Initiation of Coverage Report

United International Transportation Co (Budget)

Despite significant anticipated headwinds from short-term rental revenues, long-term lease and vehicles sales are expected to provide some resilience for Budget's revenues during 2020. However, bottom-line is expected to drop amid high operating leverage and lower profit margins from the sale of vehicles in H2 2020.

09 July 2020

Recommendation	Neutral
Current Price (08-07-2020)	SAR30.5
Target Price (52 Weeks)	SAR28.5
Upside/ (Downside)	(6.6%)
Shariah Compliance	Pass

Reuters Code	4260.SE
Bloomberg Code	BUDGET: AB
52 Weeks High	SAR39.2
52 Weeks Low	SAR23.1
Market Cap	SAR2.2bn
P/E (TTM)	11.9x
EPS (TTM)	SAR2.6
Dividend (TTM)	SAR1.0
AVG Value Traded	SAR129.6mn

Key Points

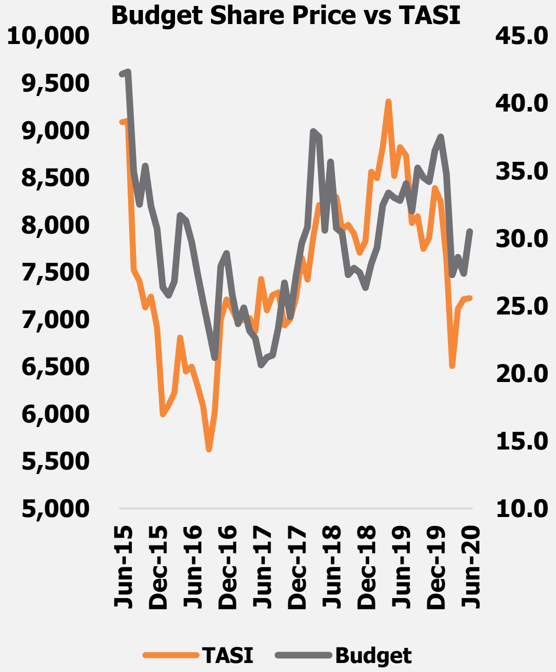
We initiate our coverage for Budget with a NEUTRAL recommendation and 52 weeks target price at SAR28.5; this represents a downside potential of 6.6%.

- United International Transportation Co (Budget) is the market leader in car rental services in Saudi Arabia, operating a fleet size of more than 29k vehicles in 23 cities across the Kingdom. Budget operates in the Kingdom under a franchise contract from AVIS Budget Group (ABG). The company operates three main segments: short term car rental services, long term lease services, and sale of used vehicles.

- COVID-19 turned the tables for the car rental sector as the industry is currently threatened by the suspension of air travel and lower demand. However, despite significant anticipated headwinds from the decline in short-term car rental revenues during 2020, and particularly Q2, long-term lease and vehicle sales are expected to support Budget's revenues during the year. We expect used vehicle sales revenue to increase during 2020, as Budget disposes of a large percentage of its fleet amid low demand, while long term lease will drop at a slower pace than short term leases, providing some resilience for revenue. Yet, we expect revenue to remain muted during FY2020 and FY2021. Margins are expected to compress during 2020 due to high operating leverage and lower profit from the sale of vehicles in H2 2020 before partially recovering in 2021.

- Key short-term downside risks are anticipated drop in tourism and consumer downtrading, which will pressure revenues in the coming 2 years. Meanwhile, Budget's ability to sell its fleet during times of low lease demand provides flexibility to maintain good margins. On the longer term, the recent emergence of alternative car rental services poses considerable risks for the company's long-term growth prospects.

Budget Share Price vs TASI



Key Growth Catalysts

- Flexible business model, aiding revenue and margins stability

Key Risk Factors

- Anticipated drop in tourism
- Weak consumer demand and downtrading
- Threat of substitute from alternative car rental services

Company Overview

Establishment

- United International Transportation Company (Budget) was established as a Saudi company in 1978 with a capital of SAR183mn. The company was listed on the Saudi stock market in 2007 with total shares reaching more than 71mn shares in 2019.

- Since its inception, Budget was engaged in car rental activity under a concession contract from the international Budget Rent a Car company. In addition to its short-term car rental activity, Saudi Budget provides long term leasing services as well as the sale of used cars. Moreover, the company obtained an exclusive license to rent out Payless cars across the Kingdom through signing a franchise agreement with AVIS Budget Group (ABG), the owner of Payless. Payless car rental provides low cost car rental services of used or small vehicles.

- Budget is the largest car rental operator in the Kingdom. The company owns more than 29k vehicles and is present in 84 locations throughout the Kingdom. Around 10k vehicles are dedicated to short term rental, while 19k vehicles are in the company's long-term lease fleet. The company's locations cover the most populated cities as well as international & domestic airports centers in the Kingdom.

- Budget's business model includes the sale of the used vehicles following their use for lease after a certain period of time. The company's vehicle sales business operates 7 used car showrooms in the Kingdom located in 6 cities.

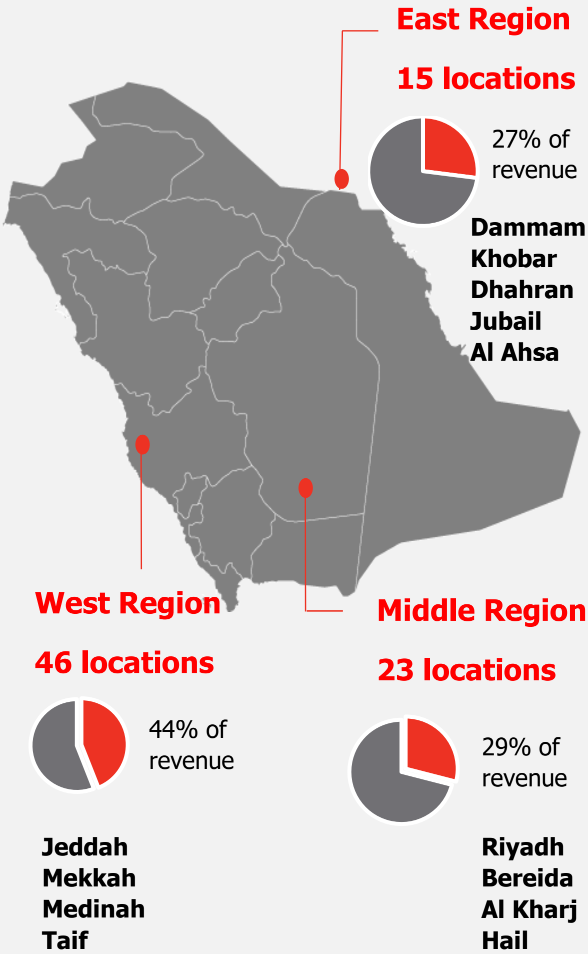
- As parent Company, Budget owns 100.0% of the issued capital of Aljozoor Alrasekha Trucking Company Limited (Rahaal). Rahaal was incorporated in Saudi Arabia and is engaged in the business of long-term leasing and sale of heavy vehicles (including trucks, trailers, and buses). During FY2019, Rahaal contributed 24.5% to Budget's total revenues and made up 43% of long-term leasing revenues. Effective January 2020, Budget acquired the remaining 51% shareholding in Unitrans Infotech Services India Private Limited (previously accounted for as an associate with 49% ownership). The company contributes less than 1% to Budget's total revenues.

Key Shareholders

Name	Ownership (%)
Alzahed Holding Group	13.1%
Free float	82.0%

Source: Tadawul

Budget's Geographic Dispersion



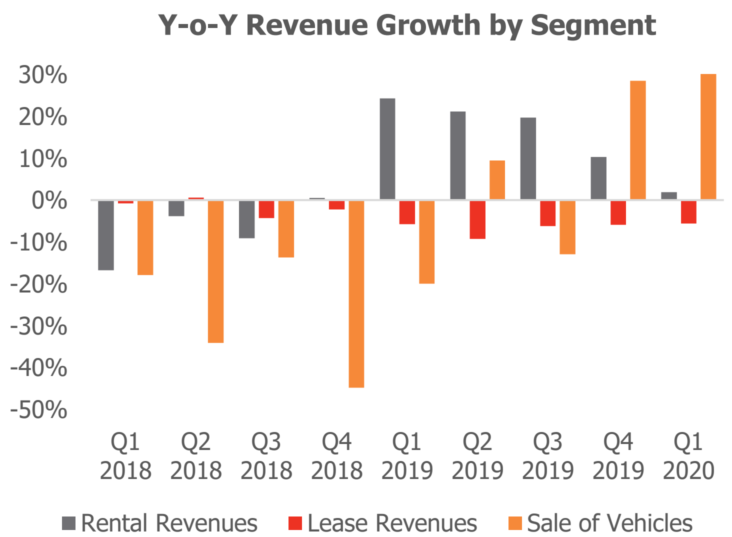
Subsidiaries and Associates

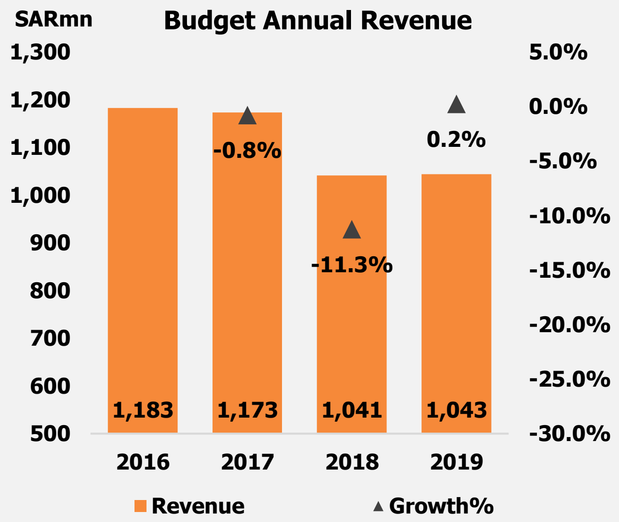
Name	Type	Country	Ownership (%)	Business
Aljozoor Alrasekha Trucking Company (Rahaal)	Subsidiary	KSA	100.0%	Rental and leasing of heavy vehicles and equipment
Unitrans Infotech Services India Private Limited (Unitrans)*	Subsidiary	India	100.0%	Providing Information Technology Services.
Tranzlease Holdings Indian Private Limited (THL)	Associate	India	32.9%	Operating Lease of Motor Vehicles.

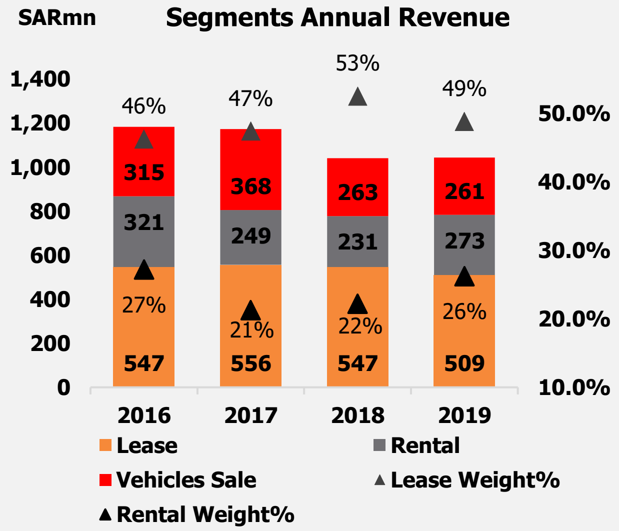
Company Overview

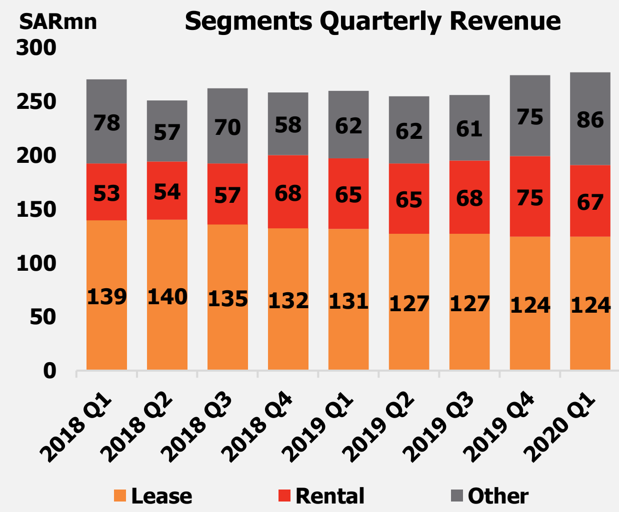
Revenue at a Glimpse

- Budget operates three main segments: car lease services, car rental services, and sale of vehicles. The leasing segment represents cars leased out to customers under medium to longer-term rental arrangements ranging from 12 to 48 months. The rental segment represents cars leased out to customers under short term rental arrangements on a daily, weekly, or monthly basis. The sale of vehicles segment represents the sale of Budget's used vehicles, which have been used in either short term or long-term leases.
- Since 2016, Budget's rental revenues were reeling as a result of lower demand and consumers downtrading to cheaper vehicles, resulting in lower revenue per vehicle and lower utilization rates. As a result of low demand, Budget was downsizing its fleet size between 2016-2018, forcing the company to sell its car rental fleet earlier than anticipated which resulted in lower profits from the sale of vehicles, especially in 2017, when it downsized its short term fleet by more than 20%. During 2017, continued decent growth in long term leases and higher vehicle revenues offset the decline in car rental segment, supporting the company's total revenues. However, starting 2018, the negative impact of low demand started to show on long term lease revenues, as long-term contracts with customers expire without renewal, and Budget downsized its long-term fleet for the first time amid low demand.
- By 2019, Budget's short-term car rental services rebounded strongly (+18% Y-o-Y) following 3 years of deceleration, thanks to the improved demand, backed by launching marketing programs, resulting in higher utilization rates and expansion in fleet size. Meanwhile, long-term lease revenues continued to decline (-6.8% Y-o-Y) as the impact of lower demand on the segment was lagged, given the pre-signed long-term contracts with customers. Car sales also started recovering during Q4 2019 (+28.5% Y-o-Y), thanks to higher selling prices and pickup in demand, yet sales remained stagnant for the full year (-1.0% Y-o-Y). FY2019 revenue grew by only 0.2% compared to FY2018, as higher short-term rent revenue was offset by the drop in long-term lease and stagnant car revenues.









Company Analysis

Key Risk Factors

Anticipated Drop in Tourism

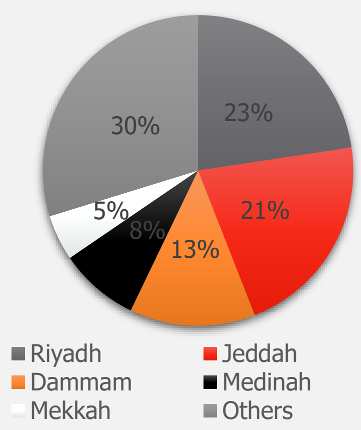
- While the whole world is focusing its attention on the massive losses incurred by the airline industry, the car rental industry's situation is not much different, being highly dependent on the tourism sector. Over the past years, the growing tourism industry was a key catalyst for car rental services in the Kingdom. The sector's growth was spurred by higher religious and business tourism; according to the World Travel & Tourism Council (WTTC), Saudi Arabia's travel and tourism industry grew by 14% during 2019. This partly explains the strong rebound in Budget's short-term rental revenues by 18% Y-o-Y during 2019.

- The global tourism industry is slammed by the spread of COVID-19, and the historic decision of umrah ban will similarly hit the Kingdom's tourism revenues during the year. According to Saudi Minister of Tourism, the impact is expected to be in the range 35%-45% drop in tourism revenues in the Kingdom during 2020. Around 53% of Budget's short-term lease is generated from the western region (Jeddah, Makkah, and Madinah), which are known to be key destinations for umrah. For the longer term, expected delays in touristic sites and cities currently under construction by the Saudi government will weigh down on future growth prospects for the Saudi leisure tourism sector, and accordingly car rental services. In terms of business travel, we expect a permanent shift in business-as-usual travel as the emergence and proven convenience of video conferencing might replace business travel, especially during times when businesses are cutting costs. This is also set to weigh down on demand for car rental services.

Weak Demand and Downtrading

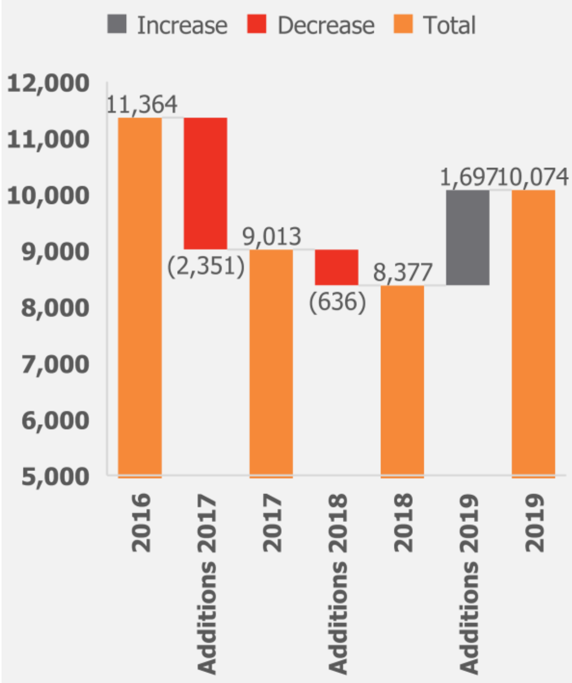
- Budget's lease revenues were reeling since 2016 as a result of lower consumer sentiment in the Kingdom. Short term rental revenues dropped by more than 15% during 2016 and continued its deceleration until 2018. Car rental is considered a highly discretionary service, easily impacted by economic downturns and lower consumer sentiment. It is worth mentioning that Budget's lease revenues did not fully recover to date from its setback starting 2016, with FY2019 lease revenues still down 10.6% compared to FY2015. We expect the company to cut its fleet size during the coming period amid lower demand as it attempts to match fleet size with market demand and maintain a stable revenue per car, and also to free up liquidity to support its cash position. On the other hand, long term lease should be more resilient in the short term due to the long-term nature of the contracts and a corporate customer base.

Budget Geographic Segmentation



Source: Company Data
*Based on number of locations per city

Budget Rental Fleet Size



Source: Company Data

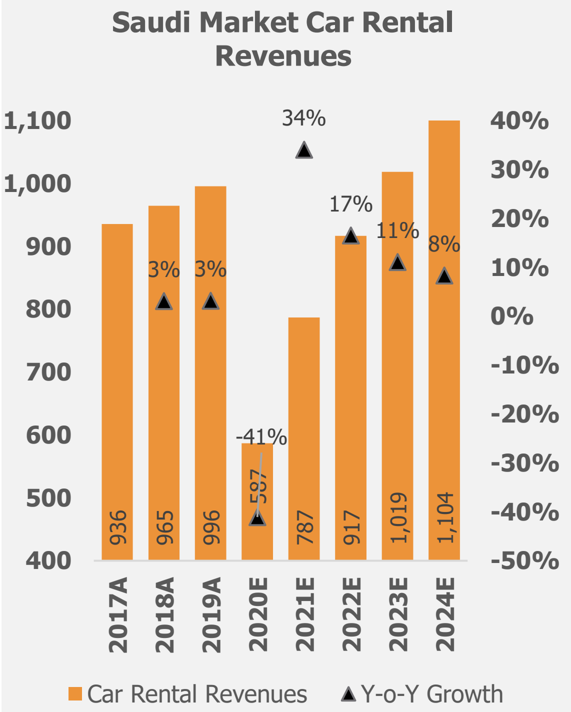
Company Analysis

Threat of Substitute from Alternative Car Rental Services

- The car rental services in Saudi Arabia is still considered in its growth stage, with more developments underway. Peer to peer vehicle sharing is a recently emerging trend in the region, and it is set to cause disruptions for the old school car rental services. With peer to peer car sharing, car owners can rent their cars to others who need a car for a short period of time. This creates a source of income for the car owner when they do not need their car, and the car rental company (acts as an intermediator) receives a fee in return.

- Such Airbnb-like platform is expected to gain exposure and popularity over the coming years, especially amid the difficult days ahead, which might encourage car owners to rent out their cars. Moreover, with the anticipated rise in car prices following VAT hikes, car owners might be induced to search for ways to gain additional value from their cars. Potential benefits for the customer (lessee) from such a business model includes a wider selection of cars, cheaper prices than traditional car rental companies, as well as less complicated paperwork and application. While traditional car rental services incur significant fixed costs and capital expenditures from purchasing their own fleet, peer to peer vehicle sharing companies are managing a virtual fleet.

- This business model was freshly introduced to Saudi Arabia in February 2020 by Ejaro, the first licensed peer to peer car sharing app in the Kingdom. Similarly, Beno Technologies Company-a UAE based technology company- offers a paperless car rental experience through its online platform acting as an intermediator between car owners and car lessees. We expect this business model to thrive, especially given Saudi's young population, leaving traditional car rental companies with a major reason for concern.



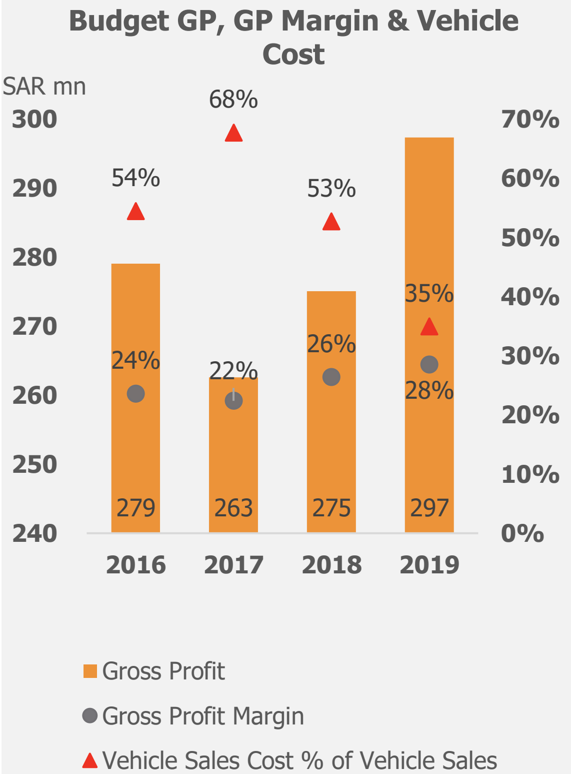
Source: Statista
*Forecast accounts for the impact of COVID-19

Key Growth Catalysts

Flexible Business Model, aiding margins stability

- Although Budget was encountering significant headwinds from low demand over the past years, the company managed to expand its margins. While FY2019 lease revenues were still down almost 10% compared to FY2016 revenues, Budget's gross margin expanded by 5% during the period. During 2019, gross profit expanded by 8% despite stagnant sales.

- Budget's business model involves the sale of vehicles used in its lease operations after an average of 2-3 years of use as it disposes of the old fleet and replaces it with new vehicles. Accordingly, during times of low demand for rental and lease services, Budget is able to support its revenue and cash flow position by disposing of a larger percentage of its fleet, achieving higher car sales which can partially offset the drop in lease revenues. On the other hand, when demand for lease segments recovers and vehicles are sold after a longer period of use, Budget can still benefit from higher profit margins upon their sale (as it sells old fleet with low net book value) as the case in 2019.



Company Analysis

Financial Results

- Budget reported strong results in Q1 2020, despite the lockdown measures during the last 2 weeks of March, thanks to higher profit from sale of vehicles during the quarter. Budget's revenues were up by 6.7% Y-o-Y in Q1 2020 recording SAR277mn compared to SAR259mn in Q1 2019. Revenue growth was supported by the strong demand for used vehicles coupled with favorable pricing.

- Short-term rental revenues posted growth of only 1.9% Y-o-Y (lowest growth since Q4 2018), as it was likely impacted by the lockdown measures starting mid-March. Long-term lease, on the other hand, continued its downtrend due to low demand reporting a drop of 5.6% Y-o-Y. Lease revenues collectively witnessed 3.1% Y-o-Y drop during the quarter. Meanwhile, the rebound of used vehicle sales from a low base in Q1 2019 resulted in 37.4% Y-o-Y hike in vehicles sales during the quarter thanks to higher selling prices.

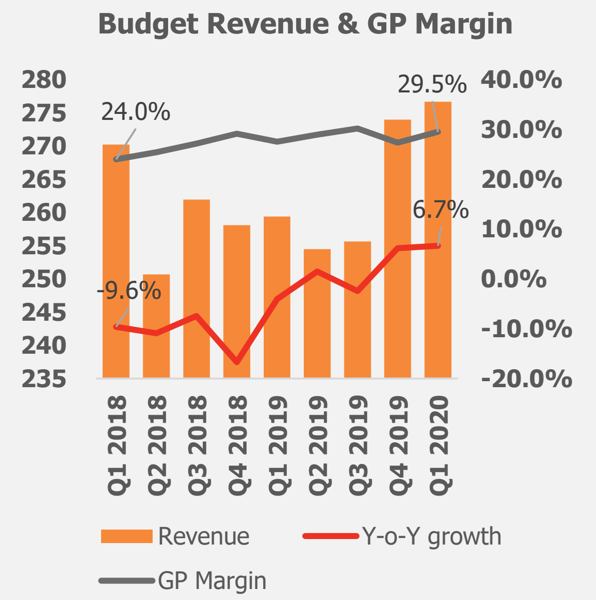
- Gross profit expanded by 14.2% Y-o-Y to reach SAR82mn in Q1 2020 compared to SAR72mn in Q1 2019. The latter was mainly backed by higher profits from sale of vehicles. Gross margins widened by almost 200bps recording 29.5% compared to 27.6% in Q1 2019.

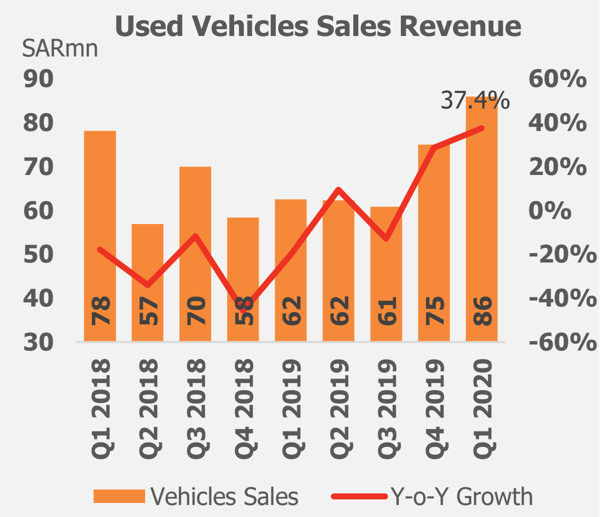
- Despite recording of SAR8.9mn provisions for bad debt in Q1 2020, as provisions due to COVID-19, EBIT grew by 9.4% Y-o-Y to reach SAR48mn compared to SAR44mn in Q1 2019. EBIT margin stood at 17.3%, up slightly from 16.9% in Q1 2019.

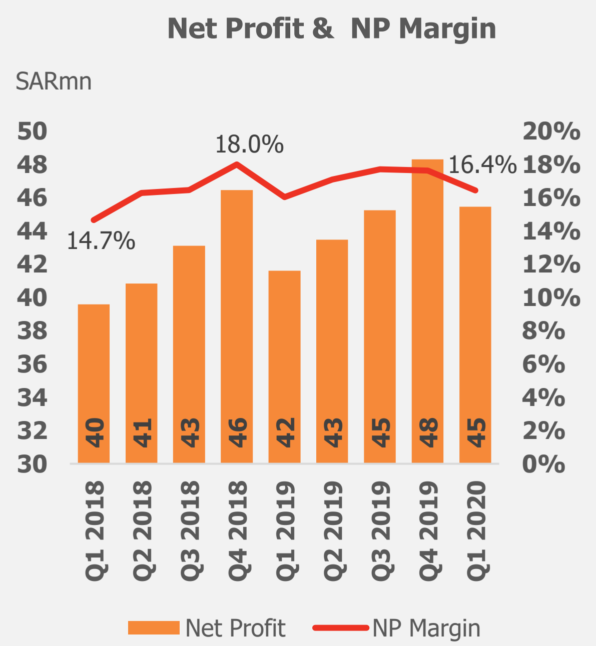
- Rise in EBIT filtered though net income, which increased by 9.3%. Net income reported SAR45mn compared to SAR42mn in Q1 2019. Net margin recorded 16.4% compared to 16.0% in Q1 2019.

- COVID-19 had a minimal impact on Budget's Q1 financial results as the rise in vehicles sales offset the drop in lease revenues. Q2 2020 results are expected to fully reflect the impact of COVID19; we expect short term leases segment to be hit the hardest by curfew measures and travel suspension. This will be reflected in lower utilization rates in short term lease, which might force Budget to sell part of its fleet. It is worth mentioning that around 62% of Budget's lease locations are located in cities that witnessed a 24hour lockdown in April. On the other hand, the impact on long term lease is expected to be less intense, given long term contracts with existing customers, which could provide some resilience for Budget's performance during 2020. Yet, the segment is still expected to continue its downtrend due to a lower number of new customers.

- Vehicle sales segment is expected to provide strong support for Budget's revenues during 2020 as the company disposes of its fleet amid low demand, which will partially offset the anticipated decline in lease revenues. Moreover, we expect the segment to witness a spike in demand during Q2 2020 as consumers rush to make large purchases before the VAT hike comes into effect. On the other hand, higher profits from the segment witnessed during Q1 2020 are unlikely to continue for the rest of the year as the company sells its used fleet before it is normally due for sale (due to low utilization), lowering the gain on sale.







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Valuation Rationale

DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	519	578	635	695	756
Operating CF	736	715	768	816	880
Capex	(535)	(546)	(600)	(648)	(690)
FCFF	201	169	167	169	190
Stub Period (FCF to be discounted)	151	169	167	169	190
PV (FCFF)	140	140	125	113	114

WACC	11.2%
Perpetuity Growth	3.0%
PV-FCFF	632
PV-TV	1,427
Net Debt	19
Less: End of services benefits	(52)
Intrinsic Value	2,027
Shares Outstanding (mn shares)	71
Equity value per share (SAR)	28.5
CMP (08/07/2020)	30.5
Upside / Downside (%)	(6.6%)

We valued Budget using the DCF approach, considering a WACC equal to 11.2% (based on a risk-free rate of 4.4%, market risk premium 7.3%, Beta of 0.97).

Based on the DCF valuation, the fair price of Budget share price is SAR28.5, which is lower than the traded value by 6.6%.

Key Valuation Assumptions

Revenue: Vehicles sales segment is expected to support Budget's revenues during 2020, thus partially offsetting the drop in lease revenues. We expect Budget to dispose of a larger than an average number of vehicles during the year in an attempt to match its fleet size with low market demand and maintain a stable revenue per car. While we expect 28.2% and 3.7% drop in short-term rental and long-term lease, respectively, vehicle sales are expected to rise by 25.2% Y-o-Y as we forecast disposal of 40% of available for sale vehicles during 2020 (up from 33% in 2019). Accordingly, revenue is expected to drop by 2.9% in 2020, and further drop by 0.9% during 2021 as lower car sales offsets recovery in lease segment during the year. Total revenue is forecast to recover to FY2019 levels by FY2022.

Cost of sales and gross profit: Depreciation accounts for a substantial 62% of Budget's total operating costs, which increases its operating leverage, pressuring Budget's bottom-line during 2020. In addition to high fixed cost, cost on sale of vehicles is expected to rise for the rest of 2020 as the fleet is sold earlier than its due time (relatively new fleet are not highly depreciated, thus delivering lower gains on sale). We expect a surge in cost of vehicles to 68% of vehicles sales before it normalizes to 53% thereafter. As a result of high fixed cost and lower profits from sale of vehicles, we estimate a drop in gross margins to 18.7% in FY2020 before it rebounds to 24.9% by FY2021.

Debt and cash flow position: Budget ended Q1 2020 with a historic high cash balance of SAR94mn thanks to higher operating cash flows, allowing it to withstand an unprecedented decline in short term rental revenues in Q2 2020. Continued inflow of vehicle sales, especially in June, and payments by long term lessees should also support cash position, though it is likely to witness a rise in receivable days in 2020. Budget has very low debt at less than 1% of total assets and is expected to be debt-free by 2021. On the other hand, vehicles CAPEX might still rise in 2020 as the company seeks to benefit from lower vehicles prices before VAT implementation in Q3 2020.

Valuation Rationale

Regional Peers*	Country	Code	Market Price (SR)	Market Cap (SRMN)	P/E (TTM)	Sales (SRMN)	Net Income (SRMN)
United International Transportation Co. (Budget)	**KSA**	**4260**	**30.5**	**2,167**	**11.9**	**1,061**	**182**
Batic Investments and Logistics Co. (BATIC)	KSA	4110	23.7	710	HIGH	456	4
Saudi Public Transport Co. (SAPTCO)	KSA	4040	14.4	1,798	HIGH	1,721	6
Saudi Ground Services Co. (SGS)	KSA	4031	28.4	5,330	19.9	2,443	268
Saudi Industrial Services (SISCO)	KSA	2190	20.6	1,678	27.7	677	61

*Budget's peers business activity is quite different from Budget's, yet they are all classified by Tadawul under the transportation sector

Financial Ratios	2018 A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Return on Average Assets (%)	11.6%	12.4%	5.2%	9.2%	11.8%	13.6%	14.9%
Return on Average Equity (%)	15.5%	15.6%	6.5%	11.3%	14.5%	16.8%	18.4%
Income Before Zakat Margin (%)	16.8%	17.6%	7.8%	13.7%	16.7%	18.5%	19.7%
Net Income Margin (%)	16.3%	17.1%	7.4%	13.3%	16.2%	18.0%	19.1%
Revenue Growth (%)	-11.3%	0.2%	-2.9%	-0.9%	7.8%	6.9%	6.8%
DPS	1.50	1.00	0.75	1.25	1.50	1.75	2.00
Payout Ratio	62.8%	39.8%	70.8%	66.7%	60.9%	59.9%	60.4%

Income Statement	2018A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Revenues	1,041	1,043	1,014	1,005	1,084	1,158	1,237
Cost of revenues	(766)	(746)	(824)	(755)	(782)	(820)	(867)
Gross Profit	**275**	**297**	**189**	**250**	**302**	**338**	**369**
SG&A	(96)	(110)	(107)	(112)	(120)	(123)	(125)
EBIT	**183**	**189**	**84**	**140**	**183**	**217**	**246**
Zakat	(5)	(6)	(3)	(4)	(5)	(6)	(7)
Net Income	**170**	**179**	**75**	**133**	**175**	**208**	**236**

Balance Sheet	2018A	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Current Assets	226	190	295	350	387	392	416
Non-Current Assets	1,210	1,263	1,138	1,111	1,123	1,158	1,200
Total Assets	**1,436**	**1,453**	**1,433**	**1,461**	**1,510**	**1,550**	**1,616**
Current Liabilities	251	215	189	186	198	204	209
Non-Current Liabilities	59	78	80	85	89	93	97
Total Equity	**1,126**	**1,160**	**1,164**	**1,191**	**1,223**	**1,254**	**1,311**
Total Liabilities and Equity	**1,436**	**1,453**	**1,433**	**1,461**	**1,510**	**1,550**	**1,616**

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

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