

Saudi Airlines Catering CO.

Inevitable losses and an uncertain future.

Saudi Airlines Catering Co. (Catering) suffered greatly in Q1 2020 due to the total freeze that the airline sector witnessed due to the Coronavirus pandemic. With a 64.1% dependency on revenues from Saudi Arabian Airlines, Catering is looking at a challenging future in the short and intermediate-term, as international travel restrictions continue in order to combat the virus. Despite some easing in domestic travel restrictions, the future remains uncertain as there is not yet a cure or a vaccine for COVID-19, and an easing in the restrictions could potentially result in further spread of the virus.

During the year 2019, the company showed resilience and ambitious planning on the back of the anticipated boost in tourism in light of Vision 2030. However, at the beginning of 2020, the company was hit with complete paralysis in the airline industry due to the fast-spreading coronavirus. Being an airline catering company, with a portfolio that is mainly dependent of revenues from inflight catering and purchases, Catering's focus should solely be on surviving the uncertainty ahead as the losses that it's facing at the moment are ones that are not expected to be compensated for in the near future.

During the first quarter of 2020, the company's revenue dropped by 13% Y-o-Y from SAR522mn in Q1 2019 to SAR452mn in Q2 2020. The topline loss is relatively small as Saudi Arabia halted international flights from the 15th of March and domestic flights from the 21st of March in response to the outbreak of COVID-19 infections. The losses represent the canceled flights during the period from the 15th of March to the 31st of March. The cost of sales remained almost flat, increasing by only 1% Y-o-Y. Gross income dropped by 38% Y-o-Y from SAR192mn in Q1 2019 to SAR119mn in Q1 2020.

The Coronavirus pandemic started towards the end of February; however, countries started actively acting against its spread by the beginning of March, which explains the significant increase in Catering's allowance of expected credit losses. The allowance of expected losses tripled in value, where it increased from SAR5mn in Q1 2019 to SAR20mn in Q1 2020, which added significant pressure on the company's operating profit. Furthermore, the company's fixed costs represent around 62% of the company's total costs, further increasing the company's operating leverage. That being said, Catering's operating profit dropped by 71% Y-o-Y from SAR121mn in Q1 2019 to only SAR35mn in Q1 2020. Similarly, the company's EBIT margin dropped from 23% in Q1 2019 to only 8% in Q1 2020.

The negative impact of the pandemic is widespread, forcing companies to account for losses on their investments, which further pressured Catering's bottom-line numbers. During the quarter, the company reported a loss in equity accounted investee (40% shareholding is Saudi French Company for Duty-free) of SAR2mn in Q1 2020 compared to a profit of SAR0.2mn in Q1 2019 due to the incurred losses as a result of the impact of the lockdown of the airport following COVID 19 outbreak. Moreover, the company reported an impairment of SAR3mn in Q1 2020.

Consequently, Catering's net income dropped by 85% Y-o-Y from SAR104mn in Q1 2019 to only SAR16mn in Q1 2020, while net margin dropped from 19.8% in Q1 2019 to only 3.4% in Q1 2020.

2 June 2020

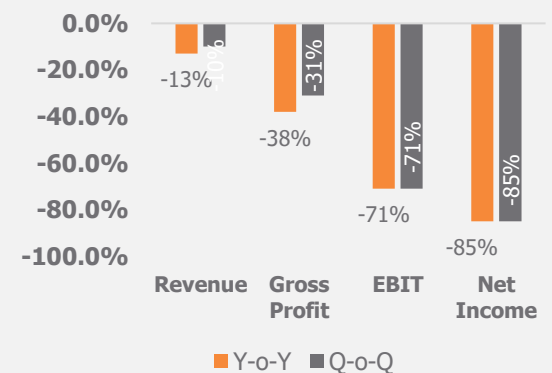
Recommendation **Under Review**

Previous Recommendation	Neutral
Current Price (02-06-2020)	SAR75.10
Target Price (52 Weeks)	-
Upside/ (Downside)	-
Shariah Compliance	Pass

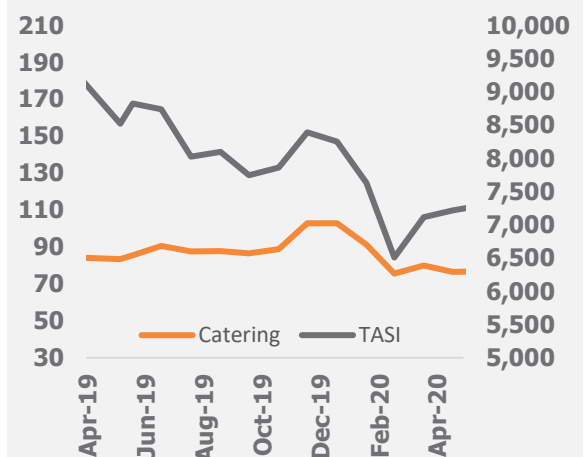
Key Financial Ratios

Ratio	Q1 2020	Q4 2019	Q1 2019
Revenue Growth	-10.3%	-13.7%	7.3%
Gross Margin	26.3%	34.1%	36.8%
EBIT Margin	7.7%	24.3%	23.3%
Net Margin	3.4%	20.1%	19.8%

Key Financial Results (Q1 2020)



Share Price Performance



Saudi Airlines Catering CO.



The Extent of Uncertainty due to COVID-19

Since the outbreak of the coronavirus towards the end of February, the Kingdom went to extreme measures to combat the spread of the virus. These measures included a complete ban of Hajj and Umrah (performed by more than 2 million pilgrims annually), in addition to halting international flights from the 15th of March and domestic flights from the 21st of March. The suspension affected not only airlines but also airport operators, airport on-site enterprises such as restaurants and retail businesses, aircraft manufacturers, air navigation service providers, and *airline catering companies*.

The International Air Transport Association (IATA) estimates that revenues generated by airlines in the Saudi market will fall by USD7.2bn in 2020, 35% below 2019 levels. That puts at risk nearly 287,500 Saudi jobs and USD17.9bn of Saudi's GDP, which is generated by aviation directly and aviation-related tourism. Moreover, with the government preoccupied with the hindering the impact of the pandemic on the economy, a lot of the Vision 2030 mega entertainment projects that were expected to draw more tourists towards Saudi Arabia are put on pause indefinitely.

According to the International Civil Aviation Organization (ICAO), the estimated impact on international passenger traffic on the Middle East is a drop in capacity by 51% to 65%, and a drop in revenue by USD17bn to USD21bn. Moreover, the estimated impact on domestic passengers in the Middle East is a drop in capacity by 54% to 60% and a drop in revenue by USD2bn. Additionally, the latest estimates indicate that the possible COVID-19 impact on world scheduled passenger traffic for the full year 2020 is an overall reduction ranging from 40% to 53% of seats offered by airlines.

In response to the impact of COVID-19, the Saudi government has introduced broad economic relief measures in excess of USD32bn in financial support for the private sector. It has also provided support for air transport by suspending the airport slot use rules for the summer season and extending licenses and certifications for crew, trainers and examiners. However, there is no implementation of specific financial relief measures for aviation to ensure the sector's recovery. Such specific financial relief is deemed necessary given the growing role that air travel and tourism was playing as part of Saudi Arabia's economic diversification plans prior to the pandemic.

Saudi Arabia's General Authority of Civil Aviation (GACA) has confirmed that domestic flights within the Kingdom, operated by national carriers, will commence from Sunday, the 31st of May, a day after Saudi Arabia announced a gradually phased reopening of activities across the Kingdom, except Makkah. While some easing in the restrictions is bound to resume the flow in the Saudi economy, it could also backfire if it resulted in an increase in the number of infections within the Kingdom.

Due to this uncertainty, it would be premature to forecast the rebound of the airline sector that would parallel the rebound of a lot of airline-dependent subsectors, including airline catering. Therefore, due to the unknown duration of the pandemic, we find it essential to keep **Catering** under review in order to properly estimate whether the rebound is in the near future, or it will take a longer time to restore the degree of consumer confidence for air travel.

Quarterly Income Statement	Q1 2019	Q4 2019	Q1 2020	Q-o-Q	Y-o-Y
Revenues	522	505	453	-10%	-13%
Cost of revenues	(330)	(333)	(334)	0%	1%
Gross Profit	192	172	119	-31%	-38%
SG&A	(66)	(65)	(64)	-1%	-3%
EBIT	121	123	35	-71%	-71%
Net Income	104	101	16	-85%	-85%
Interim Balance Sheet					
Total Assets	2,676	2,504	2,833	13%	6%
Total Liabilities	1,394	1,199	1,625	36%	17%
Total Equity	1,282	2,656	2,504	-6%	95%
Total Liability and Equity	2,676	2,656	2,504	-6%	-6%

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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