Qatar Gas Transport Company - Nakilat (QE: QGTS)

3Q20 Earnings Results Conference Call Transcript

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Moderator: Ahmed Hazem, VP – Equity Research at EFG Hermes
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Executives:

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

Questions by:

1) Bobby Sarkar - QNB Financial Services
2) Santosh Gupta - Drewry Maritime Research
3) Ferisy Radcliff - Bloomberg
4) Mohamed Adel - Alfaisal Investment
5) Onkar Jambhale – Demical Point Analytics
6) Anastasios Dalgiannarkis - Alfaisal Investment

Operator:

Good morning and good evening, ladies and gentlemen. I hope everyone is staying safe and healthy. This is Ahmed Hazem from EFG Hermes Research, and we are pleased to welcome you today on Nakilat's third quarter 2020 results conference call. We have with us on the line Mr. Hani Abuaker, CFO of Nakilat, and Mr. Fotios Zeritis, Head of Investor Relations. I'd like to start off by congratulating management on the strong set of results for the third quarter. And with that, I hand over the call to Fotios. Fotios, please go ahead.

Fotios Zeritis:

Good Afternoon and welcome to Nakilat's third quarter 2020 results Conference Call. For your convenience, the transcript of this call and presentation will be available on the company's investor relations section of our website, www.nakilat.com. As a reminder, this conference call is being recorded.

Many of our remarks contain forward-looking statements and for factors that cause actual results to differ materially from these forward-looking statements, please refer to slide 2 of the Investor Relations presentation. In addition, some of our remarks contain non-IFRS financial measures. A reconciliation of this is included in the note of this presentation.

Nakilat's CFO Hani Abuaker will begin today's call with a discussion of company's highlights and followed by a brief discussion of group's great earnings results. After, I will give you an overview of LNG shipping market. And finally, Nakilat's CFO Hani Abuaker will walk you through the company's business outlook. We will then be happy to address your questions.

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

Hani Abuaker:

Thank you everyone and welcome to Nakilat's third quarter 2020 earnings results Conference Call. I hope that all of you and your families are safe and follow the precautious measures against COVID-19 pandemic. Before getting into our great financial results, we will take a moment to thank all our seafarers and shore-based staff for their continued dedication to maintain business continuity and bringing clean and reliable energy to the world.

As we continue to navigate through this challenging and uncertain environment, this quarter's performance once again demonstrates the benefits of our defensive business model. Nakilat's long-term contract with our high-quality customers has ensured a minimal impact on Nakilat's LNG shipping operations and long-term visible cash-flows.

We have a number of slides to get through this quarter, each of which we believe is important for current and future investors to consider when evaluating Nakilat’s equity story. Therefore, we will only briefly touch on each slide, which will provide more time for Q&A at the end.

Although the COVID-19 pandemic continues to present challenges and uncertainties for our shipping industry, I'm pleased to report Nakilat's stellar operational and financial performance in the first nine months of 2020.

Turning to the page 5, you can see that Nakilat continues to have in place COVID-19 preventive measures and our personnel’s safety remains our first priority. We remain fully focused on delivering reliable, high-quality service to our customers. This focus has allowed us to maintain a high degree of uptime and fleet utilization, which it has also be translated into better results compared to the same period of last year. Since the toll from Covid-19 continues to rise, the global economy is largely the same, vaccines remain some time off; we continue to monitor the global developments of Covid-19 pandemic and its potential implications on global LNG transportation.

Now, turning to slides 8 and 9 of the presentation; you can see some of Nakilat's recent financial highlights. Nakilat’s resilient business model, and our constant efforts for operational excellence as well as cost efficiencies support us to generate an increase of revenues, EBITDA and EPS compared to the first nine months of 2019.

Now, I am pleased to report that Nakilat had achieved landmark financial results for the nine months of 2020 despite the challenges related to COVID-19 which it has maybe a minor impact on our operating costs. However, we’re still being able through management’s initiatives to reduce our costs compared to the same period of last year.

The company achieved a net profit of QAR 900 million compared to QAR 728 million during the same period in 2019, which is translated to a remarkable increase of 23.6%. In similar positive trend, Nakilat’s EBITDA was up by 13.6% year-over-year to reach QAR 2.4 billion. This continues to be aligned with Nakilat's goal to maximize sustainable bottom-line growth and value for its shareholders.

The company's strong financial performance is primarily attributed to operational excellence in the management of its entire fleet, and management's focus on cost optimization initiatives which have been translated to a decrease of G&As by 18.7% in the first nine months of 2020. Structural improvements to our expenses have come from our cost optimization initiatives and the delivery of six vessels under the management of Nakilat Shipping Qatar Ltd. (NSQL) since the beginning of 2020 which has improved the economy of scales in the way we efficiently deliver our services. Again, all the above emphasize Nakilat's ability to deliver the required earnings and operating cash-flow during an unfavorable economic environment and a volatile LNG shipping market. Now, I would like to talk about Nakilat's financial position.

Turning to slide number 10, Nakilat maintains a strong balance sheet with total assets of QAR 32.6 billion as well as a cash balance of QAR 2.9 billion. As you expected, the repayment of Nakilat's scheduled debt amortization continues to boost our position while freeing up our balance sheet capacity and equity value for future ventures that are on the horizon. Reducing debt balances will lower the company's cash-flow and income breakeven levels over time, improving the economic competitiveness of our fleet. Also, this has contributed to the strong results that we have seen in the last nine months of 2020.

Turning to slide 11, we can see that the Net Borrowings have reduced by almost QAR 4.9 Bn since 2014. Due to the acquisition of the 4 Q-Flexs and change of accounting treatment from equity method to fully consolidation within the group's consolidated financial statements for the 9M20, the net borrowings reached at QAR 21Bn.

While a significant portion of our interest rate exposure has been hedged, the interest cost on our floating rate debt will also decline. We are confident that our financial foundation is strong, because of our very manageable debt repayment profile which is based on the company's long-term cash-flow visibility of our fixed long-term charters. 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.

The coronavirus has shaken-up the global economy and the LNG shipping market could not be the exception. However, Nakilat's prudent strategy and resilient business model have assisted us to navigate smoothly these unprecedented global economic conditions.

On a bigger picture, global energy demand continues to grow driven by increasing prosperity and living standards in the emerging world. A transition to a lower carbon energy system is likely to lead to fundamental restructuring of the global energy system, with a more diverse energy mix, greater consumer choice, more localized energy markets, and increasing levels of integration.

Global LNG shipping demand is set to grow in the long term, despite the setback in demand for all kinds of energy due to the coronavirus pandemic. Coal-to-gas switching from North America to Europe and Asia, as well as increased use of natural gas in the industrial sector, will drive demand for LNG over the next two decades. The growing demand for LNG will produce a growing demand for LNG shipping requirements.

Wood Mackenzie expects LNG demand to grow approximately 2% this year. The economic recession as a result of the Coronavirus pandemic has taken a toll on the consumption of LNG with year-on-year growth remaining in the single digits. China is the only country to see strong growth from recovering industrial and residential consumption, putting it on track for a 10% YoY increase by the end of the year.

Now, I will give you an overview of global LNG shipping market for the third quarter of 2020 which can be seen in our presentation from slide 13

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to slide 14. In 3Q20, we saw a meaningful improvement on spot LNG shipping charter rates due to some arbitrage opportunities, seasonality, and the restart of the global economies. According to SSY, the current spot charter rates for modern two-stroke tonnage is around $72,000 per day, $62,000 per day for DFDEs, and $42,000 per day for STEAMs.

On the term contacts, there is not so much volatility as it is in the spot shipping market. Poten & Partners assesses the one-year LNG shipping charter rates at $60,000pd for MEGIs/XDFs, $48,000pd for DFDEs, $26,000pd for STEAMs which is a helpful benchmark when discussing term charter opportunities.

Now, please turn to slide 14 of our presentation. The positive sign for the LNG shipping market is that we are not seeing many new LNGC newbuilding orders in 2020. As of 3Q20, 19 LNGC newbuild orders have been placed for conventional size ships compared to 50 vessels full year of 2019. In the 2020, the LNG newbuilding costs have been stabilized at an average price of ~$186 million. Furthermore, you can see the global LNG fleet has 538 vessels in operation and another 113 vessels on the orderbook until 2024 as per Clarksons. This implies an increase of ~21% of total LNG fleet, in terms of number of vessels as of September 2020.

As a final market note, market participants expect that LNG shipping market will continue to be volatile in the upcoming quarters due to the fact that the COVID-19 pandemic still is on-going, and it creates an economic uncertainty in almost every industry. In a long-term point of view, LNG is a clean and reliable fuel and for this reason, we see an accelerate rate of switch from coal to gas consumption driven by increased industrial output. Thus, the demand for LNG shipping requirements will increase and it will be a very positive sign for Nakilat’s future prospects.

Now, I would like to hand it back to Mr. Hani Abuaker to give you an insight into Nakilat’s business outlook. Please, go ahead.

Hani Abuaker:

Thanks again Fotios for the brief overview of LNG shipping market during the 3rd quarter of 2020. Moving on to slide 16, I will shortly discuss about Nakilat's business outlook, so I can give you a chance to ask questions if necessary. I will try to be very brief here.

Our strategy is the maximization of our vessel utilization. In this way, our LNG fleet's revenue is set to continue. We continue to engage in business discussion with world-class charterers, to ensure that we secure term charter contracts if there is any available vessel in our fleet. In this way, we smoothly navigate through this unprecedented storm and to maintain sustainable and long-term returns to our shareholders. Regarding the Nakilat LNG shipping business, we took the delivery of "*Global Energy*" without any delay and on budget. Currently, this vessel is on multi-months charter hire, with an international first-class charterer, until we conclude our long-term charter for that vessel.

Regarding to Nakilat's Opex optimization, as you can see, Nakilat has taken 6 carriers under the management of Nakilat Shipping Qatar Ltd. (NSQL) from STASCO (Shell) in the first nine months of 2020. This action has helped in optimizing and streamlined our operating costs, which is translated into additional savings that eventually provided us better bottom-line results, and a good growth within our earnings, compared to the same period of last year.

In regard to our shipyard business, we expect more positive momentum going forward. I think that the first two quarters of this year were not good in terms of shipyard's performance due to the pandemic of COVID-19. However, in the third quarter of 2020, we saw an almost 180 degrees change in results and in momentum, which has significantly helped in for the better results compared to the first two quarters of 2020. In summary, we have a strong liquidity balance, very manageable debt maturity, and all of the above will provide us again a compelling investment proposition for new and our existing shareholders. With that, I will ask the operator, to open the floor for questions and answers. Please, go ahead.

Operator:

Our first question comes from Bobby Sarkar, from QNB Financial Services. Please, go ahead.

Bobby Sarkar:

Hi, Hani. Hi, Fotios. This is Bobby from QNB Financial Services. A couple of questions. If you could just let us know what contribution or percentage growth you saw in your income from JVs from the shipyard in the third quarter, versus maybe the second quarter. And what, if any, color you can lend in terms of the run rate of the shipyard. I see last year it was about QR44 million in net income from the shipyard JB. What is it so far this year, nine months? And then, secondly, on the finance charges, what percentage of your debt now is floating, versus fixed? And were there any major refinancing or anything that would move the financial charges number for the third quarter? Thank you.

Hani Abuaker:

Thanks, Bobby. I will start with the shipyard results. Basically, the shipyard results were not good for the first two quarters of 2020. Our shipyard business incurred financial losses in the first half of the year compared to the third quarter results which were good and there were not losses. Actually, some businesses were break-even, and some of them, they made money. For this reason, you see the swing between the first two quarters and the third quarter. So, less financial exposure that we have seen in the shipyard business translated to better results in our third quarter. I hope that I answered that question on the shipyard.

In relation to the finance charges, as we have mentioned in our previous calls, Nakilat's group hedged debt is approximately 75% and 25% is floating part. This is on group level and includes all group's joint ventures.

It also includes the corporate loan that we currently have. So, this has also contributed to lower interest cost in our financial performance.

In addition, the debt repayment will continue as per the debt schedule going forward. As we continue to amortize our debts, our interest expense will become lower year over year. This is just by virtue of paying the debt by itself. Regarding any potential savings through refinancing opportunities, one of our joint ventures' debts come to maturity before the end of our 25-years contract. That will translate into better results in the securing of leverage with a lower interest expense. Note that we have seen it in one of our LNG shipping joint ventures, and it helped in contributing to better results. Nevertheless, the LNG shipping JV segment has also benefited from the amortization of its debt, because as we pay the debt, or some of the portion of their debt which is not hedged, it translates into lower interest costs. Moreover, we have seen a well-managed and disciplined optimization across the board, including joint ventures, in the operating costs, which also has translated for us to have better results from our LNG shipping JVs. So, I hope I did answer your question, Bobby.

Bobby Sarkar:

Yes. Thank you, Hani. Just a quick follow up on the JV income. Were there any one-offs in the third quarter or is this on normalized basis? Thank you.

Hani Abuaker:

I want to be clear and transparent. The only one-off you could say is that during the third quarter; the performance of shipyard was significantly better than the first and the second quarter of this year which were impacted by the pandemic, which was not normal. During the first two quarters of 2020, our shipyard had very low activities, and for this reason, it incurred financial losses. So, I don't want to say that the third quarter was abnormal. It's just the first and second quarters that they were abnormal because of a much lower shipyard activities due to the pandemic of COVID-19.

Bobby Sarkar:

Great! Thank you so much.

Hani Abuaker:

Thank you.

Operator:

Thank you. Our next question comes from Santosh Gupta, from Drewry. Santosh, please go ahead.

Santosh Gupta:

My first question is, we have seen 18.7% volume-wide decline in G&A expenses, so do we think that this is sustainable going forward in, say, the coming two to three quarters? Should we expect to see that decline? This is my first question. And my second question is, can you please throw some light on your LPG business, how this has done this quarter, and what is your view going forward? Thank you.

Hani Abuaker:

Sure. I'm going to answer the first question about the G&A and the LPG shipping from a financial point of view, and maybe if Fotios would like to shed more light about the rates, I'll leave it up to him.

In regard to the G&A, we, as a company, are evolving over time. As a company, we started as an LNG shipowner. Then we started to take the operation of LNG fleet. During all over the years, there's a lot of infrastructure has been built in within this company to become a world-class ship operator. As you understand, we are reaping these benefits now. How are we doing that? Because now we have more vessels which are being managed in-house, and a lot of these infrastructure costs have been utilized over time. Much of these costs are being absorbed by taking over the operation in-house. This process has provided us the necessary optimizations.

Even though that Nakilat has a resilient business model, our CEO and Nakilat’s management wants to continue our efforts to enhance further Nakilat’s resilient business model due to the COVID-19 and global economic uncertainty. We, as senior management, know that things are still fluid, and we don’t know what could happen in the future with this pandemic.

Thus, all these cost initiatives and decisions as well as the optimization of contracts have translated to additional savings for the company. Now, I know that you mentioned the percentage. We should really expect going forward to maintain that efficiency levels of G&As. The current levels of G&As is where it should be more or less. It might go to 1%-4% higher than the current levels, but it still means ~15% lower than historically what was the rate last year.

Regarding LPG shipping business, the first quarter of 2020 was great. During the second quarter of 2020, we had the dip due to the pandemic. And then, in the third quarter of the year, it’s actually ramped again up, and it performed very well for us. I should mention that it was one of the contributors to our better results of the first nine months of 2019. In relation to the LPG Shipping market, I think Fotios can elaborate briefly about that.

Fotios Zeritis:

I would like to mention that COVID-19 pandemic has generally created market volatility and fluctuations. At the beginning of 2020, we saw good market conditions. However, the COVID-19 came to our life and it changed the market conditions. The LPG market reached at the lowest levels of $11,000 per day in June. According to Clarksons, now it’s back to improved levels of $45,000 per day due to the restart of the global economies and the improved demand of LPG. From this swing, you can see our improvement on the LPG shipping segment. Since the COVID-19 crisis is still ongoing, it is normal to expect volatility in the following quarters. The normality will come back when this pandemic is over. The long-term fundamentals for LPG shipping are healthy. Furthermore, you know that our LPG vessels are on time-charters which are linked to the market. Thus, we can see improvement on our LPG segment as long as we see improvement in the LPG market. However, we continue to monitor the current uncertain market conditions due to COVID-19 and we are very cautious of the situation. I hope that I answered your question.

Santosh Gupta:

Sure! Thanks, Hani, and thanks, Fotios.

Operator:

Thank you. Our next question comes from Ferisy Radcliff, from Bloomberg. Please go ahead.

Ferisy Radcliff:

Hi. My question is about fleet growth. There's some information about up to, I think it was the end of 2021. Can you talk up to, ideally, 2025, just how you anticipate that changing? Thanks.

Fotios Zeritis:

As you can see from the IR presentation, the current newbuild orderbook, for conventional LNG carriers, is 113 vessels until 2024. The majority of these vessels have been placed in shipyards yards in South Korea, Japan, and China.

The shipowners have placed these newbuild orders due to the need of transportation of the upcoming LNG supply which is coming the following years. It is simply to understand that more LNG supply in the market, more LNG shipping requirements are needed to serve the transportation demand. Always, the LNG needs a vessel to be transported. As per market participants, the fundamentals are very healthy for the LNG market in the next 10 to 20 years or more. Also, we can see it from the historic growth of LNG trade all over these years. Wood Mackenzie expects that the global liquefaction capacity to grow by approximately ~130mtpa from 2020 until 2025. For post-2025, there are many pending liquefaction projects that will be approved, and they will bring additional supply of LNG in the global market. As you understand, all these things are very favorable for LNG shipowners like Nakilat, because more LNG supply in the global markets create more demand for new LNG shipping requirements. I hope that I answered your question.

Operator:

As a reminder, ladies and gentlemen, if you wish to ask a question, please press star followed by one on your telephone keypad. And if you're joining us via the web, please use the flag icon. Our next question is from Mohamed Adel, from Alfaisal Investment. Please, go ahead.

Mohamed Adel:

Hi. Thanks for taking my question. I have only one question about the chartering. Now, you said that the rates on the time charter is related to the market, so this means in case of the time charter rates going down, the current vessels on contract, it will go down as well? Thank you.

Fotios Zeritis:

For the sake of clarity, I spoke about LPG shipping contracts earlier. I did not spoke about the LNG shipping time-chartering contracts. Regrading the LPG time-chartering contracts, it is a standard practice to have time charter to be linked with LPG Baltic Index, which is a global acceptable index in the shipping world. This index tracks the LPG shipping charter rates. So, the answer is yes for LPG, but it is not applicable to our LNG portfolio. I just want to make this clarification.

Mohamed Adel:

Okay, thank you very much!

Operator:

One of our participants has just registered another question. Onkar Jambhale, from Decimal Point. Please, go ahead.

Onkar Jambhale:

Thanks for the call. I have just one question. I just wanted to confirm the delivery of the remaining vessels for JV vessels. Are they on time or is there any delay? Could you please throw some colour on that?

Fotios Zeritis:

The 2nd newbuild vessel is expected in December 2020. The remaining two newbuild vessels are expected the second half and end of 2021.

Operator:

Thank you. Our next question comes from Anastasios Dalgiannarkis, from Asset Management Faisal Investments. Please, go ahead

Anastasios Dalgiannarkis:

Thank you for taking in my question. You mentioned before, you are freeing now balance sheet in order to utilize it for new vessels. Could you give us a feel of how much you believe you can leverage existing equity or EBITDA, according to your existing contractual agreements, and whether in the equity we should consider the swap mark to market or excluded? Thank you.

Hani Abuaker:

If I can understand well your question, yes, we continue to free up our balance sheet; it will allow us to have the required equity for new potential opportunities in terms of funding. In the shipping business practice, the levels of leverage depend on the terms of charter contract. The financing could be on a range of 70% and 85%. For example, we have seen vessel financing at levels of 90% in Nakilat Inc. (our wholly owned fleet). Usually, we prefer to swap from 50% to 75% of our debts. This was our strategy over the last 12 years. In aggregate, we can say that.

Anastasios Dalgiannarkis:

Thank you!

Operator:

We currently have no further questions, so, Ahmed, I hand back to you.

Ahmed Hazem:

Thank you, Abbie. Thank you, Mr. Hani, and thank you, Fotios. If there are no further questions, Mr. Hani, would you like to make a closing statement.

Hani Abuaker:

I would like to thank you all for taking the time to participate in today's conference call. We are always committed to improve our practices and make them better, quarter after quarter and year after year. And also, we're committed as a company to provide good results for our shareholders, existing ones and for the future.

There's one thing that I would like to emphasize as we do all the time, all kinds of questions, comments, even after the call, that you guys convey to us, rest assured, it does go to the management of this company, to ensure that we really assess them and take the right actions in response.

I would like to encourage you, if you have any questions or answers, I think Fotios has done a great job over the last couple of years to address these questions or inquiries. With that, I'll leave it up to Fotios just to say anything if he has.

Fotios Zeritis:

Thank you so much, guys, for taking the time out to join us. Always, we appreciate your feedback and participation in this call. We are always happy to accommodate any question or clarification that you need from us. Please, contact us anytime. Thank you so much. Have a great afternoon!