QNB Financial Services

Moderator: Saugata Sarkar
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Operator: This is Conference # 76482345

Operator: Good afternoon, ladies and gentlemen, and thank you for standing by. And welcome to the Milaha Year End 2016 Financial Results conference call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time if you wish to ask a question, you will need to press star and one on your telephone keypad.

I must advise you that this conference is being recorded today, Thursday, 2nd of March, 2017. I would now like to hand the conference over to your speaker today, Sami. Thank you. Please go ahead.

Sami Shtayyeh: Thank you, Operator, and thank you, everyone, for joining the call today. My name is Sami Shtayyeh and I have with me Akram Iswaisi, the executive vice president of finance and investments. I also have Imtiaz Patel, who is the acting vice president of finance and accounting.

I'll start off with the consolidated financial results for the year, and then I will move on to getting into a bit on the segments, and then we'll top it off with a brief outlook on the business, as well as open the line for questions and answers.

So starting off with the consolidated financial results for the year, operating revenues came in at 2.55 billion riyals, compared to 2.89 billion riyals in 2015, for a decrease of 14 percent year-over-year.

Operating profit for 2016 came in at 555 million riyals compared to 855 million for the same period in 2015, for a decrease of 35 percent year-over-year.

And net profit for 2016 was 711 million riyals, compared to 1.095 billion riyals for the same period in 2015, for a decrease of 35 percent year-over-year.

OK, now on to the segments, starting with maritime & logistics. Overall revenue was down 14 percent year-over-year, with the majority of the decrease coming from our port services unit. This has pretty much been the same story all along, but for those that are new to the issue, let me briefly describe what happened here.

So storage revenues were (off) considerably from 2015, which was the year the number of free door – free days at the port decreased from ten to three. With that drop, we earned significant revenues in 2015, because (Consign East) could not clear their goods through customs and arrange transportation fast enough to not incur storage fees.

Towards the end of 2015, we saw this revenue start to dip as (Consign East) planned better, and as the customs authorities cleared goods faster. That dip continued in 2016, and thus led to significantly lower revenues. In addition, bulk and general cargo volumes decreased relative to 2015, due to a general economic slow down in projects. On the operating expense side, overall costs remained flat.

On to offshore, revenues decreased 19 percent, with most of that coming from our diving and commercial units. The diving unit came in lower, largely due to the delayed mobilization of a vessel in Q1 of 2016 as well as rate pressure. Our commercial unit came in lower due to lower utilizations and rate pressure that the entire industry is facing today.

On the expense side overall it came in lower as there was a concerted effort to lower expenses during this unprecedented downturn, as well as due to the fact that fewer utilized vessels translated into fewer personnel related expenses.

On to gas & petrochem, overall revenue increased by 14 percent. Our added stake in the two LNG vessels from last year boosted revenues by 89 million riyals. Over on the flip side, our five tankers exposed to market prices came down by 46 million riyals due the continuing drop in rates being faced in this segment.

On the expense side, the two LNG vessels contributed to the majority of the 62 million increase, and on the non-operating income side, numbers decreased by 34 million riyals with most of that coming from our joint partnerships, partially offset by one-time expenses that occurred in 2015.

On to our trading segment, we posted a 26 percent revenue and 65 percent net profit decline year-over-year. The slow-down in project activity hurt our equipment sales on the revenue side, and that in turn translated into lower cost of sales on the expense side.

And last but not least, our capital segment. On the financial investment front, we posted 43 million in lower dividends, which was offset by 52 million in additional revenue from our Held For Trading portfolio. Our Qatar Quarries subsidiary posted 91 million in lower revenue, along with a decrease of 45 million in cost of goods sold. And our real estate unit posted slightly higher rental income from higher occupancy levels.

And that essentially sums up our operations, bringing us once again to an overall net income of 711 million riyals for 2016. Now I want to switch gears and go over to the outlook, and where applicable, touch base on some updates to our business units.

In maritime & logistics, we began operations at Hamad Port on December the 1st. Operationally things are moving forward, with productivity continuously getting better, as each week passes. As far as the segment outlook is concerned, we expect growth relative to 2016, but it's difficult to predict with 100 percent certainty. Within the container shipping unit, rates and margins are still expected to remain under pressure.

On to offshore, in short, despite oil prices stabilizing, or even increasing slightly, we don't expect any short-term relief on rates. At least for the next six months we expect this to remain a challenged segment.

On to gas & petrochem, and I'll take this segment by segment, the VLGCs charter rates remain depressed. We have four VLGCs in a 50-50 partnership with (Nokelabs). One of those vessels came off long-term charter at the end of 2016, and is placed now in a one-year charter. Two came off charter – sorry, two will come off charter mid to end of 2017, and one comes off charter in 2018.

On the jointly and fully owned LNG carriers, we expect limited fluctuation versus 2016, due to the long-term fixed nature of the contracts. On to the fully owned product tankers and the one crude tanker – sorry, one crude carrier, these are all trading in the spot markets, and rates still remain depressed.

The fully owned gas carriers, one vessel is on time charter, which ends middle of 2018, and we're working to put the other vessel on a new time charter. Rates are thus far depressed, so we're not expecting the same level of earnings as 2016.

And last but not least, harbor marine vessels, the older vessels that found work in 2016 may not find work in 2017, but that's not a major impact because of the 20-year contract we have with Qatar Petroleum on the 19 newer vessels, newer boats.

On to Milaha Trading, we expect an uptick in sales in 2017, as projects related to the FIFA World Cup and major infrastructure works move ahead.

And into capital, aside from earnings related to the portfolio, we expect an uptick in real estate as the warehouses in Al Thumama go live towards the second half of 2017. And with that, Operator, I'd like to now turn it over to questions.

Operator: Thank you, Sami. Ladies and gentlemen, we will now begin the question and answer session. And as a reminder, if you wish to ask a question , please

press star and one on your telephone keypad, and wait for your name to announce.

Once again, if you wish to ask a question, just press star and one on your telephone keypad, and wait for your name to announce. If you wish to cancel the request, just press the hash key. And your first question comes from the line of Philip Kanan. Your line is open, please go ahead.

(Philip Kanan): Yes. Thank you, Sami, for the presentation. I have two questions. First, we see that most of the debt is floating. Do Milaha plan to keep it that way, especially with the Fed rate hikes happening? My second question is how much more and how quickly can Milaha do more in cost cutting, specifically in higher debt segments such as offshore?

Sami Shtayyeh: Yes. Well with respect to hedging, we've got – we've got everything in place to quickly hedge our exposure to potential hikes in interest rates, so we are looking at taking, again, fixing some of the floating exposure in the near future.

(Philip Kanan): How is it split right now, fixed floating, what is the percentage?

Sami Shtayyeh: It's effectively 100 percent floating.

(Philip Kanan): It's all floating.

Sami Shtayyeh: Actually about 90 percent floating.

(Philip Kanan): Yes, OK.

Sami Shtayyeh: Obviously that depends on your view of potential interest rate hikes and how quickly, or how many times.

(Philip Kanan): Yes, but it's happening, it's bound to happen sooner or later.

Sami Shtayyeh: Saying that for the past couple of years, right, and we've had (no) incremental increases, so we have our own view, and we are going to react to that.

(Philip Kanan): OK, fair enough.

Sami Shtayyeh: With respect to cost cutting, again, you know, one of the things that we've done this year is actually look at the way we're running our business, looking for ways to cut costs, negotiating some of our contracts with various vendors, I can tell you that, saving millions in – from (retendering) various contracts.

And so what we've got – what we have right now is a huge procurement initiative looking at how we can maximize, you know, the best – maximize the best return on the contracts that we have in place, so that's from a procurement perspective.

And from an operational perspective as a company, we've been pretty lean over the past five to six years, but there are opportunities that we're looking at. So in terms of how we react to the market and cost cutting, definitely this is something that we have been looking at, and we have some things that we are going to pull the trigger on.

But don't expect, again, at the end of the day, massive cost cutting, or drastic cost cutting initiatives, because we have been extremely lean, and as you're probably well aware, you know, we manage ships, we manage critical operations.

If you cut too much into the bone, this could impact health and safety at some point, so we are trying to balance, you know, smart cost cutting with maintaining the right level of health and safety, and providing good service to our customers, because we do have (SLA's) and expectations, so we cannot let's say renege on that.

(Philip Kanan): OK, fair enough. Thank you.

Operator: Thank you. Once again, if you wish to ask a question, please press star and 1 on your telephone keypad. And there are no further questions at this time. Sami, please continue. Sorry, one moment, we have – yes we have questions on the line now. Comes from the line of (Lee Bethwick). Your line is open, please go ahead.

(Lee Bethwick): Hi, guys. Sorry, apologies I missed the first part of the presentation. I hope you didn't mention what my questions. Can we just ask – can I just ask about the dividend, and can I just ask what the specific, very specific rationale was for cutting the dividend with the balance sheet, which is – you know, your balance sheet was effectively net cash, and you have too much cash, what the specific rationale was behind that – behind the board. Can you communicate that to shareholders, please?

Male: Sure, absolutely. Well first of all, let me start by talking about the cash. I mean the cash you see on our balance sheet, you know, talking about 4 billion plus effectively sitting in cash equivalents, which a big chunk of that is deposits.

If you look at the other side of the balance sheet, you will find a substantially large short-term loan balance similar to the amount in the deposits of our five – four billion and some change. This is effectively we have projects right now, CapEx projects in the range of four billion plus in progress, including the Al Thumama, various initiatives that we're looking at.

So the other side of the balance sheet are basically debt commitments that we are using to fund some of these projects. And we put them in deposits, and as these payments all become due, and as these projects materialize or progress further, we basically use them to pay down the CapEx amount.

So it's not necessarily cash available to pay dividends. This is cash that's committed either to debt or to projects, OK. So with respect to the rationale, again, the rationale is as a company we have to invest, and we've got, as I mentioned, we've got a significant CapEx program right now, and we need to continue to invest in these projects.

And again, looking at cash flow, looking at cash requirements, CapEx requirements, the board has looked at all these different variables, and decided this is the right amount that we can pay.

(Lee Bethwick): OK, so – sorry, so on CapEx use, you mentioned four billion as a figure, so we should expect to see four billion of CapEx spend in 2017?

Male: No, this is over the next few years. I mean these are big projects that are happening over the next few years. So I can't give you the exact amount for 2017, but this is going to happen over the next two to three years effectively.

(Lee Bethwick): OK, yes, I'm just trying to work it out, because …

Male: It's not going to be four billion in one year, definitely not.

(Lee Bethwick): OK. So four billion, let's say four billion over three years, so you're talking just over one billion …

Male: (Inaudible) the next two to three years we've got a CapEx program, as I said, and we've got Al Thumama, we're trying to complete the next phases of Al Thumama, and so the first phase effectively is pretty much done.

And it's going to be done second quarter of this year, and we're building out the rest of Al Thumama, and we're talking about a plot of land on 520,000 square meters, which is going to be a key growth engine for Milaha. So again, the fundamental …

(Lee Bethwick): Which is a logistics bit.

Male: Logistics, primarily.

(Lee Bethwick): OK.

Male: Logistics is a – is a – for us, is a key growth engine for us, and specifically warehousing, and so again, we'll talk about rationale for cutting back dividends, we need to be able to invest in these projects, and invest in the future.

(Lee Bethwick): Yes. OK, so you would – just in terms of the balance sheet looking forward, given where it is today, you would expect sort of a run down of that cash in effectively in a few – let's say you keep the debt that you have outstanding, so you would have then a reasonable amount of leverage coming through in the next two or three years, in a sort of appropriately leveraged balance sheet.

Male: Well if you look at our debt to equity ratio today, and again, if you look at the true debt to equity – net debt to equity ratio, considering some deposits are funded through debt, it's effectively 21, 22 percent. So we're extremely – well we're highly under-leveraged, and there's a lot of potential to gear up.

(Lee Bethwick): OK, but we will see that CapEx being spent in 2017, in first half of 2017 I should say?

Male: Absolutely. And obviously, you know, we have projects, we have milestones, some projects get delayed, sometimes projects get moved around, but as of right now, we have a significant amount of CapEx that we need to spend in 2017.

And if you look, we've got some real estate development projects, that's sometimes we're subject to local licensing and certain restrictions that we have to abide with, but as according to our plans, we should be able to spend a good chunk of it this year.

(Lee Bethwick): OK. And when does the revenue begin to hit from that?

Male: From the warehouses?

(Lee Bethwick): Yes.

Male: Should be beginning of Q3.

(Lee Bethwick): Beginning of Q3. OK. And sorry, last question, do you see the logistics market as under-supplied in Qatar that would warrant such large expenditure on warehousing?

Male: Absolutely, we do. I mean I think the value proposition that we bring, I mean let's be frank about it, I mean historically, you know, we have a trucking business, we have freight forwarding, we've had a warehouse in Dubai, we have container ships, we've been managing the Doha port.

Historically we have not connected all these services to provide supply chain solutions. So the model for us has changed. Now what we're trying to do is provide supply chain solutions. We can manage your end-to-end logistics

supply chain. So the potential for us to bring a lot of value to the market is there.

More importantly, we continue to look at niche markets in which we can operate, and I don't want to disclose too much, because we are executing on part of that strategy, but again, we do see – we've done our market research, we know the market quite well, there's still a lot of potential in the logistics and warehousing market, not only in Qatar, but regionally.

(Lee Bethwick): OK.

Male: You guys are – I mean again, you guys are in the market, and you're probably seeing a lot of private equity firms are also looking at logistics companies in this region, so there's a lot of interest in logistics and warehousing in this region, not only from strategic players like us, but also financial investors and private equity firms, so that tells you something.

(Lee Bethwick): OK, thanks.

Male: Sure.

Operator: Thank you. Your next question comes from the line of (Rami Jamal). Your line is open. Please go ahead.

(Rami Jamal): Good afternoon, gents. (Rami) from (Amwan). Quick question on your current ship deployment, we've noticed that the charter rates are quite depressed currently, and earlier you mentioned that you have no worries about that due to your long-term contracts. If you can just shed more light on that, please. Thank you.

Sami Shtayyeh: Hi, (Rami). This is Sami. Thanks for the question. I don't think it's – it's not a blanket answer, I mean we have long-term contracts in some of the segments that we operate, but in other segments, we definitely don't, so you really have to look at it segment by segment.

Container shipping for example, those are not long-term contracts. Those are typically one-year contracts with the main line operators. The LNG, those are

long-term contracts, 20-25 years. The harbor marine operations, those are long-term contracts, that's a 20-year contract.

The VLGCs, those are – they were two-year contracts, in some cases even longer than that, but those are coming off contract, so those are steadily coming off contract. We had one come off last year, we have two coming off this year, another one coming off in 2018.

Offshore, we've got a mix. We've got over 40 vessels, some are on long-term, and long-term for offshore is not what long-term for offshore meant a couple years ago. Long-term for offshore nowadays is essentially you're lucky to get anything two years or more.

So that model is changing as well, so yes, we've got some long-term contracts in nature, we've also got spotted nature, we've also got midterm contracts in nature.

(Rami Jamal): Just a follow up question on that, are we looking into a shift in your business model to where it's less spot exposed?

Sami Shtayyeh: Not really, not really, Rami. I mean we are reacting to the – to the dynamics of the marketplace. Offshore is changing. What it used to be is not what it is today.

Male: Well I mean the reality, I mean depending which segment you're talking about, any strategic player would love to have, you know, long-term contracts and less exposure to the spot market, but by default, you know, the offshore market today is extremely volatile, it's a lot more, you know, it's a lot – it's more of a spot play to a large extent, unless you position yourself with a strategic player, such as QP, or you know, Aramco, but that's a reality.

Now if you look at for example, you know, product tankers, it's a highly spot market today. LNG shipping today, you know, it moved from long-term contracts to spot market today. So again, as a strategic player, we are always keen on going after long-term contracts if we can find them.

But the reality is depending on the segment in which you operate, some may have long-term contracts, and some may not. And so we have to be able to manage that exposure as well in the spot market, because there is money in the spot market.

(Rami Jamal): Are you finding it difficult though, with all the consolidation that's happening in Qatar right now? Early in the year it was (Ras) Gas, and Qatar Gas, and now it's – what was it a few days ago, with other synergies with (Timsaad) and IQ.

Male: Well I mean the reality is these – let's say these mergers or synergies, they're intended to streamline their internal cost structure, right. I mean the volume of production is not going to change, their requirements are not going to change.

Obviously there are pressures on suppliers, right, like ourselves. We have to continue to provide value added services at reasonable prices, so that's not, again, given the current environment. But these mergers that you're talking about, these synergies, are focused primarily on streamlining their own internal cost structure and operations.

So – but the reality is, again, we're in a market where oil prices, you know, are in the mid-50's. That puts pressure on oil companies and consequently that puts pressure on us. And so there will be this tug-of-war a little bit, but it's important for us to continue to provide value added services to what we do today, and continue to articulate what we bring to the table.

And again, we cannot sacrifice safety and quality, and companies cannot afford to, because the risk is too high, and the severity of an incident is pretty high. So I think we're comfortable with where we are.

(Rami Jamal): All right, thank you very much. No further questions.

Operator: Thank you. And no further questions at this time, please continue.

Sami Shtayyeh: OK, with that we'll end the year end conference call. We look forward to you being on the call during our Q1 2017 conference call. Until then, have a good day, and thank you. Thank you, Operator.

Operator: That does conclude our conference for today. Thank you all for participating. You may all disconnect. Speakers, please stand by.

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