

## Saudi Industrial Services Company (SISCO)

Equity Research Update

Sector – Industrials

### Portfolio ramp-up underway; maintain 'Outperform'

#### Holdings begin to showcase improving efficiencies and product-mix gains

We forecast SISCO's current portfolio of operating holdings to exhibit strong performances going forward as: 1) RSGT is expected to see a higher gateway volume run-rate and reach SAR 1Bn of revenues by 2024E-25E; 2) Logistics, Parks & Services starts to witness growth in higher margin Services revenues and 3) Water Solutions improves revenue mix and margins on better pricing and cost-recognition. The recent improvement in market dynamics and segments' operating metrics also provide an ideal backdrop for SISCO's M&A ambitions in our view, as the company considers new investments across the Ports and Logistics segments with a minimum target IRR of 12%. We reiterate our Outperform rating on SISCO, as we remain optimistic on the company's capabilities to operate as a full-cycle investment holding company, and to invest, incubate, monetize, and recycle returns into new investment opportunities.

#### Recovery of RSGT gateway volumes manifesting; M&A timing looks opportune

Average shipping rates (USD/TEU) collapsed by 70%-90% from the highs of Q4-2021/Q1-2022 across key container routes such as Asia - US West Coast and Asia - North Europe, in line with expectations outlined in our initiation report - [SISCO: De-risked & segueing to new sources of growth; Initiate with Outperform](#)). This trend should continue and translate into higher gateway volumes at RSGT and other port terminals in the Middle East/Red Sea container lanes, as shipping lines allocate more capacity to these routes while container congestion continues to unwind. Further, the market share of gateway volumes has reversed back towards Saudi Arabia's Western Province ports such as JIP from ports in the Eastern Province as the rates differential has declined towards a more normalized SAR 200-300/TEU (earlier SAR 2,000-3,000/TEU). We therefore forecast RSGT's gateway volumes to pick up starting Q4-2022E and reach a quarterly run-rate of above 300k TEUs in 2023E and 340k TEUs in 2024E (Q1 to Q3-2022 avg: 250k TEUs). Further, we expect total combined volumes (gateway+ transshipment) to grow at CAGR of 6.2% from 2.9 Mn TEUs in 2021 to 3.48 Mn TEUs in 2024E, leading RSGT to approach SAR 1 Bn of revenues by 2024-25 (gateway/transshipment volumes mix of 40%/60%). Our forecasts include MSC's recently signed deal with JIP to introduce a new call on its HEX service, which is expected to add 120k TEUs per annum of gateway volumes. We also believe that SISCO's timing for pursuing potential M&A aspirations in Asia and Africa is positive, as global shipping metrics like rates and TEU miles continue to normalize, driving higher capacity utilization and IRRs for port terminal operations in these opportunities.

#### Logistics & Water segments' product-mix optimization to pick up

LogiPoint's bonded warehouse footprint will continue to grow as built-to-suit (BTS) facilities such as Aramex BTS and UWC join the existing 100% occupied portfolio of leased spaces. Further, higher gateway volumes at JIP should drive occupancy rates for the open yards higher in 2023E (55%) and 2024E (60%) from 47% in 9M-22, in our view. These trends should enable higher Services revenues to be unlocked and push overall segment GP margins to 45%-46% going forward as witnessed in 9M-2022E (45.6%). The ongoing optimization for the Water businesses continue as revenue mix and margins improve on better pricing for customer contracts and revised cost recognition accounting from clients. We expect this to improve Water Solutions segment margins by at least 250bps-300bps on an annualized basis from 2023E onwards.

#### Valuation & Risks –TP revised to SAR 27.00 (Previous: SAR 29.50)

Our revised TP represents a 33.1% upside to SISCO's current share price and is based on SotP valuation. We value each segment individually based on a 70:30 split between DCF and EV/EBITDA multiples of its closest peers. Key downside risks: 1) Higher shipping rates from global container market congestion persisting; 2) Leaner importer inventory strategies leading to lower bonded warehouses demand.

### Outperform

**CMP 15-Dec-22: SAR 20.28**
**Target Price (TP): SAR 27.00**
**Upside: +33.1%**


Price Perf.	1M	3M	12M
Absolute	-12.3%	-14.8%	-36.3%
Relative	-4.6%	-1.8%	-27.3%

#### Stock Data

Bloomberg Ticker	SISCO AB
Tadawul Ticker	2190
Last Price (SAR)	20.28
MCap (SAR Mn)	1,655
MCap (USD Mn)	441
EV (SAR Mn)	3,221
Stock Performance - YTD (%)	-33.9%
PE - 2022E (x)	47.1
EV/EBITDA - 2022E (x)	7.9
Dividend yield - 2022E (%)	3.9%
52-Week Range (SAR)	19.48/35.10

Sources: KAMCO Invest Research &amp; Bloomberg

SISCO Financials	2021	2022E	2023E
Revenue* (SAR Mn)	921	867	1,064
GP margins (%)	48.5%	46.5%	47.4%
EBITDA (SAR Mn)	498	408	508
EPS (SAR/share)	0.80	0.43	1.03
PE (x)	38.6	47.1	19.8
EV/EBITDA (x)	8.3	7.9	6.3
Div Yield (%)	2.6%	3.9%	3.9%

Source: Kamco Invest Research, SISCO, \* excluding construction revenue

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## Valuation and Risks

### Revised TP of SAR 27.00/share; maintain 'Outperform' rating

Post the SISCO Q3-2022 call and speaking to the management, we have updated our thesis and fine-tuned our forecasts. We forecast SISCO's current portfolio of operating holdings to exhibit strong performances going forward as: 1) RSGT is expected to see a higher gateway volume run-rate and reach SAR 1Bn of revenues by 2024E-25E; 2) Logistics, Parks & Services starts to witness growth in higher margin Services revenues and 3) Water Solutions improves revenue mix and margins on better pricing and cost-recognition. Further, we revise our target price (TP) to SAR 27.00/share (Previous: SAR 29.50/share), as our segment-specific cost of capital (WACC) estimates incorporate higher risk premiums warranted by the market in a rising interest rate environment. Our TP represents a 33.1% upside to SISCO's current share price and is based on sum-of-the-parts (SotP) valuation. We reiterate our Outperform rating on SISCO, as we remain optimistic on the company's capabilities to operate as a full-cycle investment holding company, and to invest, incubate, monetize, and recycle returns into new investment opportunities.

#### SISCO SotP Valuation

(Individual segments valued based on 70:30 blend between DCF & EV/EBITDA)	Valuation (SAR Mn)	SISCO's effective shareholding	SISCO's share	Notes
Port development and operations (RSGT)	3,249.9	36.36%	1,181.7	Avg. EBITDA margins of 55%, WACC of 11.75% and terminal growth of 2%; 2023 EV/EBITDA of 10.8x
Logistics parks and support services (LogiPoint & ISNAD)	272.7	76%	207.3	Avg. EBITDA margins of 43%, WACC of 8.5% and terminal growth of 2%; 2023 EV/EBITDA of 9.5x
Water desalination and distribution (Kindasa)	306.1	65%	198.9	Avg. EBITDA margins of 32%, WACC of 12.0% and terminal growth of 2%; 2023 EV/EBITDA of 18.4x
<b>EV of operations</b>	<b>3,828.7</b>		<b>1,587.9</b>	
Associates			412.5	Tawzea (50%) - 2023 P/E of 20x; SA Talke (33.3%) - 2023 P/E of 10x; WESSCO (31.85%), Xenmet (19%) & Green Dome (24%) each at P/B - 1x
Cash at center			12.8	as of 9M-2022
ST deposits			477.7	as of 9M-2022
Other assets SISCO center			26.7	as of 9M-2022
Other liabilities at SISCO center			-69.8	as of 9M-2022
<b>Equity value prior to complexity discount</b>			<b>2,447.7</b>	
Holding company complexity discount			10%	
<b>SISCO SotP equity value (SAR Mn)</b>			<b>2,202.9</b>	
<b>SISCO SotP equity value per share (SAR)</b>			<b>27.00</b>	
Current Price (as of 15 Dec 2022)			20.28	
<b>Upside (%)</b>			<b>33.1%</b>	

Sources: Kamco Invest Research

We value each segment individually based on a 70:30 split between DCF and EV/EBITDA multiples of closest regional and international peers. For SISCO's individual segment DCFs, we utilize steady-state EBITDA margins, and apply segment specific WACC and net debt estimates. We model each segment's capacity progression and utilization over 10 years and assume a terminal growth rate of 2.0%. For each segment's terminal value, we have assumed a return on new investment capital (RONIC) that is comparable to the terminal year WACC. For SISCO's associates' valuation, we value each associate based on P/E or P/B multiples. We further apply a 10% complexity discount to the aggregate equity value, as SISCO operates as a holding company, and the company's investments operate as distinct entities within its portfolio. Our thesis on RSGT's Pattenga terminal concession signing remains positive, but we prefer to wait for all the finer details and guidance, before including the terminal's results in our model forecasts and valuation.

**Downside risks to our valuation & forecasts include:**

- Worsening of the global container market congestion, and higher resultant shipping rates
- Port tariffs being adjusted downwards by port regulatory authorities
- Competition for Ports segment from new challenger terminals impacting gateway and transshipment volumes
- Importers preferring to maintain lean inventory levels that could lead to lower import volumes, and lesser demand for bonded warehouses
- Oversupply of bonded warehouses in Saudi Arabia
- Competition in SISCO's water segments for future desalination and wastewater treatment bids
- Declines in global GDP growth, international trade due to an economic slowdown, rising inflation and higher interest rates
- Slower non-oil GDP transformation of Saudi Arabia than outlined under the Vision 2030 plan

**SISCO Financials**

Balance Sheet (SAR Mn)	2020	2021	2022E	2023E	2024E
<b>Assets</b>					
Cash & cash equivalents	336.5	892.4	43.3	53.2	60.4
Receivables	132.9	161.8	190.7	234.0	265.8
Other assets	31.7	36.6	525.7	546.2	572.2
<b>Total current assets</b>	<b>501.2</b>	<b>1,090.7</b>	<b>759.7</b>	<b>833.4</b>	<b>898.4</b>
Net property, plant and equipment	386.4	427.1	785.2	1,141.3	1,368.3
Goodwill	8.8	8.8	8.8	8.8	8.8
Intangibles	3,141.6	3,052.9	2,953.4	2,802.0	2,626.9
Other assets	369.2	415.6	436.5	458.0	479.7
<b>Total assets</b>	<b>4,407.2</b>	<b>4,995.1</b>	<b>4,943.6</b>	<b>5,243.5</b>	<b>5,382.0</b>
<b>Liabilities</b>					
Liabilities	1,947.3	1,961.7	1,950.4	2,253.4	2,356.3
Total debt	750.3	736.9	682.8	637.7	593.9
<b>Total liabilities</b>	<b>2,697.6</b>	<b>2,698.7</b>	<b>2,633.2</b>	<b>2,891.1</b>	<b>2,950.2</b>
<b>Shareholders' Equity</b>					
Share capital	852.4	852.4	852.4	852.4	852.4
Retained earnings	248.3	202.5	205.0	223.5	271.0
Minority Interest	535.0	810.4	820.3	843.9	875.7
Other Equity	73.8	431.1	432.7	432.7	432.7
<b>Total Equity</b>	<b>1,709.6</b>	<b>2,296.4</b>	<b>2,310.4</b>	<b>2,352.4</b>	<b>2,431.8</b>
<b>Total liabilities and equity</b>	<b>4,407.2</b>	<b>4,995.1</b>	<b>4,943.6</b>	<b>5,243.5</b>	<b>5,382.0</b>
<b>Income Statement (SAR Mn)</b>	<b>2020</b>	<b>2021</b>	<b>2022E</b>	<b>2023E</b>	<b>2024E</b>
Revenue (excluding construction revenue)	861.6	921.2	866.8	1,063.6	1,208.0
Cost of goods sold	-437.9	-474.7	-463.4	-559.1	-628.6
<b>Gross profit</b>	<b>423.7</b>	<b>446.5</b>	<b>403.4</b>	<b>504.6</b>	<b>579.4</b>
SG&A	-167.5	-168.1	-173.4	-212.7	-241.6
Adjustments related to non-recurring items	191.0	219.6	178.3	216.1	261.1
<b>Reported EBITDA</b>	<b>562.4</b>	<b>490.8</b>	<b>408.3</b>	<b>507.9</b>	<b>598.9</b>
<b>Adjusted EBITDA</b>	<b>447.3</b>	<b>497.9</b>	<b>408.3</b>	<b>507.9</b>	<b>598.9</b>
Depreciation and amortization	-163.8	-173.7	-182.3	-223.2	-268.2
Adjustments related to non-recurring items	-142.3	-38.8	0.0	0.0	0.0
<b>EBIT</b>	<b>256.2</b>	<b>278.3</b>	<b>226.0</b>	<b>284.7</b>	<b>330.7</b>
Finance costs	-133.5	-203.5	-220.0	-229.4	-237.3
Finance income			13.6	20.9	24.0
Share associates and other income	110.3	38.8	45.1	46.6	48.1
<b>Net income before taxes</b>	<b>233.1</b>	<b>113.6</b>	<b>64.7</b>	<b>122.8</b>	<b>165.5</b>
Provision for Income Taxes	-16.4	-18.4	-19.6	-15.5	-20.9
<b>Net income after taxes</b>	<b>216.7</b>	<b>95.1</b>	<b>45.1</b>	<b>107.3</b>	<b>144.7</b>
Minority interest	-77.3	-37.2	-9.9	-23.6	-31.8
<b>Net income attributable to parent</b>	<b>139.4</b>	<b>57.9</b>	<b>35.1</b>	<b>83.7</b>	<b>112.8</b>
Non-recurring adjustments to net income	-72.9	7.1	0.0	0.0	0.0
<b>Adjusted net income</b>	<b>66.5</b>	<b>65.0</b>	<b>35.1</b>	<b>83.7</b>	<b>112.8</b>
<b>Adjusted EPS (SAR)</b>	<b>0.81</b>	<b>0.80</b>	<b>0.43</b>	<b>1.03</b>	<b>1.38</b>

Source: Kamco Invest Research and SISCO

Cash Flow (SAR Mn)	2020	2021	2022E	2023E	2024E
Net cash from operating activities	356.1	236.3	(172.6)	443.3	520.6
Net cash (used in) from investing activities	(194.7)	511.4	(544.2)	(375.2)	(263.0)
Net cash from (used in) financing activities	(120.0)	(191.9)	(132.2)	(58.3)	(250.4)
Change in cash and cash equivalents	41.4	555.8	(849.0)	9.8	7.2
FX and other adjustments					
<b>Cash and cash equivalents at the end of the year</b>	<b>336.5</b>	<b>892.4</b>	<b>43.3</b>	<b>53.2</b>	<b>60.4</b>
Valuation & Financial Ratios	2020	2021	2022E	2023E	2024E
<b>Asset Structure and Leverage Ratios</b>					
Total Debt / Total Assets (x)	0.17	0.15	0.14	0.12	0.11
Total Debt / Equity (x)	0.44	0.32	0.30	0.27	0.24
Total Liabilities/Equity (x)	1.58	1.18	1.14	1.23	1.21
<b>Profitability Ratios</b>					
Return on Average Equity (%)	3.9%	3.2%	1.5%	3.6%	4.7%
ROIC (%)	9.7%	8.6%	6.9%	9.0%	10.2%
<b>Margins</b>					
Gross profit margin (%)	49.2%	48.5%	46.5%	47.4%	48.0%
EBITDA margin (%)	51.9%	54.1%	47.1%	47.8%	49.6%
EBIT margin (%)	29.7%	30.2%	26.1%	26.8%	27.4%
Net profit margin (%)	16.2%	6.3%	4.1%	7.9%	9.3%
<b>Per Share Data and Valuation Ratios</b>					
Earnings Per Share (SAR)	0.81	0.80	0.43	1.03	1.38
Book Value Per Share (SAR)	21.0	28.1	28.3	28.8	29.8
Dividend Per Share (SAR)	0.60	0.80	0.80	0.80	0.80
PE (x)	39.8	38.6	47.1	19.8	14.7
EV/EBITDA (x)	9.0	8.3	7.9	6.3	5.4
PB (x)	1.5	1.1	0.7	0.7	0.7
Dividend Yield (%)	1.9%	2.6%	3.9%	3.9%	3.9%

Source: Kamco Invest Research and SISCO

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