

SGS reported lower than expected set of Q3-18 results. Net income came at SAR92.7mn (EPS SAR 0.49) against our estimates and consensus of SAR144.2mn and SAR132.0mn respectively. The disappointing set of results came from considerably higher than estimated COGS, attributed to higher employee cost, leading to the lowest GP margin. Revenue maintained flat y/y growth, standing in-line with our estimates. We should note that the pressure on GP margins partially resulted from higher direct costs (attributed to cost of living allowance) which is a one-off impact for FY18. We expect improvement in gross margins in FY19. We remain **"Neutral"** on the company with a TP of SAR37.2 per share.

- SGS reported net income of SAR92.7mn (EPS SAR 0.49) compared to SAR160.0mn for the same quarter last year; posting a decline of 42.1% Y/Y and 17.7%Q/Q, standing 35.7% below our estimates and 30.0% below consensus. The company attributed the Y/Y decline to i) increase in COGS by SAR64.7mn associated to cost of living allowance provided to staff (effective January 2018) and other operating expense including fuel and utilities. ii) Increase in G&A by SAR12.3mn due to increase in provisions and consultancy expenses.
- Revenue was flat on Y/Y basis for the quarter, standing at SAR700.7mn, in-line with our estimates of SAR707.4mn, posting a minor increase of 0.5%Y/Y and 6.2%Q/Q mainly due to seasonality. Revised FY18 revenues estimated to stand at SAR2,579.2mn, posting a minor decline of 0.2%Y/Y.
- Gross profit for the quarter stood at SAR166.5mn compared to SAR227.7mn for the same quarter last year; posting 26.9%Y/Y decline. Gross margins stood at 23.8%, recording the lowest level in record on quarterly basis, compared to 28.7% last quarter and 32.6% for the same quarter last year. COGS increased 13.8%Y/Y, followed by pressured margins on all income lines despite the flat growth in revenue.
- Operating income stood at SAR85.5mn, posting 46.3%Y/Y and 23.6%Q/Q decline. OPEX increased 17.9%Y/Y and 4.5%Q/Q due to SAR12.3mn increase in G&A attributed to provisions. Tighter margins are expected throughout FY18 on a gross level, estimated to stand at 25.8%.

AJC View: We should note that the pressure on GP margins partially resulted from higher direct costs (attributed to cost of living allowance) which is a one-off impact FY18; therefore, we expect improvement in gross margins FY19. However, we believe the company can potentially enhance its revenue growth driven by fleet expansion from airline operators and higher aircraft traffic. Downside risk to valuation would include further price revisions from Saudia and slower than expected ramp up in number of flights. FY18 DPS is estimated to stand at SAR2.6 per share, at a yield of 7.3% at current prices. Revised FY18 EPS is estimated to stand at SAR1.70 per share, implying 37.0%Y/Y decline. The company currently trades at TTM PE of 16.7x and an estimated forward PE multiple of 21.0x. We remain **"Neutral"** on SGS company with a TP of **SAR37.2 per share**.

Results Summary

SARmn (unless specified)	Q3-2017	Q2-2018	Q3-2018	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	697.3	659.9	700.7	0.5%	6.2%	(0.9%)
Gross Profit	227.7	189.4	166.5	(26.9%)	(12.1%)	(25.0%)
Gross Margin	32.6%	28.7%	23.8%	-	-	-
EBIT	159.1	111.9	85.5	(46.3%)	(23.6%)	(40.7%)
Net Profit	160.0	112.7	92.7	(42.1%)	(17.7%)	(35.7%)
EPS	0.85	0.60	0.49	-	-	-

Source: Company reports, Aljazira Capital

Neutral

Target Price (SAR) 37.2

Upside / (Downside)* 3.9%

Source: Tadawul *prices as of 1st of November 2018

Key Financials

SARmn (unless specified)	FY16	FY17	FY18E
Revenue	2,726.7	2,585.5	2,579.2
Gross Profit	924.2	872.3	665.5
Net Profit	685.8	501.5	318.9
EPS	3.65	2.67	1.70

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY16	FY17	FY18E
Gross Margin	33.9%	33.7%	25.8%
Net Margin	25.2%	19.4%	12.4%
P/E	18.1x	14.7x	21.0x
P/B	4.2x	2.6x	2.5x
Dividend Yield	3.9%	6.6%	7.3%

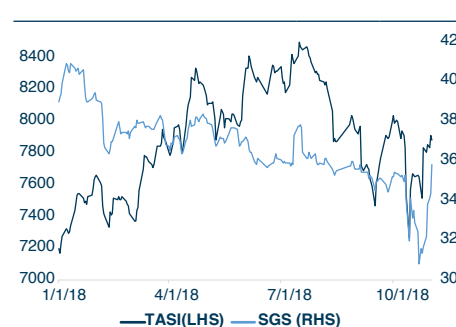
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	1,880.0
YTD %	(14.4%)
Shares Outstanding (mn)	188.0
52 Week (High / Low)	41.7 / 30.6

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

Analyst

Muhana Al-Odan

+966 11 2256115

M.alodan@aljaziracapital.com.sa

RESEARCH DIVISION

Head of Research

Talha Nazar

+966 11 2256250

t.nazar@aljaziracapital.com.sa

Analyst

Muhanad Al-Odan

+966 11 2256115

M.alodan@aljaziracapital.com.sa

Analyst

Jassim Al-Jubran

+966 11 2256248

j.aljabran@aljaziracapital.com.sa

Analyst

Waleed Al-jubayr

+966 11 2256146

W.aljubayr@aljaziracapital.com.sa

BROKERAGE AND INVESTMENT CENTERS DIVISION

General Manager – Brokerage Services & sales

Alaa Al-Yousef

+966 11 2256060

a.yousef@aljaziracapital.com.sa

AGM-Head of international and institutional brokerage

Luay Jawad Al-Motawa

+966 11 2256277

l.almutawa@aljaziracapital.com.sa

AGM-Head of Qassim & Eastern Province

Abdullah Al-Rahit

+966 16 3617547

a.alrahit@aljaziracapital.com.sa

AGM-Head of Sales And Investment Centers

Central Region, & acting head Western and

Southern Region Investment Centers

Sultan Ibrahim AL-Mutawa

+966 11 2256364

s.almutawa@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

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

The purpose of producing this report is to present a general view on the company/economic sector/economic subject under research, and not to recommend a buy/sell/hold for any security or any other assets. Based on that, this report does not take into consideration the specific financial position of every investor and/or his/her risk appetite in relation to investing in the security or any other assets, and hence, may not be suitable for all clients depending on their financial position and their ability and willingness to undertake risks. It is advised that every potential investor seek professional advice from several sources concerning investment decision and should study the impact of such decisions on his/her financial/legal position and other concerns before getting into such investments or liquidate them partially or fully. The market of stocks, bonds, macroeconomic or microeconomic variables are of a volatile nature and could witness sudden changes without any prior warning, therefore, the investor in securities or other assets might face some unexpected risks and fluctuations. All the information, views and expectations and fair values or target prices contained in this report have been compiled or arrived at by Al-Jazira Capital from sources believed to be reliable, but Al-Jazira Capital has not independently verified the contents obtained from these sources 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 report. Al-Jazira Capital shall not be liable for any loss as that may arise from the use of this report or its contents or otherwise arising in connection therewith. The past performance of any investment is not an indicator of future performance. Any financial projections, fair value estimates or price targets and statements regarding future prospects contained in this document may not be realized. The value of the security or any other assets or the return from them might increase or decrease. Any change in currency rates may have a positive or negative impact on the value/return on the stock or securities mentioned in the report. The investor might get an amount less than the amount invested in some cases. Some stocks or securities may, by nature, of low volume/trades or may become like that unexpectedly in special circumstances and this might increase the risk on the investor. Some fees might be levied on some investments in securities. This report has been written by professional employees in Al-Jazira Capital, and they undertake that neither them, nor their wives or children hold positions directly in any listed shares or securities contained in this report during the time of publication of this report, however, The authors and/or their wives/children 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. This report has been produced independently and separately by the Research Division at Al-Jazira Capital and no party (in-house or outside) who might have interest whether direct or indirect have seen the contents of this report before its publishing, except for those whom corporate positions allow them to do so, and/or third-party persons/institutions who signed a non-disclosure agreement with Al-Jazira Capital. Funds managed by Al-Jazira Capital and its subsidiaries for third parties may own the securities that are the subject of this document. Al-Jazira Capital or its subsidiaries may own securities in one or more of the aforementioned companies, and/or indirectly through funds managed by third parties. The Investment Banking division of Al-Jazira Capital maybe in the process of soliciting or executing fee earning mandates for companies that is either the subject of this document or is mentioned in this document. One or more of Al-Jazira Capital board members or executive managers could be also a board member or member of the executive management at the company or companies mentioned in this report, or their associated companies. No part of this report may be reproduced whether inside or outside the Kingdom of Saudi Arabia without the written permission of Al-Jazira Capital. Persons who receive this report should make themselves aware, of and adhere to, any such restrictions. By accepting this report, the recipient agrees to be bound by the foregoing limitations.

Asset Management | Brokerage | Corporate Finance | Custody | Advisory

Head Office: King Fahad Road, P.O. Box: 20438, Riyadh 11455, Saudi Arabia, Tel: 011 2256000 - Fax: 011 2256068