this is something sustainable and its something that is part of our day-to-day culture, this is part of our CEO mandate to us. We continuously improve, innovate and provide new ways that we can really be more competitive and ensuring that we are doing more cost saving which is not cost reduction. I just want to be clear, it is very important to say that it is cost saving and ensuring that we do things in a more efficient way and we deploy different methods and resources. Also, we do a lot of automation and bring a lot of ideas from different external consultants to assist us in becoming an efficient, lean and agile organization.

About the shipyard, I can say that this year for sure it is not a money losing venture. Our activities have increased significantly due to the number of ships and some of the offshore projects and industrial engineering. We believe that over the coming years, with a lot of actions going on in the marine side, and a lot of balanced water treatment systems that needs to be installed, we can see a lot of activities going there. So, we foresee that these ventures will start to have some good numbers by themselves. Yet, as you know, we are a big LNG shipping company, most of our earning is coming from shipping rather than from these shipyard facilities. However, currently they are not losing money at least for this year. We can see that they will be able to sustain positive numbers over the next couple of years. So, I hope that I answered your question.

Nikhil Arora

All right, thank you. And probably just one last question from my end. So, the lost time incident frequency rate, the LTIFR data that you have provided on the slide, this is on slide 19, which is like very low for Nakilat versus let's say the average for the industry; does this include your joint ventures as well or is this only for the wholly owned vessels?

Hani Abuaker

It is only for the wholly owned vessels that we currently operate. As you can see, the numbers are still below the industry average even for our joint ventures. However, we are just reporting about Nakilat. And just to show that Nakilat is a global leader company with track records that we can present to our charterers, not only in Qatar, not in the region but globally when they want to come and do business with us. As you know, like any LNG producer, the most important thing in business is reliability. We want to make sure that the customers receive the product on time and as per expectation. And I am sure that showing such safety records and comparing it to the industry average, that's proving that Nakilat is the global leader and hopefully in all aspects, whether from size, contracts, cost efficiency and most importantly safety in all operations.

Nikhil Arora

All right. Thank you, gentlemen.

Hani Abuaker

Thank you.

Operator

Thank you. There are no further questions in the phone queue at this time. I would like to hand the call back over to you, Mr. Sarkar, for any additional or closing remarks.

Bobby Sarkar

Sure, thank you all for dialing into the call. Thank you, Hani. Thank you Fotios. Please, if you have any additional questions get in touch with QNBFS sales or myself and/or company management and we will be happy to help you out.

Thank you all, bye.

Fotios Zeritis

Thank you very much and thank you for QNB, and we are always happy to participate in conference calls. Thank you.

Operator

This will conclude today's conference call. Thank you all for your participation. You may now disconnect.