

Saudi Industrial Services Company (SISCO)

Equity Research Update

Sector – Industrials

Portfolio races to full throttle with vertical synergies

Efficiencies & portfolio synergies allow focus on SISCO 2.0. Retain Outperform

Strong performances in SISCO's existing portfolio investments at both subsidiary and associate level partnerships should unlock vertical synergies and additional efficiencies, that should drive group level GP margins higher by ~400 bps to 53% over 2023E-25E, as per our forecasts. It also ushers in the ideal backdrop for SISCO 2.0 and its 6x26 strategy to grow revenues to SAR 2 Bn and AUMs to SAR 6 Bn at a minimum target IRR of 12% in our view. Further, the current trajectory of organic operations, cash positions and funding options allow those targets to be achieved by 2026, while the execution of corporate M&A should further upgrade our thesis and forecasts. We reiterate our Outperform rating on SISCO, as we remain optimistic on the company's capabilities to find new investments and operate as a full-cycle investment holding company that invests, incubates, monetizes, and recycles returns.

Holdings enroute to achieving peak performance in key KPIs

SISCO's current portfolio holdings exhibited strong H1-2023 performances in-line with our expectations. In Port operations, we expect RSGT to achieve gateway/total volumes of ~1.4 Mn/~3.4 Mn TEUs in 2023E (2022:1.04/ 2.84 Mn TEUs) and expect average gateway/total volumes of ~1.56 Mn/~3.7 Mn TEUs over 2023E-25E, driven by the continuation of growth seen in the consumption of food, construction materials, electronics, and other consumables. Average gateway pricing of ~SAR 485/TEU over 2023E-25E and improvement of the mix of transshipment to gateway to 55:45 should also be achieved in our view. Transshipment volumes should grow at CAGR of 8%-9% over 2023E-25E, as liners continue to prefer JIP and divert most of their growing accounts to RSGT with the recent upgrade of the terminal's throughput to 6.2 Mn TEUs. For the Logistics segment, the healthy open yard utilization rate and ratio of open yard to warehouses should drive segment revenues to reach SAR 127.3 Mn in 2023E (2022: SAR 93.5 Mn). We forecast revenues to grow at a CAGR of 17.7% over 2022-25E and achieve and average GP margin of 50% over the period (GP Margin - 2022: 44%). Our Water segment revenue forecasts of SAR 92.6 Mn for 2023E and growth to SAR 97.75 Mn by 2025E is supported by better revenue mix of volumes sold and pricing which should additionally drive strong GP margins of ~49% over 2023E-25E (2022: 37.5%).

6x26 strategy drives transformation to 'One-Stop Logistics Solutions Provider'

The vertical synergies in current portfolio holdings should provide a roadmap for achieving additional synergies with potential new investments which the company hopes to derive through its corporate M&A ambitions via various investment vehicles such as RSPDI, RSGTI, GDI etc. SISCO aims to become a diversified regional logistics solutions provider and drive growth at the holding level through inorganic investments focusing on 3PL cold chain and adjacencies such as e-commerce in the logistics value chain via a pipeline of deals. We believe SISCO is comfortably placed in securing its 6x26 strategy target of achieving SAR 2 Bn of revenues based on our organic revenue forecasts of SAR 1.54 Bn for 2026E and staying conservative and factoring in H1-2023 cash balances of SAR 0.79 Bn (and not based on our 2026E estimates). SISCO should also have flexibility and would not need to exhaust 100% its cash at the center and affiliates, in our view. The company guides that the pipeline for M&A remains strong, and we believe potential deals could be executed on a 50:50 mix of debt and equity and P/S multiple of 1.1x - 1.2x for its prospective M&A investments.

Valuation & Risks –TP raised to SAR 28.10 (Previous: SAR 27.00)

Our revised TP represents a 16.1% 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) Geopolitical risks impacting each segment's demand and disrupting H1-2023 momentum; 2) Challenges in global container market due to closure of trade lanes; 3) Leaner importer inventory strategies leading to lower bonded warehouses demand.

Outperform

CMP 16-Oct-23: SAR 24.20

Target Price (TP): SAR 28.10

Upside: +16.1%



Price Perf.	1M	3M	12M
Absolute	-7.6%	-19.5%	9.7%
Relative	-2.9%	-10.1%	16.6%

Stock Data

Bloomberg Ticker	SISCO AB
Tadawul Ticker	2190
Last Price (SAR)	24.20
MCap (SAR Mn)	1,975
MCap (USD Mn)	527
EV (SAR Mn)	3,073
Stock Performance - YTD (%)	19.2%
PE - 2023E (x)	24.0
EV/EBITDA - 2023E (x)	5.5
Dividend yield - 2023E (%)	3.3%
52-Week Range (SAR)	19.30/31.10

Sources: Kamco Invest Research & Bloomberg

SISCO Financials	2022	2023E	2024E
Revenue* (SAR Mn)	855	1,082	1,218
GP margins (%)	48.7%	52.6%	52.7%
EBITDA (SAR Mn)	458	559	628
EPS (SAR/share)	0.51	1.01	1.47
EV/EBITDA (x)	7.3	5.5	4.9
Div Yield (%)	3.9%	3.3%	3.3%

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

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Valuation and Risks

TP raised to SAR 28.10/share; maintain 'Outperform' rating

Post speaking to the management and receiving confirmation of our positive expectations from H1-2023 results, we have updated our model forecasts for SISCO's current portfolio holdings. We revise our forecasts for SISCO's current operating holdings as we expect 1) RSGT to achieve average gateway/total volumes of ~1.56 Mn/~3.7 Mn TEUs over 2023E-25E, with average gateway pricing of over SAR 485/TEU over 2023E-25E and an improvement of the mix of transshipment to gateway to 55:45; 2) Optimized ratio of open yard to warehouses should drive segment revenues to grow at a CAGR of 17.7% over 2022-25E and achieve an average GP margin of 50% over the period; 3) Water segment revenues to reflect better revenue mix of volumes sold while pricing should contribute to strong GP margins of ~49% over 2023E-25E. Further, we raise our target price (TP) to SAR 28.10/share (Previous: SAR 27.00/share), and TP represents a 16.1% 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)	3,899.1	36.36%	1,417.7	Avg. EBITDA margins of 55%, WACC of 11.75%, concession term until 2049; 2024 EV/EBITDA of 8.8x
Logistics parks and support services (LogiPoint & ISNAD)	262.7	76%	199.6	Avg. EBITDA margins of 42%, WACC of 8.5% with a term until 2039 for JIP & Modon and 2053 for Khumrah; 2024 EV/EBITDA of 8.5x
Water desalination and distribution (Kindasa)	299.2	65%	194.5	Avg. EBITDA margins of 32%, WACC of 12.0% and terminal growth of 1.5%; 2024 EV/EBITDA of 17.2x
EV of operations	4,460.9		1,811.8	
Associates			453.6	Tawzea (50%) - 2024 P/E of 20x; SA Talke (33.3%) - 2024 P/E of 10x; WESSCO (31.85%), Xenmet (19%) & Green Dome (24%) each at P/B - 1x
Cash at centre			463.4	as of H1-2023
Other assets SISCO center			26.6	as of H1-2023
Other liabilities at SISCO center			-57.6	as of H1-2023
Equity value prior to complexity discount			2,697.7	
Holding company complexity discount			15%	
SISCO SotP equity value (SAR Mn)			2,293.1	
SISCO SotP equity value per share (SAR)			28.10	
Current Price			24.20	
Upside (%)			16.1%	

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 its respective concession terms. For SISCO's associates' valuation, we value each associate based on P/E or P/B multiples. We further apply a 15% 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 TP currently only reflects SISCO's organic operations forecasts and portfolio valuation estimates. 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:

- Geopolitical risks impacting each segment's demand and disrupting momentum witnessed in H1-2023.
- Challenges in global container market due to closure of trade lanes.
- 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.

Investment Thesis Update

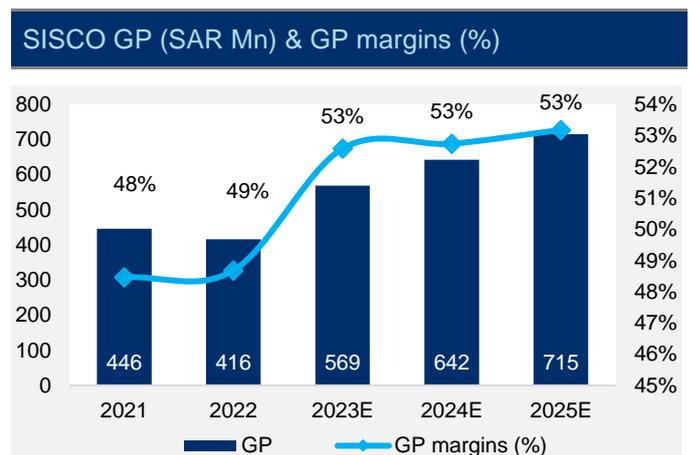
Investment holdings begin to exhibit peak KPI performances

We refreshed our positive investment thesis on SISCO and updated our model forecasts for the company's current portfolio as holdings have exhibited strong H1-2023 performances in-line with our expectations from our previous update from [Dec 2022: SISCO Portfolio ramp-up underway; maintain 'Outperform'](#). Our rationale for raising forecasts for SISCO's holdings:

- Ports & Terminals:** The segment posted impressive gateway volumes of 655 TEUs for H1-2023 (+ 31% y-o-y) along with an 8% y-o-y growth in transshipment volumes over the same period at transshipment to gateway mix of 58:42. As a result, segment revenues improved by +25.5% to SAR 404.2 Mn at the end of H1-2023, while segment profitability improved significantly to SAR 38 Mn. We now expect RSGT to continue to achieve gateway/total volumes of ~1.4 Mn/~3.4 Mn TEUs in 2023E (2022:1.04/ 2.84 Mn TEUs) and expect average gateway/total volumes of ~1.56 Mn/~3.7 Mn TEUs over 2023E-25E, driven by the continuation of growth seen in the consumption of food, construction materials, electronics, and other consumables. The current product mix should also keep gateway pricing at an average of over SAR 485/TEU over 2023E-25E and improve the mix of transshipment to gateway to 55:45 in our view. Transshipment volumes should grow at CAGR of 8%-9% over 2023E-25E, as liners continue to prefer JIP and divert most of their growing accounts to RSGT with the recent upgrade of the terminal's throughput to 6.2 Mn TEUs.



Source: Kamco Invest Research, SISCO



Source: Kamco Invest Research, SISCO

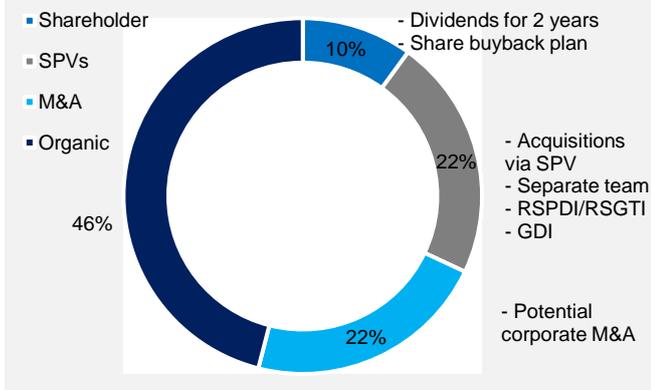
- Logistics, Parks & Services:** Land occupancy rates improved to 60% as: 1) An underutilized portion of open yard (~230k-250k sq.m) was returned to Mawani and 2) The increase of bonded warehouse capacity by around 20k sq.m also meant more land was utilized for parking etc. The healthy open yard utilization rate and ratio of open yard to warehouses significantly optimizes costs, logistics portfolio's revenues and unlocks higher services revenues. As a result, with the addition of more bonded warehouse capacity, we forecast segment revenues to reach SAR 127.3 Mn in 2023E (2022: SAR 93.5 Mn). Revenues should grow at a CAGR of 17.7% over 2022-25E and achieve an average GP margin of 50% over the period (GP Margin - 2022: 44%).
- Water Solutions:** Water sales volumes recovered by ~4% y-o-y in H1-2023 (7.9 m3) despite sequentially lower volumes sold q-o-q in Q2-2023. We expect water volumes to recover to 15.95 m3 in 2023E and approach closer to 2021 levels (16.96 m3) in 2025E (16.85 m3). Our revenue forecasts for 2025E at SAR 97.75 Mn however beat 2021 revenues (SAR 97.37 Mn) on better revenue mix and pricing, which should additionally combine with the revised lower depreciation cost to help GP margins to remain at ~49% over 2023E-25E from 37.5% in 2022.

Synergies amongst portfolio investments imminent

With portfolio investments beginning to show efficiencies, vertical synergies are also being actively pursued, especially between the Ports and Logistics businesses such as high margin landside services like packing-unpacking of containers. Further the management seemed optimistic on deriving and monetizing higher synergies between its Water businesses – Kindasa and Tawzea. Going forward,

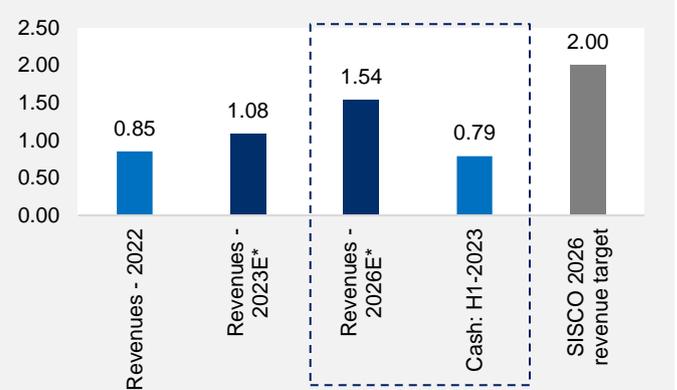
these should optimize and provide additional recurring revenues in our view, and should help in providing a roadmap for achieving incremental synergies for the company's newer investments and inorganic capital allocation via SPV's and corporate M&A.

Capital Allocation Structure *



Source: SISCO, * indicative percentages that could potentially change

SISCO revenue target looks achievable

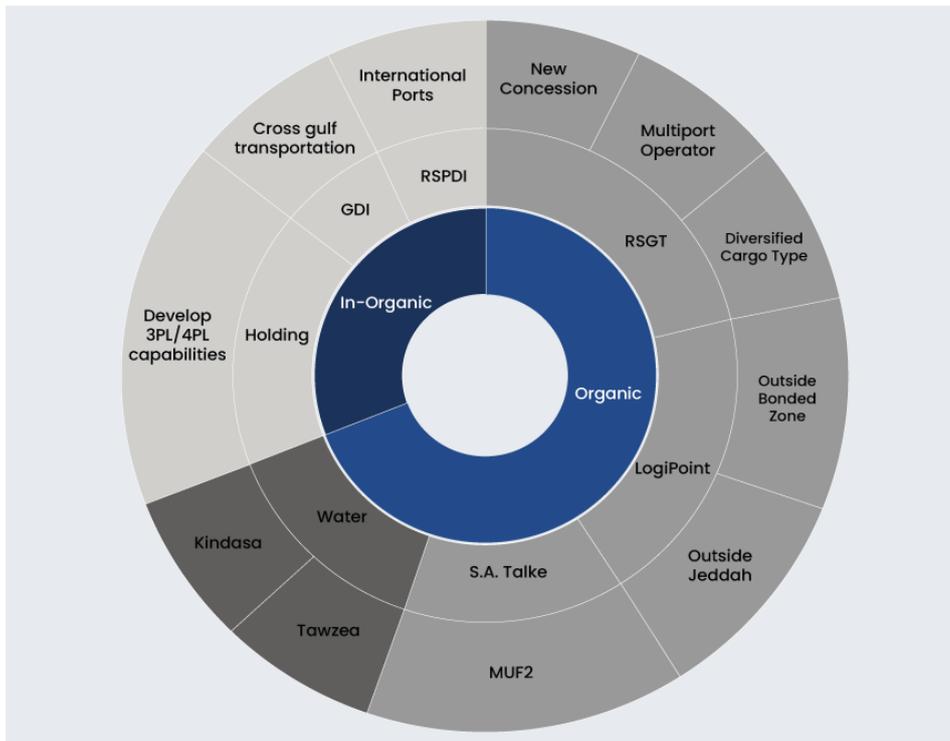


Source: Kamco Invest Research, SISCO, * Kamco Invest Research forecast

6x26 strategy envisions a regional one-stop logistics solutions provider

We believe SISCO is comfortably placed in securing its 6x26 strategy target of achieving SAR 2 Bn of revenues based on our organic revenue forecasts of SAR 1.54 Bn for 2026E and staying conservative and factoring in H1-2023 cash balances of SAR 0.79 Bn (and not based on our 2026E estimates). SISCO should also have flexibility and would not need to exhaust 100% its cash at the center and affiliates, in our view. The company guides that the pipeline for M&A remains strong, and we believe potential deals could be executed on a 50:50 mix of debt and equity and P/S multiple of 1.1x - 1.2x for its prospective M&A investments.

SISCO portfolio roadmap



Sources: SISCO

Key initiatives within the 6x26 strategy's portfolio roadmap and investment vehicles include:

- **Red Sea Gateway Terminal International (RSGTI):** RSGTI is actively evaluating multiple investment opportunities and is currently in negotiations for securing the concession to operate the Patenga Container Terminal in Bangladesh and is looking at a pipeline of opportunities in both Asia and Africa.
- **Red Sea Port Development (RSPD):** RSPD is the investment vehicle which holds RSGT, and SISCO mentioned that it continues to seek opportunities to expand within the Kingdom through new concessions or acquisitions.
- **RSPD International (RSPDI):** The company's inaugural foray into international investments at SISCO's RSPD level.
- **Green Dome Investment (GDI):** GDI was established as a logistics investment vehicle in 2020 and later in 2021 acquired Elite Logistics. This has enabled SISCO to achieve operational footprint in UAE, Qatar, Kuwait Bahrain, Oman, and GDI continues to look to expand with more cross-gulf transportation investment opportunities.
- **Holding level investments:** SISCO aims to drive growth at the holding level through inorganic investments in logistics, primarily focusing on 3PL cold chain and adjacencies in the logistics value chain via a pipeline of deals developed within the 3PL cold chain and e-commerce segment.
- **Associates portfolio:**
 - **Tawzea:** SISCO aims to extract maximum value for its shareholders by scaling Tawzea to achieve synergies with Kindasa, and new signings as the company continues to secure new projects. These include the recently bagged 1) SAR 199.5 Mn contract to operate and maintain the water network in Makkah and its governorates for a contract period of 60 months, and the 2) SAR 34.5 Mn contract to operate and maintain wastewater treatment plants in the cities of Dammam and Khobar for a project duration of 18 months.
 - **SA Talke:** Completion of the Multi User Facility 2 (MUF2) expansion project in 2023 with revenue recognition from 2024 onwards to provide yard and warehouse space together with additional logistic services to its existing customers.

SISCO Financials					
Balance Sheet (SAR Mn)	2021	2022	2023E	2024E	2025E
Assets					
Cash & cash equivalents	892.4	787.9	844.2	905.5	1,178.1
Receivables	161.8	155.5	218.5	245.9	271.4
Other assets	36.6	39.3	38.3	37.9	39.2
Total current assets	1,090.7	982.7	1,101.0	1,189.3	1,488.8
Net property, plant and equipment	427.1	575.0	737.8	883.4	912.6
Goodwill	8.8	8.8	8.8	8.8	8.8
Intangibles	3,052.9	3,010.7	3,041.9	2,999.4	2,921.2
Other assets	415.6	481.1	548.3	553.1	557.8
Total assets	4,995.1	5,058.3	5,437.8	5,634.0	5,889.2
Liabilities					
Liabilities	1,961.7	1,962.1	2,052.0	2,106.9	2,156.8
Total debt	736.9	780.0	996.5	1,003.2	1,009.8
Total liabilities	2,698.7	2,742.1	3,048.6	3,110.1	3,166.6
Shareholders' Equity					
Share capital	852.4	852.4	852.4	852.4	852.4
Retained earnings	202.5	170.3	188.5	243.2	336.3
Minority Interest	810.4	800.3	855.1	935.1	1,040.7
Other Equity	431.1	493.2	493.2	493.2	493.2
Total Equity	2,296.4	2,316.2	2,389.3	2,523.9	2,722.6
Total liabilities and equity	4,995.1	5,058.3	5,437.8	5,634.0	5,889.2
Income Statement (SAR Mn)	2021	2022	2023E	2024E	2025E
Revenue (excluding construction revenue)	921.2	854.8	1,082.2	1,217.7	1,344.1
Cost of goods sold	-474.7	-438.7	-513.1	-575.5	-629.3
Gross profit	446.5	416.2	569.1	642.2	714.8
SG&A	-168.1	-186.1	-216.4	-243.5	-268.8
Adjustments related to non-recurring items	219.6	228.1	206.2	229.3	269.4
Reported EBITDA	490.8	456.1	556.9	628.0	715.4
Adjusted EBITDA	497.9	458.1	558.8	628.0	715.4
Depreciation and amortization	-173.7	-171.6	-189.5	-197.3	-207.0
Adjustments related to non-recurring items	-38.8	-54.5	0.0	0.0	0.0
EBIT	278.3	230.0	367.4	430.7	508.4
Finance costs	-203.5	-213.6	-254.0	-258.3	-266.6
Finance income	0.2	12.3	13.7	14.0	19.0
Share associates and other income	38.5	44.9	51.7	51.6	53.4
Net income before taxes	113.6	73.7	178.8	238.0	314.3
Provision for Income Taxes	-18.4	-18.2	-41.6	-38.1	-50.3
Net income after taxes	95.1	55.5	137.1	199.9	264.0
Minority interest	-37.2	-18.8	-54.9	-80.0	-105.6
Net income attributable to parent	57.9	36.7	82.3	119.9	158.4
Non-recurring adjustments to net income	7.1	4.8	1.2	0.0	0.0
Adjusted net income	65.0	41.5	83.5	119.9	158.4
Adjusted EPS (SAR)	0.80	0.51	1.01	1.47	1.94

Source: Kamco Invest Research and SISCO

Cash Flow (SAR Mn)	2021	2022	2023E	2024E	2025E
Net cash from operating activities	236.3	213.2	410.2	534.5	603.8
Net cash (used in) from investing activities	511.4	(245.8)	(373.7)	(243.0)	(95.5)
Net cash from (used in) financing activities	(191.9)	(72.0)	19.7	(230.2)	(235.7)
Change in cash and cash equivalents	555.8	(104.5)	56.3	61.3	272.7
FX and other adjustments					
Cash and cash equivalents at the end of the year	892.4	787.9	844.2	905.5	1,178.1
Valuation & Financial Ratios	2021	2022	2023E	2024E	2025E
Asset Structure and Leverage Ratios					
Total Debt / Total Assets (x)	0.15	0.15	0.18	0.18	0.17
Total Debt / Equity (x)	0.32	0.34	0.42	0.40	0.37
Total Liabilities/Equity (x)	1.18	1.18	1.28	1.23	1.16
Profitability Ratios					
Return on Average Equity (%)	2.8%	1.8%	3.6%	4.9%	6.0%
ROIC (%)	8.6%	6.8%	9.6%	11.1%	12.3%
Margins					
Gross profit margin (%)	48.5%	48.7%	52.6%	52.7%	53.2%
EBITDA margin (%)	54.1%	53.6%	51.6%	51.6%	53.2%
EBIT margin (%)	30.2%	26.9%	33.9%	35.4%	37.8%
Net profit margin (%)	6.3%	4.3%	7.6%	9.9%	11.8%
Per Share Data and Valuation Ratios					
Earnings Per Share (SAR)	0.80	0.51	1.01	1.47	1.94
Book Value Per Share (SAR)	28.1	28.4	29.3	30.9	33.4
Dividend Per Share (SAR)	0.60	0.80	0.80	0.80	0.80
PE (x)	38.6	39.9	24.0	16.5	12.5
EV/EBITDA (x)	8.3	7.3	5.5	4.9	4.3
PB (x)	1.1	0.7	0.8	0.8	0.7
Dividend Yield (%)	2.0%	3.9%	3.3%	3.3%	3.3%

Source: Kamco Invest Research and SISCO

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