APRIL 2016

SAUDI RETAIL SECTOR

LOWER SPENDING POWER IMPACTS ORGANIC GROWTH

The Saudi Retail sector witnessed a shift in spending patterns, as a result of lower consumer spending power from revised subsidies. As a result of this and pressures from VAT by 2018, we revised organic growth estimates downward for discretionary names. Over the medium term, we believe higher average salaries due to Saudisation programs may offset the negative impact of revised subsidies and VAT. We prefer non-discretionary over discretionary names. Al Othaim is our top pick, due to its focus on consumer staples and expansion execution record.

This is an extract of our published report, the full version of which can be found on the ncbc.com website.

- **Subsidy cuts impact spending power; Prefer consumer staple names**

We believe the introduction of energy subsidy cuts has impact the spending power of consumers, specifically on discretionary products. Signs of weakness have been reflected in PoS transaction values post-3Q15, which grew by 6.8% YoY vs. 2-year historical average of 15.3%. Moreover, the average ticket size declined by 22% to SR380 vs. a historical 5-year average of SR490. We believe Al Othaim is resilient to this trend, given its focus on consumer staples.

- **Inflation spikes, organic growth rates revised**

Lower subsidies have led to an increase in overall inflation rates in Saudi. In February 2016, the inflation rate came in at 4.2% vs. 2.1% in February 2015. This, in addition to the proposed introduction of VAT led us to reduce our organic growth estimates for discretionary names from an average of 6% to 3.5%. With further subsidy cuts expected, organic growth rates may remain low.

- **Saudisation and demographics support long-term outlook**

Saudi has a young population, with over 50% of the current population under the age of 30. With low labour market participation and further Saudisation programs such as “Balanced Nitaqat”, we believe the relative weakness in the spending power from increased prices and VAT will be partially offset by higher average salaries and lower remittances over the medium-term.

- **Attractive sector valuations, Al Othaim is our top pick (+27% upside)**

The Retail sector traded at a 5-year average premium of 36.1% over the TASI index. However, currently it is trading at similar levels, which we believe is unjustified due to its overall defensive nature and relatively more positive earnings growth outlook. Al Othaim is our top pick among covered stocks, driven by its 1) store expansion execution record, 2) sustainable organic growth rates supported by its loyalty program and 3) product portfolio of consumer staples, which is unaffected by lower discretionary spending.

Retail companies under coverage – Valuation matrix

	Rating	Current Price	PT (SR)	Upside/ Downside	Stock perf (%) Mar	Stock perf (%) YTD	P/E (x) '16	Implied P/E (x) '16	EV/ EBITDA '16	P/BV (x) '16	DY (%) '16	ROE (%) '16
Al Hokair*	OW	42.7	105.9	148%	(4.2)	(39.6)	11.0	27.4	7.8	3.3	5.3	31.6
Jarir	OW	113.9	169.7	49.0%	(13.5)	(28.8)	12.8	19.0	12.3	6.2	6.5	51.0
Al Othaim	OW	89.9	114.6	27.5%	9.2	1.1	15.1	19.2	10.3	3.2	2.2	22.5
Extra	OW	27.2	46.4	70.5%	5.8	(32.0)	13.1	22.3	6.9	1.7	3.7	13.2
Shaker	OW	23.6	40.1	69.8%	1.7	(16.5)	9.3	15.7	15.7	1.3	4.2	14.6

Source: NCBC Research, All prices as of March 27, 2016; * 2016 numbers refer to FY16 – year ending March 2016;
N: Neutral, UW: Underweight, OW: Overweight, NC: Not Covered

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NCBC Investment Ratings

OVERWEIGHT: Target price represents an increase in the share price in excess of 15% in the next 12 months

NEUTRAL: Target price represents a change in the share price between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

Other Definitions

NR: Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

CS: Coverage Suspended. NCBC has suspended coverage of this company

NC: Not covered. NCBC does not cover this company