

1Q 2018 Results Update
May 14, 2018

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (SAR)	84.7
Target Price (SAR)	84.9
Upside/Downside (%)	0.2%

As of May 13th 2018
Key Data (Source: Bloomberg)

Market Cap (SAR bn)	6.9
52 Wk High (SAR)	91.0
52 Wk Low (SAR)	75.2
Total Outstanding shares (in mn)	82.0
Free Float (%)	63.8%

CATERING vs. TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	3.3%	3.8%
6m	5.7%	(8.1%)
12m	(6.1%)	(20.3%)

Major Shareholders (%)

Public Institution for Arab Airlines	35.70
Strategic Supply Co. Ltd.	9.31
Abdul Mohsen Abdul Aziz Al-Hokair Holding Group	8.67

Quarterly Sales (SAR mn) and Operating Margin

Source: Bloomberg, Company Financials, FALCOM Research; Data as of 13th May 2018
1Q18 results impacted by weak retail segment performance

Saudi Airlines Catering (Catering) reported better than consensus 1Q18 results. Though, net profits declined (-0.9% YoY, 21.6% QoQ) on lower sales in the retail segment and losses incurred from an associate company. The primary reason for the increase in sequential net income was the implementation of IFRS 9 with effect from January 2018, in addition to narrowing of losses from equity accounted investees

The company announced dividends worth SAR110mn (SAR1.35/share) for 1Q18, consistent with its dividend pay-out policy of more than 90%. Healthy balance sheet and stable profit margins continue to support stock's attractiveness to the investors, however, the emergence of the low cost carriers, poses an inherent risk to Catering's business model. Since the start of 2018, Saudi government rolled over multiple reforms such as VAT, an expat levy and electricity and gasoline price hikes, which impacted the Catering's retail segment results. Further decline in the consumer spending over the next couple of months, will adversely impact the airlines industry in general and Catering in particular.

- Revenues stood at SAR 531mn in 1Q18, down 0.5% from SAR 534mn in 1Q17 (- 1.0% QoQ from SAR 536mn in 4Q17). The decline in the top line can be attributable to a significant decline in the retail segment (-39.7% YoY), while the inflight and catering services segments witnessed an improvement of 4.2% YoY and 18.3% YoY respectively. 1Q18 saw full-quarter sales from inflight catering and logistics services provided to Flynas, a 5-year contract worth SAR 501mn which was signed during the last quarter.
- 1Q18 gross profit came in at SAR 175mn (+5.0% YoY, +11.6% QoQ), resulting in 170bps YoY improvement in gross margins from 31.3% in 1Q17 to 33.0% in 1Q18 driven by lower cost of materials and goods.
- Higher SG&A expenses countervailed the impact of lower cost of sales, resulting in a 1.1% YoY growth in operating income. Operating margins were largely flat YoY at 25.0%. On a segmental basis, the inflight margins improved to 49.5% (from 37.3% in 1Q17), catering segment reported 6.2% margins (versus -15.1% last year), while the retail segment margins declined from 12.8% last year to 6.8% in 1Q18.
- Net profit for the quarter stood at SAR 120mn, down -0.9%YoY, while the net margins remained flat at 22.6%. We believe the company needs to focus on operational efficiency and cost optimization to moderate the impact of any future hike in fuel and electricity costs, apart from macro-economic headwinds and unexpected changes in the contract terms. Also, we think the 'Sky sales' segment will remain pressured over the next few quarters, driven by constricted consumer spending.
- Despite the short-term pressures, we believe that the company will start to witness growth in the core segment from 2018 and beyond, driven by Saudi Airlines expansion after launching its 5-years SV2020 strategic plan, coupled with the NTP initiatives to increase Haj pilgrims and Umrah visitors.
- Valuation:** We have revised our target price upwards with a fair value of SAR 84.9 per share, in-line with current share price run-up and incorporating 1Q18 performance. We maintain our 'Neutral' rating on the stock.

	1Q'18	1Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR bn)	0.5	0.5	-0.5%	2.3	2.2	4.6%
Gross Profit (SAR bn)	0.2	0.2	5.0%	0.8	0.7	10.6%
EBITDA (SAR bn)	0.1	0.1	2.0%	0.7	0.6	14.0%
Net Profit (SAR bn)	0.1	0.1	-0.9%	0.6	0.5	18.1%
EPS basic (SAR)	1.5	1.5	-0.9%	6.7	5.7	18.1%
Gross Margin (%)	33.0%	31.3%	1.7%	34.4%	32.5%	1.8%
EBITDA Margin (%)	27.4%	26.7%	0.7%	28.6%	26.2%	2.3%
Net Profit Margin (%)	22.6%	22.7%	-0.1%	23.8%	21.7%	2.1%

Source: Company Financials, FALCOM Research

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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 more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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