



Qatar Navigation Co. (QNNC.QA)

August 14, 2006

Country: Qatar
Exchange: Doha Securities Market
Sector: Maritime Shipping

Local Ticker: QNNS
Reuters Code: QNNC.QA

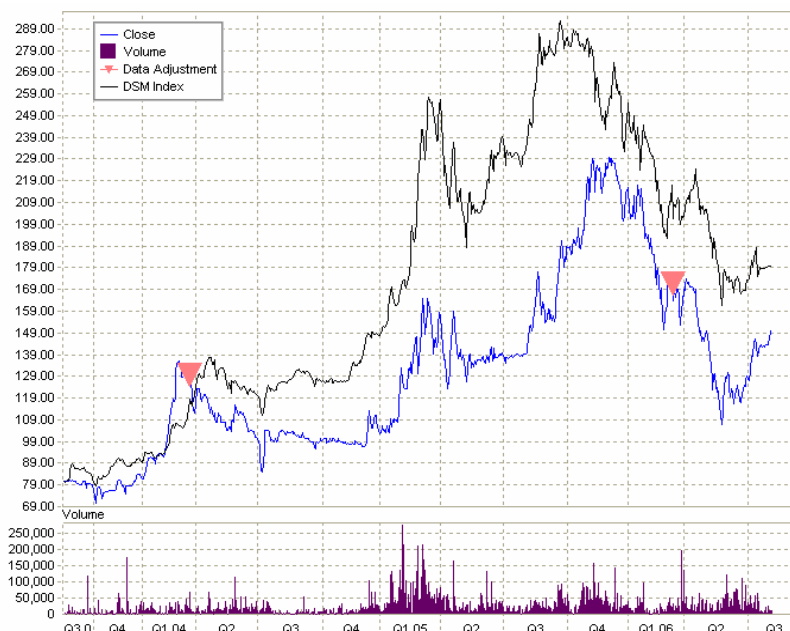
Investment Opinion: Neutral
Last traded Price: QAR 151.50
Fair Value: QAR 123.73

Areas of Operation: Shipping agencies and cargo handling; marine transport; navigation freight services; commercial activities; offshore services vessels; ship repair and steel fabrication.

Current Price (QAR)			151.50
YTD Stock Performance			-29.1%
Shares (Million)			46.8
Market Cap (QAR Million)			7,090.2
EPS, '06 annualised (QAR)	7.06	P/E	21.5
BVPS, Jun '06 (QAR)	109.18	P/B	1.4
Dividend, 2005 (QAR)	4.5	Dividend Yield (%)	2.9
52-week High (QAR)	232.31	52-week Low (QAR)	106.30

Source: Doha Securities Market and Qatar Navigation Reports

Share Price Movement QNNS vs. DSM Index



IMPORTANT: Please refer last page for Disclosure and Opinion Ratings

- Qatar Navigation Co. (QNNS) is the leading player in feeder services between UAE and Qatari Ports, with a dominant 90% market share.
- The company is in the process of acquiring new vessels to cope with the rising demand for bulk goods transportation.
- QNNS has made huge investments in other companies, which could affect its net profit margins in a 'negative-sentiment' stock market scenario.
- Shipping rates are expected to soften, with more new vessels being inducted to meet the spiraling demand.
- In 2005, the Baltic Dry Index fell by 48% from record highs due to the fleet addition and easing of port congestion.
- We estimate a Fair Value of QAR 123.73 per share considering all the risks involved.

Qatar Navigation the leading Maritime Shipping company of Qatar

Controls 90% market share between UAE and Qatari ports

Prestigious clients add to credibility

Outstanding 2005 performance

Background

Qatar Navigation Co. (QNNS) was established in 1957 as the Qatar National Navigation & Transport Co., and started operations as an agent for major shipping lines in Qatar. The company has since grown by venturing into a variety of businesses with innovative and advanced services in marine transportation, freight forwarding, international land transportation, cargo handling operations, warehousing & distribution services and container & break-bulk operations. Its holistic approach has led the company to expand towards ancillary services like ship repair & steel fabrication, bunkering, offshore construction and maintenance.

QNNS' revenues accrue from several operating segments, which include:

- Commercial Activities
- Marine Transport
- Ship Repair & Steel Fabrication
- Shipping Agencies
- Navigation Freight Services
- Offshore Services

This apart, the company's Dubai operations contribute the lion's share of its revenues.

Outfitted with the latest state-of-the-art equipment, QNNS handles approximately 2.7 million tons of general and bulk cargo annually. The company also operates feeder services between the UAE and Qatari ports in which it has a 90% market share. As of today, 75% of the total sea borne container trade into Doha and 100% of the exports from Mesaieed port is carried out by QNNS. The company's Navigation Freight Services segment operates 140 trucks and handles loads of up to 80 metric tones, alongside a fleet of 17 vessels including tugs and flat top barges. QNNS continuously upgrades its assets and has recently purchased two tugs and two barges at a total cost of QAR 13 million.

The company operates in a variety of areas across the GCC region. It has a lone branch in Dubai, which was incorporated to take care of its non-Qatari operations. Plans are on the anvil to open more offices outside Qatar in 2006.

QNNS is not only the agent for the transportation of commodities of various companies, but also a lessee representing 50 ship owners and handling approximately 650 vessels per annum. The major companies for which QNNS works as an agent are Qatar Petroleum, Qatar Gas, Ras Gas among others. The company has recently bagged orders from the Qatar Petrochemicals Co. (QAPCO) and Qatar Chemicals (Q-Chem) to become their official transporters. Both these companies are heavyweight exporters of chemicals such as polyethylene and ethylene.

With an equity interest of 50% in Halul Offshore Services Co. and 25% in Qatar Quarries & Building Materials Co., QNNS has a substantial presence in other sectors as well. The company is in the process of constructing its new office in the Daffna area at an estimated cost of QAR 420 million. It is also planning to build three new vessels to transport its containers. The capacity of each vessel is anticipated to be 1000 TEUS (Twenty Foot Equivalent Units).

Year 2005 was an outstanding one for QNNS with a 75.5% rise in net profits coupled with a QAR 4.5 dividend per share paid to the shareholders. However, the half year ended June 2006, could not match the earlier trend and profits rose by a marginal 3.2% as compared to the same period last year.

Chaired by Sheikh Hamad Bin Suhaim Bin Hamad Al Thani

Majority stake with Qatari nationals

Robust growth in the last couple of years ...

... may not be sustainable

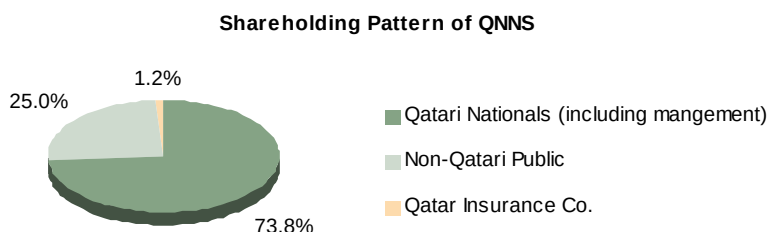
Board of Directors

The Board of QNNS comprises of twelve members. The Honorary Chairman is HE Ali Bin Khalifa Al Hitmi, the Prime Minister of Qatar. The Chairman of the board is Sheikh Hamad Bin Suhaim Bin Hamad Al Thani and the Vice-Chairman is Sheikh Abdullah Mohammed Jabor Al Thani. The rest of the Board consists of the following members:

Name	Designation
Sheikh Jassim Bin Hamad Bin Jabor Al Thani	Director
Sheikh Nawaf Bin Nasser Al Thani	Director
Sheikh Ali Bin Jassem Al Thani	Director
Suleiman Haider Suleiman	Director
Mohammed Hamad Al Mana	Director
Adel Ali Bin Ali	Director
Hitmi Ali Al Hitmi	Director
Yousef Ahmad Al Nama	Director
Ali Ahmad Al Kwari	Director

Shareholding Pattern

Qatari nationals hold 73.8% of the company's 46.8 million shares, while a chunk of 25% is with Non-Qatari investors. Meanwhile, Qatar Insurance Co. owns 1.2% of the pie. QNNS in turn has a stake of 50% in Halul Offshore Services Co. and 25% in Qatar Quarries & Building Materials Co.



The Industry Scenario

A rapidly accelerating world economy, the rising need for oil, and higher demand for imported commodities from emerging economies have significantly boosted the shipping industry. However, while the industry has been growing energetically in the past couple of years, the sustainability of this growth is open to debate.

The shipping industry is currently in the midst of a comprehensive vessel replacement exercise, with carriers replacing vessels across the board - a process that is expected to be largely completed by the end of this decade. However, the world fleet of coal and iron ore carriers is growing faster than the demand for these commodities. Likewise, the capacity of global dry bulk carrier fleet is anticipated to rise by 6.9% in 2006 outpacing the expected 4.5% increase of trade in commodities.

Consequently, the revenues for dry bulk carrier vessels are expected to dip with the average revenues projected to remain around USD 32,000 per day in 2006 as compared to USD 37,552 in the previous year. In 2005, the Baltic Dry Index (which measures shipping costs for a range of dry bulk ships on the most common voyages) fell by 48% from record highs, as the result of fleet addition and easing of port congestion. The Baltic Dry Index that was hovering around 1500 to 2000 levels in 2003 moved up to 6000 by the end of 2004 and by mid-2006 was lingering at around 3600. This indicates that the freight rates as compared to 2004 have fallen drastically.

Looking to become an international maritime center

Virtually nil competition

Assets concentrated in available for sale investments

Equity-based capital structure.

According to optimists, the shipping industry will remain robust through 2009, but red flags are already visible within the container market. It is estimated that while the container market will soften in the next two years because of deliveries, the industry in general will perform satisfactorily until 2009 or 2010. The significant fall in container freight rates witnessed in early 2006 is expected to continue through the year as capacity growth begins to outpace demand. The fall in freight rates, despite continued robust growth in demand, demonstrates that container shipping is on the brink of a multi-year downturn.

The Qatar Ministry for Energy & Industry, in alliance with the American Bureau of Shipping, is planning to develop Qatar into an international maritime center. This will not only fulfill Qatar's future needs for LNG, LPG and bulk carriers for export trades, but also facilitate the establishment of a major new ship repair facility. However, the construction of the Dubai Maritime City along the same lines in the UAE, will pose a direct threat to the Qatari Maritime Shipping sector.

Apart from QNNS, the other major player in the country's maritime shipping industry is Qatar Shipping. While Qatar Shipping has a strong focus on transporting crude oil and natural gas, QNNS specializes in dry and bulk cargo from the feeder services between UAE and Qatari ports in which it is a leader.

Asset Structure

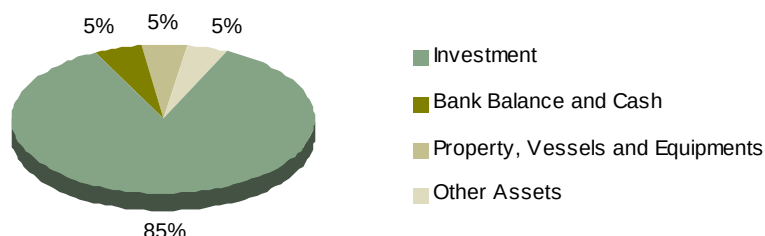
QNNS has 85% of its total assets amounting to QAR 9,057 million deployed in available-for-sale investments, which include:

Company	% stake	Total Equity Capital (QAR mn)
Qatar Shipping Co.	16.00%	1,000.00
Qatar Gas Transport Co.	15.00%	2,770.13
Amwal	5.00%	NA
National Leasing Co.	2.67%	176.40
Qatar German Co. for Medical Devices	2.00%	55.00
Qatar Insurance Co.	1.00%	424.71

In our opinion, too much exposure to these assets can pose a serious threat to the company's net profit margins in a falling stock market, as was reported by the company for the first half of 2006.

QNNS's fleet of trucks, tugs, barges, containers and other fixed assets constitute a mere 5% of the total assets. Another 5% of its total assets comprises of cash and bank balance.

Asset Structure of QNNS

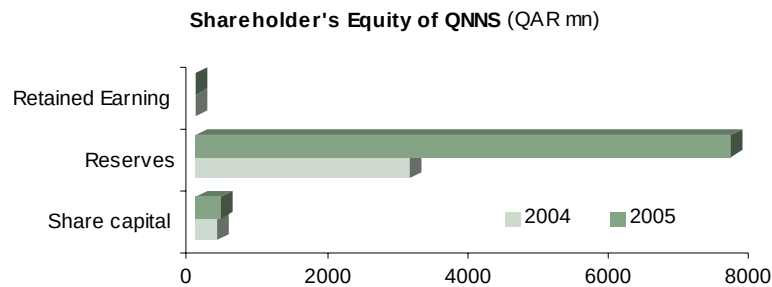


Capital Structure

With the influx of bonus shares worth QAR 60 million distributed by the company in 2005, QNNS' share capital stood at QAR 360 million. In the first half of 2006, this share capital expanded further to QAR 468 million, due to the distribution of shares worth QAR 108 million.

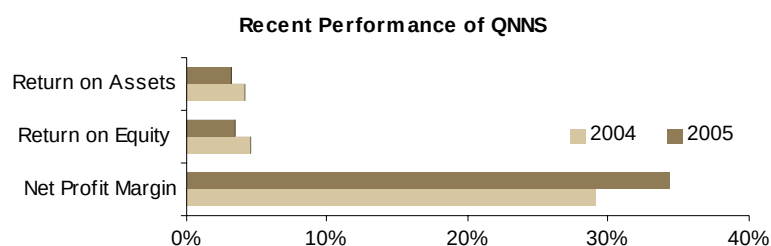
In 2005, the company reported a debt-equity ratio of 0.018 as the fair value reserve increased to QAR 6,486 million on account of unrealized gain from investments. However, excluding the fair value reserve, the company's debt-equity ratio stands at 0.083.

In the year ended 2005, the company's reserves saw a 150% increase as compared to the same period last year. The major contribution to this increase came from a 242% climb in the fair value reserve due to the unrealized gains from available for sale investments. The company posted retained earnings of QAR 6.49 million, which was low as compared to other reserves; QNNS used its net profit to pay bonus and dividends to shareholders.



QNNS's Recent Performance

- The year 2005 proved to be a very gratifying one for QNNS. The company witnessed a 48.7% increase in top-line to QAR 834.6 million as compared to 2004, while net profit saw an impressive rise of 75.5% to QAR 286.2 million. The company's largest revenue generator, the Dubai Operations, expanded 41% in 2005 as compared to 2004. Further, the Commercial Activities segment, the second largest revenue center, saw an impressive 140% increase. The smaller segments namely, Marine Transport, Ship Repair and Steel Fabrication, Shipping Agencies, Navigation Freight Services, Offshore Services also reported a growth in revenues from their previous year in a range of 33% and 96%.
- QNNS was also able to satisfy shareholders. It declared a dividend of QAR 4.5 per share and a bonus issue of 30% amounting to QAR 108 million for the year ended 2005.
- The company's net profit margin increased by 525 basis points to 34.3% in 2005 from 2004. This boost in net profit margin was mainly due to an 81.4% increase in the investment income. If the abnormal increase in the investment income is excluded, net profit margin stood at 17.6%, up by 223 basis points from the level in 2004.
- Gross Profit Margin declined by 25 basis points to 26.9% for the year ended 2005. This indicates that the operating cost increased faster than the revenue growth. On the other hand, the operating profit margin improved by 111 basis points and moved to 22.79%.
- For the year, return on equity and return on average assets saw a dip of 115 and 101 basis points, and stood at 3.46% and 3.16%, respectively. However, without taking into account the impact of fair value reserve and available for sale investments, both the ratios saw an increase of 295 and 290 basis points and stood at 8.2% and 10.6%, respectively. We believe that if the company reduces the amount of investments, it can increase its return on equity and return on average assets.



Revenue growth of 48.7% for 2005

Bonus and dividend boost investor confidence.

General and administrative cost are ominous

Revenues rise but profits dwindle in 1H'06

Adding heft in breadth and scale

Chinese Chery - a new venture

Over sizing by invested companies may undersize profits

Number one in market share

A softening market can impact top-line

- QNNS's rising staff cost raised general and administrative expenses by 9.5%. We anticipate that the industry trend will see a northward movement in the future, increasing the pressure on the margins
- The company's interest expense increased by 74% in 2005 to QAR 15.74 million. On the flip side, its long-term loans have fallen. This increase in interest expenses is primarily due to the QAR 400.4 million that the company borrowed to finance its working capital requirements.
- For the half year ended June 2006, the company's revenues saw an impressive increase of 30.1% to QAR 508.35 million. However, profits increased only marginally by 3.2% to QAR 165.09 million from the same period last year. This phenomenon may be attributed to a rise in general and administrative expenses, other expenses and falling income from investment.
- The company's net profit margin fell drastically by 846 basis points to 32.48%. In our opinion, if the company continues to lock-in a large amount of capital in available for sale investments, it could jeopardize shareholders returns.
- Interestingly, QNNS reported a 41% decline to QAR 4,506.52 million in its available for sale investments during the first half of 2006, mainly due to a sharp fall in the regional bourses. Correspondingly, the fair value reserve has dwindled by 49% to QAR 3,310.74 million.

Strategy and New Projects

QNNS is the market leader in the feeder service business. It is ramping up operations by increasing its fleet count; it has just completed the acquisition of two tugs and two barges. The company is now considering a project to build three new vessels for the transportation of containers with a capacity of 1000 TEUs (twenty-foot equivalent units) each that will expand its transportation business. The fleet expansion comes on the back of growing demand for carriers in the Gulf waters. The company also expects to receive a new floating dry dock by the end of August 2006, to repair vessels from Ukraine.

To diversify its sources of income and test new waters, QNNS has taken up a dealership of Chinese Chery, a four-wheel vehicle. It has opened up a showroom at Salwa road in Qatar and a service center in the industrial area.

Around 85% of the company's total assets comprise available-for-sale investments. The unrealized gain from these investments has increased multi-fold. The major investments of the company are concentrated in related companies that operate in oil and natural gas transportation in Qatari waters. Thanks to a heavy demand in the transportation of these vital commodities, these companies are expected to fare well in the future. Further, these oil and gas transportation companies are ramping up their expansion plans. However, due to a massive increase in the number of operating vessels, the revenues of these companies come under threat. In such a scenario, returns to shareholders will also take a plunge. This will further pose a peril for QNNS.

Positives

- QNNS is the leader in feeder traffic between Qatar and UAE ports, with over 90% market share.
- It is acquiring new fleet and is on the verge of expanding its business and exploring new areas of operations.

Negatives

- The decrease in the performance of available for sale investment can have a negative effect on the company's performance.
- Shipping rates are expected to soften in 2006 and 2007, pressured by excessive supply built up by shipping companies.

Cost of Capital: 10.80%

Fair Value: QAR 123.73

Opinion: Neutral

Valuation: Discounted Cash Flows

For our valuation, we have used the Moody's Country Risk Premium of 1.43% for Qatar and 4.84% for the US markets. The Beta considered for QNNS is the emerging market Beta for the Maritime Shipping Industry in which the company operates.

We have used the interest rate on 10-year US treasury notes as the proxy for risk-free rate of interest, since interest rates of Qatar correlate closely with US rates. Our estimate for the cost of equity, based on CAPM, stands at 10.81%. The cost of debt of the company is taken as 10.00% which reflects the interest paid on long term debt. The Weighted Average Cost of Capital is 10.80%.

Seeing the diminishing debt to equity ratio of the company and with debt forming a very small part of the total assets of the company, we have considered the Free Cashflow to Equity Model for arriving at the fair value.

QNNS has seen an increase in revenues in the recent past. This incline is largely due to expanding operations and its emergence as a market leader. The Dubai Operations segment is the highest revenue garner for the company. This segment looks after the entire UAE operations and controls the businesses coming in from the other GCC countries. The Commercial Activities segment, which is the next biggest revenue initiator, is also performing well and it is expected to continue to do so, as in the half year 2006 it has posted better revenues than the Dubai Operations. The other segments are also expected to perform well. However, the increase in the growth in these segments is estimated to be at a diminishing rate. The available for sale investments of the company are projected to decrease in the year 2006, on account of losses incurred by the major invested companies in the half year ending June 2006. This will affect the profitability of QNNS negatively.

Our resultant Fair Value for Qatar Navigation is QAR 123.73.

Investment Opinion

QNNS has witnessed a substantial increase of 48.66% in revenues for the year ended 2005. It is venturing into new areas of operations. With the continuous acquisition of shipping fleets the company has been a dominant player in Qatari waters. We are a bit skeptical about the company's performance as a major portion of its assets are parked as investment in related companies. With the asset structure skewed towards such assets, QNNS's chances of losing out in the future increases.

Our Fair Value of QAR 123.73 is at a discount of 18.3% to the current stock price (QAR 151.50 on August 13, 2006). This reflects a PE of 21.50, compared to current market PE of 20.71 and the services sector PE of 23.84.

Observing the future strategies of the company and its asset structure, we feel that the discount in our Fair Value estimate is justified. Considering the growth rate in the company's core business, we favor a NEUTRAL Investment Opinion on QNNS's stock at current prices.

Condensed Projections

(QAR Million)	2005	2006E	2007E	2008E
Revenues	835	1,108	1,303	1,459
Net profits	285	397	497	559
Total assets	9,057	7,504	9,266	10,950
Total equity	8,284	7,190	9,146	11,117

FINANCIAL STATEMENTS

BALANCE SHEET
as on

(QAR Million)	31 Dec '05	31 Dec '04	%Chg	30 June '06	30 June '05	%Chg
Non-Current Assets						
Property, Vessels and Equipments	424.70	376.83	12.7	486.33	424.70	14.5
Investment Properties	99.21	106.06	-6.5	100.55	99.21	1.4
Deferred Dry Docking Costs(Net)	2.79	2.02	38.3	2.99	2.79	7.0
Investment in an Associate	17.82	15.00	18.8	16.43	17.82	-7.8
Available for sale Investment	7,663.10	2,783.40	175.3	4,506.52	7,663.10	-41.2
Other financial Assets	1.07	1.28	-15.9	0.76	1.07	-29.6
Total Non-Current Assets	8,208.70	3,284.59	149.9	5,113.57	8,208.70	-37.7
Current Assets						
Inventories	28.17	22.32	26.2	53.86	28.17	91.2
Accounts Receivable and Prepayments	241.58	150.95	60.0	303.24	241.58	25.5
Trading Investment	131.22	54.28	141.7	118.29	131.22	-9.9
Bank Balance and Cash	441.30	400.16	10.3	578.95	441.30	31.2
Non-current Assets held for Sale	6.52	-	N.A.	-	6.52	-100.0
Total Current Assets	848.78	627.71	35.2	1,054.34	848.78	24.2
TOTAL ASSETS	9,057.48	3,912.30	131.5	6,167.91	9,057.48	-31.9
Equity						
Share Capital	360.00	300.00	20.0	468.00	360.00	30.0
Legal Reserve	537.54	537.54	-	537.54	537.54	-
General Reserve	623.43	623.37	-	623.51	623.43	-
Fair Value Reserve	6,486.29	1,894.49	242.4	3,310.74	6,486.29	-49.0
Retained Earnings	6.45	3.76	71.6	169.99	6.45	2536.3
Proposed Dividend	162.00	120.00	35.0	-	162.00	-
Proposed Bonus Shares	108.00	60.00	80.0	-	108.00	-
Total Equity	8,283.71	3,539.15	134.1	5,109.77	8,283.71	-38.3
Non-current Liabilities						
Non-current portion of term loans	149.52	157.32	-5.0	130.20	149.52	-12.9
Employees end of service benefit	29.80	26.91	10.7	31.54	29.80	5.9
Total Non-Current Liabilities	179.32	184.22	-2.7	161.74	179.32	-9.8
Current Liabilities						
Accounts Payable and Accruals	150.40	94.89	58.5	195.83	150.40	30.2
Bank Overdraft	6.73	9.75	-31.0	52.14	6.73	675.1
Current portion of Term Loan	437.33	84.30	418.8	648.42	437.33	48.3
Total Current Liabilities	594.46	188.93	214.6	896.39	594.46	50.8
TOTAL EQUITY AND LIABILITIES	9,057.48	3,912.30	131.5	6,167.91	9,057.48	-31.9

FINANCIAL STATEMENTS

INCOME STATEMENT

For the period ending

(QAR Million)	31 Dec '05	31 Dec '04	%Chg	30 June '06	30 June '05	%Chg
Operating Revenues	834.59	561.40	48.66	508.35	390.80	30.08
Operating Expenses	648.76	443.00	46.45	395.60	306.65	29.01
Gross Profit	185.83	118.40	56.95	112.74	84.15	33.98
Investment Income	139.15	76.69	81.43	91.60	92.78	-1.28
Rental Income	13.80	12.95	6.55	7.16	6.67	7.38
Profit from Sale of Vessels and Equipment	0.65	0.70	-7.82	-	-	-
Miscellaneous Income	6.11	6.08	0.41	0.16	0.98	-83.60
General and Administration Expenses	-42.38	-38.70	9.51	-30.01	-19.65	52.72
Finance Cost	-15.74	-9.05	73.94	-17.25	-4.96	248.09
Share of Profit of an Associate	2.82	-	-	0.69	-	-
Net Profit Before Provision for Social and Charitable Activities	290.23	167.08	73.71	165.09	159.98	3.20
Provision for Social and Charitable Activities	-4.00	-4.00	-	-	-	-
Net Profit for the Year	286.23	163.08	75.51	165.09	159.98	3.20

IMPORTANT RATIOS

	2005	2004	2003
Operating profit margin (%)	35.72	30.66	60.47
Net profit margin (%)	34.18	29.05	62.20
Return on assets (%)	3.15	4.17	8.10
Return on equity (%)	3.44	4.61	9.40
Total asset turnover ratio (x)	9.21	14.35	13.01
Earnings per share (OMR)	7.92	4.66	9.64

OPINION RATINGS:

OVERWEIGHT The stock is expected to perform better than the market index; investors may give the stock more weight in their portfolio, than its weight in the overall market

NEUTRAL The stock is expected to perform in tandem with the market index; investors may give the stock the same weight in their portfolio as in the overall market.

UNDERWEIGHT The Stock is not expected to perform in line with the market index; investors may give the stock less weight in their portfolio than its weight in the overall market.

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