August 2024

CATRION Catering Holding Co.

Investment Update

Rising air traffic to drive in-flight catering growth, non-airline business shows vulnerability but expected to pick up; maintaining a “Neutral” recommendation.

Catrion Catering Holding Co. (Catrion) is set to deliver healthy growth in top line as well as bottom line fueled by rising air traffic, tourism boost and opportunities arising from growing leisure activities and mega projects. In-flight catering will gain support from the expected growth in the aviation sector that would translate into a higher number of meals for Catrion. The slowdown in non-airlines revenue is a concern for the company, but big contract wins such as two Red Sea Global contracts worth SAR 9.0bn will support a pick-up in growth FY25E onwards. Topline growth is expected to be assisted further with gradual expansion of margin. However, increased costs of materials, change in menu by airlines and increased contribution from low-margin non-airline segment will limit margin expansion. We revise our TP on Catrion to SAR 115/share, keeping “Neutral” recommendation. We believe the current valuation captures the company’s prospects, despite a 20.0% decline in the stock price over the last 6 months.

Healthy inflight revenue growth and GP margin expansion led to double-digit earnings growth in Q2-24, despite a spike in OPEX: Catrion posted net income of SAR 73mn (+14.8% Y/Y) in Q2-24, in line with AJC’s estimate of SAR 71mn. The earnings growth was driven by 13.6% increase in topline to SAR 565mn (AJC estimate: SAR 570mn) and expansion of GP margin. Lower zakat expenses also supported net income. The revenue growth was led by a 23.8% Y/Y rise in in-flight revenue, while non-airlines revenue fell 9.5% Y/Y. GP margin expanded 133bps Y/Y to 26.5% but was below our expectation of 27.0%. Operating profit rose 7.6% to SAR 74mn (AJC estimate: SAR 75mn), as OPEX growth of 34.3% Y/Y limited the increase in operating profit.

Surge in domestic and international flights to continue traction in in-flight catering: Saudi Arabia’s focus on tourism and increasing number visitors is showing up in the form of higher number of flights and passengers. In H1-24, Catrion witnessed a 17% Y/Y growth in the number of flights it operated on (domestic and international combined), leading to a 16% Y/Y increase in the number of meals. We forecast the number of in-flight meals served by the company to increase at CAGR of 11.7% over FY23-28E to reach 72.3mn in FY28E on the back of expected increase in number of flights amid fleet expansion plans of Saudia and other airlines. We also assume additional revenue from Riyadh Air, as Catrion being a dominant player in this space is expected to benefit from the new airline. This translates into a revenue CAGR of 12.8% for the in-flight segment over FY23-28E. Moreover, growing air traffic will also reflect in the higher number of visitors to business lounges. Thus, we forecast a revenue CAGR of 11.5% for Catrion’s lounge business.

Non-airline business shows vulnerability in a fragmented market but expected to pick up FY25E onwards as the Red Sea contract commences: The non-airlines revenue plunged 13.7% Y/Y in H1-24, after witnessing exponential growth in the past 2-3 years. The recent significant decline in the top line is due to the loss of a few contracts (HHR and DAKKAR) and is an indication that the company is vulnerable to competition and may face a few challenges for its business expansion in the segment. Nevertheless, Catrion is still placed well to see strong non-airlines topline growth on account of two contracts worth SAR 9.0bn signed by the company with Red Sea Global Co., spanning 20 years. The positive contribution from these two contracts will start appearing from Q3-25. Upcoming big sports, entertainment and business events along with mega projects are also expected to provide ample opportunities for non-airline catering to grow. Overall, non-airlines revenue growth is likely to be robust but could be lower than earlier expected. We forecast a CAGR of 11.6% during FY23-28E for the segment.

Recommendation	**Neutral**
Target Price (SAR)	**115.0**
Upside / (Downside)*	**-2.5%**

Source: Tadawul *prices as of 20th of August 2024

Key Financials

in SAR mn, (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	1,818	2,134	2,330	2,726
Growth %	49.9%	17.4%	9.2%	17.0%
Gross Profit	516	566	631	765
Net Income	257	283	308	412
Growth %	NM	9.9%	8.9%	34.0%
EPS	3.14	3.45	3.75	5.03
DPS	0.50	1.50	2.63	3.52

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	28.4%	26.5%	27.1%	28.1%
Net Margin	14.1%	13.2%	13.2%	15.1%
ROE	25.8%	23.5%	23.1%	28.6%
ROA	13.0%	13.4%	13.7%	17.4%
P/E	23.9	37.4	31.4	23.5
P/B	5.5	8.2	7.0	6.4
EV/EBITDA (x)	13.5	23.9	20.0	16.1
Dividend Yield	0.7%	1.2%	2.2%	3.0%

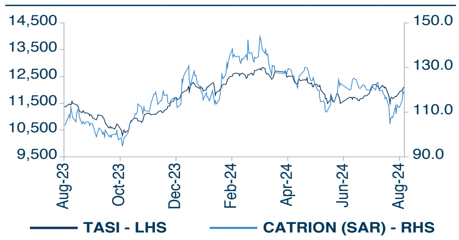
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	9.7
YTD%	-8.5%
52 weeks (High)/(Low)	147.4/92.2
Share Outstanding (mn)	82.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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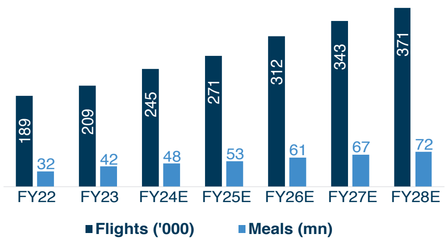
Margins to improve but new revenue mix and increased costs to limit margin expansion: Supported by strong revenue growth, Catrion's GP margin is expected to improve from 26.5% in FY23 to 29.7% in FY28E, as the company will be able to leverage its existing capacity amid anticipated growth in demand for number meals. The company's existing capacity of 72mn seems just sufficient to cater to in-flight meals demand till FY28E, based on our assumptions. That said, there are a few factors that are putting pressure on GP margin such as increased cost of materials and change in revenue mix due to switch in menu by airlines to cut down costs. Moreover, increased contribution from the non-airline segment, which typically generates lower margins, is also expected to weigh on margins. Thus, the GP margin is less likely to return to the historical range of 33-37%. Net margin is estimated to increase from 13.2% in FY23 to 16.9% in FY28E.

Lower dividend payout amid CAPEX requirements: Two new contacts worth SAR 9.0bn signed by the company require building production and laundry units and hence would require CAPEX. As per management SAR 200mn CAPEX is estimated this year for this project. Management has also guided on lower dividend payout and mentioned that dividend policy will also consider future investment requirements going forward. Thus, dividend payout is expected to be lower in future, despite current net cash position and debt free balance sheet. We expect a 70% payout ratio in the forecasted period as against an average exceeding 90% before the pandemic.

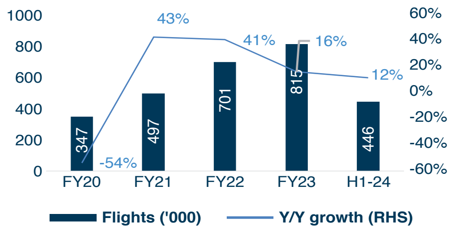
AJC view and valuation: Upsurge in Saudi aviation industry is bound to reflect in Catrion's growth over the next few years. Additionally, growing tourism and leisure activities are also conducive for the company's business. The company is well placed in terms of existing capacity and market position to make the most out of these opportunities. However, the new low-margin revenue mix and recent slowdown in the non-airline segment are a few challenges that are likely to partially impact the company's growth prospects. We valued Catrion with 50% weightage to DCF (WACC = 9.0% and terminal growth = 2.5%) and 25% weightage to FY25E P/E (23.0x) and EV/EBITDA (16.0x) each to arrive at a revised TP of SAR 115/share. We maintain our "**Neutral**" recommendation on the stock, as we believe the company's prospects are already factored in at current valuation.

Projected no. of flights and meals served by Catrion



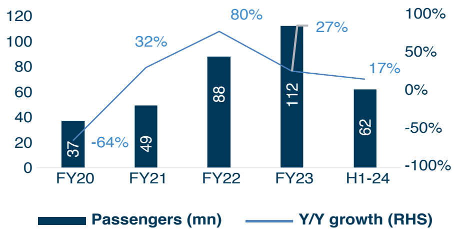
Source: Company reports, Aljazira Capital

No. of flights at KSA airports



Source: GACA, Aljazira Capital

No. of passengers at KSA airports



Source: GACA, Aljazira Capital

Discounted Cash Flow model

SAR mn	FY24E	FY25E	FY26E	FY27E	FY28E
NOPAT	286.3	376.7	479.5	538.9	596.2
Depreciation & Amortization	147.7	153.7	155.3	155.2	160.5
Change in working capital	-88.9	-53.1	-54.9	-44.4	-28.6
Capex	-203.9	-81.8	-72.2	-61.3	-56.8
FCFF	141.2	395.5	507.8	588.4	671.3
Discounting factor	1.0	0.9	0.8	0.7	0.7
Present value of FCFF	**136.9**	**351.5**	**413.8**	**439.8**	**460.0**
Sum of Present Value					1,802.0
PV of Terminal Value					7,203.6
Enterprise Value					**9,005.6**
Equity Value to common shareholders					9,343.2
No of outstanding share (in mn)					82.0
Fair value per share (SAR)					**113.9**

Source: AlJazira Capital research

Blended valuation summary

	TP (SAR)	Weight	Weighted TP
DCF	113.9	**50%**	57.0
P/E	116.0	**25%**	29.0
EV/EBITDA	116.0	**25%**	29.0
Blended TP			**115.0**

Source: AlJazira Capital research

Key Financials

Amount in SAR mn, unless otherwise specified	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement								
Gross Revenue	1,213	1,818	2,134	2,330	2,726	3,210	3,502	3,786
Y/Y	**30.9%**	**49.9%**	**17.4%**	**9.2%**	**17.0%**	**17.8%**	**9.1%**	**8.1%**
Cost of Revenue	(881)	(1,302)	(1,568)	(1,699)	(1,960)	(2,277)	(2,474)	(2,663)
Gross Profit	**332**	**516**	**566**	**631**	**765**	**933**	**1,029**	**1,123**
General & Administrative Expense	(236)	(232)	(288)	(317)	(365)	(422)	(453)	(486)
Operating Income	60	284	304	319	420	535	601	664
Y/Y	**NM**	**370.5%**	**7.2%**	**4.8%**	**31.6%**	**27.3%**	**12.4%**	**10.6%**
Finance costs	(27)	(21)	(20)	(19)	(10)	(6)	(4)	(4)
Income before Zakat	**34**	**286**	**317**	**343**	**460**	**580**	**650**	**715**
Zakat	(20)	(29)	(34)	(35)	(47)	(60)	(67)	(73)
Net income	**14**	**257**	**282.7**	**307.8**	**412**	**520**	**583**	**641**
Y/Y	**NM**	**NM**	**9.9%**	**8.9%**	**34.0%**	**26.1%**	**12.1%**	**10.0%**
EPS	**0.17**	**3.14**	**3.45**	**3.75**	**5.03**	**6.34**	**7.11**	**7.82**
DPS	**-**	**0.50**	**1.50**	**2.63**	**3.52**	**4.44**	**4.97**	**5.47**
Balance sheet								
Assets								
Cash and cash equivalents and Short term Investment	**176**	**417**	**702**	**532**	**580**	**646**	**712**	**735**
Other current assets	885	944	770	914	1,021	1,181	1,307	1,438
Total current assets	**1,062**	**1,361**	**1,472**	**1,446**	**1,601**	**1,827**	**2,019**	**2,174**
Property Plant and equipment	408	341	415	536	535	525	507	481
Right of use assets	417	267	235	217	198	182	166	148
Other non-current assets	44	62	73	95	119	164	243	389
Total assets	**1,931**	**2,031**	**2,195**	**2,294**	**2,452**	**2,698**	**2,935**	**3,193**
Liabilities								
Total current liabilities	572	563	582	589	621	706	757	807
Total non-current liabilities	487	349	327	326	329	335	345	360
Total liabilities	**1,058**	**911**	**909**	**915**	**950**	**1,040**	**1,102**	**1,167**
Shareholders' Equity								
Share capital	820	820	820	820	820	820	820	820
Statutory reserve	246	246	246	246	246	246	246	246
Retained earnings	(193)	54	220	312	436	592	767	959
Total shareholders' equity	**873**	**1,120**	**1,286**	**1,378**	**1,502**	**1,658**	**1,833**	**2,025**
Total liabilities and shareholders' equity	**1,931**	**2,031**	**2,195**	**2,294**	**2,452**	**2,698**	**2,935**	**3,193**
Cashflow statement								
Operating activities	373	346	608	386	534	644	720	802
Investing activities	(36)	(15)	(123)	(250)	(134)	(130)	(121)	(117)
Financing activities	(419)	(90)	(200)	(306)	(352)	(448)	(534)	(661)
Change in cash	(81)	241	285	(171)	48	66	65	24
Ending cash balance	**176**	**417**	**702**	**532**	**580**	**646**	**712**	**735**
Key fundamental ratios								
Liquidity ratios								
Current ratio (x)	1.9	2.4	2.5	2.5	2.6	2.6	2.7	2.7
Quick ratio (x)	1.5	2.2	2.2	2.1	2.2	2.3	2.3	2.3
Profitability ratios								
GP Margin	27.4%	28.4%	26.5%	27.1%	28.1%	29.1%	29.4%	29.7%
Operating Margins	5.0%	15.6%	14.3%	13.7%	15.4%	16.7%	17.1%	17.6%
EBITDA Margin	18.8%	24.6%	19.9%	20.0%	21.0%	21.5%	21.6%	21.8%
Net Margins	1.2%	14.1%	13.2%	13.2%	15.1%	16.2%	16.6%	16.9%
ROE	1.6%	25.8%	23.5%	23.1%	28.6%	32.9%	33.4%	33.2%
ROA	0.7%	13.0%	13.4%	13.7%	17.4%	20.2%	20.7%	20.9%
Market valuation ratios								
EV	6,661	6,040	10,120	9,323	9,244	9,154	9,067	9,026
EV/sales (x)	5.5	3.3	4.7	4.0	3.4	2.9	2.6	2.4
EV/EBITDA (x)	29.2	13.5	23.9	20.0	16.1	13.3	12.0	10.9
EPS (SAR)	0.17	3.14	3.45	3.75	5.03	6.34	7.11	7.82
BVPS (SAR)	10.6	13.7	15.7	16.8	18.3	20.2	22.4	24.7
Market price (SAR*)	77.60	75.00	129.00	118.00	118.00	118.00	118.00	118.00
Market Cap (SAR mn)	6,363	6,150	10,578	9,676	9,676	9,676	9,676	9,676
DPS	0.0	0.5	1.5	2.6	3.5	4.4	5.0	5.5
Dividend yield	0.0%	0.7%	1.2%	2.2%	3.0%	3.8%	4.2%	4.6%
P/E (x)	452.7	23.9	37.4	31.4	23.5	18.6	16.6	15.1
P/BV (x)	7.3	5.5	8.2	7.0	6.4	5.8	5.3	4.8

Source: Company reports, Aljazira Capital Research

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RESEARCH DIVISION

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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