United Electronics Company

Retail – Industrial
EXTRA AB: Saudi Arabia
12 January 2015

الراجحي المالية
Al Rajhi Capital

US$0.636bn	40%	US$2.467mn
Market cap	Free float	Avg. daily volume

Target price	92.5	14.2% over current
Consensus price	111.8	38.0% over current
Current price	81.0	**as at 11/1/2015**

Existing rating

Underweight	Neutral	Overweight

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Extra

Profit plunges due to store closure

Extra reported a mixed set of results for Q4 2014. The company's revenues beat our estimates, surging 19.1% y-o-y to SAR1,089mn, despite the Commerce Ministry closing down its stores during the Mega Sale event. On the other hand, its adjusted net profit was below our estimates. The company made a one-time provision of SAR14mn for high inventory. We will revise our estimates on the company after the release of detailed financials and a discussion with the management. For now, we reiterate our Neutral rating with a target price of SAR92.5.

Earnings vs our forecast	Above	In Line	**Below**
Likely impact:			
Earnings estimates	Up	**No Change**	Down
Dividend estimates	Up	**No Change**	Down
Recommendation	Upgrade	**No Change**	Downgrade
Long term view	Stronger	**Confirmed**	Weaker

- **Revenues:** Extra's revenues jumped 19.1% y-o-y to SAR1,089mn, coming in ahead of both our (SAR940mn) as well as the consensus (SAR894mn) estimate. We were conservative on the company's top-line this quarter and estimated sales to rise by a marginal 3% because of the closure of 8 of its stores for 7 days, due to which Extra missed its Mega Sales target by SAR150mn. We believe the company would have undertaken additional discounting and aggressive marketing efforts to make up for this loss in sales.
- **Gross and operating profit:** Despite the increase in revenues, the company's gross profit fell 5.5% y-o-y to SAR163.9mn. The company's gross profit margin fell about 400bps y-o-y to 15.1% as compared to our forecast of 16%. Extra's operating profit plunged 85.4% y-o-y to SAR8.8mn. The fall was partly due to a one-off provisioning of SAR14mn due to the high levels of inventory, related to the store closures. Adjusting for this, operating profit fell 62.2% y-o-y to SAR22.8mn, indicating a sharp increase in operating expenses.
- **Net profit:** The company's net profit fell 85.6% y-o-y to SAR8.4mn. Adjusting for the inventory provisioning, net profit stood at SAR22.4mn, missing our SAR26.9mn as well as consensus SAR43.5mn estimates.

Figure 1 Extra: summary of Q4 2014 results

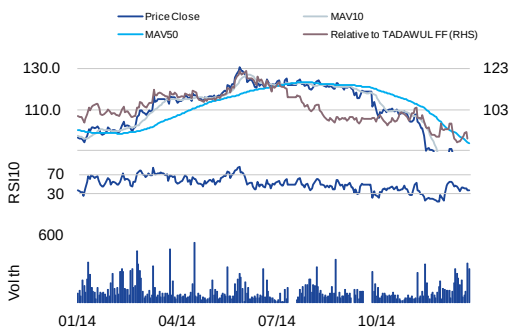
(SAR mn)	Q4 2013	Q3 2014	Q4 2014	% chg y-o-y	% chg q-o-q	ARC est
Revenue	914	809	1,089	19.1%	34.6%	940
Gross profit	174	144	164	-5.5%	13.7%	150
Gross profit margin (%)	19.0%	17.8%	15.1%			16.0%
Operating profit	60.3	30.3	8.8	-85.4%	-71.0%	28.2
Net profit	58.4	29.7	8.4	-85.6%	-71.7%	26.9

Source: Company data, Al Rajhi Capital

Flash view

Flash View is an analyst's preliminary interpretation of a results announcement or the impact of a major event. Our investment rating and earnings estimates are not being changed in this report. Any formal changes to our investment rating or earnings estimates will be made in a subsequent report, which may differ from the preliminary views expressed here.

Performance



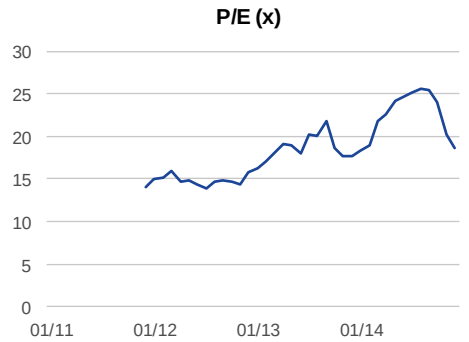
Source: Bloomberg

Earnings

Period End (SAR)	12/13A	12/14A	12/15E	12/16E
Revenue (mn)	3,388	3,689	3,990	4,364
Revenue Growth	12.4%	8.9%	8.1%	9.4%
EBIT (mn)	172	126	195	229
EBIT Growth	5.5%	-27.0%	55.4%	17.2%
EPS	5.58	4.04	6.35	7.25
EPS Growth	5.2%	-27.6%	57.3%	14.1%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Conclusion: We believe the company has significantly increased its sales and marketing efforts to make up for the loss of sales due to the closure of its stores. The company's management had mentioned that it would undertake an aggressive PR campaign to win back the customer confidence lost due to regulatory action. This may have partly resulted in the sharp rise in operating expenses witnessed during the quarter and hence a decline in margins.

We believe the government action resulting in store closures was a one-off event and retail companies like Extra will be more careful in the future to avoid such a situation. The company may have to spend more on marketing strategies for a quarter or two to counter the loss of customer loyalty due to this event. We will revise our estimates on Extra after the release of detailed financial results and a discussion with the management. For now, we reiterate our Neutral rating on the company with a target price of SAR92.5.

Major Developments

Commerce ministry closes several stores

The commerce ministry closed 8 Extra stores for a period of 7 days after these stores were found not meeting all the regulations during its annual Mega Sale event. The authorities mentioned that Extra was selling more products on discount than it had approval for and also giving larger discounts than allowed. Further, the regulator found that there were price tags missing on some items, while some items had overstated discount rates.

The company stated that this move has led to a potential revenue loss of worth SAR150mn, which impacted the gross profit by SAR27mn. In addition, the company made a provision of SAR14mn on account of the high level of inventory, especially for goods like mobile phones and computers which witness fast changing prices.

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": **Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.**

"Neutral": **We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 6-9 month time horizon.**

"Underweight**": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.**

2. Definitions

"Time horizon": **Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.**

"Fair value": **We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.**

"Target price": **This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.**

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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