Abdullah Al Othaim Markets Co.

Investment Update

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Abdullah Al Othaim Markets Co. (AlOthaim) posted Q2-19 earnings below estimates due to aggressive promotions during the Ramadan season. Revenue is expected to grow in high-single digits as a result of store expansion, leading to higher market share. The company plans to open 28 stores in FY19, after a net addition of 50 and 36 in FY17 and FY18, respectively. We expect consumer demand to gain pace as economic growth picks up. Margins are likely to remain stable during FY19, driven by cost efficiency. "**Overweight**" recommendation on AlOthaim with a TP of **SAR 88.60/share**.

New store openings to drive revenue growth: AlOthaim posted earnings of SAR 58.7mn in Q2-19, which was below AJC's and the market consensus estimate of SAR 77.2mn and SAR 76.8mn, respectively. Revenue grew 7.4% Y/Y mainly due to the addition of new stores. The company has consistently increased its store count over the years (from 142 stores in FY15 to 270 in Q2-19. Al Othaim intends to open 28 stores in FY19. The company is well positioned to capitalize on the rise in consumer demand due to its expansion plans. Less revenue per store from Egypt, a decline in consumer demand in Saudi Arabia, and restatement of revenue in accordance with IFRS 15 led to subdued sales for FY17 and FY18. We anticipate growth revenue per store to remain flattish weighed by lower revenue from Egypt. We expect revenue growth of 6.6% in FY19, driven by new store additions (22 stores) and a pick-up in consumer demand due to economic recovery in Saudi Arabia.

GP Margin expansion spurred by cost efficiency: Al Othaim's GP Margin decreased Y/Y in Q2-19 to 18.2% from 18.6%. The decline was attributed to aggressive promotions during the Ramadan season, which we believe is a one-off. GP Margin has consistently increased over the years (from 16.5% in FY15 to 20.4% in FY18), which reflects the company's ability to manage costs despite store expansion. The stability in the GP Margin is predicted to continue in FY19 and beyond, as the company benefits from economies of scale (higher number of stores), increase in bargaining power, and enhancement in the product mix.

Pick-up in consumer demand supported by store expansion to drive long-term growth: The Saudi economy is witnessing a rebound in consumer demand, driven by higher disposable income and rising employment (due to the Saudization drive). This would result in higher revenue per customer and benefit Al Othaim. The company's expansion strategy would enable it to expand its footprint and capture market share. Going forward, growth could arise from expansion into smaller cities where competition is limited. A higher number of stores would help the company achieve economies of scale, thus boosting margin growth.

AJC view and valuation: We believe Al Othaim stands to benefit from increased retail demand, which would bolster the company's growth in the long term. We have projected an increase in store count to 357 at the end of FY22 from 270 in Q2-19. The company's strategy of continued expansion augurs well, enabling it to increase its market share and capitalizing on the growth opportunity. Revenue growth is well supported by stable margins, driving net profit growth.

We value Al Othaim on 50% weight for DCF (3.0% terminal growth and 7.0% average WACC), and 25% weight each for P/E (19.1x FY20 EPS) and EV/EBITDA (11.0x FY20 EBITDA) based relative valuation. These yield a target price of **SAR 88.60/share**, implying a 11.5% upside from the current levels. The stock is currently trading at a P/E of 19.4x based on our FY20 EPS estimate. We have a positive outlook on the company with "**Overweight**" recommendation.

Overweight

Target Price (SAR)	**88.60**
Upside / (Downside)*	**11.5%**

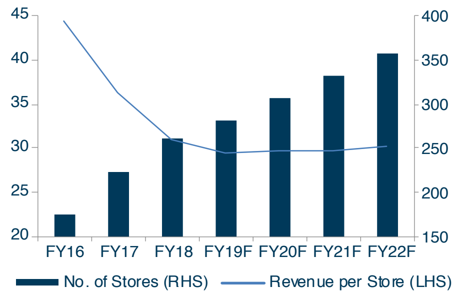
Source: Tadawul *prices as of 5th of August 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenue	7,231.1	7,515.1	8,012.5
Gross Profit	1,439.6	1,532.3	1,621.2
Net Profit	337.6	341.3	317.3
EPS	3.75	3.79	3.53

Source: Company reports, Aljazira Capital

No.of Stores and Revenue per Store



Source: Bloomberg, AlJazira Capital, Company reports

Key Ratios

SARmn (unless specified)	FY17	FY18E	FY19E
Gross Margin	19.9%	20.4%	20.2%
Net Margin	4.7%	4.5%	4.0%
P/E	15.5x	17.8x	22.8x
P/B	3.5x	3.9x	4.5x
EV/EBITDA (x)	11.1x	12.0x	12.6x

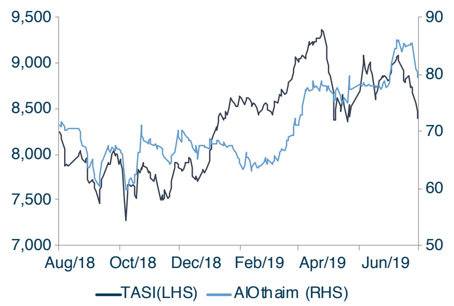
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	7.2
YTD %	17.7%
52 Week (High / Low)	86.4/59.0
Shares Outstanding (mn)	90.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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Key Financial Data

Amount in SAR mn, unless otherwise specified	2016	2017	2018	2019E	2020E
Income statement					
Revenues	7,015	7,231	7,515	8,013	8,725
Y/Y growth	*16.2%*	*3.1%*	*3.9%*	*6.6%*	*8.9%*
Cost of Sales	(5,803)	(5,792)	(5,983)	(6,391)	(6,952)
Gross profit	**1,211**	**1,440**	**1,532**	**1,621**	**1,772**
Rental income	66	75	81	79	87
Selling & distribution exp	(942)	(1,077)	(1,173)	(1,234)	(1,344)
General & administrative exp	(100)	(118)	(118)	(117)	(127)
Operating profit	**237**	**322**	**325**	**351**	**391**
Y/Y growth	*12.7%*	*36.4%*	*0.9%*	*8.0%*	*11.3%*
Share in income of associates	15	39	36	34	44
Other income/(expenses)	4	4	(0)	6	8
Financial charges	(15)	(14)	(5)	(59)	(53)
Profit before zakat	**242**	**352**	**319**	**333**	**389**
Zakat	(8)	(11)	(9)	(10)	(12)
Non-controlling interest	4	(4)	(7)	(6)	(8)
Net income	**237**	**338**	**341**	**317**	**370**
Y/Y growth	*2.8%*	*42.2%*	*1.1%*	*-7.0%*	*16.5%*
Balance sheet					
Assets					
Cash & bank balance	288	264	219	64	153
Other current assets	891	901	1,037	927	1,019
Property & Equipment	1,265	1,428	1,459	1,577	1,696
Other non-current assets	907	753	1,889	1,948	2,003
Total assets	**3,351**	**3,347**	**4,605**	**4,516**	**4,871**
Liabilities & owners' equity					
Total current liabilities	1,592	1,643	2,733	2,612	2,700
Total non-current liabilities	496	176	287	266	291
Paid -up capital	450	450	900	900	900
Statutory reserves	68	113	30	62	99
Other reserve	(5.2)	(6.9)	(9.1)	(9.1)	(9.1)
Retained earnings	720	939	624	639	837
Non-controlling interest	31	33	40	46	53
Total owners' equity	1,263	1,528	1,585	1,638	1,880
Total equity & liabilities	**3,351**	**3,347**	**4,605**	**4,516**	**4,871**
Cashflow statement					
Operating activities	585	616	596	707	833
Investing activities	(496)	22	(365)	(489)	(523)
Financing activities	(125)	(662)	(275)	(374)	(220)
Change in cash	(36)	(24)	(45)	(155)	89
Ending cash balance	**288**	**264**	**219**	**64**	**153**
Key fundamental ratios					
Liquidity ratios					
Current ratio (x)	0.7	0.7	0.5	0.4	0.4
Quick ratio (x)	0.3	0.3	0.2	0.1	0.1
Profitability ratios					
GP Margin	17.3%	19.9%	20.4%	20.2%	20.3%
Operating Margins	3.4%	4.5%	4.3%	4.4%	4.5%
EBITDA Margin	5.4%	6.8%	6.8%	8.3%	8.5%
Net Margins	3.4%	4.7%	4.5%	4.0%	4.2%
Return on assets	7.4%	10.1%	8.6%	7.0%	7.9%
Return on equity	20.3%	24.8%	22.5%	20.2%	21.6%
Market/valuation ratios					
EV/sales (x)	0.7	0.8	0.8	1.0	1.0
EV/EBITDA (x)	12.4	11.1	12.0	12.6	11.3
EPS (SAR)	5.3	3.8	3.8	3.5	4.1
BVPS (SAR)	27.4	16.6	17.2	17.7	20.3
Market price (SAR)*	45.1	58.2	67.6	79.5	79.5
Market-Cap (SAR mn)	4,446.5	5,534.6	6,318.0	7,155.0	7,155.0
Dividend yield	4.4%	3.4%	2.2%	3.8%	1.9%
P/E ratio (x)	8.6	15.5	17.8	22.6	19.4
P/BV ratio (x)	1.6	3.5	3.9	4.5	3.9

Source: Company financials, AlJazira research

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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