

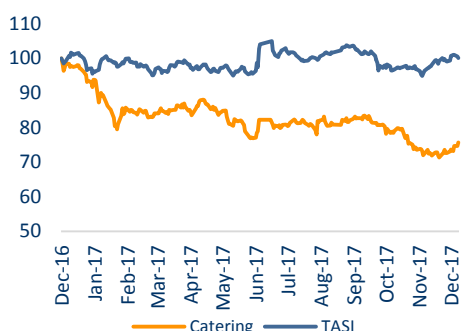
Initiation Coverage
December 31, 2017

Recommendation	Neutral
Current Price (SAR)	80.0
Target Price (SAR)	79.0
Upside/Downside (%)	-1.3%

As of December 28, 2017

Key Data (Source: Bloomberg)

Market Cap (SAR bn)	6.6
52 Wk High (SAR)	105.8
52 Wk Low (SAR)	75.5
Total Outstanding shares (in mn)	82
Free Float (%)	41.2%

Catering Vs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	2.8	-0.3
6m	-8.0	-4.2
12m	-23.2	-22.6

Major Shareholders (%)	%
Saudi Arabian Airlines Corporation	35.7%
Strategic Catering Company	9.3%
Abdul Mohsen Alhokair	8.7%

Quarterly Sales (SAR mn) and Operating Margin

Source: Bloomberg, Company Financials, FALCOM Research; Data as of 28th December 2017

Saudi Airlines Catering (Catering)'s 3Q17 earnings fell to SAR 130.4mn (-9.5% QoQ and -6.3% YoY), missing the consensus estimate of SAR 140.9mn. Earnings deteriorated due to higher cost of sales, particularly personnel expenses.

An expanding aviation sector, diverse service offerings, low competition, robust profitability and a healthy balance sheet are key positives for Catering. However, the company is weighed by low-cost airlines gaining traction due to low oil prices; we recommend a neutral rating on the stock.

Debt free; high dividend pay-outs:

With an asset-light business model, the company is debt free and has a healthy bottom line, with gross and net margins coming in at 33.5% and 22.1%, respectively, in FY2016. A robust balance sheet and healthy profitability have enabled it to offer dividend pay-outs consistently above 90%.

Direct beneficiary of Vision 2030:

KSA's vision 2030 envisages the travel and tourism industry to be among the prime drivers of economic growth in the country. This bodes well for Catering's businesses. Historically, during 2010–15, air passenger traffic at KSA's airports increased at a CAGR of 11.3%. Growth is expected to be driven by expansion in the number of pilgrims and tourists, as KSA braces for issuing tourist visas. However, in the short term, a decrease in expat passenger traffic is likely to weigh on the overall growth trend as household economics have pressured expats living with family following the tax regulation pertaining to expats.

Diversifying business revenue key to addressing risk:

Saudia accounts for 57.4% of Catering's total revenue; this dependence induces business risk as Saudia has a high negotiating power. The ongoing supply contract is set to expire in 2019, and future earnings are subject to changes in contract terms and pricing. To de-risk the business model, the company is focusing on developing business streams other than in-flight catering. The company expects earnings from in-flight catering, which currently contribute 70% to the total earnings, to reduce to 59% by 2019. Catering could potentially benefit from the General Authority of Civil Aviation (GACA)'s decision to privatise 27 airports by mid-2018. Sales growth in other business lines, such as laundry (non-airline revenue) and lounge, is likely to indicate Catering's ability to generate value in future.

Dominant local position, but changing airline preferences could pose threat:

Catering has a strong market position, with an estimated meal capacity to serve 128,000 meals per day. In comparison, closest local rival Adel Abuljadayel Flight Catering (AAFC) has an estimated capacity to serve 8,000 meals per day. However, regional players such as Etihad Airways and Qatar Airways could enter the Saudi market, which favour back catering (loading meals from the flight's origination base). This could prove an impediment for Catering's growth.

Growth in low-cost carriers to pose challenge for Catering:

Low-cost carriers are an inherent threat to Catering's business as the airlines do not offer meals. Although just two low-cost carriers operate in the Kingdom, their fleet are expected to grow rapidly due to prevailing low oil prices, impacting the business of full-service aircraft.

Valuation: We valued Catering using the DCF Approach to arrive at a fair value of SAR 79.0 per share. We considered WACC at 11.9%, with a terminal growth rate of 2.0%.

	2016	2017E	2018E	2019E
Revenues (SAR bn)	2.3	2.3	2.5	2.7
Operating Profit (SAR bn)	0.5	0.6	0.6	0.7
EPS (SAR)	6.2	6.5	7.1	7.9
Operating Margin (%)	23.7%	24.2%	24.8%	25.4%
D/E (x)	NA	NA	NA	NA
RoE (%)	40.3%	39.8%	40.8%	42.4%
P/E	16.7	13.8	12.6	11.3
Price/BV	4.4	3.3	3.1	2.8
EV/EBITDA	14.7	10.1	9.0	8.0

Source: Company Financials, FALCOM Research *NA – Not Applicable

Initiation Coverage

December 31, 2017

Valuation Summary

Explanation of valuation methodology and assumptions

We valued Catering using the DCF Approach to arrive at a fair value of SAR 79.0 per share. We considered WACC at 11.9% with a terminal growth rate of 2.0%.

In relative terms, Catering is trading at 1yr forward PE of 12.6x, at a discount of 29% to its sector peers and 4.0% to the Tadawul All Share Index.

SAR Mn	FY 2016A	FY 2017E	FY 2018E	FY 2019E	FY 2020E
EBIT	534	566	621	689	728
Taxes	(34)	(39)	(43)	(48)	(50)
Depreciation, amortization and impairment	(33)	(43)	(46)	(50)	(55)
Changes in working capital	(120)	231	32	36	48
Net capital expenditure	(145)	(58)	(62)	(68)	(72)
Free Cash Flow to firm	203	657	501	559	600
Discount Factor		1.0	0.9	0.8	0.7
PV of free cash flow to firm		657	447	446	428
Net Present Value (A)					1,978
PV Terminal Value (B)					4,403
Assumed Terminal Growth Rate					2.0%
Discount Rate					11.9%
Enterprise Value (A+B)	6,381	WACC Assumptions			
Total Cash	91.0	Risk free rate			
Total Debt	-	Market returns			
Minority Interest	-	Beta			
Equity Value in SAR mn	6,472	Cost of equity			
Number of shares in mn	82	Post tax cost of debt			
Target Price in SAR per share	79.0	Weight of equity in capital structure			
CMP in SAR as on December 28th 2017	80.0	Weight of debt in capital structure			
Upside/(Downside) to current market price	-1.3%	WACC			

Source: Company Financials, FALCOM Research Estimates

Risks

Upside Risks:

- Recovery in oil prices would be a positive for the Saudi economy.
- An increase in disposable income is likely to result in more Saudi residents preferring full-service airlines
- Better than expected pickup in Catering's other businesses like laundry can give it greater value unlocking potential
- Possible inclusion in MSCI EM Index would lead to greater interest in the stock, which would push the prices up

Downside Risks

- Unfavorable terms in the agreement with SAUDIA could affect Catering's business materially due to high dependence on it. The current contract period is from January 2015 to December 2019.
- Persistently low oil prices could impact consumer spending as disposable incomes remains constrained and could steer passengers towards low cost airlines
- Stricter visa rules or an increase in visa fees, etc. could result in lower passenger volumes and negatively impacting Catering's business

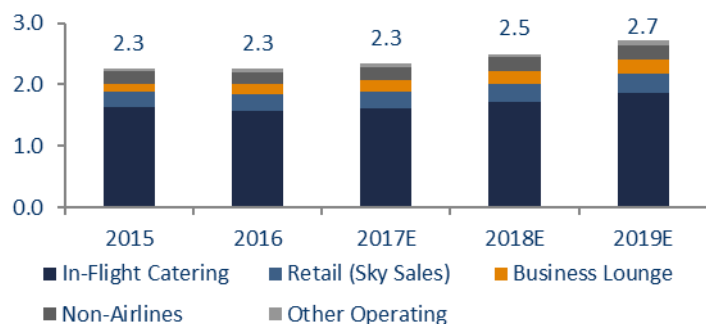


Initiation Coverage

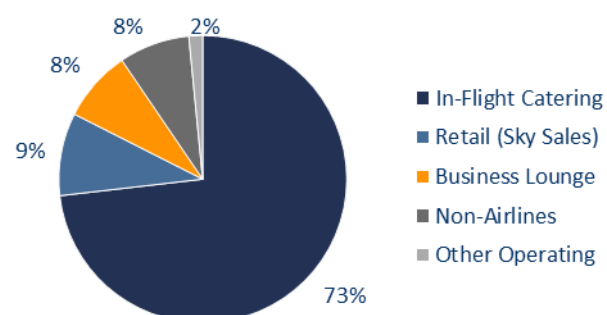
December 31, 2017

Key Charts

Revenue (SAR bn)



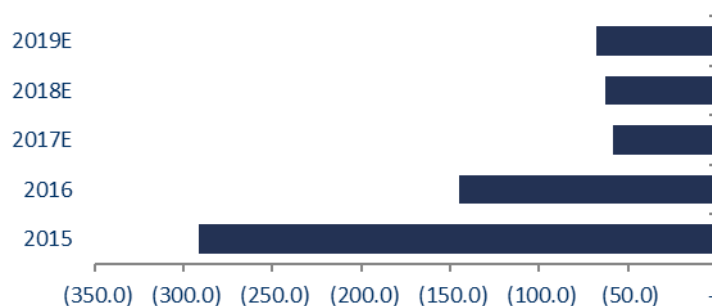
Revenue Split (9 months 2017)



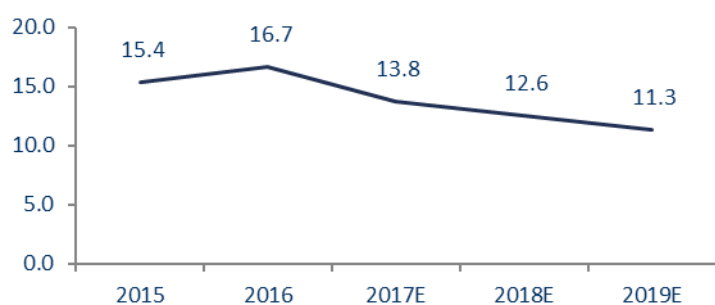
EBITDA & Margins



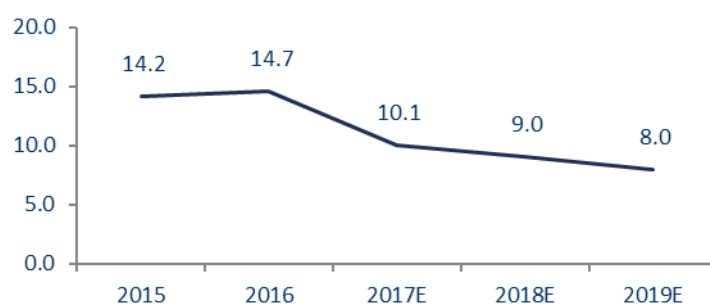
CAPEX



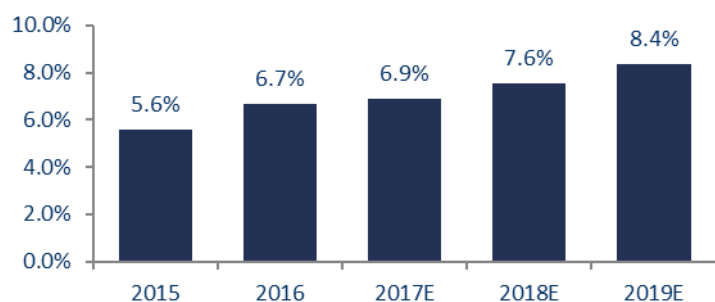
Price to Earnings



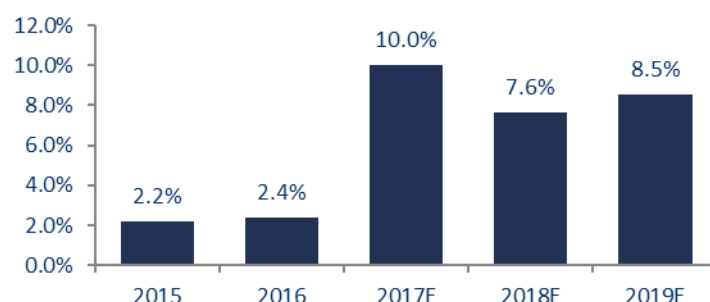
EV/EBITDA



Dividend Yield



Free Cash Flow Yield



Source: FALCOM Research Estimates

Initiation Coverage

December 31, 2017

Summary Financials

P&L (SAR mn)	2016	2017E	2018E	2019E
Sales	2,257	2,338	2,499	2,708
Gross Profit	756	796	866	955
EBITDA	567	609	667	739
EBIT	534	566	621	689
Other	7	7	7	7
PBT	541	573	628	696
Zakat	(34)	(39)	(43)	(48)
Net Income	508	534	585	648
EPS	6.1	6.5	7.1	7.9
DPS	6.9	5.5	6.0	6.7

BS (SAR mn)	2016	2017E	2018E	2019E
Cash	152	432	550	680
Current Assets	1,108	894	896	904
Fixed Assets	564	579	596	613
Intangibles	-	2	2	2
Total Assets	1,905	2,016	2,151	2,308
Current Liabilities	481	497	531	575
Shareholders Equities	1,261	1,342	1,431	1,530
Total Liabilities	1,905	2,016	2,151	2,308

CF (SAR mn)	2016	2017E	2018E	2019E
Operating Cash Flow	551	590	644	712
Working Capital Changes	(120)	231	32	36
Cash Flow from Operating Activities	431	821	676	748
Capex	(145)	(60)	(62)	(68)
Cash Flow from Investing Activities	(19)	(88)	(62)	(68)
Dividends	(564)	(453)	(496)	(550)
Cash Flow from Financing Activities	(564)	(453)	(496)	(550)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2016	2017E	2018E	2019E
Revenue	-0.2%	3.6%	6.9%	8.4%
EBITDA	-17.8%	7.5%	9.5%	10.8%
Operating profit	-20.1%	6.0%	9.6%	11.0%
PBT	-22.5%	5.9%	9.5%	10.8%
Net Income	-22.7%	5.2%	9.5%	10.8%

Ratios (%)	2016	2017E	2018E	2019E
Gross Margin	33.5%	34.0%	34.7%	35.3%
EBITDA Margin	25.1%	26.0%	26.7%	27.3%
EBIT Margin	23.7%	24.2%	24.8%	25.4%
Net Margin	22.1%	22.8%	23.4%	23.9%
ROE	39.6%	39.6%	40.7%	42.2%
ROCE	37.5%	37.3%	38.3%	39.8%
ROA	26.6%	26.5%	27.2%	28.1%
Debt/Equity	NA	NA	NA	NA
Net Debt/EBITDA	NA	NA	NA	NA
FCF Yield	2.4%	10.0%	7.6%	8.5%
Dividend Yield	6.7%	6.9%	7.6%	8.4%

Valuation	2016	2017E	2018E	2019E
PE	16.7	13.8	12.6	11.3
PB	4.4	3.3	3.1	2.8
EV/EBITDA	14.7	10.1	9.0	8.0
EV/EBIT	15.5	10.8	9.7	8.5
EV/Sales	3.7	2.6	2.4	2.2

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
SATS	23.2	18.0
Gategroup Holding AG	14.9	8.3
DO & CO AG	17.7	6.4
Servair Abidjan	NA	17.7
Saudi Catering Co.	12.6	9.0
Sector Median	17.9	12.8
TASI	13.1	10.2

Initiation Coverage

December 31, 2017

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts.

Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for additional analysis, (2) waiting for comprehensive financials, (3) waiting for more statistics to be updated, (4) major variation in company's performance, (5) change in market circumstances or (6) any other reason from FALCOM Financial Services.

FALCOM Financial Services

Contact us on the below phone numbers:

Customer Services: **8004298888**

Brokerage Services: **920004711**

Fax or Email us at the below number:

Fax: +966 11 2032546

Email: addingvalue@falcom.com.sa

Mail us at the following address:

P.O. Box 884

Riyadh 11421

Kingdom of Saudi Arabia

Disclaimer

This research report provides general information only. Information and opinions contained in this report have been obtained from sources believed to be reliable, but FALCOM Financial Services has not independently verified the contents of this document and such information may be considered 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. The information mentioned here is not considered as an advice to buy, sell, or commit any investment actions. Investors should seek advice from their investment adviser before making investment decision. Investors should note that income from such securities or other investments, if any, may fluctuate and that price or value of such securities and investments may rise or fall. Accordingly, investors may receive back less than originally invested. Any investment action based on the contents of this report is entirely the responsibility of the investor.

All rights reserved.

FALCOM Financial Services acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.