August 2020

Fawaz Alhokair Co.

Result Flash Note Q1-FY21

الجزيرة كابيتال

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Alhokair, in Q1-FY21, posted a net loss of SAR 525.4mn (loss per share: SAR 2.55), lower than our estimated loss of SAR 129.4mn and surpassing a consensus estimated loss of SAR 175.3mn. Net loss was driven by a steep decline in revenue and SAR 169.2mn in one-off adjustments. Margins are likely to improve, as inventory write-off has now been completed. We expect consumer demand to increase with the easing of restrictions. We maintain our "**Neutral**" rating on the stock with a revised TP of **SAR 22.7/share**.

- Alhokair recorded a net loss of SAR 525.4mn in Q1-FY21 (loss per share of SAR 2.55) compared to the net profit of SAR 224.0mn posted in Q1-FY20. Net loss for Q1-FY21 was higher than our estimated loss of SAR 129.4mn and above the market estimated loss of SAR 175.3mn. The loss could be attributed to a steep decline in sales along with a drastic drop in the GP Margin. The company recorded SAR 169.2mn in one-off adjustments and completed its portfolio optimization drive.
- The company's revenue was SAR 564.9mn in Q1-FY21, down 67.4% Y/Y and 48.0% Q/Q, below our estimate of SAR 1,247mn. On a like-for-like (LFL) basis, net revenue declined 53.8% Y/Y in Q1-FY21.The F&B business contributed 6% to the company's sales. COVID-related closures impacted revenue by SAR 1.2bn Y/Y. The decline was also due to the final stages of the company's portfolio optimization strategy. With good traction witnessed in July and August, we expect Alhokair to post better sales performance in the coming quarters.
- Gross loss stood at SAR 242.7mn as compared to a gross profit of SAR 655.9 in Q1-FY21, below our estimate of a gross profit of SAR 455.3mn. The decline was due to lower revenue and operating leverage amid COVID-related closures, as the impact of SAR 1.2bn worth of sales translated into a decline of SAR 525mn in gross profit compared to Q1-FY20. Depreciation expenses of SAR 152.4mn as a result of IFRS-16 adoption and SAR 106mn in one-time inventory provisions also adversely affected the gross profit. As the company has completed its inventory write-offs, we expect Gross margin to expand.
- Operating loss stood at SAR 412.1mn as opposed to an operating profit of SAR 347.9mn in Q1-FY20. The company received payroll support from the government under the SANED program and lowered rent expenses through negotiations with landlords which helped reduce expenditure. Alhokair has drawn a cost initiative plan, which is expected to result in annual savings of SAR 25mn.

AJC view: Alhokair's results were below our expectations. Margins are likely to improve, as the one-off write-off on inventory has now been completed. Going forward, the management expects inventory provisions to be in the range of 0.5%-1% of sales, which would improve Gross Margins.

We believe Alhokair would benefit from increased retail demand, which would primarily drive growth in the long term. With the new management implementing cost-saving initiatives and completion of inventory write-off, we expect the operating results to improve. We update our FY21 loss per share to SAR -2.41 to reflect the Q1-FY21 results and initiatives announced by the company. We value Alhokair on 50% weight for DCF (3.0% terminal growth, 6.6% average WACC) and on 25% weight each for P/E (20.4x FY21E EPS) and EV/EBITDA (11.8x FY21E EBITDA) based on relative valuation. These yield a TP of SAR 22.7 per share, implying a 2.7% upside from the current levels. The stock is currently trading at a P/E of 22.0x as per our FY22E EPS estimate. We maintain our "**Neutral**" rating on Alhokair with a revised TP of **SAR 22.7/share**.

Results Summary

SARmn	Q1-20	Q4-20	Q1-21	Change Y/Y	Change Q/Q	Deviation from AJC Estimates
Revenue	1,732.4	1,085.0	564.9	-67.4%	-47.9%	-54.7%
Gross Profit	655.9	998.4	-242.7	NM	NM	NM
Gross Margin	*37.9%*	*92.0%*	*-43.0%*	-	-	-
EBIT	349.7	739.8	-412.1	NM	NM	NM
Net Profit	**224.0**	**887.6**	**-535.6**	NM	NM	NM
EPS	1.07	4.23	-2.55	-	-	-

Source: Company Reports, AlJazira Capital

Neutral

Target Price (SAR)	**22.7**
Upside / (Downside)*	**2.7%**

Source: Tadawul *prices as of 30th of August 2020

Key Financials

(in SAR mn, unless specified)	FY20	FY21E	FY22E
Revenues	5,341.8	4,077.3	5,360.1
Growth %	-1.5%	-23.7%	31.5%
Net Income	-656.3	-506.8	210.2
Growth %	NM	NM	NM
EPS	-3.13	-2.41	1.00

Source: Company reports, Aljazira Capital

Key Ratios

	FY20	FY21E	FY22E
Gross Margin	7.6%	12.5%	22.5%
Net Margin	-12.3%	-12.4%	3.9%
P/E	NM	NM	22.0x
P/B	2.4x	4.5x	3.8x
EV/EBITDA	42.0x	28.2x	7.4x
Dividend Yield	0.0%	0.0%	0.0%

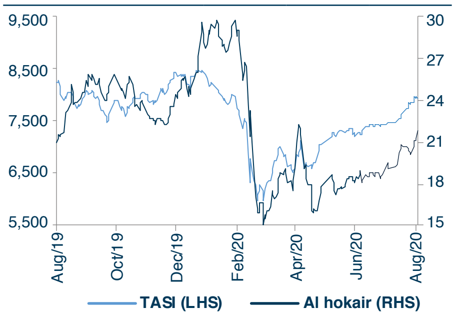
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	4.6
YTD %	-13.8%
52 week (High)/(Low)	30.60/15.04
Shares Outstanding (mn)	210.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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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