KSA Travel and Tourism Sector Report: Temporary headwinds, but promising future

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The travel and tourism sector in KSA was significantly impacted by the COVID-19 pandemic in 2020, facing the maximum brunt compared with other sectors. Owing to lockdown restrictions imposed last year; awareness of COVID-19-appropriate behaviour; and availability of vaccines, the situation in KSA has improved in 2021. However, due to the spread of the second strain of the virus and the time taken to vaccinate the entire population, the travel and tourism sector would take some time to return to pre-COVID-19 levels. The recovery was reflected in the stock market, as TASI rebounded at a rapid pace. However, the increase in stocks in the travel and tourism sector has not been as significant as in other sectors. While the sector is expected to face short-term challenges, the long-term potential remains unchanged. The current situation, hence, presents a good opportunity for investors from a long-term perspective.

- **Disruptive impact of pandemic on sector:** Saudi Arabia implemented restrictive measures in March 2020 as COVID-19 started to spread in the country. The preventive measures included ban on international and domestic travel, suspension of Hajj and Umrah pilgrimages, and a complete lockdown during April–May 2020. These restrictions had a direct and most severe impact on the travel and tourism sector. Businesses remained completely closed for almost two months in Q2-20. Later, with the easing of curbs, operations resumed partially. However, the impact persists and operations at most companies in the sector are yet to recover to pre-pandemic levels.
- **Vaccination drive, full reopening of international borders vital for recovery:** Emergence of a new strain toward the end FY20 and surge in infections in multiple countries amid the second wave delayed recovery. However, approvals to multiple COVID-19 vaccines across the world, coupled with the anticipated pick-up in vaccination drive, are likely to help in controlling the spread of the virus. Furthermore, announcement of lifting restrictions on travel for certain citizens from May 17 and expected opening of international borders (air, water, road) in May 2021, postponed from March 31 as announced earlier, would give a boost to the sector. Return of Hajj and Umrah pilgrims at full capacity is another key driver that would help the sector recover.
- **Long-term story intact:** While the pandemic significantly impacted travel and tourism, the sector's long-term prospects remain intact. KSA continues to focus on opening the economy by reducing its reliance on oil in line with Vision 2030. The transformation plan is aimed at developing the country into a tourist destination. Saudi Arabia aims to host 30mn pilgrims by FY30 and intends to invest heavily in the development of infrastructure, transportation, and hospitality in Makkah and Madina. Apart from religious tourism, KSA is planning several new projects to boost non-religious tourism, such as the entertainment city at Qiddiya, NEOM (smart city), Amaala (a luxury tourism project), and Diriyah (a UNESCO World Heritage Site). These initiatives are likely to provide a solid foundation for growth in the domestic travel and tourism sector.
- **Aviation industry to be a major beneficiary of growth in tourism:** Aviation and related businesses would gain from increase in tourist arrivals in the country. The General Authority of Civil Aviation (GACA) is actively engaged in developing the airport infrastructure so as to enable airports to cater effectively to a higher number of travelers; increasing the number of flights; and improving the quality of services offered. It also issued a license to set up a second cargo station to a private player in FY20. Thus, given the strong support from the GACA, the aviation industry is likely to benefit the most from the opportunities expected to arise in the long term.

The long-term prospects for the travel and tourism sector are bright. Although the sector's recovery from the pandemic is likely to be slow, once conditions normalize, the pace of recovery could pick up significantly. Catering is our top pick in the sector with potential upside of 24.5% at current valuation on account of good revenue visibility, strong financial and healthy expected dividend yield.

Table 1. Price target and recommendation

Company Name	Recommendation	TP(SAR/share)	CMP (SAR/share)	Upside/ (Downside)
Catering	Overweight	**98.3**	79.0	24.5%
SGS	Neutral	**36.8**	36.0	2.4%

*prices as of 02nd May 2021;
Source: Bloomberg, AJC Research

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Saudi Airlines Catering Co. (Catering): Expected to be in the black by FY22; good revenue visibility thereafter

Catering was no exception to the impact of the pandemic on the travel and tourism sector, recording net loss of SAR 335mn in FY20. The impact is expected to fade gradually during FY21. The company is estimated to return to profitability in FY22. We believe that Catering's long-term story remains intact due to the growth potential in the sector, driven by government support and the company's firm position in both in-flight catering and non-airlines business. Thus, based on the company's stronghold in operating markets and high growth potential in the sector, we raise our TP to **SAR 98.3/share** from SAR 97.6/share and upgrade our rating "**Overweight**" on the stock.

- **Growth in aviation sector, higher Hajj and Umrah pilgrims crucial for Catering:** KSA's plans to attract more tourists to the country, increasing number of international flights, and development of airports to handle the higher number of visitors would have a direct positive impact on the company's in-flight revenue (~70% of total revenue during FY16–20). Furthermore, the government is focusing on increasing its capacity to host more Hajj and Umrah pilgrims (30mn by FY30), which would benefit Catering's non-airlines segment. Additionally, with the recent announcement that the Kingdom is expected to achieve most of its Vision 2030 targets by FY25, accelerated growth can be seen across sectors.
- **Existing long-term contracts, and ability to win and retain new contracts provide good revenue visibility:** Catering has a 10-year contract (ending December 2029) worth SAR 12bn with Saudia to provide in-flight catering. Other long-term contracts of the company include a contract to design, construct, and operate the Alfursan domestic lounge at the new King Abdulaziz International Airport in Jeddah (SAR 308mn, 10 years) and a contract with Saudi Railways to provide food and beverage services to Haramain high-speed railway carriages and cafeteria (SAR 85mn, 5 years). Catering was also appointed as the exclusive caterer for Hajj pilgrims in FY20 by the Government of KSA. Thus, the company is expected to generate consistent revenues once the operating conditions are normalized. Additionally, the company is exploring opportunities in new sectors to diversify its revenue stream. Catering is also planning to expand its reach to other international sports events organized by KSA. The company also intends to enter the healthcare sector as a part of its strategy to lower its dependence on the aviation sector.
- **Strong financial position provides scope for future expansion:** As of December 2020, Catering has a healthy debt-to-equity ratio of 5.1%. Furthermore, the company has a track record of generating strong operating cashflow. Thus, the company possesses financial capability to cater to potential high demand in future through the expansion of its facilities.
- **Attractive dividend yields for income-seeking investors:** Historically, Catering's stock has generated healthy dividend yields (FY17–19 avg. yield: 6.1%); yields are expected to be above 4.0% in FY22 after earnings normalize and increase to 6.0% thereafter.

AJC View and Valuation: We believe that Catering's operating segments have great potential. Given the company's reputation of providing high-quality services and ability to handle large volumes, the company is well-positioned to grab the growth opportunities.

We value Catering based on DCF (2.5% terminal growth and 7.2% WACC) to arrive at TP of SAR 98.3/share, implying a 24.5% upside from the current levels. The stock is currently trading at a P/E of 15.7x and EV/EBITDA of 10.3x based on our FY22 estimate. We upgrade our rating on the stock to "**Overweight**" from "Neutral" earlier.

Overweight

Target Price (SAR)	**98.3**
Upside / (Downside)*	**24.5%**

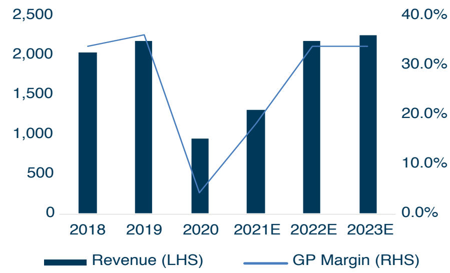
Source: Tadawul *prices as of 2nd of May 2021

Key Financials

SARmn (unless specified)	FY20	FY21E	FY22E
Revenue	927	1,318	2,166
Growth %	-57.0%	42.2%	64.4%
Gross Profit	42	247	736
Net Profit	-335	-95	413
Growth %	NM	NM	NM
EPS	-4.08	-1.16	5.04

Source: Company reports, Aljazira Capital

Revenue (SAR mn) and GP Margin



Source: Bloomberg, AlJazira Capital

Key Ratios

SARmn (unless specified)	FY20	FY21E	FY22E
Gross Margin	4.6%	18.7%	34.0%
Net Margin	-36.1%	-7.2%	19.1%
P/E	Neg	Neg	15.7x
P/B	7.4x	10.4x	8.7x
EV/EBITDA (x)	Neg	High	10.3x
Dividend Yield	1.8%	2.2%	4.5%

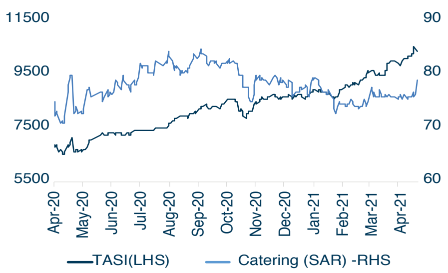
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	6.6
YTD %	2.5%
52 Week (High / Low)	87.4/71.3
Shares Outstanding (mn)	82.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY18	FY19	FY20	FY21E	FY22E	FY23E
Income statement						
Gross Revenue	2,036	2,156	927	1,318	2,166	2,239
Y/Y	**4.3%**	**5.9%**	**-57.0%**	**42.2%**	**64.4%**	**3.4%**
Cost of Revenue	(1,339)	(1,369)	(884)	(1,071)	(1,430)	(1,475)
Gross Profit	**696**	**787**	**42**	**247**	**736**	**764**
General & Administrative Expense	(214)	(246)	(256)	(270)	(246)	(253)
Other expenses	(2)	(4)	(2)	-	-	-
Reversal of impairment of trade receivables	13	(7)	(37)	-	-	-
Other Income	12	9	5	1	1	3
Operating Income	**506**	**539**	**(271)**	**(23)**	**491**	**514**
Y/Y	**-5.6%**	**6.7%**	**NM**	**NM**	**NM**	**4.7%**
Finance income	1	1	1	-	-	-
Finance costs	(5)	(34)	(34)	(45)	(42)	(39)
Share of loss of equity accounted investee	(5)	(3)	(11)	-	-	-
Income before Zakat	**496**	**503**	**(316)**	**(67)**	**449**	**475**
Zakat	(37)	(39)	(19)	(28)	(36)	(38)
Net income	459	464	(335)	(95)	413	437
Y/Y	**-4.7%**	**1.0%**	**NM**	**NM**	**NM**	**5.9%**
EPS	5.60	5.66	(4.08)	(1.16)	5.04	5.33
Balance sheet						
Assets						
Cash and cash equivalents and Short term Investment	147	189	257	215	318	294
Sub-leased Assets	-	13	14	7	4	2
Prepaid expenses and other receivables	193	109	91	95	124	149
Total current assets	**1,415**	**1,332**	**1,279**	**1,190**	**1,391**	**1,442**
Intangible Assets	0	2	1	1	1	1
Other financial Assets	30	20	17	15	14	12
Total assets	**2,086**	**2,504**	**2,307**	**2,139**	**2,320**	**2,382**
Liabilities						
Accounts payable - trade	587	454	390	440	549	566
Lease Liabilities	-	117	168	174	119	108
Zakat and income Tax payable	30	34	12	12	12	12
Total current liabilities	617	605	869	926	979	986
End-of-service indemnities	167	177	166	169	172	176
Lease Liabilities	-	417	412	422	422	431
Total non-current liabilities	167	593	578	591	595	607
Total liabilities	**784**	**1,199**	**1,447**	**1,517**	**1,574**	**1,593**
Shareholders' Equity						
Share capital	820	820	820	820	820	820
Statutory reserve	354	354	354	354	354	354
Retained earnings	128	132	(314)	(552)	(428)	(384)
Total shareholders' equity	1,301	1,306	860	622	746	789
Total liabilities and shareholders' equity	**2,086**	**2,504**	**2,307**	**2,139**	**2,320**	**2,382**
Cashflow statement						
Operating activities	419	744	(35)	148	586	556
Investing activities	(48)	(61)	(46)	(75)	(144)	(187)
Financing activities	(325)	(641)	149	(115)	(338)	(393)
Change in cash	46	42	69	(43)	104	(24)
Ending cash balance	147	189	257	215	318	294
Key fundamental ratios						
Liquidity ratios						
Current ratio (x)	2.3	2.2	1.5	1.3	1.4	1.5
Quick ratio (x)	1.8	1.7	1.2	1.0	1.2	1.2
Profitability ratios						
GP Margin	34.2%	36.5%	4.6%	18.7%	34.0%	34.1%
Operating Margins	24.8%	25.0%	-29.2%	-1.7%	22.7%	22.9%
EBITDA Margin	27.9%	32.4%	-9.6%	9.7%	30.1%	30.8%
Net Margins	22.6%	21.5%	-36.1%	-7.2%	19.1%	19.5%

Source: Company financials, AlJazira research

Saudi Ground Services Co. (SGS): COVID-19 pressure to continue in short term; long-term outlook positive

SGS operations will likely continue to feel the impact the pandemic in FY21, as travel restrictions are still in place. However, operating conditions are expected to be improve in FY22, driven by vaccination drives. Moreover, the company's long-term prospects remain intact, given the government's emphasis on the development of the travel and tourism sector under Vision 2030. Furthermore, General Authority of Civil Aviation (GACA)'s focus on upgrading the airports and services offered bodes well for the company. Additionally, initiatives taken toward cost-cutting and liquidity improvement during the pandemic would help SGS to recover from the crisis strongly. Thus, based on the company's rapid expected recovery and long-term positive outlook, we increase our TP to SAR 36.8/share from **SAR 27.9/share** and maintain our "**Neutral**" rating on the stock..

- **Huge potential for aviation and related businesses in KSA to benefit SGS:** KSA plans to increase the number of Umrah pilgrims to 30mn by FY30. Under this plan, GACA would implement initiatives to provide air transport networks and infrastructure. GACA would also support national airlines to increase their capacity as well as number of flights. The national carrier, Saudia, plans to expand its fleet by adding 73 new aircraft units. As SGS derives ~50% of its revenue from Saudia, the fleet expansion by the airline would benefit the company. As SGS is the leading ground-handling service provider in KSA (96% market share in FY20), the overall growth of the aviation sector would reflect in the company's topline growth in future. Thus, we expect SGS' revenue to grow in mid-single digit from FY22, which has been stagnant in past few years and was impacted severely in FY20 due to the pandemic.
- **Cost reduction and liquidity measures to help sail through tough times:** To mitigate the impact of the pandemic, SGS has taken few steps, such as measures to control operating costs and raising debt to cushion significant cash outflows due to losses. SGS reduced operating costs by SAR 581mn in FY20, of which SAR 124mn was permanent reduction. In FY20, SGS signed loan facilities worth SAR 2.0bn, of which it has drawn up to ~SAR 500mn as of December 2020, thus ensuring sufficient liquidity in case of delayed recovery.
- **Short-term pain persists; vaccination drive holds key to recovery:** With the recent surge in COVID-19 cases in several countries globally, restrictions on international flights are likely to continue in the near term. Thus, operations of the company are not expected to recover to pre-covid volumes anytime soon. However, the situation might improve in the second half of the year, driven by vaccination drives worldwide.

AJC View and Valuation: We expect gradual recovery in the aviation sector during FY21, while long-term prospects remain bright, with the government's support and a conducive regulatory environment, SGS' position remains strong in the ground-handling business. The company's financial and operational strength would enable it to gain back the momentum and revenue owing to the growth potential in the sector.

We value SGS based on DCF (3.0% terminal growth and 8.0% WACC) to arrive at a TP of SAR 36.8/share, implying a 2.4% upside from the current levels. The stock is currently trading at a P/E of 19.4x and EV/EBITDA of 11.6x based on our FY22 estimate. We maintain our "**Neutral**" rating on the stock.

Neutral

Target Price (SAR)	**36.8**
Upside / (Downside)*	**2.4%**

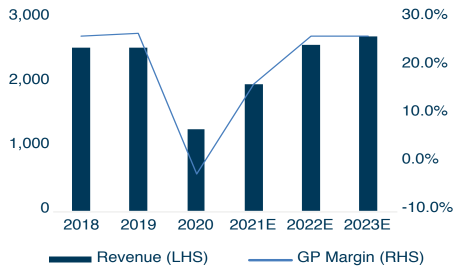
Source: Tadawul *prices as of 2nd of May 2021

Key Financials

SARmn (unless specified)	FY20	FY21E	FY22E
Revenue	1,252	1,968	2,558
Growth %	-50.7%	57.2%	30.0%
Gross Profit	-21	331	688
Net Profit	-454	15	349
Growth %	NM	NM	NM
EPS	-2.42	0.08	1.86

Source: Company reports, Aljazira Capital

Revenue (SAR mn) and GP Margin



Source: Bloomberg, AlJazira Capital

Key Ratios

SARmn (unless specified)	FY20	FY21E	FY22E
Gross Margin	-1.7%	16.8%	26.9%
Net Margin	-36.3%	0.8%	13.6%
P/E	Neg	High	19.4x
P/B	2.4x	2.7x	2.6x
EV/EBITDA (x)	Neg	26.3x	11.6x
Dividend Yield	0.0%	0.0%	3.1%

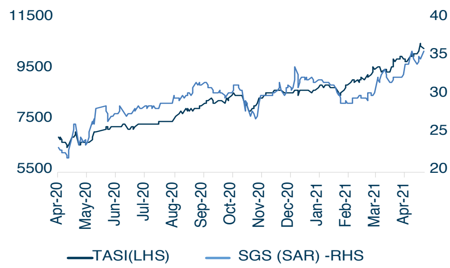
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	6.9
YTD %	12.0%
52 Week (High / Low)	36.9/22.8
Shares Outstanding (mn)	188.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY18	FY19	FY20	FY21E	FY22E	FY23E
Income statement						
Gross Revenue	2,554	2,540	1,252	1,968	2,558	2,711
Y/Y	**-1.2%**	**-0.6%**	**-50.7%**	**57.2%**	**30.0%**	**6.0%**
Cost of Revenue	(1,870)	(1,853)	(1,273)	(1,637)	(1,870)	(1,980)
Gross Profit	**684**	**687**	**(21)**	**331**	**688**	**732**
General & Administrative Expense	(313)	(239)	(257)	(271)	(350)	(368)
Other Income	0	0	2	2	5	8
Operating Income	**371**	**416**	**(403)**	**6**	**343**	**371**
Y/Y	**-25.0%**	**12.1%**	**NM**	**NM**	**NM**	**8.4%**
Share in net income of equity accounted investee	**8**	**12**	**(22)**	**10**	**11**	**12**
Financial Income	**18**	**35**	**14**	**34**	**34**	**34**
Financial Charges	(3)	(9)	(16)	(7)	(8)	(10)
Income before Zakat	395	454	(427)	43	379	407
Zakat	(26)	(31)	(27)	(28)	(30)	(32)
Net income	**368**	**423**	**(454)**	**15**	**349**	**375**
Y/Y	-26.5%	14.9%	NM	NM	NM	7.4%
EPS	1.96	2.25	(2.42)	0.08	1.86	1.99
Balance sheet						
Assets						
Cash and cash equivalents	310	120	96	355	312	406
Short term Bank Deposits	-	-	-	-	-	-
Investment Held for Trading	305	944	977	977	977	977
Trade Receivables, net	1,308	872	1,148	1,203	1,279	1,296
Inventories, net	0	0	0	0	0	0
Prepayment & Other receivables	**354**	**461**	**531**	**590**	**614**	**651**
Total Current Assets	**2,277**	**2,397**	**2,751**	**3,125**	**3,182**	**3,329**
Investment accounted under equity method	130	142	99	109	120	132
Property & Equipment	**635**	**593**	**526**	**669**	**741**	**810**
Intangbile assets	**891**	**885**	**849**	**761**	**674**	**586**
Prepayment & Other receivables	5	124	61	96	100	79
Total non-current assets	1,661	1,926	1,666	1,635	1,634	1,607
Total Assets	**3,938**	**4,323**	**4,417**	**4,761**	**4,816**	**4,936**
LIABILITIES						
Trade Payables	49	21	96	112	102	108
Accrued Zakat	86	107	126	145	166	187
Accrued Expenses & other Liabilities	452	543	522	651	599	587
Current- Lease Liabilities	**-**	**45**	**42**	**18**	**16**	**16**
Total current liabilities	587	716	786	927	883	898
Employees end of services benefits	474	531	558	696	622	610
Non -Current- Lease Liabilities	-	130	80	129	163	204
Non-current Liabilities	474	661	1,132	1,319	1,278	1,309
Total Liabilities	**1,062**	**1,377**	**1,918**	**2,246**	**2,162**	**2,207**
EQUITY						
Share Capital	1,880	1,880	1,880	1,880	1,880	1,880
Statutory Reserve	457	499	499	499	499	499
Retained Earnings	540	567	120	135	275	350
Total Shareholder's Equity	**2,876**	**2,946**	**2,499**	**2,515**	**2,654**	**2,729**
Total Liabilities & Equity	**3,938**	**4,323**	**4,417**	**4,761**	**4,816**	**4,936**
Cashflow statement						
Operating activities	436	966	(419)	431	402	637
Investing activities	204	(734)	(40)	(171)	(237)	(244)
Financing activities	(367)	(422)	436	-	(209)	(300)
Change in cash	274	(190)	(24)	260	(44)	94
Ending cash balance	310	120	96	355	312	406
Key fundamental ratios						
Liquidity ratios						
Current ratio (x)	3.3	2.7	2.8	2.7	2.9	3.0
Quick ratio (x)	3.3	2.7	2.8	2.7	2.9	3.0
Profitability ratios						
GP Margin	26.8%	27.0%	-1.7%	16.8%	26.9%	27.0%
Operating Margins	14.5%	16.4%	-32.2%	0.3%	13.4%	13.7%
EBITDA Margin	20.0%	24.5%	-16.5%	13.6%	24.0%	24.4%
Net Margins	14.4%	16.7%	-36.3%	0.8%	13.6%	13.8%

Source: Company financials, AlJazira research

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer