

July 11, 2016

## Price Data (SAR)

Current Price	48.79
Target Price	52.00
52 wk High/Low	79.75/31.10

## Ratings

Short-term	Positive
Long-term	Neutral
Risk Profile	Normal

## Market Data

Sector	Transportation
Market Cap	USD 2.43bn
Primary Market	Saudi Arabia
Other Exchg	
Reuters	SGSC.SE
Bloomberg	SGS AB Equity
Free Float	30%

## Valuation Ratio

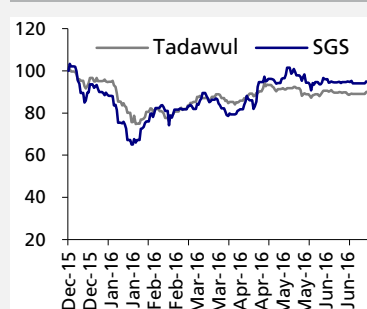
	2016E	2017E
P/E x	11.9	11.6
P/BV x	3.0	2.8
EV/EBITDA x	8.9	8.6
Div Yld %	5.4	5.8

## Trading Data

Daily Vol (6M Avg)	0.4
Daily T/o (6M Avg USD)	4.5
Issued Shares	188.0

All in millions

## Relative Price Performance



Restated to 100

Performance (%)	1m	3m	12m
Absolute	(1.6)	10.7	(32.5)
Relative	(0.9)	6.7	(3.2)

Source: SICO Research, Bloomberg

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## Saudi Ground Services

## A muted 2Q ahead

- Expect marginal YoY improvement in 2Q; earnings expected at SAR 177mn
- Swissport commenced operations in Saudi; expect competitive pressures to gradually increase
- Downgrade to 'Neutral'; TP at SAR 52/sh

## Expect improved 2Q16 earnings at SAR 177mn, up 2% YoY

SGS' 2Q16 earnings is expected to be broadly flat at 2% YoY increasing to SAR 177mn despite our forecast of 7% YoY in revenue to SAR 654mn in 2Q16, led by margin compression. We have not yet heard any announcement for renegotiation of rates for Saudia contract, while certain cost elements have increased, which may likely put some margin pressure in 2Q16. Additionally, 2Q, should be a seasonally slow quarter due to more number of days of the holy month of Ramadan falling in the quarter. Our estimates suggest a lower net margin of 27% in 2Q16 compared to 28.5% YoY, due to higher personnel (SAR 12mn) and medical costs (SAR 5.8mn) from 3Q15 onwards.

Recall, SGS had a strong 1Q16 with a net earnings of SAR 195mn compared to SAR 111mn YoY, due to the absence of one-off expense relating to royal decree bonus of SAR 98mn in 1Q15. The company's top line also grew by 10.2% YoY in 1Q16 to SAR 686mn, compared to 1Q15 revenue of SAR 623mn.

## Exhibit 1: 2Q16 estimates

SAR mn	2Q16E	1Q16	2Q15	YoY	QoQ
Revenue	654	686	611	7.0%	-4.7%
Gross Profit	235	260	224	4.9%	-9.4%
Gross Margin	36.0%	37.9%	36.7%		
Operating Profit	182	205	178	2.2%	-11.0%
Operating Margin	27.9%	29.8%	29.2%		
Net Profit	177	195	174	1.6%	-9.1%
Net Margin	27.1%	28.4%	28.5%		

Source: Company Data, SICO Research

## Downgrade to 'Neutral' rating; TP at SAR 52/sh

We downgrade our rating to 'Neutral' for SGS with a one year DCF target price of SAR 52/sh (previously SAR 50/sh), offering an upside of 7.6% from current levels. Our increased target price incorporates the impact from strong 1Q16, which outperformed our estimate by 3.7%. However, the rating downgrade was led by 17% increase in SGS' stock price since our last report on 21<sup>st</sup> February 2016. SGS was expected to renegotiate its contract with Saudia by 4Q15 end, targeting 3-5% hike in contract rates. However, there has not been any update on this since then. We have factored a 2% YoY growth in the revenue per flight from Saudia into our FY16 estimates and any higher increase in contract rates can be a positive catalyst for the stock.

## Exhibit 2: Revised estimates ( SAR mn)

	Revised Estimates		Old Estimates		% Change	
	FY16	FY17	FY16	FY17	FY16	FY17
Revenues	2,766	2,891	2,796	2,924	-1.1%	-1.1%
Operating Profit	782	804	781	794	0.2%	1.3%
Net Profit	767	788	765	778	0.2%	1.3%

Source: SICO Research, Company Data

**Expect SAR 2.60/sh in dividends for FY16, yield of 5.4%**

SGS paid a higher dividend of SAR 0.65/sh in 1Q16 compared to FY15 quarterly average dividends of SAR 0.51/sh. We expect SGS to pay total dividend of SAR 483mn (SAR 2.57/sh) in FY16, translating into a pay-out ratio of 63%, in line with 1Q16 and dividend yield of 5.3% at current levels. SGS' 1Q16 capex stood at SAR 53.7mn and we forecast the annual capex to be SAR 194mn in FY16 (SAR 30mn in FY15) deployed to invest in environmental friendly electrical infrastructure. SGS had a cash balance of SAR 800mn by 1Q16 end compared to SAR 411mn by FY15 end, mitigating the risk of higher capex on dividend payout.

**Competition introduced in the sector, do not see major near term impact**

Swissport acquired the second ground services license in Saudi Arabia in April 2015 and for the time being plans to operate from three key international airports in Saudi, i.e., Jeddah, Riyadh and Dammam. Swissport is the world's largest ground services company and can become a formidable competitor to SGS in the long term. The company commenced its operations in Saudi with Singapore based LCC, Scoot on 2<sup>nd</sup> May 2016 at King Abdulaziz International Airport in Jeddah for three weekly flights between Singapore and Jeddah. In addition, Swissport signed an agreement with Jazeera Airways of Kuwait to provide ground services to the airline with 9 weekly flights in Jeddah and 5 in Riyadh.

However, we do not see Swissport's entry as a major threat to SGS' recurring business in the near term as the company would initially operate only out of three airports in Saudi compared to SGS' operations in all 27 airports. Hence, SGS is strategically better placed than Swissport due to its wider coverage in the kingdom. Based on the company prospectus, 71% of Saudi's ground handling volume was contributed by Saudia and NAS in FY13, which are SGS' related parties. Accordingly, a major portion of SGS business is secure for the time being.

## Financials

### Income Statement (Consolidated)

Year ending 31 Dec (SAR mn)	2015A	2016E	2017E
Revenue	2,541	2,766	2,891
Cost of Goods Sold	(1,703)	(1,765)	(1,875)
<b>Gross Profit</b>	<b>837</b>	<b>1,001</b>	<b>1,016</b>
Selling, General and Admin.	(242)	(248)	(245)
<b>EBITDA</b>	<b>779</b>	<b>912</b>	<b>934</b>
Operating Profit	630	782	804
Other Income	50	35	38
Net Interest Income	(1)	(1)	(1)
Tax	(23)	(20)	(20)
Minority Interest	0	0	0
<b>Net Profit</b>	<b>621</b>	<b>767</b>	<b>788</b>

### Cash Flow Statement (Consolidated)

Year ending 31 Dec (SAR mn)	2015A	2016E	2017E
Net profit before Zakat	644	786	808
Depreciation	149	130	130
Other Adjustments	11	0	(1)
Working Capital Changes	(140)	(50)	(148)
<b>Cashflow from Operations</b>	<b>665</b>	<b>867</b>	<b>789</b>
Capital Expenditure	(28)	(194)	(202)
Other Investing Activities	24	0	0
<b>Cashflow from Investing</b>	<b>(3)</b>	<b>(194)</b>	<b>(202)</b>
Debt Raised/Repaid	0	0	0
Dividend	(402)	(462)	(518)
Other Financing Activities	0	0	0
<b>Cashflow from Financing</b>	<b>(402)</b>	<b>(462)</b>	<b>(518)</b>
Net Chg in Cash	260	211	69

Note: The above statements may not match the published cash flow statements due to adjustments made by us.

### Balance Sheet (Consolidated)

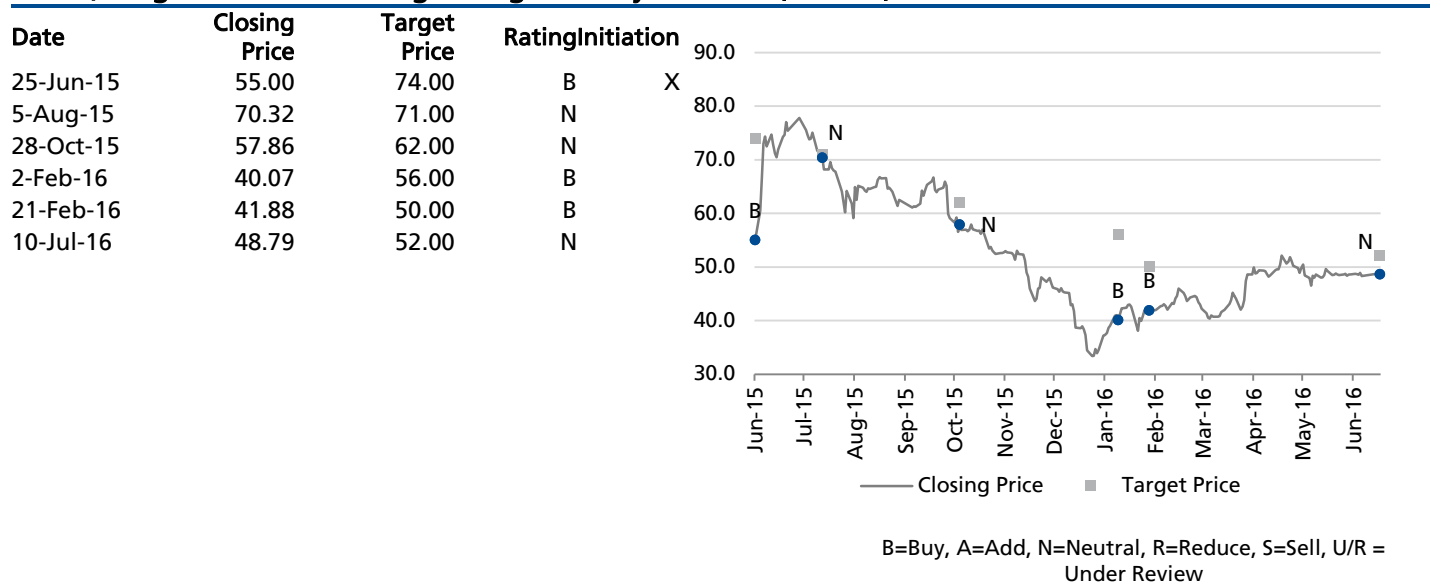
Year ending 31 Dec (SAR mn)	2015A	2016E	2017E
Cash & Short Term Deposits	779	990	1,059
Other Current Assets	986	1,056	1,224
Investments	0	0	0
Net Fixed Assets	473	575	682
Net Intangible Assets	934	896	861
Other Non-Current Assets	76	106	139
<b>Total Assets</b>	<b>3,249</b>	<b>3,622</b>	<b>3,965</b>
Current Liabilities	280	299	320
Total Debt	0	0	0
Other Liabilities	0	0	0
Total Liabilities	545	614	687
Minority Interest	0	0	0
Share Capital	1,880	1,880	1,880
Reserves & Surplus	824	1,128	1,398
Shareholders Funds	2,704	3,008	3,278
<b>Total Equity &amp; Liabilities</b>	<b>3,249</b>	<b>3,622</b>	<b>3,965</b>

### Key Ratios (Consolidated)

Year ending 31 Dec (SAR mn)	2015A	2016E	2017E
EPS	3.30	4.08	4.19
EPS Growth (%)	(5.5)	23.4	2.8
Gross Margin (%)	33.0	36.2	35.2
EBITDA Margin (%)	30.7	33.0	32.3
EBITDA Growth (%)	0.0	17.0	2.4
Net Margin (%)	25.8	28.8	28.4
ROAE (%)	23.9	26.8	25.1
ROAA (%)	21.2	23.2	21.6
Debt/Equity (%)	0.0	0.0	0.0
<b>Valuation Ratios</b>			
PER (x)	14.7	11.9	11.6
PBV (x)	3.4	3.0	2.8
Dividend Yield (%)	4.2	5.4	5.8
EV/EBITDA (x)	9.9	8.9	8.6

Source: Company, SICO Research, Bloomberg

## Price, Target Price and Rating Change History Chart of (SGS AB)



### Securities & Investment Company BSC

#### Analyst Stock Rating Definitions

Time horizon	
Short term	SICO Research issues a Short term outlook if the analyst feels that there are factors which might affect the short-term performance of the stock during the immediate six months after issuing a rating. This might be due to both quantitative and qualitative factors which the analyst think can affect the price performance in the short- term. Short term outlook can be different from the long term rating and the estimated up side or down side from the current price based on the Target Price estimate for the company
Long term	SICO Research's Long-term rating is based on the Target Price target price (given below) calculated by the Target Price is arrived at using both fundamental and comparative valuation methods based on the detailed Financial models developed by analysts incorporating current expectations and analyst's assumptions. Target price for a stock is calculated one year forward from the valuation date
Recommendation (Short term)	
Positive	Analyst expect positive triggers in the short term which might affect current price positively (> 10%)
Neutral	Analyst does not expect any short term triggers/events (+/- 10%)
Negative	Analyst expect negative triggers in the short term which might affect current price adversely (< 10%)
Recommendation (Long term)	
Buy	If Risk profile is "High" Target price estimate offers <b>20%+</b> return from the current share price. If Risk profile is "Normal" Target price estimate offers <b>15%+</b> return from the current share price.
Neutral	If Risk profile is "High" Target Price estimate offers <b>0% to 20%</b> return from the current share price. If Risk profile is "Normal" Target Price estimate offers <b>5% to 15%</b> return from the current share price
Sell	If Risk profile is "High" Target price estimate offers less than <b>0%</b> return from the current share price. If Risk profile is "Normal" Target price estimate offers less than <b>5%</b> return from the current share price.
Risk	
High	Stock volatility (360 days standard deviation) exceeds 2x of S&P GCC market volatility
Normal	Stock volatility (360 days standard deviation) lower than 2x of S&P GCC market volatility

## NOTES

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