

Saudi Airlines Catering CO. (Catering)

Strategic Planning by Catering Ensures Business Continuity with Gradual Recovery Anticipated FY2021e

Despite being one of the hardest hit company's during the COVID-19 Pandemic, Catering showed strategic planning during FY2020. Q1 2021 showed great promise, where revenues grew by 24.4% Q-o-Q. Going forward, the governmental support is bound to boost the recovery for the aviation and tourism sector, while the company's operational efficiency will ensure a competitive advantage.

Material recovery was seen in Catering's revenues for Q1 2021 compared to the previous 9M. For Q1 2021, Catering posted revenues of SAR256mn, an increase of 24.4% compared to SAR206mn in Q4 2020. Meanwhile, the temporary suspension of flights led to a direct impact on the company's operations with a decrease in revenue by -43.4% Y-o-Y (amounting to SAR256.3mn), as during Q1 2020, travel restrictions due to the pandemic hadn't been implemented for most of the quarter. COGS dropped by 5.1% Q-o-Q in Q1 2021 compared to Q4 2020 (-38.7% Y-o-Y), thanks to the company's efforts to optimize its cost structure. Gross profit for Q1 2021 amounted to SAR52mn, compared to losses of SAR9mn in Q4 2020 (-56.6% Y-o-Y), suggesting a gradual recovery for Catering. Gross profit margin stood at 20.2% compared to -4.6% in Q4 2020 and 26.3% in Q1 2020.

During the quarter, the company reported SG&A of SAR68mn an increase of 23.0% Q-o-Q (5.1% Y-o-Y), however, it's important to note that in an attempt to increase operational efficiency, the company achieved a reduction in personnel costs of SAR23.4mn, rent and maintenance cost of SAR6mn in Q1 2021. Nevertheless, operating losses were SAR19mn compared to the operating income of SAR35mn in Q1 2020 (operating losses for Q4 2020 amounted to SAR88mn, including SAR22.9mn impairment). Operating profit margin for Q1 2021 was -7.3% compared to 7.7% in Q1 2021 and -42.7% in Q4 2020.

Finally, net loss for the Q1 2021 was only SAR30mn compared to net income of SAR16mn in Q1 2020 and net loss of SAR100mn in Q4 2020. Net income margin stood at -11.7% in Q1 2021 compared to 3.4% in Q1 2020 and -48.6% in Q4 2020.

During the quarter, Catering announced on February 22nd the distribution of cash dividends of 14% (SAR1.4/share, amounting to SAR114.8mn) for Q4 2019, however in another statement in March the company decided against the previously set date of distribution (March 12th) in an attempt to maintain cash balance and pushed the date to March 26th.

While the travel sector being the hardest hit sectors during the COVID-19 pandemic, the company was able to turn the challenges of the year into diversification opportunities to decrease its dependence on the aviation sector. Catering showed outstanding efforts to diverse revenue sources in addition to cost efficiency initiatives that significantly hindered the negative impact of the economic climate.

Furthermore, it is important to highlight the role the government plays in the recovery of the aviation sector and hence Catering. The significantly rapid vaccine rollout, coupled with the lifting of travel restrictions on citizens starting May 17th, and the return of the pilgrims and Umrah performers are important factors in the recovery of the travel sector and simultaneously Catering's IFC segment. We expect gradual recovery in Catering's top line performance FY2021e, with full recovery to pre-COVID levels by FY2024e.

We update our 52 weeks target price for SACO to SAR97.91 /share with a Buy recommendation.

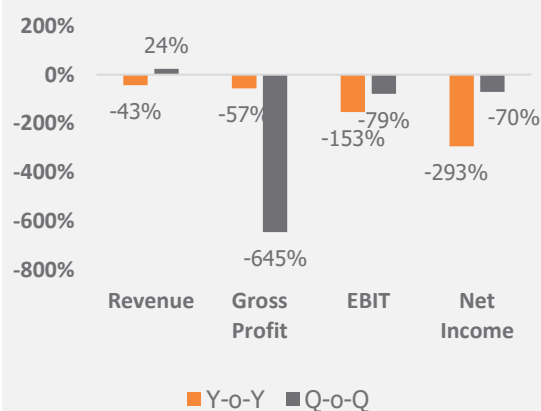
24 May 2021

| Recommendation | Buy |
|----------------------------|----------------|
| Previous Recommendation | Neutral |
| Current Price (24-05-2021) | SAR80.6 |
| Target Price (52 Weeks) | SAR97.9 |
| Upside/ (Downside) | 21.5% |
| Shariah Compliance | Pass |

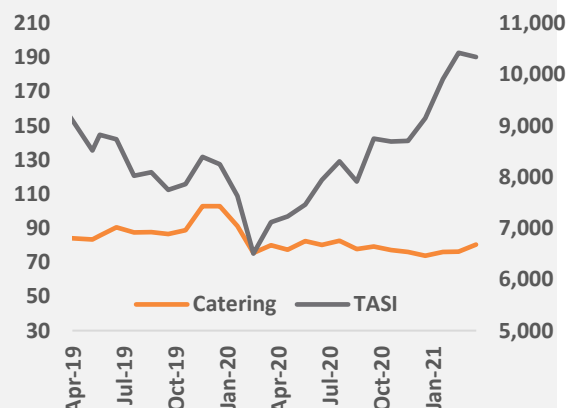
Key Financial Ratios

| Ratio | Q1 2021 | Q4 2020 | Q1 2020 |
|----------------|---------|---------|---------|
| Revenue Growth | 24.0% | 33.1% | 10.3% |
| Gross Margin | -20.2% | -4.6% | 26.3% |
| EBIT Margin | -7.3% | -42.7% | 7.7% |
| Net Margin | -11.7% | -48.6% | 3.4% |

Key Financial Results (Q1 2021)



Share Price Performance





Saudi Airlines Catering CO. (Catering)

Overview & Outlook

Catering showed strong strategic planning despite the immense pressure during the year 2020, on the back of the COVID-19 pandemic that resulted in world-wide travel restrictions. A 90% reduction in footfall was experienced during the initial phase of the pandemic at major airports such as Jeddah – which has since only reached half the numbers seen in 2019. This resulted in only 60–65% of total scheduled flights operating and only 40–50% of projected passengers travelling during the year 2020. That being said, Catering was able to revamp its corporate strategy in order to sustain revenue inflow and reduce dependency on the aviation sector. During the 2020, the company focused on its catering and facilities segment, where it was chosen by the Saudi Government to be the sole caterer to fulfill the comprehensive catering needs for Hajj pilgrims. Moreover, the company signed hospitality and catering services contract with Saudi Automobile & Motorcycle Federation (SAMF) for the Dakar Rally 2021, the international car race hosted, supervised and managed by the Ministry of Sport. It is worth noting that the company signed the contract to cater the Dakar Rally again in 2021. Furthermore, the company launched a new branded cafeteria offering, 'Enjoy', aimed to at the labor market, providing low cost meals for B&I and remote sites customers.

For its Retail segment, despite having maintained only 13 on-ground outlets during 2020, the company saw almost +300% increase in new visits to SKYSales online, with plans to launch a new e-commerce website by Q2 2021 to complement on-board sales.

Finally, during the year 2020 Catering adapted strategic cost efficiency measures including digitizing their operations to optimize both business sustainability and cost structure as to secure a competitive edge for the company. The cost efficiencies include planning of competitive operational costs for food and labor, restructuring the organization while injecting needed capabilities in terms of business development, branding and data analytics and finally activating M&A department for opportunities in Healthcare and Government sectors.

Gradual recovery in the aviation sector is expected towards the end of FY2021e, with more rapid recovery in the near future thanks to the Government support. Prior to the pandemic, the Kingdom's priority was to reduce the Saudi's economic dependence on oil through transforming the Kingdom into a global tourist destination, as highlighted in the Kingdom's 2030 Vision. With the expected opening of the international borders (air, sea and land) in 2021, in addition to the rapid vaccine rollout, we expect the Kingdom to proceed with its pre-COVID plans. The Kingdom is expected to host a total of 30 million tourists by 2030, through planning several touristic projects such as the entertainment city in Qiddiya, Neom (the smart city), Amaala (a luxury tourism project) and Diriyah (a UNESCO World Heritage Site). Moreover, the Kingdom is focused in reaching the same number of pilgrims and Umrah and Hajj performers to its previous levels in addition to increasing its capacity to host more pilgrims by 2030, which is a key catalyst to the recovery of the aviation and tourism sectors in the medium and long term.

Going forward, we believe that the company's newly adapted measures in terms of revenue diversification and cost efficiencies are key catalysts for the company's operational recovery on the short term, and business continuity on the long-term. As for the economic recovery, it is expected that the aviation sector will be able to recover rapidly as soon as global travel restrictions are fully lifted and vaccine rollout reaches its full capacity.

Financial Projection

DCF Valuation

| | 2021E | 2022F | 2023F | 2024F | 2025F | 2026F |
|------------------------------------|--------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|-------|
| EBITDA | 338 | 473 | 589 | 647 | 692 | 707 |
| Operating CF | 300 | 357 | 517 | 599 | 649 | 607 |
| Capex | (78) | (109) | (116) | (121) | (113) | (103) |
| FCFF | 222 | 248 | 401 | 479 | 537 | 504 |
| Stub Period (FCF to be discounted) | 167 | 248 | 401 | 479 | 537 | 504 |
| PV (FCFF) | 160 | 223 | 338 | 378 | 398 | 350 |
| WACC | 6.28% | | | | | |
| Perpetuity Growth | 2.00% | | | | | |
| PV-FCFF | 1,846 | We have valued Catering using DCF approach, considering a WACC is equal to 6.3% (based on a risk-free rate of 2.7%, market risk premium 7.0%, Beta of 0.71). | | | | |
| PV-TV | 6,930 | | | | | |
| Net Debt | (632) | Based on the DCF valuation, the fair price of Catering share price is SAR97.9, which is higher than the traded value by 21.5%. | | | | |
| Less: End of services benefits | (164) | | | | | |
| Add: Investment | 48 | | | | | |
| Intrinsic Values | 8,028 | | | | | |
| Shares Outstanding | 82 | | | | | |
| Equity value per share | 97.91 | | | | | |
| CMP (24-05-2021) | 80.60 | | | | | |
| Upside / Downside (%) | 21.47% | | | | | |

Financial Ratios

| | 2020 A | 2021 E | 2022 F | 2023 F | 2024 F | 2025 F | 2026 F |
|----------------------------------|--------|--------|--------|--------|--------|--------|--------|
| Return on Average Assets (%) | -13.9% | 6.4% | 12.0% | 16.5% | 19.0% | 20.9% | 21.1% |
| Return on Average Equity (%) | 85.5% | 141.3% | 233.6% | 251.1% | 259.0% | 262.9% | 262.7% |
| Earnings Before Zakat Margin (%) | -34.1% | 13.2% | 15.0% | 19.1% | 20.6% | 21.7% | 21.7% |
| Net Income Margin (%) | -36.1% | 12.2% | 13.8% | 17.6% | 19.0% | 20.0% | 20.0% |
| Revenue Growth (%) | -57.0% | 29.9% | 64.7% | 8.9% | 5.1% | 4.0% | 3.1% |
| EPS | -4.08 | 1.79 | 3.34 | 4.63 | 5.27 | 5.75 | 5.93 |

Income Statement

| | 2020 A | 2021 E | 2022 F | 2023 F | 2024 F | 2025 F | 2026 F |
|---------------------|--------------|------------|------------|------------|------------|------------|------------|
| Revenues | 927 | 1,204 | 1,983 | 2,159 | 2,270 | 2,360 | 2,432 |
| Cost of Revenues | (884) | (843) | (1,388) | (1,447) | (1,498) | (1,534) | (1,581) |
| Gross Profit | 42 | 361 | 595 | 713 | 772 | 826 | 851 |
| SG&A | (256) | (163) | (258) | (259) | (261) | (271) | (280) |
| Zakat | (19) | (12) | (23) | (32) | (36) | (40) | (41) |
| Net Income | (334) | 147 | 274 | 380 | 432 | 472 | 486 |

Balance Sheet

| | 2020 A | 2021 E | 2022 F | 2023 F | 2024 F | 2025 F | 2026 F |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Current Assets | 1,279 | 1,320 | 1,332 | 1,401 | 1,324 | 1,399 | 1,487 |
| Non-Current Assets | 1,028 | 968 | 941 | 921 | 904 | 879 | 846 |
| Total Assets | 2,307 | 2,288 | 2,273 | 2,321 | 2,228 | 2,278 | 2,333 |
| Current Liabilities | 869 | 854 | 815 | 840 | 713 | 730 | 738 |
| Non-Current Liabilities | 578 | 591 | 604 | 616 | 628 | 640 | 652 |
| Total Equity | 860 | 843 | 854 | 865 | 887 | 908 | 943 |
| Total Liabilities and Equity | 2,307 | 2,288 | 2,273 | 2,322 | 2,229 | 2,278 | 2,333 |

Guide to Ratings and Disclaimer

Guide to Ratings

| | |
|--------------------|----------------------------------------------------------------------|
| Buy | An upside potential of more than 20% in 52-week period |
| Overweight | An upside Potential of more than 10% in 52-week period |
| Neutral | Will stay in the range of it value (up/down 10%) in a 52-week period |
| Underweight | A downside potential of more than 10% in 52-week period |
| Sell | A downside potential of more than 20% in 52-week period |

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