

SGS reported a higher than expected set of Q2-18 results. Net income came at SAR112.7mn (SAR0.60 EPS) against our estimates of SAR104.2mn. The deviation is mainly due to higher than estimated top-line growth and marginally lower OPEX. Flat growth in revenue is an early sign of recovery after 6 consecutive quarterly decline. Going forward, we believe the company can potentially enhance its revenue growth driven by fleet expansion from airline operators and higher aircraft traffic. We remain "Neutral" on the company with a TP of SAR39.5 per share.

- SGS reported net income of SAR112.7mn (EPS SAR 0.60) compared to SAR122.2mn for the same quarter last year; posting a decline of 7.8%Y/Y, standing 8.1% above our estimates and 3.1% below consensus. The company attributes the Y/Y decline to increase in COGS by SAR57.8mn associated to cost of living allowance provided to staff (effective January 2018) and other operating expenses. The deviation is mainly due to higher than estimated top-line growth and marginally lower OPEX, despite lower than expected murabaha and other income.
- Revenue stood at SAR659.9mn compared to SAR659.3mn for the same quarter last year, above our estimates of SAR630.1mn due to higher than estimated utilization rate; posting marginal increase of 0.1% Y/Y and a 6.1% Q/Q. for FY18, we expect SGS to post revenues of SAR2,537.3mn, posting 1.9%Y/Y decline.
- Gross profit stood at SAR189.4mn compared to SAR180.8mn last quarter and SAR246.6mn for the same quarter last year; posting 23.2%Y/Y decline due to higher COGS, this came above our gross profit estimates of SAR183.0mn due to higher than estimated revenue. Gross margins stood at 28.7% compared to 29.1% last quarter, and 37.4% for the same quarter last year. Operating income stood at SAR111.9mn for the quarter, posting 6.9%Y/Y decline and 4.7%Q/Q increase. OPEX declined 38.6%Y/Y due to reduction of provisions. Tighter margins are expected throughout FY18 on a gross level, estimated to stand at 28.9%.

**AJC view:** Flat growth in revenue is an early sign of recovery after 6 consecutive quarterly declines. Going forward, we believe the company can potentially enhance its revenue growth driven by fleet expansion from airline operators and higher aircraft traffic. We should note that the level of pressure on GP margins resulted from higher direct costs (attributed to cost of living allowance) which is a one-off impact for FY18; therefore, we expect improvement in gross margins FY19. Downside risk to valuation would include further price revisions from Saudia and slower than expected growth in number of flights. Revised FY18 EPS is estimated at SAR2.29 per share. The company currently trades at TTM PE of 15.2x and an estimated forward PE multiple of 15.7x. We remain "Neutral" on SGS with TP of **SAR 39.5 per share**.

#### Results Summary

SARmn (unless specified)	Q2-2017	Q1-2018	Q2-2018	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	659.3	621.8	659.9	0.1%	6.1%	4.7%
Gross Profit	246.6	180.8	189.4	-23.2%	4.7%	3.4%
Gross Margin	37.4%	29.1%	28.7%	-	-	-
EBIT	120.2	106.9	111.9	-6.9%	4.7%	9.1%
Net Profit	122.2	106.7	112.7	-7.8%	5.6%	8.1%
EPS	0.65	0.57	0.60	-	-	-

Source: Company reports, Aljazira Capital

## Neutral

Target Price (SAR) **39.5**

Upside / (Downside)\* **9.7%**

Source: Tadawul \*prices as of 30<sup>th</sup> of July 2018

#### Key Financials

SARmn (unless specified)	FY16	FY17	FY18E
Revenue	2,726.7	2,585.5	2,537.3
Gross Profit	924.2	872.3	732.6
Net Profit	685.8	501.5	431.5
EPS	3.65	2.67	2.29

Source: Company reports, Aljazira Capital

#### Key Ratios

SARmn (unless specified)	FY16	FY17	FY18E
Gross Margin	33.9%	33.7%	28.9%
Net Margin	25.2%	19.4%	17.0%
P/E	18.1x	14.7x	15.7x
P/B	4.2x	2.6x	2.4x
Dividend Yield	3.9%	6.6%	7.2%

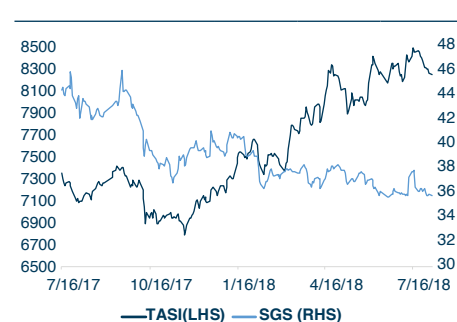
Source: Company reports, Aljazira Capital

#### Key Market Data

Market Cap (mn)	6,730.4
YTD %	(8.55 %)
Shares Outstanding (mn)	188.0
52 Week (High / Low)	46.0 / 35.5

Source: Company reports, Aljazira Capital

#### Price Performance



Source: Tadawul, Aljazira Capital

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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.

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