Jarir Marketing Co.

Challenging quarters ahead despite strong performance in H1

28 July 2020

Jarir Market Co. (Jarir) achieved an impressive 25.4% Y-o-Y growth during Q2 2020, which is mainly due to the company's omni-channel presence, coupled with pre-VAT sales in May/June. The profit margin was under pressure due to a shift in the sales mix in favor of segments with relatively low profitability (i.e., Computers and electronics). While import duties should have a minimal impact on Jarir, we expect that the decrease in consumers' disposable income as a result of the VAT will have a significant impact on the company's performance in the second half of the year, especially Q3 2020.

During Q2 2020, Jarir sales witnessed a significant increase due to the hike in consumer demand that was triggered by the announcement of the 15% VAT. Revenue increased by 25.4% Y-o-Y from SAR1,893mn in Q2 2019 to SAR2,374mn in Q2 2020. Consumers were eager to lock down prices prior to the application of the VAT, especially in terms of durables like computers and electronics. The company's online presence and quick adaptation to the current pandemic seem to have significantly supported the increased demand during the quarter. Online sales accounted for 23% of total sales in Q2 2020, during the time when a curfew was imposed on the kingdom, which is 6x higher than the same period last year. Gross profit remained relatively flat Y-o-Y, sitting at 12.8% in Q2 2020.

Since the start of the pandemic, the Saudi government has shown strong initiatives aiming to mitigate the impact of the COVID-19. One of which was the Monetary Agency initiative to incur fees for point of sale and e-commerce operations, which resulted in a decrease in some elements of the companies operating costs. However, during the quarter, Jarir showed support for the Health Endowment Fund in the Ministry of Health by SAR20mn, which increased the company's Q2 2020 SG&A. EBIT margin slightly dropped from 10.1% in Q2 2019 to 9.6% in Q2 2020. Moreover, the net margin remained flat Y-o-Y, sitting at 8.8% in Q2 2020.

While Jarir showed a resilient performance and a strong value proposition in H1 2020, especially given the dire conditions of the market, the outlook for H2 is not promising. VAT hikes, custom duties, and the cancellation of subsidies are expected to alter longer-term consumer trends and spending patterns, which is expected to reflect in a significant drop in demand during the second half of the year. Moreover, despite Q3 being a back -to- school season, we expect that the demand on stationary (high profitability segment) will be significantly lower than previous years on the back of the online school arrangement, which will further pressure profitability margins. However, on a longer-term, Jarir being a strong player, is bound to support the company obtaining market share from smaller market players as the market consolidates, especially given the company's steady expansion strategy.

It is worth mentioning that on July 27th the company opened a new showroom in Skaka City, bringing the total number of its showrooms in Saudi Arabia to 51 and outside the Kingdom to 61.

We forecast that Jarir will achieve Y-o-Y revenue growth of around 8.0% FY20e, mainly due to the company's performance during the first half, coupled with the slight rebound that is anticipated in Q4 2020, due to the company's annual sales discounts.

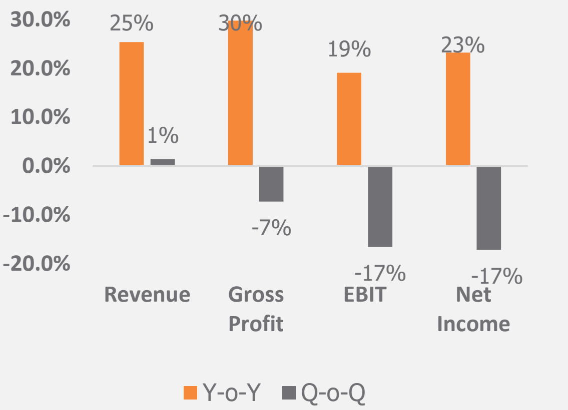
That being said, and in consideration of the impact of COVID-19 on the company, **we cut our 52 weeks target price SAR164.0/share while maintaining our Neutral recommendation.**

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (27-07-2020)	SAR150.0
Target Price (52 Weeks)	**SAR164.0**
Upside/ (Downside)	9.3%
Shariah Compliance	Pass

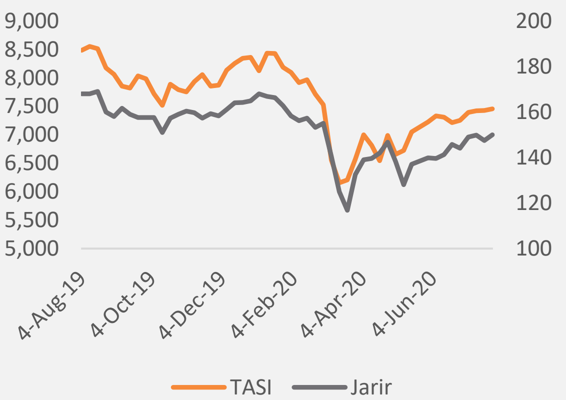
Key Financial Ratios

Ratio	Q2 2020	Q2 2019	Q1 2020
Revenue Growth	1.4%	0.3%	-2.2%
Gross Margin	12.8%	12.4%	14.0%
EBIT Margin	9.6%	10.1%	11.6%
Net Margin	8.8%	8.9%	10.8%

Key Financial Results (Q2 2020)



Share Price Performance



Financial Projection

DCF Valuation

	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	1,191	1,190	1,251	1,373	1,489	1,610
Operating CF	942	1,140	1,241	1,293	1,405	1,522
Capex	(209)	(223)	(248)	(287)	(329)	(376)
FCFF	733	917	993	1,006	1,076	1,146
Stub Period (FCF to be discounted)	0	462	993	1,006	1,076	1,146
PV (FCFF)	0	445	885	830	821	809

WACC	7.9%
Perpetuity Growth	3.0%
PV-FCFF	0.0
PV-TV	16,484
Net Debt	(899)
Less: End of services benefits	(149)
Add: Investments	449
Intrinsic Values	19,674
Shares Outstanding	120
Equity value per share	164.0
CMP (27-07-2020)	150.0
Upside / (Downside%)	9.3%

We have valued Jarir using DCF approach, considering a WACC is equal to 7.9% (based on a risk-free rate of 3.3%, market risk premium 7.3%, Beta of 0.85).

Based on the DCF valuation, the fair share price is SAR164.0, which is higher than the traded value by 9.3%.

Financial Ratios

Financial Ratios	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Return on Average Assets (%)	31.5%	27.3%	23.7%	24.0%	25.7%	26.3%	26.6%
Return on Average Equity (%)	57.7%	58.9%	58.3%	58.7%	61.6%	62.1%	61.2%
Earnings Before Zakat Margin (%)	13.2%	12.0%	11.1%	11.4%	11.7%	11.8%	11.8%
Net Income Margin (%)	13.0%	11.7%	10.8%	11.1%	11.4%	11.5%	11.6%
Revenue Growth (%)	6.0%	14.4%	7.6%	2.7%	8.8%	8.3%	7.9%
EPS	8.0	8.2	8.2	8.6	9.6	10.5	11.4

Income Statement

Income Statement	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Revenues	7,362	8,425	9,066	9,312	10,127	10,965	11,825
Cost of Revenues	(6,248)	(7,151)	(7,757)	(7,949)	(8,627)	(9,335)	(10,065)
Gross Profit	**1,114**	**1,273**	**1,309**	**1,364**	**1,500**	**1,630**	**1,760**
SG&A	(200)	(251)	(292)	(294)	(314)	(335)	(355)
Zakat	(14)	(25)	(25)	(24)	(27)	(29)	(32)
Net Income	**960**	**985**	**983**	**1,038**	**1,154**	**1,261**	**1,369**

Balance Sheet

Balance Sheet	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Current Assets	1,758	1,789	2,010	1,968	2,113	2,279	2,462
Non-Current Assets	1,457	2,212	2,286	2,381	2,509	2,672	2,872
Total Assets	**3,215**	**4,002**	**4,296**	**4,349**	**4,622**	**4,951**	**5,334**
Current Liabilities	1,364	1,551	1,748	1,708	1,827	1,949	2,073
Non-Current Liabilities	**151**	**805**	**820**	**835**	**855**	**881**	**912**
Total Equity	**1,699**	**1,645**	**1,728**	**1,806**	**1,940**	**2,121**	**2,350**
Total Liabilities and Equity	**3,215**	**4,002**	**4,296**	**4,349**	**4,622**	**4,951**	**5,334**

Financial Projection

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

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