Fawaz Abdulaziz Alhokair Co.

Investment Update

Transformation plan bearing fruits; upgrade to 'Overweight'

Cenomi retail is right-sizing its store network (Cenomi has shutdown 287 stores and plans to close 88 more by the year end), transforming its brand portfolio (plans on divesting 29 brands) and exiting non-strategic geographies (USA and Balkans). The management has renewed focus on the higher margin food and beverage segment, champion retail brands and domestic market ('Saudi First' strategy). The company is optimizing balance sheet by deleveraging and improving working capital management. We expect the retail giant to benefit from KSA's strong consumer outlook (POS sales up 15% Y/Y), high purchasing power (GDP per capita USD59,065), large young population (63% of the population is under the age of 30 years), new e-commerce and micro consumer finance ventures. We expect net income to reach six year high of SAR 168.3mn in 2023, and then drop by 13.6% Y/Y in 2024 to SAR 145.4mn (due to normalization of land lord support). Discretionary spending on other activities (events) and changing consumer behavior towards online shopping are a key risk to the company. Our revised TP for Cenomi stands at SAR 22.1/ share, which translates to an "Overweight" rating with 18.3% potential upside.

Cenomi witnessed 410bps improvement in margins in Q2-23, however sales were lower Y/Y due to store closures: Cenomi recorded a 5.4% Y/Y drop in total revenue in Q2-23 to SAR 1,613.4mn, the subdued topline is mainly attributable to domestic business, which saw sales decline by 8.3% Y/Y to SAR 1,318.6mn, due to store closures. International sales improved by 10.4% Y/Y to SAR 294.9mn in Q2-23. The retail giant experienced a 410bps Y/Y (+866bps Q/Q) expansion in gross margins to 20.4% in Q2-23, due to closure of inefficient/loss making stores. Operating margins expanded by 854bps Y/Y to 17%, this expansion farther down the income statement mainly came from the SAR118mn land lord support (rent reduction, capex support and/or direct cash payment that land lord pays to get champion brands). Overall, despite doubling of the finance charges to SAR 59.2mn (due to increase interest rates), the company was able to log in net income of SAR 167.2mn up 189% Y/Y in Q2-23.

Revenue per sqm (excluding F&B and online sales) improved by 9.6% Y/Y in Q2-23, further improvement is likely due to more store closures and planned divestment of brands: Cenomi began its transformational journey last year, with plans to right size its branch network. The company has shutdown net 287 stores since June-22, and plans on closing down net 88 more stores in the remaining part of the year. Total gross floor area for retail (after store closures) is down 9.5% Y/Y to 408,000 sqm in Q2-23. According to the management, these stores were adding to the topline, however had little contribution to the bottom-line. Overall, closure of these stores have improved revenue per sqm to SAR 12,573, up 9.6% Y/Y. Interestingly, despite closure of these stores, strong performance from champion brands enabled the company to limit reduction in topline to just 5.4% Y/Y in Q2-23. As part of its transformation plan Cenomi has decided to divest 29 brands and exit non-strategic markets such as USA and Balkans, this will further improve margins for the company in the medium term.

Focus on Food & beverage, champion brands and domestic Saudi market: The management has renewed focus on the higher margin food and beverage segment (7 net openings in 1H23, as compared to 178 net closures in the retail segment). Our recent interaction with the management suggests that EBITDA margins in the F&B segment average around ~20%. Overall the target is to grow food and beverage business to ~12% of total sales in the long run from 7.5% in H1-23. Champion brands (Zara, Massimo Dutti, and Cinnabon) are another area of focus. Geographically, the management wants to make the most out of the growth opportunities in the domestic Saudi market and the MENA region. That said, the company has plans to right size its exposure in Morocco and Egypt by closing 16 and 39 stores, respectively.

Cenomi to benefit from favorable demographics, new e-commerce and micro consumer finance ventures: Consumer outlook in Saudi is promising, as shown by the increasing POS spending (up 15% Y/Y in 7M23), strong tourism (more than 100mn annual visits), high purchasing power (GDP per capita USD59,065), huge young population (63% of the population is under the age of 30 years) and. The company, in addition to the favorable demographics, will also benefit from new e-commerce and micro finance ventures. Cenomi has invested into online fashion retail space via Vogacloset (the e-commerce platform), which is an asset light structure; overall online sales constituted 5.6% of total sales in Q2-23, as compared to 4.9% in SPLY. The target is to grow online sales to ~6-7% of total revenues in the medium term. Moreover, FAS labs, consumer micro finance company which is a 50/50 joint venture between Cenomi retail and Cenomi centres, has achieved final approval from Saudi Arabian central bank. This initiative shall enable Cenomi to provide its customers a fully integrated shopping platform and further improve the affordability of its products.

Recommendation	Overweight
Target Price (SAR)	22.1
Upside / (Downside)*	18.3%

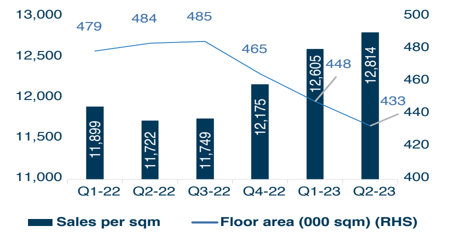
Source: Tadawul *prices as of 7th September 2023

Key Financials

SARmn (unless specified)	FY22*	2023E	2024E	2025E
Revenue	4,543	5,704	5,691	5,759
Growth %	-23.2%	25.6%	-0.2%	1.2%
Gross Profit	710	985	1,041	1,060
Net Profit	94	168	145	183
Growth %	109.5%	NM	-13.6%	26.0%
EPS* (SAR)	0.82	1.46	1.27	1.59

Source: Company reports, AlJazira Capital, * 9M-2022 from April - December

Revenue per sqm (SAR)



Source: AlJazira Capital, Company reports

Key Ratios

	FY22*	2023E	2024E	2025E
GP Margin	15.6%	17.3%	18.3%	18.4%
Net Margin	2.1%	3.0%	2.6%	3.2%
P/E (x)	22.9	12.7	14.7	11.7
P/B (x)	6.2	4.2	3.2	2.5
EV/EBITDA (x)	15.3	9.7	9.9	9.6

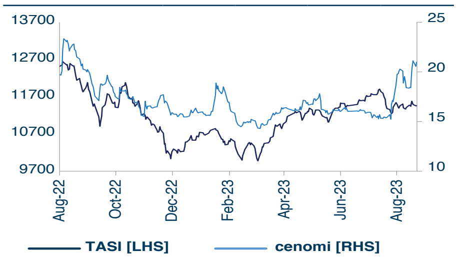
Source: Company reports, Aljazira Capital, Apr-Dec22

Key Market Data

Market Cap (SAR bn)	2.3
YTD%	26.6%
52 weeks (High)/(Low)	22.7/14.3
Share Outstanding (mn)	114.9

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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Investment Update

Optimizing balance sheet through deleveraging and working capital improvement: The management plans to reduce debt (Debt/Equity 568% as of 2Q23) to a more sustainable level, accordingly the company is in talks with banks to restructure loans (maturity and covenants). This would help ease pressure off the cash flows. Along with that, cenomi has improved its working capital efficiency, inventory on hand was reduced to 18 weeks in Q2-23, from 21 weeks in the previous quarter. The company is cleaning its balance sheet, recently cenomi announced the termination and liquidation of non-strategic investment in Al-Mubarak real estate fund 2 in which the company owned 33.33% of the total units, cenomi's share in the fund's book value as of December 31, 2022, was SAR 217 million. In our view, plans for right issuance have been back burnered for now. However, if SAR 1bn right issuance materializes it would substantially strengthen the balance sheet as well as improve the return metrics as the company is likely to reduce the debt burden by SAR 750mn

Net income to make six year high in 2023: Looking ahead we expect Cenomi to post a 3.8/0.2% Y/Y decline in revenues in 2023/24 respectively, to SAR5.70/5.69bn, mainly due to lower domestic sales owed to branch closures and brand divestments. We forecast revenue per store to expand to SAR 3.9mn in 2023 (up 42% Y/Y). We expect gross margins to expand to 17.3/18.3% in 2023/24 from 15% in CY22, and operating margins to average around 9.4% in 2023, and then drop to 8.4% in 2024, due to normalization of land lord support. Net income is projected to reach six year high of SAR 168.3mn in 2023, and then drop by 13.6% Y/Y in 2024 to SAR 145.4mn, once again the drop is due to normalization of landlord support.

Investment thesis and Valuation: Cenomi's strategy of shutting down inefficient stores has materially improved profitability of the retail giant. More store closures and brand divestments will further enhance margins in the medium term. Company's e-commerce venture Vogacloset and consumer micro finance company (FAS labs) shall enable Cenomi to provide its customers a fully integrated shopping platform, this would further increase sales. The management has renewed focus on the higher margin food and beverage segment (7 net openings in 1H23, as compared to 178 net closures in the retail segment). Moreover, outlook for consumer products in Saudi is promising, as shown by the increasing POS spending (up 15% Y/Y in 7M23), strong tourism (more than 100mn annual visits), high purchasing power (GDP per capita USD59,065) and huge young p opulation (63% of the population is under the age of 30 years). Net income is projected to reach six year high of SAR 165.8mn in 2023. Overall, we upgrade our rating to '**Overweight**' on the stock with an upside of 18.3%.

Valuation Summary

Blended valuation summary

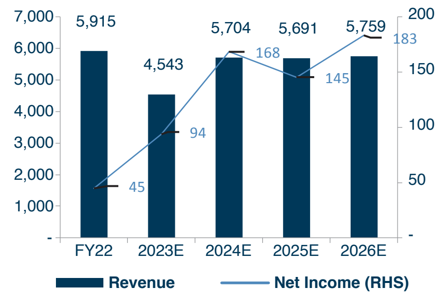
All figures in SAR, unless specified	Fair value	Weights	Weighted average
DCF based value	21.4	50%	10.7
Relative Valuation - P/E	22.8	50%	11.4
Weighted average 12-month price target			**22.1**
Expected Capital Gain			**18.3%**

We value Cenomi based on 50% weight to DCF (2.5% terminal growth and 9.0% avg. WACC) which gives a fair value of SAR 21.4 and 50% P/E (18.0x 2024E EPS) resulting in fair value of SAR 22.8. Our weighted average target price stands at **SAR 22.1/share**, implying an 18.3% upside from current levels and an '**Overweight**' rating. The stock is currently trading at a P/E of 14.7x, based on our 2024E EPS estimate.

Key Upside Risk: 1. Higher than estimated gross margin expansion 2. Fintech and consumer micro finance initiative gaining substantial momentum thereby increasing bottom line. 3. Company managing favourable terms on debt restructuring.

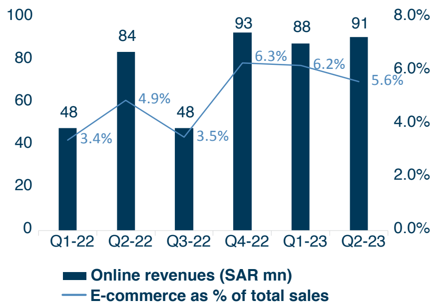
Key Downside Risk: 1. Higher than expected inflation impacting the purchasing power of customers 2. Slower than expected growth in e-Commerce segment 3. Higher transportation cost or stockouts amid prolonged supply chain/logistics challenges.

Revenue and net income (SAR mn)



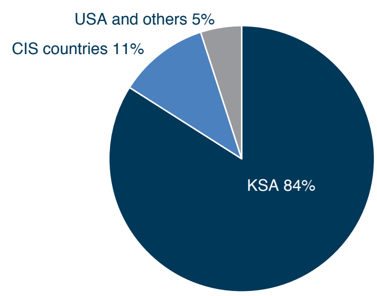
Source: AlJazira Capital, Company reports

E-commerce sales as % of total retail sales



Source: AlJazira Capital, Company reports

Revenue by geography



Source: AlJazira Capital, Company reports

Key Financial Table

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY22*	2023E	2024E	2025E	2026E
Income statement								
Revenues	5,342	4,233	5,915	4,543	5,704	5,691	5,759	5,941
Y/Y	**-1.5%**	**-20.8%**	**39.8%**	**-23.2%**	**25.6%**	**-0.2%**	**1.2%**	**3.2%**
Cost of Sales	(4,934)	(4,321)	(4,924)	(3,834)	(4,719)	(4,649)	(4,699)	(4,842)
Gross profit	**408**	**(88)**	**991**	**710**	**985**	**1,041**	**1,060**	**1,099**
Selling and marketing expenses	(138)	(146)	(170)	(140)	(195)	(194)	(196)	(203)
General and Administrative exp	(218)	(295)	(321)	(186)	(323)	(297)	(296)	(299)
Depreciation and amortization	(296)	(299)	(179)	(126)	(172)	(213)	(224)	(236)
Other income	168	141	121	65	238	142	144	149
Operating profit	**(133)**	**(687)**	**371**	**322**	**534**	**480**	**487**	**510**
Y/Y	**-132.1%**	**418.7%**	**-154.0%**	**-13.4%**	**66.0%**	**-10.2%**	**1.6%**	**4.6%**
Financial charges	(204)	(146)	(92)	(97)	(236)	(224)	(184)	(146)
Profit before zakat	**(634)**	**(1,063)**	**105**	**115**	**191**	**160**	**202**	**255**
Zakat	(48)	(46)	(67)	(21)	(21)	(13)	(16)	(20)
Net income	**(656)**	**(1,091)**	**45**	**94**	**168**	**145**	**183**	**232**
Y/Y	**NM**	**NM**	**NM**	**109.5%**	**79.7%**	**-13.6%**	**26.0%**	**26.6%**
EPS	**-3.13**	**-5.19**	**0.21**	**0.82**	**1.46**	**1.27**	**1.59**	**2.02**
Balance sheet								
Assets								
Cash & bank balance	686	468	198	194	170	133	211	237
Other current assets	2,369	1,746	2,239	1,754	1,608	1,661	1,779	1,889
Property & Equipment	1,514	1,327	1,358	1,324	1,409	1,424	1,431	1,432
Other non-current assets	5,448	4,818	4,752	3,881	3,600	3,489	3,529	3,559
Total assets	**10,018**	**8,359**	**8,547**	**7,153**	**6,787**	**6,708**	**6,949**	**7,117**
Liabilities & owners' equity								
Total current liabilities	2,352	2,655	5,094	4,693	2,435	2,362	2,395	2,391
Total non-current liabilities	6,137	5,253	2,949	2,114	3,838	3,686	3,712	3,652
Paid -up capital	2,100	2,100	2,100	1,148	1,148	1,148	1,148	1,148
Statutory reserves	206	-	-	-	-	-	-	-
Other reserve	(579.0)	(510.6)	(506.6)	(482.0)	(482.0)	(482.0)	(482.0)	(482.0)
Retained earnings	(112)	(1,038)	(982)	(228)	(59)	86	269	501
Minority interest	(85)	(100)	(107)	(92)	(92)	(92)	(92)	(92)
Total owners' equity	1,530	452	504	346	514	660	843	1,075
Total equity & liabilities	**10,018**	**8,359**	**8,547**	**7,153**	**6,787**	**6,708**	**6,949**	**7,117**
Cashflow statement								
Operating activities	543	702	1,112	889	384	431	469	537
Investing activities	285	(217)	(382)	(569)	(314)	(285)	(288)	(297)
Financing activities	(691)	(765)	(1,038)	449	(25)	(148)	(86)	(191)
Change in cash	137	(279)	(307)	769	45	(2)	95	49
Ending cash balance	**686**	**468**	**198**	**967**	**1,012**	**1,010**	**1,106**	**1,155**
Key fundamental ratios								
Liquidity ratios								
Current ratio (x)	1.3	0.8	0.5	0.4	0.7	0.8	0.8	0.9
Quick ratio (x)	0.6	0.4	0.1	0.2	0.4	0.4	0.4	0.4
Profitability ratios								
GP Margin	7.6%	-2.1%	16.8%	15.6%	17.3%	18.3%	18.4%	18.5%
Operating Margins	-2.5%	-16.2%	6.3%	7.1%	9.4%	8.4%	8.5%	8.6%
EBITDA Margin	3.1%	-9.2%	9.3%	9.9%	12.4%	12.2%	12.4%	12.6%
Net Margins	-12.3%	-25.8%	0.8%	2.1%	3.0%	2.6%	3.2%	3.9%
Return on assets	-7.8%	-11.9%	0.5%	1.2%	2.4%	2.2%	2.7%	3.3%
Return on equity	-32.1%	-100.7%	7.7%	17.8%	32.2%	21.4%	21.7%	22.1%
Market/valuation ratios								
EV/sales (x)	1.3	1.6	1.2	1.5	1.2	1.2	1.2	1.2
EV/EBITDA (x)	42.0	(17.6)	12.4	15.3	9.7	9.9	9.6	9.2
EPS (SAR)	(3.1)	(5.2)	0.2	0.8	1.5	1.3	1.6	2.0
BVPS (SAR)	7.3	2.2	2.4	3.0	4.5	5.7	7.3	9.4
Market price (SAR)*	31.4	41.2	27.3	18.7	18.7	18.7	18.7	18.7
Market-Cap (SAR mn)	6,585.6	8,652.0	5,724.6	2,143.5	2,143.5	2,143.5	2,143.5	2,143.5
P/E ratio (x)	NM	NM	128.1	22.9	12.7	14.7	11.7	9.2
P/BV ratio (x)	4.3	19.2	11.4	6.2	4.2	3.2	2.5	2.0

Source: Company filings, AlJazira Capital Research, * 9M-2022 from April - December

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RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer