United Electronics Company
Retail – Industrial
EXTRA AB: Saudi Arabia
17 April 2019

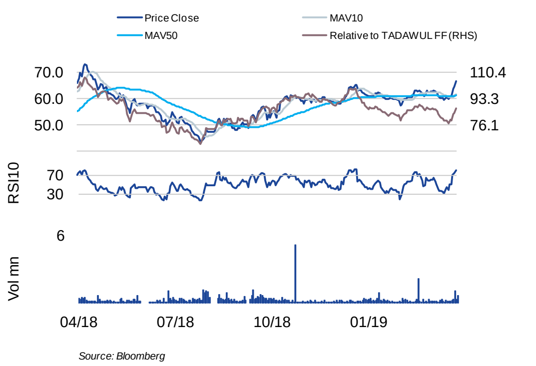
US$0.887bn	40%	US$4.146mn
Market cap	Free float	Avg. daily volume

Target price	70.00	+5.2% over current
Current price	66.50	as at 14/4/2019

Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

Period End (SAR)	12/18A	12/19E	12/20E	12/21E
Revenue (mn)	4,394	4,820	5,157	5,415
Revenue Growth	4.4%	9.7%	7.0%	5.0%
EBITDA (mn)	220	262	289	315
EBITDA Growth	14.6%	18.8%	10.2%	9.1%
EPS	3.22	3.82	4.40	4.84
EPS Growth	14.9%	18.6%	15.1%	10.2%

Source: Company data, Al Rajhi Capital

Valuation

Period End	Mar-19
P/E (Current)	20.1
P/E (Forward)	17.4
P/B	4.9
EV/EBITDA	16.3
ROE	26.6%
Div. Yield	2.6%

Source: Company data, Al Rajhi Capital

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Extra

Multiple levers to push further growth

Extra recorded an impressive set of results in Q1 2019 with its topline growing 22% y-o-y to SAR1.05bn. This was driven by increasing online sales, stores addition, Tasheel instalment program and continued shift from unorganized to organized retail, apart from low base due to VAT. The bottom line grew even better, by 57% y-o-y to SAR34mn. We expect steady growth to continue (sales up ~10% in FY 2019) led by multiple levers. Among them, we believe aggressive promotion of Tasheel instalments program to be key as it would help a) accelerate further shift to organized market, b) boost margins by enhancing sale of premium products and generate additional margin from lending c) tap into newer customer segments. Structural growth factors remain healthy with increasing consumption of electronics devices, favorable demographics, pick up in homeownership and economic recovery. Based on our revised model, we have a TP of SAR70/share based on equal mix of DCF and PE valuations and maintain Neutral rating.

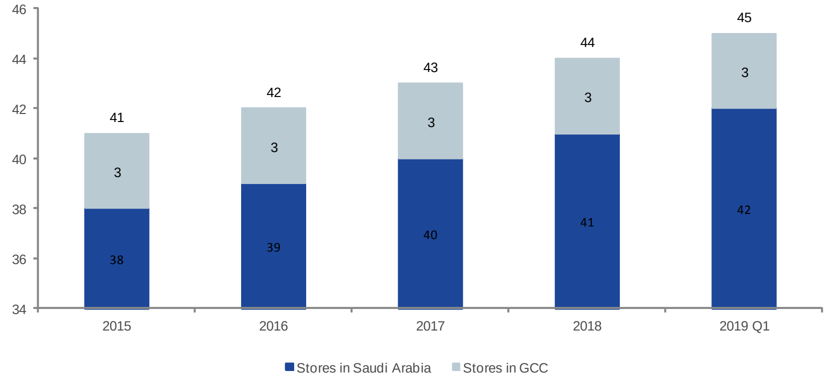
Tasheel Instalments Program: Tasheel program is driving earnings growth significantly as seen in the pick-up in receivables to SAR380mn in 2018 from SAR27mn in 2015. In Emerging and Developed markets, consumer loans and EMI schemes contribute to ~20-25% of the total sales while contribution of Tasheel sales to Extra's total sales was ~ 7%, up from 3% in 2017, implying room for growth. We expect Tasheel program to enable the company to target newer customer base, enhance margins and take more market share from unorganized segment.

Steady store expansions: In 2018, Extra added one store in Saudi Arabia taking the total store count to 41 in Saudi Arabia and 3 stores in GCC. In FY 2019 we expect the company to add two more stores in Saudi Arabia (one was opened in Q1) and one store in Oman. Extra's revenues from GCC have grown by 13%, faster than overall company sales. Further store expansions in GCC and enhanced brand image will benefit the company. Figure 1 depicts store expansions over the last five years in GCC and Saudi Arabia.

Demand for Consumer Electronics products to pick up post reforms: Saudi Arabia witnessed an economic slowdown in past two years mainly due to economic and structural reforms. However as the economic indicators indicate, we are witnessing a recovery in consumer spending. POS transactions increased by +31% y-o-y in Jan and 26% in February. The loans provided by banks for real estate and loans provided against mortgages have also witnessed an increase in the second half of 2018 which bodes well for consumer appliances. Despite a challenging year, Extra was able to post a net profit growth of 15% y-o-y in 2018 mainly driven by volume growth towards the end of the year and by capturing market share from the unorganized players. Thus not just the market share gains, with overall market size growth, Extra is likely to benefit further.

Valuation: We continue to value Extra based on equal weights for DCF and P/E based relative valuation (19.6x FY19 EPS), yielding a target price of SAR70 per share, implying an upside of 5.2%. The stock is currently trading at a P/E of 18.8x, based on last 12month EPS, lower than its 3-year average P/E of 20.4x. Based on an upside of 5%, we maintain our "Neutral" rating for the stock.

Figure 1 Number of stores

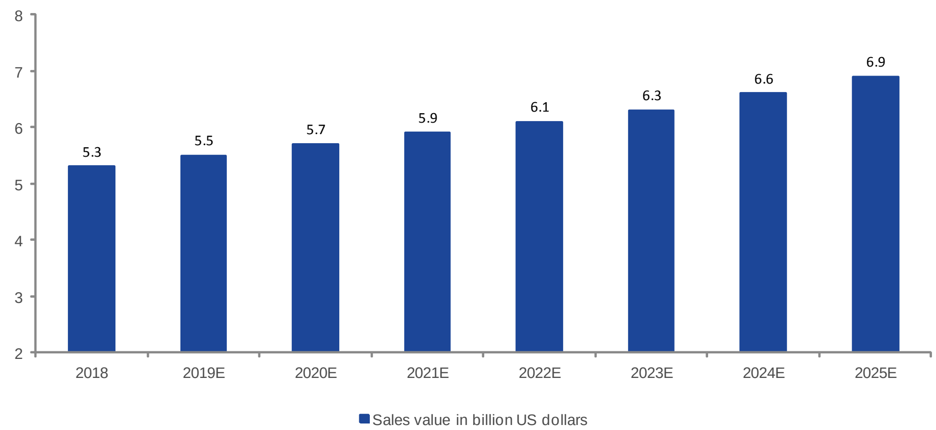


Source: Company data, Al Rajhi Capital

Saudi Consumer Electronics market overview

The consumer electronics market size in the country has been on a decline since 2015, largely due to low oil prices and weaker economic activity which led to lower demand for non-discretionary products. Moreover, need for fiscal consolidation post the decline of oil prices has prompted the Government to undertake reforms that pushed lower tendency to spend. However our research shows that there has been a gradual pickup in consumer demand as citizens adapt to the structural reforms.

Figure 2 Sales value in billion US dollars



Source: Company data, Al Rajhi Capital, Statista

According to Statista market survey the total sales of home appliances in FY 2018 in Saudi Arabia was USD5.3bn and this is expected to grow at a CAGR of 4% to USD 6.9 billion mainly driven by rise in population, demographic changes and increasing demand for technologically advanced products.

As for the consumer electronics segment, as per Statista's research the total revenue from this sector amounts to USD1.4bn and this number is expected to grow at a CAGR of 9.4% to USD 2038 million by 2023.

Globally the revenue from consumer electronics segment in developed nations is very high and if we see the global comparison of revenue from consumer electronics segment, Saudi Arabia has significant growth opportunity to climb up the ranking and we believe the revenue from the sector will improve as we achieve almost bottom of a slowdown in consumer spending

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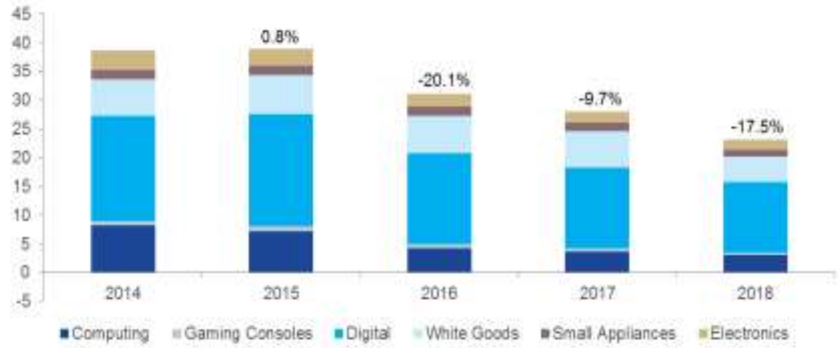
Figure 3 Saudi Consumer Electronics Market Historical Trend



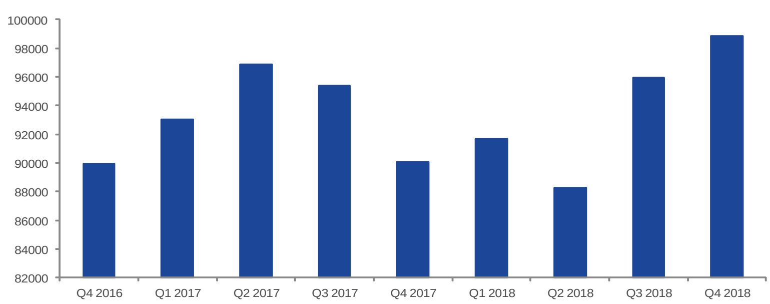
Source: Company data, Al Rajhi Capital

The weak macroeconomic conditions resulted in a market decline for all the sub-segments within consumer electronics market but it is noteworthy to observe that the share of digital goods remained resilient. This could be because of increasing demand for smartphones and tablets with latest technologies especially among young population which constitutes more than 50% of the population.

Demographic shift to aid sale of consumer appliances: The growth of consumer appliances was not as negatively impacted as anticipated in 2018 mainly due to increasing population (CAGR growth for the last 10 years is 2.5% vs. 1.1% world average) and significantly young population who prefer to use new technology. The impact of structural reforms led to a marginal decline to flattish growth in revenue of matured appliances however the sale of newly launched product continued to witness growth with growing young population. We believe that this demographic shift will have a positive impact in the long run and will boost the need for technologically advanced home appliances in the household which in turn will increase the overall market for consumer electronic products.

As per the latest data released by SAMA we have observed a steep increase in the real estate loans disbursed by bank especially towards the end of the FY 2018 and we believe this is a positive sign for the overall economy. As the construction activities increase, the demand for household appliances and other electrical products increases. We believe this to create an increasing demand for the overall electronics market.

Figure 4 Real Estate loans by bank (In SAR mn)



Source: SAMA, Al Rajhi Capital

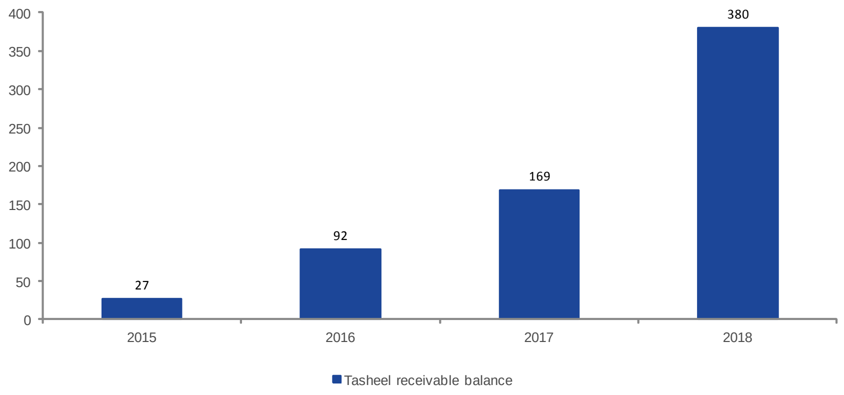
Women Participation in workforce to increase disposable income and change buying behaviour: The increase in women participation rate (from 17.8% at the end of 2017 to 19.5% at the end of 2020) will increase the disposable income of the families.. Unemployment rate (to 30% by 2020 from 32.7% in 2017) could drop further which could help pick up demand .

Investment Rationale

Extra to witness increase in sales through launch of Tasheel scheme: We believe that sales could pick up significantly post aggressive promotion of installment sales as seen from examples in other emerging markets. For example, while Tasheel provides 7% of sales to Extra, empirical evidence points to 25% of sales from such schemes in emerging countries.

Since 2015 the value of installment sales (as seen in receivables) has increased from SAR27mn in 2015 to SAR380mn in 2018. The company is planning to increase that figure to SAR500mn by the end of 2019. Sale on credit could especially boost demand for premium products which are normally higher margin products. This could be noticed by an increase in basket size as such schemes will make premium products affordable to people and give them an option to distribute the cost over several months. Apart from increased margin from premium products, there will be margin generated from lending facilities provided to the customer by Extra itself. This would also help accelerate the shift from unorganized sector to organized sector as such EMI facilities are not available with small retailers.

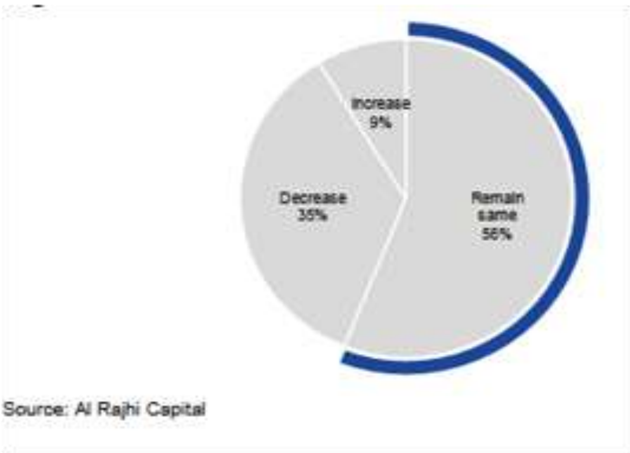
Figure 5 Tasheel receivable balance growing (In SAR mn)



Source: Company data, Al Rajhi Capital

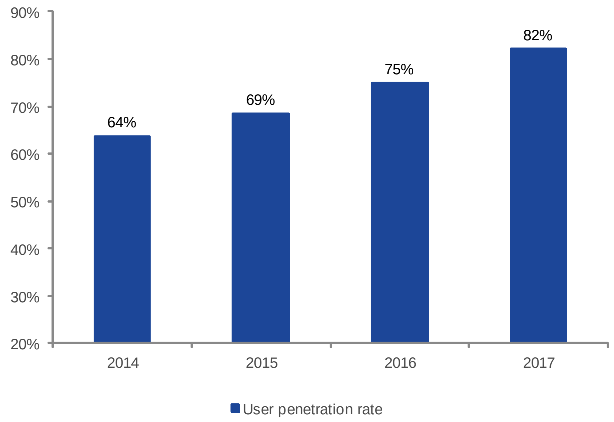
Smart phones now a non-discretionary spending: Availability of fast and cheap internet has led to a drastic increase in internet penetration in Saudi Arabia, as of 2017 the user penetration ratio increased to 82% from 64% in 2014 and is expected to grow to 90% by 2020. We conducted a survey in which we observed that 65% of the citizens are expected to either increase their internet consumption which could further drive the sale of smartphones, tablets and laptop.. Thus we believe companies like Extra which is one of the market leaders in the organized consumer electronics market to be the direct beneficiary of this growth as it forays into new regions and expands its market share.

Figure 6 Spending on Telecom to remain firm



Source: Al Rajhi Capital

Figure 7 Internet user penetration rate increasing

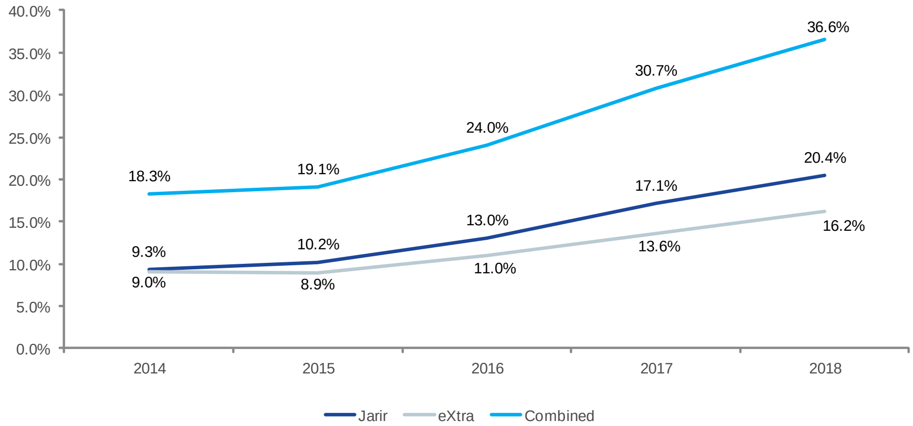


Source: Al Rajhi Capital, CITC.

Increasing urbanisation to benefit Extra: With the technological advancement reaching new heights, people are now perceiving smart appliances such as remotely monitored kids cameras , smart dish washers , smart microwaves and other smart home devices as a means to save time and as a replacement for housemaids which accounts for ~6% of Saudi Arabia households expenditure. With urbanization the demand for such smart devices will increase and it will directly benefit the sale of large player like Extra.

Organized Retailers Capturing Market Share: After the imposition of VAT in early 2018 and increase of gasoline/electricity prices, revenue for the electronics appliances sellers has been from flat to negative. Despite an overall slowdown in electronics business, Extra was able to post a net profit of 15% y-o-y in FY 2018 mainly driven by increased sales growth towards the end of the year and by capturing market share from the unorganized players. We strongly believe that the unorganized players will face margin pressure due to operating inefficiencies as compared to organized players. This will further narrow the competition to organized retailer over the long run. Companies like Extra provide an enhanced assistance to buyers and after sales service compared to smaller retailers. Moreover whenever people buy any electronic devices above USD200 they prefer to buy it from a recognized and trust worthy brand like Extra. Therefore we believe that there is much growth still to come in extra's revenue as the company will gain leverage from its brand as well as leadership position.

Figure 8 Jarir and Extra market share increasing



Source: Company data, Al Rajhi Capital

E-commerce is more of an opportunity rather than threat: The e-commerce market in Saudi Arabia is growing at a rapid pace, recording USD7.9bn in 2017 and is expected to reach USD10bn in 2020, with average expected user growth of 9.2% per annum. Further, e-commerce in Saudi Arabia is highly under-penetrated with percentage of e-commerce sales to overall retail sales of only 2.1% (well below global peers), implying further room for penetration. This presents a significant opportunity to major players - Jarir and Extra as they can boost their sales (particularly smart phones) through their e-commerce platforms. Both have well established e-commerce platforms and they can leverage their existing logistics network, well established brands and economies of scale to offer products at low prices to the consumers. Moreover, variety of shipping and payment options such as shop pick up and other advantages can be provided to the consumers. All these factors provide Jarir and Extra a competitive edge over new entrants and E-commerce companies.

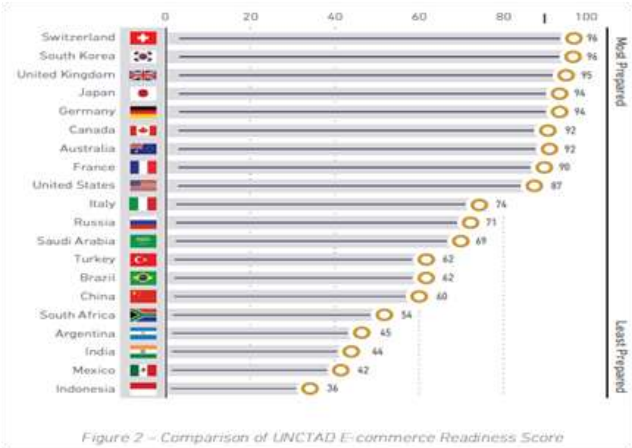
Figure 9 Top 10 countries by E-commerce sales

Top 10 countries with retail E-commerce sales as %age of total retail sales

Country	2015	2016	2017	2018
UK	14.4%	15.6%	16.9%	18.0%
China	12.0%	13.8%	15.5%	16.6%
Norway	10.7%	11.5%	12.1%	12.7%
Finland	10.4%	10.8%	11.2%	11.5%
South Korea	9.8%	10.5%	11.3%	12.0%
Denmark	9.3%	9.9%	10.4%	10.8%
Germany	8.4%	9.4%	10.4%	11.2%
US	7.1%	7.7%	8.3%	8.9%
Canada	5.9%	6.6%	7.4%	8.2%
Japan	5.4%	5.8%	6.2%	6.7%

Source: Al Rajhi Capital , invespcro

Figure 10 E-commerce Readiness Score



Source: Al Rajhi Capital, CITC

Extra

Highlights:

- The company's revenue had a steady growth in the past 5 years (CAGR of 3.6%), even though the economy witnessed an overall slowdown post drop in oil prices.

- While the revenue had grown steadily, the company was able to improve its profitability efficiently, as net margin stood at 3.7% in FY2018 (3.3% in FY2014).

- Extra was able to improve its gross margin slightly to 17.7% in FY2018 from 16.8% in FY2014, but still well below the industry average of 23.1%. This reflects its competitive pricing policy and provides room for future profitability improvement.

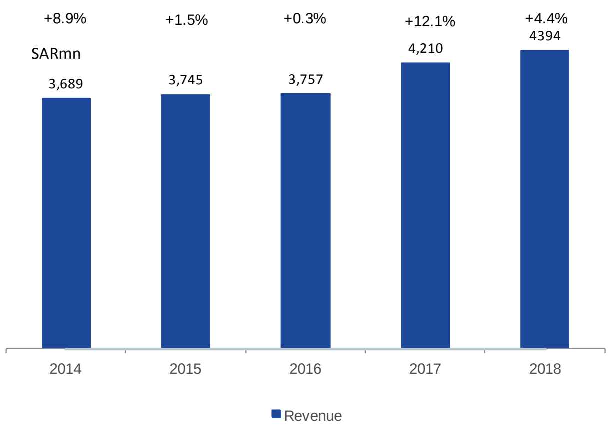
- Extra earned significant market share with market share doubling from 2014 to 16.5% of the consumer electronics market in 2018. Looking forward, we expect Extra to increase its market share in the future and in-parallel increase sales following the market overall recovery.

- Extra managed to expand its stores, with number of stores increasing from 38 stores in FY2014 to 44 stores in FY2018 (5 stores added in Saudi Arabia and 1 store added in Oman).

- Extra is gaining more market share in GCC countries other than Saudi market. Its sales in Bahrain and Oman have increased from SAR196mn in FY2014 to SAR279mn (as per our calculations) at a CAGR of 7.4% ,growing faster than the company overall. We expect Extra to expand further in GCC countries as Extra has started to earn a good reputation abroad which in our view will be one of the drivers for their future growth.

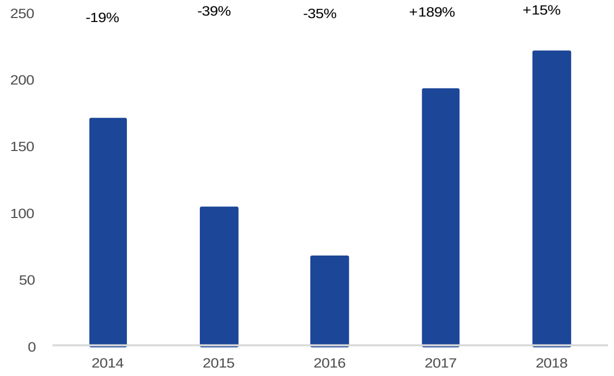
- Extra instalment program "Tasheel": Extra launched "Tasheel" for the first time in 2014, since 2016., The book value stood at SAR283mn inQ3 2018 as compared to SAR126mn in Q3 2017 (+124%). Looking forward we expect the portfolio of Tasheel to increase to SAR500mn by the end of 2019. We view Tasheel as a major growth driver as it targets a new audience of customers. We calculate the interest income generated from these sales at 2.2% of revenue in FY2020.

Figure 1   Revenue 2014-2018 (In SAR mn)



Source: Company data, Al Rajhi Capital

Figure 2   EBITDA 2014-2018 (In SAR mn)



Source: Company data, Al Rajhi Capital

Financials

Figure 3 Extra Co. Income statement 2016-2020

SAR mn	12/16A	12/17A	12/18A	12/19E	12/20E
Revenue	3,757	4,210	4,394	4,820	5,157
Gross Income	589	710	780	886	964
- Selling, General & Admin Expenses	567	564	601	668	722
Operating Income	23	148	178	217	242
Net Income Adjusted*	2	140	161	191	220
EPS	0.04	2.80	3.22	3.82	4.40
Dividends Per Share	0.00	1.75	1.88	2.2	2.6
Payout Ratio %	0%	62%	58%	58%	60%
EBITDA	**67**	**192**	**219**	**262**	**289**

Source: Company data, Al Rajhi Capital

Valuation

Given the growing environment of Extra business, the earnings added by Tasheel instalment program, growth from online sales withNoon.com partnership and stores expansion in Saudi Arabia as well as GCC, we expect the company earnings to grow at an CAGR of 11% till 2020 helped by its high operating leverage.

We continue to value Extra based on equal weights for DCF and P/E based relative valuation (19.6x FY19 EPS), yielding target price of SAR70 per share, implying an upside of 5.2%. The stock is currently trading at a P/E of 18.8x, based on last 12months EPS, lower than its 3-year average P/E of 20.4x. We maintain our “Neutral” rating for the stock.

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"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 12 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 12 month time horizon.

"Target price": We estimate target 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.

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