

SAUDI GROUND SERVICES



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

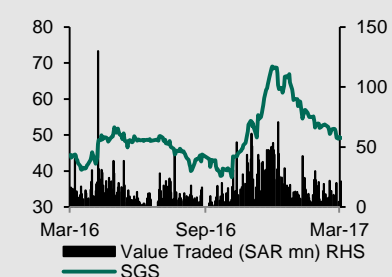
Reuters code	4031.SE
Bloomberg code	SGS AB
	www.saudiags.com

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 planning 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.

MARCH 2017

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

NCBC Research website

<http://research.ncbc.com>

Brokerage website

www.alahlitadawul.com
www.alahlbrokerage.com

Corporate website

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

The authors of this document hereby certify that the views expressed in this document accurately reflect their personal views regarding the securities and companies that are the subject of this document. The authors also certify that neither they nor their respective spouses or dependants (if relevant) hold a beneficial interest in the securities that are the subject of this document. Funds managed by NCB Capital and its subsidiaries for third parties may own the securities that are the subject of this document. NCB Capital or its subsidiaries may own securities in one or more of the aforementioned companies, or funds or in funds managed by third parties. The authors of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. The Investment Banking division of NCB Capital may be in the process of soliciting or executing fee earning mandates for companies that are either the subject of this document or are mentioned in this document.

This document is issued to the person to whom NCB Capital has issued it. This document is intended for general information purposes only, and may not be reproduced or redistributed to any other person. This document is not intended as an offer or solicitation with respect to the purchase or sale of any security. This document is not intended to take into account any investment suitability needs of the recipient. In particular, this document is not customized to the specific investment objectives, financial situation, risk appetite or other needs of any person who may receive this document. NCB Capital strongly advises every potential investor to seek professional legal, accounting and financial guidance when determining whether an investment in a security is appropriate to his or her needs. Any investment recommendations contained in this document take into account both risk and expected return. Information and opinions contained in this document have been compiled or arrived at by NCB Capital from sources believed to be reliable, but NCB Capital has not independently verified the contents of this document and such information may be condensed or incomplete. Accordingly, no representation or warranty, express or implied, is made as to, and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this document. To the maximum extent permitted by applicable law and regulation, NCB Capital shall not be liable for any loss that may arise from the use of this document or its contents or otherwise arising in connection therewith. Any financial projections, fair value estimates and statements regarding future prospects contained in this document may not be realized. All opinions and estimates included in this document constitute NCB Capital's judgment as of the date of production of this document, and are subject to change without notice. Past performance of any investment is not indicative of future results. The value of securities, the income from them, the prices and currencies of securities, can go down as well as up. An investor may get back less than he or she originally invested. Additionally, fees may apply on investments in securities. Changes in currency rates may have an adverse effect on the value, price or income of a security. No part of this document may be reproduced without the written permission of NCB Capital. Neither this document nor any copy hereof may be distributed in any jurisdiction outside the Kingdom of Saudi Arabia where its distribution may be restricted by law. Persons who receive this document should make themselves aware, of and adhere to, any such restrictions. By accepting this document, the recipient agrees to be bound by the foregoing limitations.

NCB Capital is authorised by the Capital Market Authority of the Kingdom of Saudi Arabia to carry out dealing, as principal and agent, and underwriting, managing, arranging, advising and custody, with respect to securities under license number 37-06046. The registered office of which is at King Saud Road, NCB Regional Building P.O. Box 22216, 11495 Riyadh, Kingdom of Saudi Arabia.