# SAUDI GROUND SERVICES

NCB Capital

This is an extract of our published report, the full version of which can be found on the ncbc.com website

INITIATING COVERAGE

## Well-positioned to benefit from Hajj and Umrah growth

We initiate on SGS with an Overweight rating and a PT of SR60.8, giving 22.8% upside. SGS is a leading provider of ground services to airlines in Saudi with a market share of c.95%, which we believe will remain high due to its strong association with Saudia. We believe the company is well positioned to benefit from the government focus on increasing religious tourism. The stock is trading P/E 2017E of 12.2x vs a peer group average of 14.3x. It is also expected to distribute a DPS 2017E of SR2.75, reflecting an attractive dividend yield of 5.6%.

- **A strong position to benefit from Hajj and Umrah**: Based on NTP 2020, the Saudi government aims to diversify its income away from oil. One of the key ways to achieve this is the expansion in Hajj and Umrah. Hajj and Umrah pilgrims are planned to increase to 2.5mn and 10mn by 2020E, from 1.8mn and 6mn in 2016 respectively. SGS's dominant market share of 95% and operations across the 27 airports in Saudi will enable it to benefit from the increased number of flights as a result of this growth.

- **Fleet expansions and new operators to support growth**: Saudia, the parent company of SGS, which deals with it on an exclusive basis, is expected to increase its fleet from 126 aircraft in 2016 to 200 aircraft by 2020. This, in addition to the focus on Hajj and Umrah, is expected to increase the top-line of SGS by 6.1% in 2017E, with a CAGR of 4.7% during 2016-2020E. The recent announcement of Flynas to increase its fleet by 80 planes will also be a key catalyst going forward. Additionally, Nesma Airline and Saudi Gulf Airlines started operations in November 2016 with 10 planes in total.

- **Growth despite overall economic slowdown**: We expect SGS to report net income of SR766mn in 2017E, growing 11.7% YoY. This is despite of the overall economic slowdown due to the decline in average oil prices and government economic reforms. Net income is expected to grow at a CAGR of 6.6% between 2016-2020 supported by revenue growth and the cost optimisation plans which will enable the company to maintain/ improve its margins.

- **Attractive valuation and favourable dividends play:** We initiate on SGS with an Overweight rating and a PT of SR60.8, reflecting an upside of 22.8%. The stock is trading at a P/E 2017E of 12.2x, lower than the peer group average of 14.3x. A DPS of SR2.75 in 2017E, which is distributed quarterly, with an attractive 2017E dividend yield of 5.6% is an additional key advantage. We believe the dividends are sustainable, supported by a FCF yield of 9.1%, and a debt free balance sheet.

**Summary Financials**

| SR mn | 2015 | 2016 | 2017E | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|
| Revenues | 2,541 | 2,727 | 2,892 | 3,029 | 3,153 | 3,274 |
| Gross Income | 837 | 925 | 1,007 | 1,081 | 1,129 | 1,149 |
| *Gross margin (%)* | *33.0%* | *33.9%* | *34.8%* | *35.7%* | *35.8%* | *35.1%* |
| Operating Income | 630 | 703 | 783 | 854 | 894 | 907 |
| *Operating margin (%)* | *24.8%* | *25.8%* | *27.1%* | *28.2%* | *28.4%* | *27.7%* |
| Net Income | 621 | 686 | 766 | 834 | 873 | 887 |
| *Net margin (%)* | *24.4%* | *25.2%* | *26.5%* | *27.5%* | *27.7%* | *27.1%* |
| EPS (SR) | 3.30 | 3.65 | 4.07 | 4.44 | 4.65 | 4.72 |

Source: Company, NCBC Research estimates

## OVERWEIGHT

| | |
|---|---|
| **Target price (SR)** | **60.8** |
| **Current price (SR)** | **49.5** |
| **Upside/Downside (%)** | **22.8%** |

### STOCK DETAILS

| | |
|---|---|
| 52-week range H/L (SR) | 69/38 |
| Market cap ($mn) | 2,482 |
| Shares outstanding (mn) | 188 |
| Listed on exchanges | TADAWUL |

| Price perform (%) | 1M | 3M | 12M |
|---|---|---|---|
| Absolute | (6.9) | (27.6) | 9.7 |
| Rel. to market | (3.1) | (23.1) | 3.1 |

| Avg daily turnover (mn) | SR | US$ |
|---|---|---|
| 3M | 16.8 | 4.5 |
| 12M | 16.1 | 4.3 |

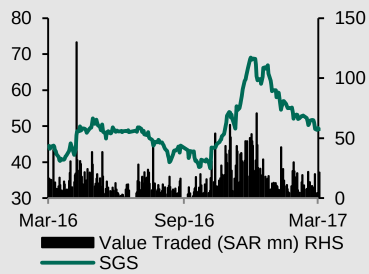
| | |
|---|---|
| Reuters code | 4031.SE |
| Bloomberg code | SGS AB |
| | www.saudiags.com |

### VALUATION MULTIPLES

| | 16A | 17E | 18E |
|---|---|---|---|
| P/E (x) | 13.6 | 12.2 | 11.2 |
| P/B (x) | 3.1 | 2.8 | 2.6 |
| EV/EBITDA (x) | 10.7 | 9.3 | 8.3 |
| Div Yield (%) | 5.3 | 5.6 | 5.6 |

Source: NCBC Research estimates

### SHARE PRICE PERFORMANCE




Source: Tadawul

**Iyad Ghulam** +966 12 690 7811
i.ghulam@ncbc.com

# Investment Summary

## Investment View

- Exposure to the attractive sector of Hajj and Umrah is expected to support a 6.6% CAGR growth in net income over the next 4 years.
- Strong relationship with the largest local airlines, Saudia and Flynas. These companies are directly and indirectly shareholders of SGS and the largest customers.
- Expertise and economies of scale which enable the company to operate across 27 airports in Saudi Arabia. SGS has a strong track record and substantial experience in Saudi, an advantage it has gained by combining the know-how of the three companies that formed SGS (Saudi Ground Services, NAS and Al-Attar) over the last few decades.
- Cost optimization programs to mitigate potential margin pressure from lower market share or declining prices.
- High and sustainable dividends of a DPS of SR2.75 in 2017E, representing an attractive dividend yield of 5.6%.

## Investment Risks

- Economic slowdown on lower oil prices and a decline in government spending could reduce the number of travellers in Saudi. Additionally, the difficulty in increasing the number of pilgrims due to 1) economic slowdown in their respective countries and/or 2) implementation of fees by MHU on pilgrims visas are also key risks.
- Saudia receivables are one of the key issues faced by SGS since the IPO of the company. Receivable days have increased from 90 days in 2013 to 143 days in 2016. This could impact the company's cash flow and dividend sustainability.
- The inability to renew the current contract with Saudia which expires in 2020E is a key risk.
- Two ground handling service companies currently operate in Saudi; SGS and Swissport. Although Swissport's market share is low, its ability to increase its market share is a key risk for SGS. Additionally, offering lower prices and the entrance of new players may also impact profitability of SGS.
- GACA is plaining to privatize all the airports within the next few years. This could increase SGS's rental expenses, reducing its margins and profitability.

## Potential Catalysts

- Lower than expected reduction in government spending, supported by the improvement in oil prices, will support the growth in the number of passengers.
- The fleet expansion of local airlines.
- Building and operating new airports.
- Reduction in receivable days by Saudia.

**Kindly send all mailing list requests to research@ncbc.com**

| **NCBC Research website** | **Brokerage website** | **Corporate website** |
|---|---|---|
| http://research.ncbc.com | www.alahlitadawul.com<br>www.alahlibrokerage.com | www.ncbc.com |

**NCBC Investment Ratings**

OVERWEIGHT: Target price represents an increase in the share price in excess of 15% in the next 12 months

NEUTRAL: Target price represents a change in the share price between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

**Other Definitions**

NR: Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

CS: Coverage Suspended. NCBC has suspended coverage of this company

NC: Not covered. NCBC does not cover this company

**Important information**