Saudi Company for Hardware (SACO)

Resilient performance by SACO FY2020 achieved through strategic planning.

25 March 2021

Saudi Company for Hardware (SACO) was able to maintain healthy margins, despite the challenging year. The company's focus on its online operations aided its topline numbers despite store closures, while non-recurring gains supported the company's bottom-line. Demand on mortgage is expected to sustain strong demand on SACO's product offering on the medium term, while the real estate-to-retail synergy SACO plans to create is bound to support the company's long-term potential.

We update our 52 weeks target price SAR61.1/share while maintaining our Neutral recommendation.

SACO saw a significantly profitable Q4 2020 compared to Q3 2020, achieving revenues SAR402mn in revenues, representing growth of 2.5% Y-o-Y (+21.0% Q-o-Q). Following Q3 2020, that was heavily impacted by the application of the VAT in July 2020, the company focused on category optimization, specifically on private brands that generate higher margins. Moreover, SACO followed a less aggressive pricing strategy, while passing on the VAT on costumers. Finally, the company's online platform launched on September, 2020 provided an efficient medium for the company's targeted promotions during the quarter leading to LFL sales growth of 4.7% during the quarter. COGS for the period increased slightly, with 1.6% Y-o-Y (+16.9% Q-o-Q), due to the company's commitment to cost reduction measures through proper supply chain planning.

SACO reported gross profit of SAR91mn in Q4 2020, representing an increase of 5.9% Y-o-Y (+37.9% Q-o-Q). Gross margin for the period reached an all-time high of 22.6% for Q4 2020, thanks to operational efficiencies and rent concessions provided by land lords during the period. While the company booked the rent concessions for the year across all quarters, rebates reached SAR2.5mn in Q4 2020. SACO disclosed that the high gross margin is mainly due to the one-off gains, and plans to maintain 20% gross margin going forward.

SG&A dropped by 33.0% Y-o-Y (+21.5% Q-o-Q), combined with the high gross profit, allowed the company to achieve significant improvement in operating profit margin. It is important to note that during the quarter, the company reclassified the vendor support provided by its suppliers during the year from SG&A to be booked in COGS instead. SACO's operating margin reached 11.4% in Q4 2020 compared to only 4.7% in Q4 2019.

It is worth mentioning that the company used the low financing costs (-24.7% Y-o-Y, 19.1% Q-o-Q) witnessed during the quarter to pay off its debt, reaching zero borrowings in Q4 2020. That being said, the company's net profit reached SAR26mn, an impressive increase compared to SAR6mn in Q4 2019. Net income margin for Q4 2020 reached 6.4%, compared to 1.5% in Q4 2019.

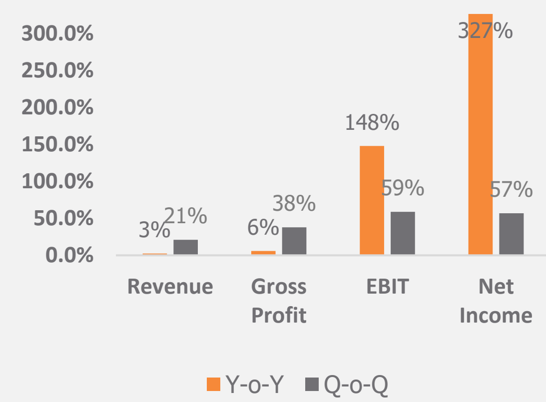
During the quarter, SACO's management focused on operational efficiencies in order to remain competitive during the challenging economic climate. The improvements included store revamping in terms of space optimization and dedicating spaces within the stores for the Pick-and-collect option provided by the company's omni-channel. In addition to reviewing supplier deals and securing inventory to avoid future disruption in the supply chain.

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (25-03-2021)	SAR59.90
Target Price (52 Weeks)	**SAR61.06**
Upside/ (Downside)	1.94%
Shariah Compliance	Pass

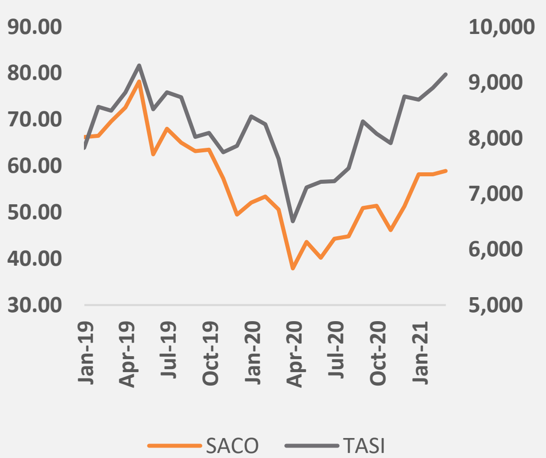
Key Financial Ratios

Ratio	Q4 2020	Q3 2020	Q4 2019
Revenue Growth	21.0%	-14.7%	11.5%
Gross Margin	22.6%	19.9%	21.9%
EBIT Margin	11.4%	8.7%	4.7%
Net Margin	6.4%	5.0%	1.5%

Key Financial Results (Q4 2020)



Share Price Performance



Financial Overview

2020A Overview & Outlook

Resilient performance by SACO during FY2020, despite major COVID-19 disruptions. SACO's year started off with a drop in sales Y-o-Y during Q1 2020, due to the outbreak in of COVID-19 that resulted in rigid movement restriction measures, which eventually lead to significant store closures in commercial centers. However, in Q2 2020, the company witnessed a surge in demand due to the announcement of the VAT application later in the year, leading to a lucrative outcome for SACO through pre-vat sales. Q3 2020, the company witnessed the impact of a slight drop in revenues due to the application of the 15% VAT, however, the company launched its online platform by September in order to maintain reach during lockdown and limited working hours. Finally, by Q4 2020, the company focused in strategic marketing and pricing that lead to a significant recovery in the top-line numbers towards the end of the year. Despite the challenging year, SACO pulled through with a slight increase in revenues of 1.6% from SAR1,458mn FY2019 to SAR1,482mn FY2020.

SACO's healthy margins were the highlight FY2020, thanks to the governmental support, non-recurring gains and the operational efficiencies obtained during the year. The Pandemic caused major disruption in the supply chain in addition to the governmental recessionary measures that took place in order to combat the spread on the virus. However, the government showed support for businesses in order to carry on activity, where SACO was able to benefit with a total of SAR13mn in 9M 2020 through "Saned program". Moreover, the company benefited from rent rebates totaling to SAR9.8mn FY2020. However, in order to remain conservative, the company booked provisions with over SAR10mn throughout the year, in addition to provisions on receivables with around SAR7mn. In light to the support received during the quarter, the company also benefited from rent concessions totaling to SAR9.8mn FY2020. In addition to the on-off gains during the year, SACO dedicated CAPEX for the purpose of optimizing store efficacies, where it revamped most of its stores to accommodate to the current trends, including Pick-and-collect areas to create synergy between its offline and online operations. Furthermore, the company created cost and commercial efficiencies, where it cut down on marketing expenses and focused on offering products that create "value for money, which sales result in higher margins. That being said, the company's gross profit margin FY2020 reached 20.0% compared to 19.3% FY 2019, operating profit margin reached 9.9% FY2020 compared to 7.4% FY 2019 and net profit margin reached 5.9% FY2020 compared to 4.2% FY2019.

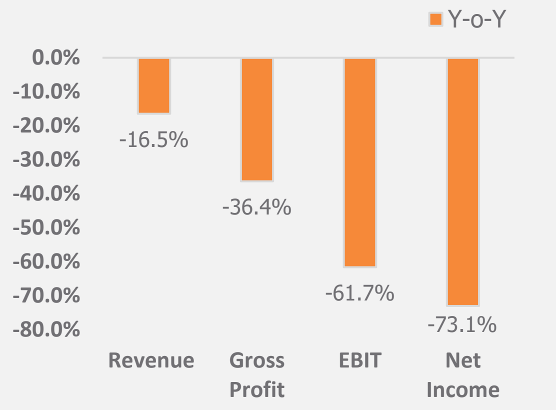
Impressive expansion FY2020, and strategic planning FY2021e. FY2020 the company successfully opened 4 new stores, while recently opened a new store on the 25th of March 2021, leading to a total number of stores of 35 within the Kingdom. Moreover, in order to avoid any future disruptions in the supply chain, the company successfully revised supplier deals to ensure cost-efficiencies, and stocked up on enough inventory for the Ramadan and summer seasons while ensuring appropriate shipment planning. Finally, the company announced its intention to enter the real estate market through SACO Real Estate, a project with a cost estimated to be SAR130mn. The company successfully reduced its borrowings to Zero, leaving enough room to finance the new project through debt.

Going forward, we believe that the governmental incentives towards mortgage will create a new demand for SACO, while the company's operational efficiencies will help maintain healthy margins going into FY2021e.

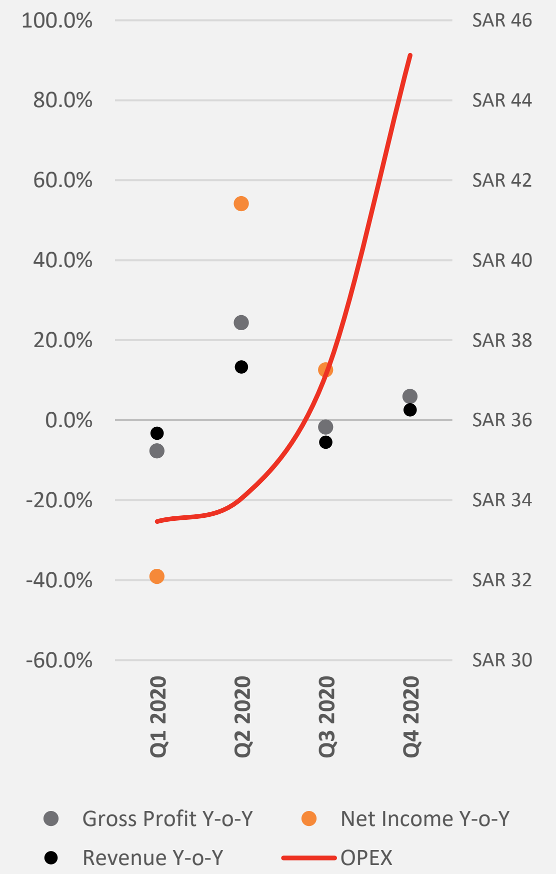
Key Financial Ratios

Ratio	FY2020	FY2019
Revenue Growth	1.6%	4.8%
Gross Margin	20.0%	19.3%
EBIT Margin	9.9%	7.4%
Net Margin	5.9%	4.2%

Key Financial Results (2020A)



Quarterly Performance



Financial Projection

DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
EBITDA	274	264	294	314	337	365	398
Operating CF	441	231	247	289	308	331	360
Capex	(135)	(157)	(133)	(136)	(138)	(140)	(142)
FCFF	306	74	114	153	170	191	217
Stub Period (FCF to be discounted)	0	74	114	153	170	191	217
PV (FCFF)	0	68	96	118	120	124	129

WACC	7.8%
Perpetuity Growth	3.0%
PV-FCFF	655
PV-TV	2,188
Net Debt	(615)
Less: End of services benefits	(40)
Less: NCI	10
Intrinsic Values	2,198
Shares Outstanding	36
Equity value per share	61.1
CMP (25-03-2021)	59.90
Upside / (Downside%)	1.9%

We have valued SACO using DCF approach, considering a WACC is equal to 7.8% (based on a risk-free rate of 2.7%, market risk premium 7.0%, Beta of 1.2).

Based on the DCF valuation, the fair price of SACO share price is SAR61.1, which is higher than the traded value by 1.9%.

All values are in SARmn

Financial Ratios	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Return on Average Assets (%)	3.8%	5.1%	5.1%	6.5%	7.4%	8.4%	9.5%	10.7%
Return on Average Equity (%)	11.3%	15.2%	13.4%	16.6%	17.8%	19.2%	20.8%	22.3%
Earnings Before Zakat Margin	5.0%	7.0%	6.4%	7.5%	8.2%	9.0%	9.8%	10.7%
Net Income Margin (%)	4.2%	5.9%	5.3%	6.6%	7.3%	8.1%	8.9%	9.8%
Revenue Growth (%)	4.8%	1.6%	7.8%	8.8%	5.1%	5.8%	6.6%	7.3%
EPS	1.71	2.43	2.37	3.18	3.72	4.36	5.12	6.02

Income Statement	2019 A	2020 A	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Revenues	1,458	1,482	1,598	1,738	1,828	1,934	2,061	2,212
Cost of Revenues	(1,176)	(1,185)	(1,290)	(1,391)	(1,452)	(1,526)	(1,614)	(1,718)
Gross Profit	**282**	**296**	**308**	**348**	**375**	**408**	**447**	**494**
SG&A	(174)	(150)	(166)	(179)	(187)	(196)	(208)	(221)
Zakat	73	104	103	130	150	174	203	236
Net Income	**62**	**87**	**85**	**115**	**134**	**157**	**184**	**217**

Balance Sheet	2019 A	2020 A	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Current Assets	865	728	780	830	878	931	994	1,072
Non-Current Assets	898	910	946	953	963	975	990	1,007
Total Assets	**1,763**	**1,639**	**1,726**	**1,783**	**1,841**	**1,907**	**1,984**	**2,079**
Current Liabilities	554	402	455	464	471	480	492	508
Non-Current Liabilities	668	627	611	600	588	577	567	555
Total Equity	**541**	**610**	**659**	**720**	**782**	**849**	**925**	**1,016**
Total Liabilities and Equity	**1,763**	**1,639**	**1,726**	**1,783**	**1,841**	**1,907**	**1,984**	**2,079**

All values are in SARmn

Guide to Ratings and Disclaimer

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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