Nakilat (QGTC) 4Q18 Results

Earnings Call Transcript

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Co-Hosting: EFG Hermes and QNB Financial Services

Conference Title: NAKILAT 2018 Earnings Conference Call

Moderator: Ahmed Hazem Maher

Date: Tuesday, 19th February 2019

Time: 13:30 (UTC+03:00)

Executives:

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

Questions by:

1) Bobby Sarkar – Head of Research at Qatar National Bank
2) Jonathan Milan – Analyst at Waha Capital
3) Shabbir Kagalwala – Associate Director at Al Rayan Investments
4) Rami Jamal - Portfolio Manager at Amwal
5) Maya Bou Kheir at Analyst at Schroders
6) Bijoy Joy – Analyst at Qatar Insurance Company
7) Sudaif Niaz – Analyst at BlackRock
8) Yazeed Alturki – Analyst at Ashmore
9) Samir Murad – Analyst at NBK Capital

Operator

Hello. Good morning and good afternoon. I would like to welcome you today to Nakilat's 2018 Results Conference Call. It's Co-hosted by EFG Hermes and QNB Financial Services. We'd like to welcome with us on the call Mr. Hani Abuaker, CFO of Nakilat and Mr. Fotios Zeritis, Head of Investor Relations of Nakilat. And with that, we leave the call to Mr. Fotios for the introductory statement. Mr. Fotios, please go ahead.

Fotios Zeritis

Good afternoon, everyone. Thank you for joining Nakilat's Fourth Quarter 2018 Conference Call. For your convenience, the transcript of this call and presentation will be available on Nakilat's website.

Please, now turn to slide 2 of the presentation. Many of our remarks contain forward-looking statements and slide 3 has the table of contents of the entire presentation. On slide 4, you can see the glossary of our presentation.

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

Now, I would like to hand it over to the CFO of Nakilat, Mr. Hani Abuaker.

Hani Abuaker

Thank you, Fotios. Good afternoon to all of you and thank you for joining us today on our fourth quarter earnings results. I will begin the call with Nakilat's financial highlights for the fiscal year 2018. Afterwards, Fotios will update you on the LNG shipping market overview. Then, I will take you through our business outlook for the 2019 after which the floor will be opened for any questions that you may have.

Now, turning to slide number six and seven, we can see that this has been a successful year for Nakilat in terms of executing our strategy which has resulted in growth of our portfolio and achieving efficiency. Given Nakilat's proven track record, I am confident that we can continue to grow our LNG fleet further with high-quality charterers and counterparties.

Following the strong operating performance and continuing fleet growth, today, I am delighted to report great annual company performance results for EBITDA, net profit and continuous cash dividend distribution for the last nine years. On Sunday, the board of directors has recommended a cash dividend of QAR 1 per share as a result of meeting our balanced growth strategy for this year.

Now, I will take you through Nakilat's financial performance. Our profitability increased by 5.3% on an annual basis, due to the acquisition of two LNG carriers and one FSRU. And if we exclude the 2017 one-off item, which was the sale of our QE stock listed securities, our normalized 2018 profit is higher by 14%. Another factor that contributed to our profitability was a higher level of shipyard activities. 2018 was a very successful year for Nakilat as shipyard's activity work-load resulted in a boost to our bottom-line.

Other factors that contribute to a higher profitability were: lower operating expenses, increased interest income from bank deposits and dividends received from shares listed on Qatar Exchange. Operationally, our total expenses have slightly decreased in 2018 by 1% compared to the same period in 2017. This is mainly due to Nakilat's continuous efforts for cost optimization and ensuring that we employ efficiencies in every element within our operating model. Our total operating expense decreased by 2.7% year over year.

Turning to slide eight, we see a strong healthy balance sheet with cash and bank balances at almost QAR 2.5 billion as well as total assets at QAR 29.6 billion. The investment in joint ventures increased mainly due to the share of operating profits, hedge gain, and investment in new joint ventures. Moreover, our schedule debt amortization continues the repayment with free up our balance sheet capacity. Specifically, borrowings have reduced by almost QAR 0.8 billion.

On slide 9, we can see that Nakilat has already reduced its net borrowing by 15% over the last five years while we have acquired additional 11 LNG carriers and 1 FSRU.

Now, let me hand it back to Fotios to take you through an overview of the LNG shipping market. So, Fotios, if you can please take it further.

Fotios Zeritis

Thank you, Hani. Now, I will take you through the LNG shipping overview.

If you turn to slide 11, it clearly shows the fundamental improvement of the LNG shipping market. The final quarter of 2018 for LNG shipping was characterized by both record high charter rates and volatility.

During October and November 2018, the market witnessed an extreme spike in charter rates which may range from $130,000 to $175,000 per day due to the shortage of tonnage.

In the fourth quarter of 2018, LNG shipping spot market significantly improved; the average charter rate for the second-generation LNG shipping carriers (DFDEs) reached approximately $146,000 per day, in comparison with around $65,500 per day in the fourth quarter of 2017, this translates in an impressive increase of 125%. With the same upward trend, the first-generation LNG carriers (steams) increased by 105%. Specifically, from $40,000 per day in the fourth quarter of 2017 to $82,000 per day this quarter.

The current spot market rate improvement is driven by many different factors. The main factor is an impressive increase of Chinese LNG demand by ~38% year on year, which made China the second largest global LNG importer. Other important factors that influenced this growth of LNG is the rising global liquefaction capacity, and the higher global average ton mile demand, which implies a larger shipping tonnage requirement.

On the LNG shipping supply, we observed that the total incremental LNG fleet growth will reach approximately 10% in terms of number of ships.

If you turn to slide 12, you can see that there are 480 vessels in operation and 107 vessels on order-book, which implies an increase of 22% of total LNG fleet, in terms of number of ships as of December 2018. Here, I should mention that the average age of LNG fleet is relatively young, approximately ten years old, and only ~5% is older than 35 years old.

The promising fundamentals of the LNG shipping market has boosted the confidence of LNG shipowners and as a result, their newbuild contract activity has impressively increased from 13 newbuild contracts in 2017 to 65 newbuild contracts in 2018.

During the fourth quarter of 2018, it is worth mentioning that 90% of LNG fleet is chartered for longer than three years, 6% of the charter fleet is from six months to three years chartered, and only 4% of the LNG fleet is on the spot market.

Now, if you turn to slide 13, you will see that the LNG shipping market balance is expected to be much tighter by 2022, due to very high LNG production of approximately 65 million tons. From the 65 million tons, approximately 55% is coming from the US, which means it will add to the ton mileage, and it will need more shipping tonnage requirement. In the next 18-24 months, the LNG charter rates will be driven by increased global liquefaction capacity, US LNG exports, and high LNG demand from Asia.

In the short term, however, the LNG shipping market is expected to experience a seasonal softness. But overall, it is still much tighter than the previous year. As a final note of the LNG shipping market, both, an ongoing progress of new liquefaction plants and an increased LNG demand should result in strong fundamentals for LNG shipping to result in potential business opportunities for Nakilat.

At this time, I would like to turn the conference call over to Hani to discuss about Nakilat's business outlook. Please, kindly go ahead.

Hani Abuaker

Thanks again Fotios. Moving on to slide 15, I will take you through our business outlook for 2019. Nakilat is committed to meet all of its strategic goals. As the world's largest LNG shipping company with current strong LNG shipping industry fundamentals, we think of it as the perfect storm for us. Nakilat is very well-placed to be in a very favorable strategic position to secure potential future business opportunities, to expand the LNG portfolio.

Furthermore, we have a great degree of confidence that the momentum to continue a higher utilization of our shipyard facilities, given what's going on in the shipyard with a lot of maritime initiatives through the IMO's new requirements and the dry dock activities; in addition there is a rise of port calls post blockade over the last year and a half. Also, we expect a further rise of potential offshore projects and for this reason, Nakilat signed a JV agreement with McDermott, USA, and it was announced yesterday during Qatar's Tawteen initiative.

In addition, we continue to be focused on our business portfolio in terms of a strategically balanced growth and diversification. The strong LNG shipping market, that Fotios talked about, improves the sentiment of owners and created an attractive investment environment for us and to anyone who is in LNG shipping, to capture new business opportunities.

And finally, with a stronger LNG shipping market in the coming years and with the continuation of execution of our strategy, shall give us an additional scope to enhance return to shareholders and maintain our sustainable dividend pay-out. With that, I think I will ask the operator, to open the floor for questions and answers.

Please go ahead.

Operator:

Thank you, Sir.

Ahmed Hazem Maher:

Thank you very much Hani and Fotios. With that, we'd like to open the room for a Q&A session. Please, go ahead.

Operator:

Thank you, sir. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speaker-phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal.

We will now take our first question from Bobby Sarkar from QNB Financial Services. Please, go ahead.

Bobby Sarkar:

Hi, this is Bobby Sarkar. Hi, Hani, hi Fotios, how are you? I have a couple of questions. First one is that, could you discuss a little bit as to how the shipyard business is going, breaking it out into the ship-building and the ship-repair business? And how does the new JV with McDermott will impact that business going forward? Secondly, if you can talk in more general terms as to how – what you see for Nakilat, given, you know, the significant expansion in Qatar's LNG capacity from 77mtpa to 110 mtpa? And how do you think Nakilat will benefit and over what time period do you think investors will start seeing results of this expansion? Thank you.

Hani Abuaker:

Okay, I'll take the first question and let Fotios to answer the second one. In 2018, we saw an increased level of shipyard activities with significant high number of vessels compared to 2017. Part of it, is due to the cycle dry-dock activities of Nakilat's fleet. In addition, the higher requirements of international compliance and regulations have caused other independent shipowners to visit our shipyard. Also, we have seen an increased workload in the off-shore marine structures. This has really contributed to a significant higher utilization of our shipyard facility, which translated to significantly good financial results in 2018. That's on the ship repair facility.

On the ship building side, it was also a good year for us. Which was marked with the delivery of 2 fast diving vessels. Also, we saw an increased number of repairs for super yachts in 2018.

However, we have seen a significant operational shift at NKOM. With the increased utilization of our shipyard and our ability to optimize our cost structure efficiently in a way that we really can generate a positive rate of return or in other words, a positive P&L in 2018.

In 2019, during the months of January and February, we have seen the same momentum that we saw in 2018. However, I cannot really elaborate further due to the fact that it is a cyclical industry. However, the 2019 outlook looks good or It continues to look good since 2018. All in all, 2018 was significantly a much better year than the previous years for our shipyard business line.

Regarding McDermott, I hope one day when you guys visit Qatar, we can take you for a visit to our world-class facility in Ras Laffan. The shipyard facility, itself, is massive. It's a great, well developed facility. The state of Qatar invested back in 2010 close to QAR 11 billion to develop that facility.

So, naturally, when McDermott decides to look for an opportunity to start the establishment of their operations in Qatar, they selected Nakilat as McDermott's ideal partner because of our excellent facilities in Ras Laffan. The main scope of this joint venture is potential fabrication services, which is basically very well-timed and supported by Qatar's medium-term needs for its expected on-shore and off-shore projects.

Our new JV partnership is expectated to complement NKOM and our other facilities within the shipyard. We expect to generate a good rate of return from our new JV partnership. As we signed the agreement yesterday, I cannot really provide further guidance at the moment. However, we will elaborate more in the near future.

Finally, I will hand over to Fotios, to elaborate more about your second question.

Fotios Zeritis:

Hello, Bobby. Regarding your interesting question about Qatar LNG expansion. This is a clear decision of Qatar Petroleum (QP) and Qatargas (QG). Nakilat does not comment on behalf of them. You should understand that they have their own team and they do their own assessment and exercises. However, we would like to highlight that we have a long-term relationship and collaboration with them through our current portfolio.

Based in Doha, Nakilat is the world's largest LNG shipping company by capacity with successfully proven track records on commercial, technical, and operational shipping capabilities since 2004. Nakilat's main goal is to grow internationally and diversify its clientele. However, if there is a big opportunity to support Qatar's plans and to extend our LNG shipping expertise to this opportunity, we are more than happy to be part of it. I hope that I fully covered your question.

Bobby Sarkar:

Great, thank you.

Operator:

We will now take our next question from Jonathan Milan from Waha Capital. Please, go ahead.

Jonathan Milan:

Good afternoon. This is Jonathan Milan from Waha Capital. So, just a quick question, a recap on the number of vessels. So, the vessels that are leased out or that are chartered with Qatari companies are the one that are used as the other joint ventures. Can you please give us a recap of how many vessels are not operating, say with Qatargas? And how many or what percentage of your fleet is on spot trade? And just a follow-up to the previous gentleman's questions, Qatar plans on adding roughly 50% capacity. Will you be asked or tasked, given the opportunity to supply Qatar with the LNG vessels required to also expand that? In other words, will you be also looking to add another 20 or 25 vessels over the next ten years? Thanks.

Hani Abuaker:

Okay. Maybe, I will answer your first question about the jointly owned vessels with the international customers. Yes, we have chartered out 11 LNG carriers, which represent almost 17% of our LNG fleet in terms of number of LNG vessels. Our fleet consists of 65 LNG vessels, 4 VLGSs and 1 FSRU. If you include the 4 VLGCs and 1 FSRU, Nakilat's international charterers' clientele reaches at 23% of our fleet portfolio.

Most of the vessels are chartered by international customers and are chartered on a long-term contracts, but some of them are chartered in the medium-term. Basically, you can say around 85% of Nakilat's fleet are chartered on the long-term. And the remaining ones, the LNG vessels are chartered on medium-term which is between two to three years' term.

Regarding Qatar's expansion, we will let Qatar Petroleum (QP) and Qatargas (QG) to comment on that. We do not comment on behalf of them. However, as a global LNG shipping company based in Qatar, whether we would be requested by any charterer to lift capacity and to acquire the assets, that's something we will go for. So, it is up to Qatar Petroleum (QP) and Qatargas (QG) to decide and to announce their decision in this regard.

Nakilat is the world's largest LNG shipping company by capacity with successfully proven track records on commercial, technical, and operational shipping capabilities for the last 15 years. Having the largest capacity and the required infrastructure, we are ready to serve any potential customers locally or internationally. We continue to look for global business opportunities. It is worth of mentioning that we have been very successful with our joint venture partners such as Maran, in the past and that's something that we will continue to pursue and to look forward for.

Jonathan Milan:

Okay. And so, for further expansions, would you rather go through jointly on vessels, or would you go for wholly owned vessels? And what's the preference generally?

Hani Abuaker:

Well, to be honest with you, for us, we are indifferent. We can go either by ourselves because we have the capacity and the capability to do it successfully or we can go through a joint venture, if that's the case. However, this is something that we will decide on a later stage but, we are indifferent because Nakilat can select any option as per the needs of the specific business case opportunity.

However, we, as a company, have the abilities to acquire our own LNG shipping capacity to transport or lift cargoes for different clients/charterers worldwide and that's something that is embodied on Nakilat's 5-year strategy. During Nakilat's 1Q19 earnings results conference call, I hope that we will have a separate section to present Nakilat's next five-year strategy map. In this way, we will explain to you how we, as an organization, strategically plan for the next five years. As a matter of fact, Nakilat is a forward-looking organization. Now, we are looking at where we want to go and what we want to achieve at Nakilat in 2019-2022.

In this way, the investment community will fully understand and realize what exactly Nakilat is trying to achieve. This high-level strategic slide may address a lot of your current questions about whether we want to go through our joint venture, or we want to go by ourselves. Again, we are indifferent on the expansion mode. If we select to invest through the joint venture avenue; It is not because we have to go through a joint venture structure, but it is because this business opportunity comes with this specific joint venture. And if we felt that it is a good opportunity for both of us, we go together as partners to acquire new accretive assets. However, a lot of these strategic decisions happen mutually between partners. So, I hope that answers your question.

Jonathan Milan:

Yes, it does. Thank you very much.

Operator:

As a reminder, to ask a question, please signal by pressing star one on your telephone keypad. We will now take our next question from Shabbir Kagalwala from Al Rayan Investment. Please, go ahead.

Shabbir Kagalwala:

Good afternoon, gents. This is Shabbir Kagalwala from Al Rayan Investment. I have a couple of questions. You mentioned that there are 107 ships on the industry level in ordering. Typically, how much time does it take if you want to order to get a delivery of a ship given the current capacity in the industry? And the ships which you construct, the fleet which you operate, what's the typical cost of a ship in current market term?

Fotios Zeritis:

Hello. Thank you very much for your question. Generally speaking, an LNG shipowner who wants to construct an LNG newbuild in South Korea, it takes approximately 2.5/3 years. This is the lead time that you need from the moment that you will place the newbuild order until the time the delivery of the ship. The current newbuild price has lately increased and it has currently reached at approximately $187million. This price increase reflects an improvement of LNG shipping market. If you remember one year ago, the price of LNG newbuild carrier was much lower at approximately $180 million per. Hopefully, I fully covered your question.

Shabbir Kagalwala:

Yeah. So, typically, if you get a mandate to operate for the additional capital load – to load the capacity for Qatar for 2023, so you should be typically placing an order by 2020 in order to get the ship?

Hani Abuaker:

We should try to think backwards. Meaning that it depends on when the new LNG production comes in the global market. It has been announced that Qatar's new LNG production comes by 2024. Thus, you need to think that you will need approximately 3 years to build an LNG carrier which implies that someone needs to place the order by 2021.

Shabbir Kagalwala:

And what will be the strategy? Will it be like you will go for a newbuild or it's like acquiring for the market?

Hani Abuaker:

Again, Nakilat is a shipping company which is based in Qatar. For this question only, Qatargas and Qatar Petroleum is well-equipped to answer. Nakilat will not answer on behalf of them. They have already announced a lot of the news over the last month and Nakilat waits to see what exactly their final decision is. However, we should emphasize that Nakilat is global LNG shipping company based in Qatar and we will continue to pursue business opportunities either locally or internationally. However, I think that you are asking us questions that we strongly believe that QP and Qatargas are the companies to answer these specific questions.

Shabbir Kagalwala:

Okay, all right. Regarding the fleet contracts, you said most of the contracts are long term, are there any charter renewals coming in this year, 2019?

Hani Abuaker:

No, we do not foresee any major change in 2019. Only one LNG carrier (JV owned) is coming open to the spot market but it is great news because LNG shipping market is very good with healthy fundamentals. We foresee the LNG shipping market to be tight over the next three years. As part of our balanced growth strategy, we will try to capture new potential business opportunities and tonnage to lift the products if we can. So, that's my answer.

Shabbir Kagalwala:

Perfect, thank you for your time and thank you for answering the question.

Operator:

We will now take a follow-up question from Bobby Sarkar from QNB Financial Services. Please, go ahead.

Bobby Sarkar:

Hi, guys. Just a couple of follow-up questions. On the LNG market dynamics, just wanted to make sure that the balance of the market that you talk about does not include Qatar's potential LNG expansion. And then regarding the orderbook of the 107 vessels, is that also secured by 90% of secured contracts? That's question number one.

And question two is, just wanted to get some more details as to, you know, the reason behind the drop in your finance charges quarter over quarter. I know we had an email exchange, but I just wanted to make sure because, you know, on a quarterly basis, it's the lowest point we've seen since your debt levels hit their peak in 2010, despite the general scheduled repayments, it seems like it's a bigger than expected drop, given the interest rates in the quarter. So, if you could just explain. Thank you.

Fotios Zeritis:

Bobby, I will answer your question about LNG shipping market, and Hani will take your question about financials. Regarding LNG shipping balance, you can see at the bottom of our presentation on slide 13, a note that it states that the LNG shipping market balance does not include Qatar's LNG expansion, which is approximately 33 million tons per year, and it does not also include Golden Pass's LNG volumes ~16 million tons per year. The purpose of this is that these LNG volumes are expected to come on-line after 2024. For this reason, this shipping balance does not include these two significant LNG liquefaction projects. Regarding your question about orderbook, nearly two-thirds of this orderbook have been already attached with multi-years charters. Only, a small number of vessels who are part of the orderbook are without long-term charter agreements. We expect all these vessels to be absorbed healthy from the upcoming LNG supplies in the coming years. In the next three years, the anticipated LNG volumes are approximately 65 million tons. For this reason, we believe that the market will continue to have strong fundamentals in the next two or three years. Of course, we expect a kind of volatility in short-term due to seasonality issues, but the LNG supply market is much better than the previous years.

Now, I will give it to Hani to respond with the financials.

Hani Abuaker:

Hi, Bobby. The main reason of our interest rates and expenses are going down, is the rescheduled repayment. We had a little bit of higher accruals on the third quarter of 2018. Perhaps, that's the purpose of a small disturbance maybe, in your figures, to make sure that you track our interest expense. So, I hope that I answered your question.

However, our earnings results are mainly due to an actual great achievement of growth and higher profitability from our expansion of 2 LNG, and one FSRU, as well as shipyards from higher activities. Furthermore, you need to understand that our loans are based on LIBOR plus fixed margin. Thus, we are eligible to refinance at a lower margin, it also could help us to reduce our interest expense. Hence, there are different factors that could also support us reducing our interest cost now or in the future. However, for that – between the third quarter and fourth quarter, scheduled repayment, additional accrual that was made in Q3 and that was a reverse in the Q4, but that's mainly it.

Bobby Sarkar:

Great. Thank you.

Operator:

We will now take our next question from Rami Jamal from Amwal. Please, go ahead.

Rami Jamal:

Good afternoon, it's Rami from Amwal. I have a couple of questions with regards to your presence in the market. So, being one of the world's largest LNG ship – basically, operators, where's your majority of presence around the world? Which market do you primarily focus on? And of your client base, how much is the Qatari government represents in terms of percentages?

Fotios Zeritis:

Hello. Thank you very much for your question. Regarding Nakilat's international portfolio, It is consisting of approximately 17% to 23% of our fleet in terms of number of ships. For example, we have contracts with Australian Woodside, and US Excelerate, who is our partner in our 1st FSRU that we acquired. Actually, all our charters are first class corporations. As matter of fact, we try to do business only with first-class charterers who have a very high credit rating from the major credit ratings agencies such as S&Ps. Nakilat's fleet have many international port calls in different countries in order to deliver our charters' cargos such as China and South Korea.

Hani Abuaker:

Wherever the charterers tell us to go, we end up going. Our vessels reached to approximately 25 countries in 2018

Fotios Zeritis:

As you understand, the majority of our port calls, are in Asia such as Japan, South Korea, Taiwan and China. Because the Asian countries are the world' s largest LNG importers. Note that we go to every country that our charterers want and we have never missed any cargo. We're a very efficient LNG shipping company.

Rami Jamal:

So, about 17% international business operation, do you see that number growing in the future taking out of your Qatari business or you're going to rely on ship expansions to cover both?

Hani Abuaker:

One of the thing that we will be sharing next quarter is Nakilat's strategy roadmap. We are going to defend our position as a global leader and we will ensure that our market share continues to be maintained. We will ensure that we capture more international business as we go along.

Rami Jamal:

Just one follow-up question. With regards to the debt levels on the balance sheet, do you plan on continuing your reduction in borrowing or are you looking at increasing debt in the near future that you've dropped by significant amount?

Hani Abuaker:

You know Rami, when we commit ourselves to any business opportunity, our economics ensures that it is risk adjusted and that we mitigate all kind of potential adverse impact on us. Our economics always show us how to achieve a minimum required rate of return. Obviously part of that is to ensure that our cash flow is not impacted with that expected rate of return. Our cash flow must yield for us after paying all of our scheduled amortization debt repayment. So, yes, we will continue to pay our scheduled amortization debt as we move on. If there are new potential business opportunities that requires us to raise more debt, we will do that.

However, it will be studied very carefully to ensure that we mitigate any potential risk or not to incur higher risk for the company. In Nakilat, over the last five years, we have paid almost 15% of our debt and we continue to do that. At the same time, we continue to generate healthy return that allows us to distribute a good dividend to our shareholders, and allowed us to expand the size of our fleet, close to 11 LNG vessels and 1 FSRU, with internally generated funds.

Rami Jamal:

Noted. Thank you so much.

Operator:

We will take our next question from Maya Bou Kheir from Schroders. Please, go ahead.

Maya Bou Kheir:

Hi. Good afternoon, gentlemen. I have a question on the JVs. Looking at the numbers of the JV, Teekay in particular, there has been a massive drop in the level of profitability. What's the reason for this and is this a one off? In general, if I look only at the JV related to LNG shipping, there has been a margin pressure in the last two years particularly. Can you please explain the reason for this? That's my first question.

My second question is, what was the contribution of the new FSRU vessel, and where can we see it in the financials?

Hani Abuaker:

Thank you. I think the one for Teekay, there's a one-time off item that happened to us back in 2017, we have disclosed in our financial statements in 2017 notes. It was a lease arrangement based on certain tax and financial assumptions when we commenced the lease back in 2007. However, the tax lease arrangement was based in UK, have been challenging – this kind of lease arrangements, not only for Nakilat, but also for other shipping companies.

In 2007, a lot of shipping companies used the capital lease arrangements. We've been in discussion with the HMRC and not ourselves, but our joint venture partners since December 2012 or '14. We have also terminated that lease on Dec'14 once we realized that this was something that's not anymore allowed by the UK tax authority. Also, we've been in discussion with the UK tax authority. However, we have noticed that we were not able to reach to a favorable conclusion with them. Therefore, we took this provision in 2018 to clean this one-time off lease arrangement with the tax authority. I hope that I answered the question about Teekay. Hopefully, next year, we don't have to really worry about any more potential tax or exposure that could happen to us relating to this tax arrangement that happened back in 2007 when we established that company.

Maya Bou Kheir:

So, I mean, is it safe to say that we can go back to the net profits margin level in the 40s for Teekay? So, this is completely a one-off time.

Hani Abuaker:

Completely one-off time, it has been cleared. Since December of 2014, we were in discussion with the UK tax authority when we realized that they're potentially no favorable outcomes. We said that we want to move on and we have taken the provision for that to settle this amount. You should not expect to see this tax item again in the near future. Yes, I can confirm that for you.

Maya Bou Kheir:

I just wanted to remind you of the next question.

Hani Abuaker:

The next question was, if there was some sort of margin pressure over the profitability from the joint venture. US Interest rate was increasing over the last year. This is the main reason for some of the pressure that came on us that caused lower profitability.

However, we tend to believe that over the next year or two years, we should start to see an improvement on the margins, particularly when US interest rates stabilize. We anticipate to see more favorable results from the joint ventures with improved margins over the next couple of years.

The question, regarding Excelerate Energy, we have included it with Pronav JV and other maritime joint ventures. As we have said before, we will start to report separately our shipyard activities. I hope that this separation will start to be implemented in the first quarter or second quarter of 2019. In this way, we can give you a better clarity about our performance.

Basically, our FSRU JV is reported under other joint venture. The other thing that I want to highlight to you, is that you should try to think about our FSRU investment as a pure LNG investment that we have invested or deployed Capex, and we generate similar required rate of return.

Maya Bou Kheir:

Perfect. Thank you very much. Just a follow up question, you mentioned interest rate is the main reason for the margin pressure, I just wanted to check this JV partnerships, how much of that is fixed interest and how much of it is viable? Also, on the FSRU, how many months are included in terms of distribution and the numbers?

Hani Abuaker:

We can say that around 80% our joint ventures are fully hedged. We have one of the joint ventures is between 25% and 50% hedged, which is with Maran. On the other hand, about the FSRU, we had it only for six months. In 2019, you should see a full year performance for the FSRU business. The same thing for our new two LNG carriers with Maran. In 2019, you should also see a full year performance.

Maya Bou Kheir:

Perfect. Thank you very much.

Operator:

We would like to take our next question from Bijoy Joy from QIC. Please, go ahead.

Bijoy Joy:

Hello, this is Bijoy from QIC. Thank you for the call and thank you for the presentation as well. I have a few questions. My first question is on the FSRU project; do you have any plans to expand there? And if yes, what kind of IRR reach are you looking at?

Hani Abuaker:

Regarding the FSRU expansion, we have engaged in this business, for one reason which is to diversify and to grow our portfolio into that growing segment. And as we said before, we always see continuous business opportunities, not only for the FSRU space, but also for the LNG shipping. Since, we are a global LNG shipping company we are very selective on business activities in order to ensure a very favorable rate of return to our shareholders. Any of our projects always meet the minimum required rate of return that we have seen over the last years since the inception of Nakilat. You should always think about a leveraged IRR of between 11% to 15%.

Bijoy Joy:

Okay. Under the Pronav and the joint venture income, do you have a contribution coming from – anything other than FSRU – which is resulting to the increase?

Hani Abuaker:

Under this reporting segment is included the shipyard facility. Again, the difference between 2017 activities and profits, and 2018 was very significant. And that's the main reason that you have seen, the major increase or significant increase in profit in 2018 compared to 2017. As I have said before, hopefully, we will see these kind of activities, maybe not as much of magnitude, but at similar kind of levels in 2019.

Bijoy Joy:

Okay. It will be great if you can break down as to what kind of contribution, you're looking at from the shipyard business.

Hani Abuaker:

As I said, we will provide you with Shipyard's segment reporting in the first quarter or the latest by the second quarter of 2019. I promise that I will do it in the first quarter so you guys can have a much better picture about the performance of our shipyard facilities. Thus, you can model our performance. Keep in mind that our shipyards have helped us, and we're expecting our new joint venture with McDermott to allow us further to maximize the utilization of that facility in 2019. However, when somebody thinks about us, they need to think of us as a global LNG shipping company, which has 70 vessels that generates approximately 90-95% of its income out of LNG shipping segment. The shipyard facility segment is always going to make us look better in a way that our results will become higher than expected. However, most of our profitability comes from our LNG shipping segment. In Q1 2019, you should expect separate segment reporting for our shipyards facilities which is the first since 2010. Hopefully, this segment reporting will help you to get a better picture and understanding.

Bijoy Joy:

Thank you, and two more questions. What would be your target debt to equity going forward? Do you have a target debt to equity?

Hani Abuaker:

Currently, we do not have any specific target of debt to equity ratio. However, we continue to pay our scheduled amortized debt on annual basis as we secure any new asset or capacity. So, if a business opportunity comes to us, we will make sure that we secure that business and we will have the capacity to pay off the debt as the scheduled payment plan. This is how we plan our business economics. So, if no new business opportunity materialized, you should expect the scheduled debts to continuously be amortized and reduced. Last year, we paid QAR 800 million for our existing debt. This year, you should expect the same, and you should continue to expect from us to pay our debt, unless there's a major business opportunity or major expansion that will dictate on us to really incur debt to secure a new business opportunity.

Bijoy Joy:

One last question on the industry. Based on the opportunity available, what kind of ships would you like to go for in terms of size? Will that be more like Q-Max and Q-Flex or will be smaller sized ships?

Fotios Zeritis:

Thanks for the question. There is no any kind of preference or a specific size of vessels that we would like to go because we usually have long-term charter agreements and under these conditions it depends on our charterer's commercial needs. The charterers decide where they will sell their LNG cargos. So, based on who is the buyer/seller, how much volume of LNG, and where is the origin country and where the LNG as commodity will eventually land, the charterer needs to decide the size of vessel. As per market's indications, the average size of an LNG carrier is approximately 178,000cbm. As I mentioned before, it's a charterer's decision. For us, we care more about projects economics, we will look at each project separately, if the economics make sense, we are willing to acquire and operate any size of vessels that the charterer decides. Hopefully, I covered your question.

Bijoy Joy:

Yeah, thank you so much.

Operator:

We will now take a follow up question from Shabbir Kagalwala from Al Rayan Investment, please go ahead.

Shabbir Kagalwala:

A follow up question on Gulf LPG if you can shed some light on that, because we have seen that the revenues have fallen significantly in 2018, as well as company JV has turned into a loss, if you can share what's happening there. Thank you.

Fotios Zeritis:

We should mention that Nakilat owns only four very large gas carriers (VLGCs), which means that we have a minor exposure on LPG shipping spot market. Nevertheless, we should say that the sentiment of LPG's market is marginally improving as rates have already started to move higher, driven by rising VLGC scrapping activity. In 2018, the average rate of very large gas carriers improved approximately 22% at approximately 18,300 per day, in comparison with 15,000 per day in 2017.

In 2018, we saw 5 VLGCs that were recycled, which is the highest level in the past five years. Obviously, this scrapping level activity, maybe will intensify before the IMO 2020 regulation take place, and the LPG market will continue to improve. I need to mention that there are 24 potential scrapping VLGCs that are older than 25 years old, The potential higher scrapping activity may improve the LPG shipping market in the coming years.

Shabbir Kagalwala:

So, this JV is with Milaha, right?

Fotios Zeritis:

Yes, with Milaha

Shabbir Kagalwala:

The other JV partner is Milaha.

Fotios Zeritis:

Yes

Shabbir Kagalwala:

Thank you.

Fotios Zeritis:

Thank you, very much.

Operator:

We will now take our next question from Sudaif Niaz from Blackrock. Please, go ahead.

Sudaif Niaz:

Hi, good afternoon. I just have one question. Given the kind of current capable dynamics of the LNG shipping market, and as you talked about in your presentation, would you expect to generate a higher return on capital or any new projects you bid for, or you work on whether that's North Field related or outside?

Hani Abuaker:

Thank you. This question now, is being asked all over the world. People think that because of the LNG shipping rate reached at a range of $150,000 and $200,000 per day during 2018. For us, we believe in the long term, we as a company, we want to secure assets with contracts for 10 years, 15 years. In this way, we can secure and continue to acquire additional assets and generate great return. Yes, maybe we will generate a better rate of return if we operate LNG carriers on the spot market for our shareholders, but that's going to be marginal because as we said before, we are a shipping company, our aim is the long term performance, and we are in it to be the leader in this sector.

So, I can answer your question, even if today the market's range is between $160,000 and $200,000, shipowners will look for a medium to a long term charter rate that is around $75,000/ $80,000 per day. If you want to trade on the spot market, you will earn maybe sometime $150,000 or $200,000 which was the case in 2018. Again, I want to emphasize that Nakilat is a global LNG shipping company, and it's focus is for the long term. We like to really acquire something when the market is so hot like this, not for short term gain of a year or a month, we would love to secure a business that expand for ten years with an attractive return so we can move on and that return will pay for our scheduled debt amortization, generate enough cash for paying off our dividend, and we will start to think about the next potential business acquisition. The rate could be better, yes, but 1%, or 2%, maybe 3% max.

Sudaif Niaz:

That's very fair and reasonable.

Hani Abuaker:

Thank you. That's how we are.

Sudaif Niaz:

Two very quick questions just to wrap it up. One, was your dividend from JVs were less than half of the level in 2017, while profitability, I mean, there's a lot of JVs, but profitability year-over-year improved. Can you explain, was 2017 dividend an aberration?

Hani Abuaker:

It depends on the business itself. For instance sometimes, we use the profit that was generated with Maran in that joint venture for our expansion in 2018. So, it depends on the year whether there was sort of an expansion that is happening or not. It depends if there was one off settlement of item such as what we have seen with Teekay. So, therefore we did not pay dividend just to clear HMRC claim that was related to 2007 setup. Over the next 3 years, if business is as usual, we should see dividend go to the long-term level of stable cash flow because our business is very stable assuming there's no potential growth opportunity, which was the case with Maran or the 11 vessels which we financed with internal fund that was generated over the last three, four years.

Sudaif Niaz:

Fair enough. And then finally, you spent a little bit more than usual Capex this year. Can you give me the breakdown of that? I understand some of that might be the FSRU, but what's the breakdown of the 205 million you spent?

Hani Abuaker:

Other than the FSRU, we had two LNG vessels that we acquired with Maran.

Sudaif Niaz:

Okay. And how much of this was the FSRU?

Hani Abuaker:

The three vessels are approximately the same value. Since this FSRU was not brand new one, we bought it at a reduced price. But we can comfortably say that this was in the range of around $185 million to $200 million per vessel tag price. So, think about three of them with a leverage of 80-85% and think about our ownership is 55% with Excelerate or 40% with Maran. I think that should get you the number for 200 million spent.

Sudaif Niaz:

Great. Thank you so much. That's it from me.

Operator:

We will now take our last question from Yazeed Alturki from Ashmore. Please go ahead.

Yazeed Alturki:

Good afternoon. Thanks for the call. I have two questions. I'm going to ask about IRR, that 11-14%. Is this roughly equivalent to the annual return and, you know, from a corporate standpoint of this, translate into return on equity? It's been trending downwards and as you're deleveraging and is now around 14%, should we hold that going forward given your IRR targets?

And then my second question is, can you maybe give us a sense of the roll over schedule of your portfolio over the next three, four years? How much of your portfolio would reprise and by how much, if you can give us some guidance on that? Thank you.

Hani Abuaker:

Okay, I understand thank you. The first question is about our potential leveraged IRR rate of return between 11% and 14%. Any new business opportunity as we said before, we look at it to generate the required rate of return of between 11-14% level. As we deleverage, as our return on equity will increase, we believe that we will try to see more of a stable return of equity over the next one or two years because of our deleverage process, we might expect that we will incur additional debt in order for us to secure new business opportunities .So, yes, our return of equity which is now maybe roughly 10-11%, that's something we expect to be maintained and hopefully it might also get better as we move on for the next one or two years. Remember there's one thing that people have not been paying careful attention to. We, as a shipping company, are not here only to buy ships. That does not what gives us a competitive advantage.

What gives us the sustainable competitive advantage is that we have the largest fleet and we started to operate them efficiently. Our capabilities and our reputation as an operator, allow many companies to want to partner with Nakilat, and it allows us to approach international customers or charters to secure new assets. Currently, we have around ten of our LNG vessels from STASCO. Next year, we are expecting to operate seven additional vessels. As we continue to operate more LNG vessels, we expect our operating cost to be optimized further. As you already know, there are two elements that we can have a better profitability or a return of equity is either we have a higher income, or we are able to deliver high quality transportation service at lower cost. So, the expected return of equity to be supported by both sides; from new business opportunity and from ensuring that we continue to provide operational excellence and improving our operating cost structure going forward.

Yazeed Alturki:

Okay. And then the second question on the roll over schedule of your portfolio, and then how much would reprise over the coming years and by how much.

Hani Abuaker:

Hopefully, next quarter, we're going to give you Nakilat's five year strategy map. It will be published in our 2018 annual report, and then I can present it to you guys. Our aim, as an organization, is to maintain our current market share and our global leadership. If you review what Fotios has presented to you with the potential new global LNG expansion and the number of vessels, on order book, and if you factor this one and look at what Nakilat's current market share. Then it should clearly give you an indication of what we are currently working on to deliver and achieve, in the next few years.

Over the next two years, we will maintain our market share. If you look at the numbers that we currently have, the ones that Fotios has provided to you, given Nakilat's current portfolio, or market share, what it's going to be. We will strive to maintain over the next three years and that should give you a bulk figure of our expansion mode.

Yazeed Alturki:

Okay, thank you.

Operator:

We will now take our next question from Samir Murad from NBK Capital. Please go ahead.

Samir Murad:

Hello, good afternoon, gentlemen. I just have one quick question regarding the dividend. You've spoken a lot about the debt to equity how you're going to be moving forward. What about the dividend? Can we expect to see an increase in dividend in the coming years, or would it be maintaining the current dividend level?

Hani Abuaker:

We wish that we can have a crystal ball about potential business opportunity in the future and particularly with the current market LNG shipping. Usually, we maintain some of our earnings within us to re-invest internally with new growth business opportunities which has helped us to achieve better results for our shareholders.

For dividend, as we move on, we will always review our dividend payout policy. As our profit increase, we strongly believe that we will return back proportionately back to our shareholders. The only thing is during the current LNG shipping market where actual LNG charter rates are favorably improved, and there's a lot of LNG shipping demand, and if you want to really take additional capacity and try to grow your portfolio, I think this is the right time that you must be very cautious about not to miss this opportunity. However, we do not foresee our dividend to be reduced unless it is necessary. We're happy with the current sustainable dividend payout and we are gradually planning to look into potential growth in our dividend payout when we believe it is the right time to return back to our shareholders. However, all the money that has been maintained, could be deployed to new lucrative global investment opportunities.

Samir Murad:

Thank you so much.

Operator:

There are no further questions in the queue. I would like to hand the conference back to the host for any additional and closing remarks.

Ahmed Hazem Maher:

Thank you very much, Mr. Hani and thank you, Mr. Fotios, for a very informative call. I'd like to leave you with your closing remarks if you'd like.

Hani Abuaker:

I would like to thank you all for attending our conference call. Thank you very much. It was very informative. All your valuable questions were well-noted, and we will discuss them with our CEO to ensure that all your comments are well-heard.

Hopefully, next quarter conference call, these two things that we're going to introduce. The nice thing about this call was the co-hosting. The next one we'll try to make it more interesting. We will share with you our five-year strategy roadmap to basically present to you where we're heading and what we are trying to achieve.

Furthermore, I would like to let you know that during the first quarter of 2019, we will try to initiate our segment reporting to make it easier and more transparent for you to analyze our company. That's all from my end. Fotios?

Fotios Zeritis:

We are very happy with your strong interest about Nakilat from all of you. All you questions were well received As Hani said, we'll communicate capital market's feedback with Nakilat's top management. Thank you so much for your well-structured questions and kind attendance.

Operator:

This concludes today's call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.