



Growth driven by a strong momentum in Saudi aviation industry; switch to “Neutral” as stock seems fairly valued

Saudi Ground Services Company (SGS) is expected to be a direct beneficiary of growing number of flights in the Saudi aviation sector. The sector is expected to witness significant growth over the medium to long term on the back of fleet expansion plans by existing airlines and upcoming commercial launch on Riyadh Air in FY25E. SGS, with 94% market share in Saudi market, is poised to expand its business which directly dependent on number of flights it caters to. The recent SAR 1.5bn contract signed with Riyadh Air and SAR 2.0bn renewal with Flynas are indicative of robust topline growth prospects of the company. We expect the company to register a revenue CAGR of 10.9% during FY23-28E. Additionally, the GP margin is forecasted to widen from 16.6% in FY23 to 23.0% in FY28E. Net income is likely to increase at a CAGR of 21.4% during the same period. Moreover, the company's financial position is very strong with ample liquidity and debt free balance sheet. Based on our revised estimates accounting for better than expected growth in the number of flights in H1-24 and more clarity on revenue from Riyadh Air, we update our TP on SGS to **SAR 48.6 per share**. However, the stock price has surged 42% YTD. Thus, we believe all the positives are factored in at current valuation and downgrade to “Neutral” recommendation.

Q2-24 results broadly in line; GP margin expansion offset by higher OPEX: SGS posted net profit of SAR 78mn in Q2-24 (+57.1% Y/Y), in line with AJC's estimate of SAR 76mn. The earnings growth was mainly driven by revenue growth and GP margin expansion. The revenue came in at SAR 687mn (+9.6% Y/Y, in line with our estimate of SAR 702mn) on the back growth in both domestic and international flight operations. GP margin expanded ~470bps Y/Y to 21.0% (AJC estimate: 18.8%). GP margin expansion was offset by higher OPEX (+49.3% Y/Y) mainly due to higher G&A due to increased operations and the spike in credit loss provisions.

Riyadh Air contract and fleet expansion plans by Saudia and other air carriers to reflect in SGS' topline growth: SGS recently signed a 6.5 years (4.5 years + 2 year extension option) contract with Riyadh Air worth SAR 1.5bn. As per the terms, this contract is expected to add ~SAR 230mn on average annually to SGS' revenue, ~9% of FY23 revenue. Moreover, Saudia has target of expanding its fleet to 241 aircrafts and connect to more than 145 destinations by 2030 from current 140+ flights and over 100 destinations. In May 2024, Saudia and Airbus signed a deal for 105 aircraft. flynas also signed an agreement with Airbus to buy 160 new aircraft in July, increasing its total orders to 280 over seven years. All these factors point to a robust growth in the number flights operated in Saudi Arabia. Thus, SGS is expected to register a healthy revenue CAGR of 10.9% over FY23-28E.

Margin expansion to follow the growth in business operation: SGS has shown a good recovery in GP margin in the last two quarters as the volume of operations increased. We see further scope for improvement in GP margin with anticipated growth in revenue. However, we don't expect GP margins to return to the pre-Covid period. The GP margin is forecasted to widen from 16.6% in FY23 to 23.0% in FY28E. Further, there could be slight pressure on OPEX front in the near to medium term related to expansion of the workforce to cater increase volume of operations. Hence, operating margin (from 9.3% to 14.7%) and net margin (from 8.6% to 13.5%) expansions are estimated to expand at lower pace during FY23-28E.

Healthy liquidity position, debt free balance sheet and limited capex requirement make case for resumption of dividend payment: As of June 2024, SGS had cash and short term investments (term deposit and mutual fund) worth SAR 891mn. The company has completely repaid its debt, and the annual CAPEX requirement for the next five years is estimated to be in the range of SAR 100-125mn. Additionally, receivables collections have also improved (from 99% of revenue in H1-23 to 111% of revenue in H1-24) for SGS. Thus, there is a possibility of resumption of dividend payments. We expect the company to pay dividends this year starting with a modest payout ratio of 50%, which may increase gradually to 90% by FY28E.

| | |
|-----------------------------|----------------|
| Recommendation | Neutral |
| Target Price (SAR) | 48.6 |
| Upside / (Downside)* | -5.3% |

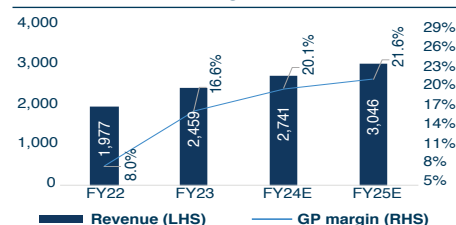
Source: Tadawul *prices as of 14th of August 2024

Key Financials

| in SAR mn, (unless specified) | FY22 | FY23 | FY24E | FY25E |
|-------------------------------|-------|-------|-------|-------|
| Revenues | 1,977 | 2,459 | 2,741 | 3,046 |
| Growth % | 23.0% | 24.4% | 11.5% | 11.1% |
| Gross Profit | 159 | 409 | 552 | 659 |
| Net Income | -244 | 211 | 303 | 377 |
| Growth % | NM | NM | 43.1% | 24.5% |
| EPS | -1.30 | 1.12 | 1.61 | 2.00 |
| DPS | 0.00 | 0.00 | 0.80 | 1.40 |

Source: Company reports, Aljazira Capital

Revenue and GP margin



Source: Aljazira Capital, Company reports

Key Ratios

| | FY22 | FY23 | FY24E | FY25E |
|----------------|------|-------|-------|-------|
| Gross Margin | 8.0% | 16.6% | 20.1% | 21.6% |
| Net Margin | 8.6% | 11.0% | 12.4% | 13.0% |
| ROE | 9.5% | 12.6% | 14.8% | 17.2% |
| ROA | 4.9% | 6.9% | 8.1% | 9.2% |
| P/E | Neg | 32.1 | 31.9 | 25.6 |
| P/B | 2.0 | 2.9 | 3.9 | 3.7 |
| EV/EBITDA (x) | 61.5 | 17.1 | 19.5 | 16.0 |
| Dividend Yield | 0.0% | 0.0% | 1.6% | 2.7% |

Source: Company reports, Aljazira Capital

Key Market Data

| | |
|------------------------|-----------|
| Market Cap (SAR bn) | 9.6 |
| YTD% | 41.6% |
| 52 weeks (High)/(Low) | 60.0/26.0 |
| Share Outstanding (mn) | 188.0 |

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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AJC view and valuation: SGS's growth prospects are strong as the company is expected to benefit from expansion of activity in the Saudi aviation. Expansion of fleet by Saudi air carriers and upcoming new airline would mean accelerated growth for SGS. Strong topline growth will be further supported by margin expansion. Moreover, the company's debt free balance sheet and healthy liquidity position adds to its strength. But the stock seems fairly valued at the current market price post a 42% rally YTD at FY25E P/E of 25.6x and EV/EBITDA of 16.0x. We valued SGS with 50% weightage to DCF (WACC = 9.2% and terminal growth = 2.5%) and 25% weightage each to P/E multiple (24.0x) and EV/EBITDA (16.0x) based on our FY25E estimates to arrive at a blended TP of **SAR 48.6 per share**. We switch to **"Neutral"** recommendation on the stock.

Discounted Cash Flow model

| SAR mn | FY24E | FY25E | FY26E | FY27E | FY28E |
|-------------------------------------|--------------|--------------|--------------|--------------|-----------------|
| NOPAT | 251.2 | 326.4 | 405.2 | 456.5 | 504.3 |
| Depreciation & Amortization | 192.3 | 202.4 | 212.1 | 220.5 | 228.3 |
| Change in working capital | (146.6) | (99.8) | (124.0) | (43.9) | (53.3) |
| Capex | (109.6) | (106.6) | (121.7) | (114.8) | (123.9) |
| FCFF | 187.3 | 322.4 | 371.6 | 518.4 | 555.3 |
| Discounting factor | 1.0 | 0.9 | 0.8 | 0.7 | 0.7 |
| Present value of FCFF | 181.1 | 285.5 | 301.4 | 384.9 | 412.4 |
| Sum of Present Value | | | | | 1,565.4 |
| PV of Terminal Value | | | | | 6,301.2 |
| Enterprise Value | | | | | 7,866.5 |
| Equity Value to common shareholders | | | | | 8600.1 |
| No of outstanding share (in mn) | | | | | 188.0 |
| Fair value per share (SAR) | | | | | SAR 45.7 |

Source: AlJazira Capital research

Blended valuation summary

| Method | TP (SAR) | Weight | Weighted TP |
|--------------|----------|--------|-----------------|
| DCF | 45.7 | 50% | 22.9 |
| P/E | 48.1 | 25% | 12.0 |
| EV/EBITDA | 54.7 | 25% | 13.7 |
| Total | | | SAR 48.6 |

Source: AlJazira Capital research




Key Financials

| Amount in USD mn, unless otherwise specified | FY21 | FY22 | FY23 | FY24E | FY25E | FY26E | FY27E | FY28E |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Income statement | | | | | | | | |
| Gross Revenue | 1,608 | 1,977 | 2,459 | 2,741 | 3,046 | 3,478 | 3,826 | 4,132 |
| Y/Y | 28.4% | 23.0% | 24.4% | 11.5% | 11.1% | 14.2% | 10.0% | 8.0% |
| Cost of Revenue | (1,413) | (1,818) | (2,050) | (2,189) | (2,386) | (2,690) | (2,952) | (3,180) |
| Gross Profit | 195 | 159 | 409 | 552 | 659 | 788 | 874 | 952 |
| General & Administrative Expense | (296) | (286) | (210) | (246) | (279) | (318) | (347) | (373) |
| Operating Income | (170) | (120) | 228 | 304 | 395 | 490 | 552 | 608 |
| Y/Y | NM | NM | NM | 33.4% | 29.6% | 24.1% | 12.6% | 10.3% |
| Financial Charges | (30) | (31) | (31) | (10) | (7) | (6) | (6) | (5) |
| Income before Zakat | (214) | (78) | 271 | 367 | 455 | 548 | 609 | 672 |
| Zakat | (40) | (167) | (59) | (64) | (79) | (95) | (105) | (115) |
| Net income | (254) | (244) | 211 | 303 | 377 | 453 | 504 | 557 |
| Y/Y | NM | NM | NM | 43.1% | 24.5% | 20.3% | 11.3% | 10.5% |
| EPS | (1.35) | (1.30) | 1.12 | 1.61 | 2.00 | 2.41 | 2.68 | 2.96 |
| DPS | - | - | - | 0.80 | 1.40 | 1.93 | 2.41 | 2.67 |
| Balance sheet | | | | | | | | |
| Assets | | | | | | | | |
| Cash and cash equivalents | 255 | 864 | 79 | 238 | 357 | 455 | 643 | 857 |
| Other current assets | 3,073 | 2,003 | 2,557 | 2,650 | 2,807 | 3,019 | 3,136 | 3,250 |
| Total Current Assets | 3,328 | 2,868 | 2,636 | 2,888 | 3,164 | 3,475 | 3,779 | 4,107 |
| Property & Equipment | 528 | 433 | 487 | 497 | 503 | 521 | 531 | 549 |
| Other non-current assets | 991 | 1,070 | 1,109 | 1,119 | 1,121 | 1,115 | 1,100 | 1,081 |
| Total non-current assets | 1,519 | 1,503 | 1,596 | 1,617 | 1,624 | 1,636 | 1,631 | 1,629 |
| Total Assets | 4,847 | 4,371 | 4,231 | 4,504 | 4,788 | 5,111 | 5,409 | 5,736 |
| LIABILITIES | | | | | | | | |
| Total current liabilities | 1,451 | 1,191 | 1,190 | 1,241 | 1,428 | 1,676 | 1,940 | 2,225 |
| Total non-current liabilities | 1,131 | 1,077 | 710 | 781 | 764 | 748 | 733 | 719 |
| Total Liabilities | 2,582 | 2,269 | 1,900 | 2,021 | 2,192 | 2,425 | 2,673 | 2,944 |
| EQUITY | | | | | | | | |
| Share Capital | 1,880 | 1,880 | 1,880 | 1,880 | 1,880 | 1,880 | 1,880 | 1,880 |
| Statutory Reserve | 499 | 499 | 520 | 520 | 520 | 520 | 520 | 520 |
| Retained Earnings | (114) | (277) | (69) | 83 | 196 | 286 | 337 | 392 |
| Total Shareholder's Equity | 2,265 | 2,102 | 2,331 | 2,483 | 2,596 | 2,686 | 2,737 | 2,792 |
| Total Liabilities & Equity | 4,847 | 4,371 | 4,231 | 4,504 | 4,788 | 5,111 | 5,409 | 5,736 |
| Cashflow statement | | | | | | | | |
| Operating activities | (10) | 32 | 353 | 551 | 608 | 700 | 871 | 956 |
| Investing activities | (475) | 1,165 | (622) | (141) | (226) | (239) | (230) | (241) |
| Financing activities | 644 | (587) | (525) | (251) | (264) | (362) | (454) | (501) |
| Change in cash | 159 | 610 | (794) | 159 | 119 | 98 | 187 | 214 |
| Ending cash balance | 255 | 864 | 71 | 238 | 357 | 455 | 643 | 857 |
| Key fundamental ratios | | | | | | | | |
| Liquidity ratios | | | | | | | | |
| Current ratio (x) | 1.9 | 1.9 | 1.6 | 1.7 | 1.6 | 1.5 | 1.4 | 1.4 |
| Quick ratio (x) | 1.9 | 1.9 | 1.6 | 1.7 | 1.6 | 1.5 | 1.4 | 1.4 |
| Profitability ratios | | | | | | | | |
| GP Margin | 12.1% | 8.0% | 16.6% | 20.1% | 21.6% | 22.6% | 22.8% | 23.0% |
| Operating Margins | -10.6% | -6.1% | 9.3% | 11.1% | 13.0% | 14.1% | 14.4% | 14.7% |
| EBITDA Margin | 0.0% | 3.1% | 16.6% | 18.1% | 19.6% | 20.2% | 20.2% | 20.3% |
| Net Margins | -15.8% | -12.4% | 8.6% | 11.0% | 12.4% | 13.0% | 13.2% | 13.5% |
| ROE | -10.7% | -11.2% | 9.5% | 12.6% | 14.8% | 17.2% | 18.6% | 20.1% |
| ROA | -5.5% | -5.3% | 4.9% | 6.9% | 8.1% | 9.2% | 9.6% | 10.0% |
| Market valuation ratios | | | | | | | | |
| EV | 5,887 | 3,823 | 6,954 | 9,711 | 9,570 | 9,450 | 9,242 | 9,009 |
| EV/sales (x) | 3.7 | 1.9 | 2.8 | 3.5 | 3.1 | 2.7 | 2.4 | 2.2 |
| EV/EBITDA (x) | Neg | 61.5 | 17.1 | 19.5 | 16.0 | 13.5 | 12.0 | 10.8 |
| EPS (SAR) | -1.35 | -1.30 | 1.12 | 1.61 | 2.00 | 2.41 | 2.68 | 2.96 |
| BVPS (SAR) | 12.05 | 11.18 | 12.40 | 13.21 | 13.81 | 14.29 | 14.56 | 14.85 |
| Market price (SAR*) | 29.55 | 21.84 | 36.15 | 51.3 | 51.3 | 51.3 | 51.3 | 51.3 |
| Market Cap (SAR mn) | 5,555 | 4,106 | 6,796 | 9,644 | 9,644 | 9,644 | 9,644 | 9,644 |
| DPS | 0.0 | 0.0 | 0.0 | 0.8 | 1.4 | 1.9 | 2.4 | 2.7 |
| Dividend yield | 0.0% | 0.0% | 0.0% | 1.6% | 2.7% | 3.8% | 4.7% | 5.2% |
| P/E (x) | Neg | Neg | 32.1 | 31.9 | 25.6 | 21.3 | 19.1 | 17.3 |
| P/BV (x) | 2.5 | 2.0 | 2.9 | 3.9 | 3.7 | 3.6 | 3.5 | 3.5 |

Sources: AlJazira Capital, Company Financials





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TERMINOLOGY

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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.

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