Lumi Rental Co.

Investment Update

Better revenue visibility due to multi-year wins in leasing, but near-term margin pressures to continue

Lumi's recent multi-year wins enhances its revenue visibility for the leasing business, but recent trends suggests the rental business could stay subdued in near term. Aggressive fleet expansion, major leasing contracts and leveraging position in used-vehicles business has aided Lumi fuel its growth and market share. However, SG&A costs have surged 3.5x post IPO, thereby increasing the operational costs levels, which we believe will likely persist. Additionally, lower margin on used vehicle sales below residual value could together pressurize operating margins in the near term. Lumi's high leverage and potential debt additions to fund near term net capex requirement may further strain the finance costs in the near term. However, as debt levels normalize post FY26E and interest rates ease, Lumi can benefit from lower finance costs which could improve net margins. Since our last report in July 2024, Lumi has faced i) sluggish revenue and fleet growth in the rental business, ii) rebound in operational costs after a significant reduction in Q2-24. We project total revenues to grow at 12.4% CAGR over FY23-28E to reach SAR 1.99bn and net income to grow at 14.2% CAGR. The stock currently trades at 20.9x on FY25E EPS. We revise down our TP to SAR 81.2/share and maintain a "Neutral" rating.

Revenue momentum remained strong, while gross margin pressure continued in Q3-24; Opex lower due to one-offs, excluding these, the operating margins would have been under pressure: Lumi's Q3-24 revenues increased 38.3% Y/Y to SAR 403.1mn and were above our expectations of SAR 374.6mn. The revenue growth was broad-based across all three segments, with strongest growth in used vehicles sales (+44.3% Y/Y), followed by leasing (+42.1%) and car rental (+22.4%). The revenue growth was largely driven by a sharp rise in the fleet size, which increased 16.5%-23.0% Y/Y across the segments, while the average pricing increased 5.1%-15.5% across the segments. Despite such strong revenue growth, the gross margins fell by ~374bps Y/Y to 28.8% in Q3-24 due to higher cost of vehicles sold. SG&A costs increased from 8.2% of Q3-23 revenues to 9.5% of Q3-24 revenues, which pressurized the operating margins in Q3-24. However, one-off cost incurred last year in employee incentive program and impairment loss aided in Y/Y expansion of operating margins, excluding which the operating margins too would have been under pressure.

Large contract wins provide better revenue visibility for leasing segment: Over FY23-24, Lumi signed several long-term contracts like; i) 3,003 vehicles for Aramco, ii) 1,500 vehicles for Ministry of Interior, iii) 1,189 vehicles for Tahakom, iv) 855 vehicles for Saudi Post, v) 400 vehicles for Saudi Emergency Force and vi) 264 vehicles for Royal Commission for AlUla. These contracts contributed to a substantial increase in Lumi's fleet size, from 13.2K in FY22 to 22.6K in 9M-24. We believe these multi-year contracts provide strong revenue visibility for the leasing segment and position it as a key growth area for Lumi in near-term. Consequently, we project leasing revenues to grow at 16.0% CAGR over FY23-28E, reaching SAR 815mn. This growth will primarily stem from fleet expansion, with the total fleet size expected to rise from 22.6K vehicles in 9M-24 to 30.9K by FY28E. While the average leasing rate is expected to rise gradually from SAR 18.6K in FY23 to 26.4K in FY28E, implying 7.2% CAGR growth.

Rental business to be muted in the short-term, however long-term prospects unwavering: Over Q1-23 to Q3-24, the rental revenues have grown tepidly at 3.7% CQGR (versus 9.7% for leasing and 7.0% for used vehicles). This is primarily due to muted fleet expansions driven by strategic optimizations and sale of vehicles at the end of their useful life. We expect this trend to continue in the near-term and thus expect the fleet size to increase marginally from 10.9K in 9M-24 to 11.8K by FY25E. However, we believe the long-term prospects for this segment are unwavering due to i) rapid infrastructure developments under KSA's Vision 2030, ii) focus on increasing the number of tourists from 109mn in 2023 to 150mn by 2030e; iii) focus on enriching Hajj & Umrah experience to expand pilgrims capacity to 30mn by 2030e. Accordingly, we expect the short-term rental revenues to grow from SAR 370mn in FY23 to SAR 574mn by FY28E, implying a 9.2% CAGR. Majority of this growth will be attributed by pricing, which could rise from an average of SAR 29.8K in FY23 to SAR 43.3K by FY28E, while the fleet size could rise from 12.4K in FY23 to 13.3K by FY28E.

Recommendation	**Neutral**
Target Price (SAR)	**81.2**
Upside / (Downside)*	**9.2%**

Source: Tadawul *prices as of 02nd of December 2024

Key Financials

in SAR mn, (unless specified)	FY22	FY23	FY24E	FY25E
Revenues	783	1,106	1,543	1,681
Growth %	50.1%	41.3%	39.6%	8.9%
Gross Profit	260	381	442	493
Net Income	151	161	171	196
Growth %	42.1%	6.6%	6.7%	14.3%
EPS	2.61	2.92	3.12	3.56
DPS	0.00	0.00	0.00	0.00

Source: Company reports, Aljazira Capital Research

Key Ratios

	FY22	FY23	FY24E	FY25E
Gross Margin	33.2%	34.4%	28.7%	29.3%
Net Margin	19.3%	14.5%	11.1%	11.7%
ROE	19.5%	17.4%	15.7%	15.4%
ROA	9.4%	6.3%	4.9%	4.8%
P/E	NA	34.2	23.8	20.9
P/B	NA	5.4	3.4	2.9
EV/EBITDA (x)	NA	2.8	2.7	2.5
Dividend Yield	NA	0.0%	0.0%	0.0%

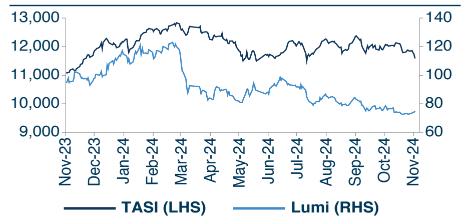
Source: Company reports, Aljazira Capital Research

Key Market Data

Market Cap (bn)	4.1
YTD%	-25.7%
52 weeks (High)/(Low)	125.0/72.5
Share Outstanding (mn)	55.0

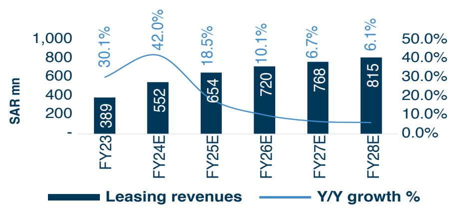
Source: Company reports, Aljazira Capital Research

Price Performance



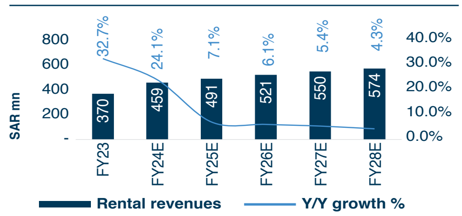
Source: Tadawul, Aljazira Capital Research

Leasing revenue



Source: Company, AlJazira Capital research

Rental revenue



Source: Company, AlJazira Capital research

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Continued lower margin on sales of used vehicles and increased SG&A post IPO could pressurize gross and operating margins in the near-term: Although Lumi's gross and operating margins have consistently shown an upward trend over FY20-23, we don't expect the same momentum to continue going forward. As the company expands its fleet size from 33.3K in FY23 to 43.9K by FY28E, we expect the depreciation component of the cost of goods sold to also increase in tandem. Additionally, expected increase in contribution of low margin leasing business could pressurize the gross margins. Thus, we forecast gross margins to contract by 570bps over FY24E to 28.7%. Post which we expect the gross margins to gradually increase by 130bps till FY28E to reach 30%. Lumi's SG&A expenses have been elevated post its IPO in September 2023. It increased from 7.2% of revenues in FY20 to 9.5% in 9M-24 (almost 3.5x increase). This elevated SG&A along with lower margins on used vehicle sales below the residual value could together pressurize operating margins in the near term. However, as the top-line expands the operating margins could likely improve gradually due to operating leverage. Hence, we forecast operating margins to contract by 90bps over FY23-24E. Post which we expect the operating margins to gradually increase by 90bps till FY28E to reach 21.1%

Lumi's expansion strategy calls for higher capex requirement and debt in the short-term: Lumi's recent multi-year contract wins over FY23-24 indicate growing demand and management's steady expansion plans. Hence, we forecast the total fleets to increase at 5.8% CAGR over FY23-28E, which could increase the fleet size from 33.3K in FY23 to 44.2K by FY28E. Majority of this expansion could be attributable to leasing fleets which could rise from 20.8K in FY23 to 30.9K by FY28E (8.2% CAGR), while rental fleets could rise tepidly from 12.4K in FY23 to 13.3K by FY28E (1.3% CAGR). The recent multi-year contracts could swell FY24E and FY25E capex. Besides the fleet expansion, regular refurbishments, replacement costs could continue to drive capex until FY25E, but we believe the rate of growth shall slow-down post FY25E. To support near term capex requirement, we expect Lumi to use debt to fund its strategic expansion plans. Accordingly, we expect the debt to rise from SAR 1,798mn in 9M-24 to SAR 2,520mn by FY26E, post which we expect the debt levels to normalize.

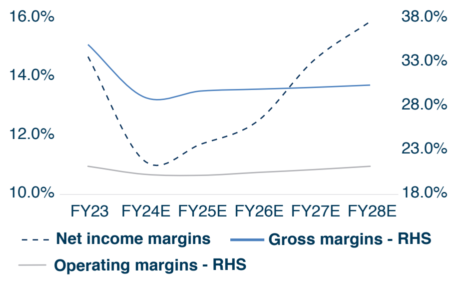
Commencement of rate cuts globally to aid in higher flow through of operating profit to net income: Lumi's high leverage and potential debt additions to fund near term capex requirement may further strain the finance costs in the near term. However, as the debt levels normalize post FY26E and potential interest rate cuts, Lumi can benefit from lower finance costs which could improve net margins. Accordingly, we expect the net income margins to expand from 11.4% in 9M-24 to 15.7% by FY28E.

AJC View and Valuation: We believe Lumi's multi-year contract wins enhances revenue visibility for leasing business, but recent trends suggests rental business to stay subdued in the near term. Long term prospects remain strong with Lumi positioned to benefit from rising tourism, multi-year contracts and robust demand for used vehicles. The total revenues could grow at 12.4% CAGR over FY23-28E, driven by leasing business (16.0% CAGR), followed by used vehicles business (10.5% CAGR) and rental business (9.2% CAGR). Despite strong revenue growth, operating margins are likely to face near term pressures due to sticky SG&A which surged 3.5x post IPO and lower margins on used vehicle sales. However, as business scales, operating leverage should support the expansion of operating margins. Moreover, normalizing of debt levels and potential interest rate cuts could improve net income flow-through, translating into net income CAGR of 14.2% over FY23-28E. We apply a blended valuation approach for Lumi. Our 50% weightage to DCF (WACC = 7.8% and terminal growth = 2.5%) and 50% weightage to P/E multiple of 19.5x for FY25E EPS helps us arrive at a blended TP of **SAR 81.2 per share**, implying an upside of 9.2%. The stock currently trades at 20.9x on FY25E EPS. We maintain our recommendation of "**Neutral**" on the stock.

Valuation Methodology	TP (SAR)	Weight	Weighted TP
DCF	92.9	50%	46.4
P/E	69.5	50%	34.7
Blended TP			**81.2**

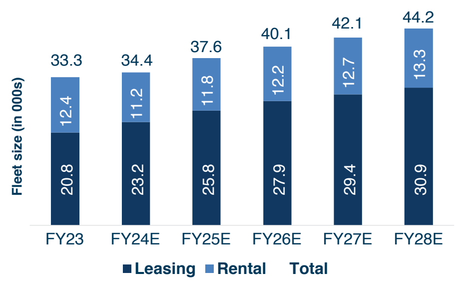
Source: Company, AlJazira Capital research

Margin profile



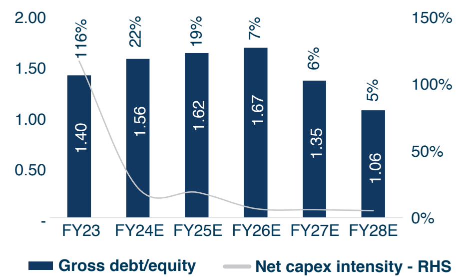
Source: Company, AlJazira Capital research

Fleet size



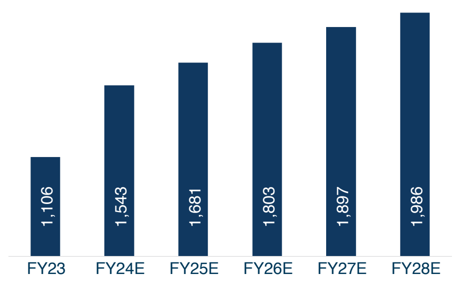
Source: Company, AlJazira Capital research

capex



Source: Company, AlJazira Capital research

Overall revenues



Source: Company, AlJazira Capital research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY23	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement							
Revenues	783	1,106	1,543	1,681	1,803	1,897	1,986
Y/Y	**50.1%**	**41.3%**	**39.6%**	**8.9%**	**7.3%**	**5.2%**	**4.7%**
Cost	-523	-725	-1,101	-1,188	-1,271	-1,333	-1,391
Gross profit	**260**	**381**	**442**	**493**	**532**	**564**	**595**
General and administrative expenses	-59	-119	-149	-156	-166	-173	-179
Other operating expenses	-28	-29	19	1.0	1.3	1.6	2.0
Operating profit	**173**	**233**	**312**	**338**	**368**	**393**	**419**
Y/Y	**65.3%**	**35.1%**	**33.8%**	**8.3%**	**8.9%**	**6.8%**	**6.5%**
Financing Expense (net)	-24	-68	-135	-136	-138	-112	-98
Other income	7	0	0	0	0	0	0
Income before zakat	**155**	**165**	**176**	**202**	**230**	**281**	**321**
Zakat	-5	-5	-5	-6	-7	-8	-9
Net income	**151**	**161**	**171**	**196**	**224**	**273**	**311**
Y/Y	**42.1%**	**6.6%**	**6.7%**	**14.3%**	**14.1%**	**22.2%**	**13.9%**
EPS (SAR)	**2.61**	**2.92**	**3.12**	**3.56**	**4.07**	**4.97**	**5.66**
DPS (SAR)	**0.00**	**0.00**	**0.00**	**0.00**	**2.00**	**2.50**	**3.00**
Balance sheet							
Assets							
Cash & equivalent	49	41	143	437	721	501	287
Other current assets	234	347	419	450	477	493	506
Total current assets	283	389	562	887	1,198	994	793
Vehicles	1,472	2,712	3,053	3,367	3,487	3,568	3,640
Property plant & equipment	79	14	28	27	27	26	26
Other non-current assets	10	129	103	93	80	65	46
Total assets	**1,844**	**3,246**	**3,747**	**4,376**	**4,794**	**4,655**	**4,507**
Liabilities & owners' equity							
Total current liabilities	577	1,215	1,240	1,397	1,510	1,437	1,353
Long-term loans & lease liabilities	411	989	1,288	1,558	1,741	1,530	1,306
Total other non-current liabilities	13	18	23	29	37	47	60
Paid -up capital	550	550	550	550	550	550	550
Additional capital							
Statutory reserves	29	29	29	29	29	29	29
Retained earnings	264	426	597	793	906	1,042	1,189
Total owners' equity	844	1,005	1,176	1,372	1,486	1,622	1,768
Total equity & liabilities	**1,844**	**3,246**	**3,747**	**4,376**	**4,794**	**4,655**	**4,507**
Cashflow statement							
Operating activities	-86	-777	-304	-63	162	254	305
Investing activities	8	-43	6	-4	-5	-5	-5
Financing activities	110	811	399	362	126	-470	-514
Change in cash	32	-8	101	294	284	-220	-214
Ending cash balance	**49**	**41**	**143**	**437**	**721**	**501**	**287**
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	0.5	0.3	0.5	0.6	0.8	0.7	0.6
Quick ratio (x)	0.4	0.3	0.3	0.3	0.3	0.3	0.4
Profitability ratios							
Gross profit margin	33.2%	34.4%	28.7%	29.3%	29.5%	29.7%	30.0%
Operating margin	22.0%	21.1%	20.2%	20.1%	20.4%	20.7%	21.1%
EBITDA margin	55.9%	45.5%	41.8%	44.1%	43.7%	43.2%	43.1%
Net profit margin	19.3%	14.5%	11.1%	11.7%	12.4%	14.4%	15.7%
Return on assets	9.4%	6.3%	4.9%	4.8%	4.9%	5.8%	6.8%
Return on equity	19.5%	17.4%	15.7%	15.4%	15.6%	17.6%	18.4%
Leverage ratio							
Debt / equity (x)	0.67	1.40	1.56	1.62	1.67	1.35	1.06
Market/valuation ratios							
EV/sales (x)	NA	1.3	1.1	1.1	1.0	0.9	0.8
EV/EBITDA (x)	NA	2.8	2.7	2.5	2.3	2.1	1.9
EPS (SAR)	2.61	2.92	3.12	3.56	4.07	5.0	5.7
BVPS (SAR) - Adjusted	15.3	18.6	21.8	25.3	27.4	29.9	32.5
Market price (SAR)*	NA	100.0	74.3	74.3	74.3	74.3	74.3
Market-Cap (SAR Mn)	NA	5,500	4,087	4,087	4,087	4,087	4,087
DPS (SAR)	NA	0.0	0.0	0.0	2.0	2.5	3.0
Dividend yield	NA	0.0%	0.0%	0.0%	2.7%	3.4%	4.0%
P/E ratio (x)	NA	34.2	23.8	20.9	18.3	15.0	13.1
P/BV ratio (x)	NA	5.4	3.4	2.9	2.7	2.5	2.3

Source: Company Reports, AJC 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