Saudi Retail Sector

Retail –Industrial
Saudi Arabia
04 September 2019

US$8.236bn	65.25%	US$27.0mn
Market cap	Free float	Avg. daily volume

الراجحي المالية
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Key theme

After the MSCI inclusion the focus is back on fundamentals. Due to recent sell-off, some stocks are trading well below their target price and we think it provides a good buying opportunity for long term.

What do we think?

Stock	Rating	Price Target
Leejam	Overweight	SAR90
Extra	Overweight	SAR80
Herfy	Overweight	SAR68

Leejam estimates

Period End (SAR mn)	12/18A	12/19E	12/20E
Revenue	800	944	1057
Revenue Growth	9%	18%	12%
EBIDTA	317	391	436
EBIDTA margin	40%	41%	41%
Net profit	180	241	271
Net profit growth	3%	34%	13%
EPS	3.44	4.60	5.18
DPS	2	2	3
Payout ratio	52%	50%	50%
Dividend Yield	2%	3%	3%
P/E	21.16	19.56	17.37
EV/EBITDA	12.70	11.21	10.05

Source: Company data, Al Rajhi Capital

United Electronics estimates

Period End (SAR mn)	12/18A	12/19E	12/20E
Revenue	4394	5025	5494
Revenue Growth	4%	14%	9%
EBITDA	219	329	403
EBITDA Margin	5%	7%	7%
Net profit	161	223	281
Net profit growth	15%	38%	26%
EPS	3.22	4.45	5.62
DPS	2	3	4
Payout ratio	58%	62%	62%
Dividend Yield	3%	4%	5%
P/E	19.85	16.40	13.00
EV/EBITDA	14.48	10.53	8.78

Source: Company data, Al Rajhi Capital

Opportunities in retail sector

Three top picks: Leejam, Extra, Herfy

The Saudi Arabian market has witnessed successful inclusion in the MSCI Emerging market index with a weightage of 2.83%. A total of 31 companies were included with the second tranche of inclusion ending August. The foreign ownership has increased to 5.38% at the end of August 2019. Post the inclusion there are concerns of lack of immediate upside triggers for the overall market and more so the heavy weight petchem and banks. In this juncture, we advocate selective buying and have identified three such stocks in the retail sector which have more than 10% upside helped by strong fundamentals, stable revenue and earnings growth. These have had some correction in the recent past which may not be justified and presents good buying opportunities

Leejam Sports Co (13% Upside)

Key investment themes: Top-line growth is expected to be driven by double digit growth in female subscriptions, corporate segment and personal training segment. For male segment we expect a modest growth of 4-5% in membership and expect the average revenue per member to remain flattish or marginally lower in the long term. We expect the company to deliver robust growth in the near term mainly due to strong expansion plans which would increase its market share. Subscriptions are offered at a discounted price in the corporate segment and thus could partially offset the higher margins from female segment.

Valuation: Leejam posted a robust set of numbers in Q2 FY19 as the net profit grew 24% y-o-y to SAR50mn beating street estimate of SAR42.5mn by 17%. We continue to value Leejam using equal weights for DCF and P/E based relative valuation methods. Our DCF based target price is SAR87 per share, assuming 9% WACC and 3% terminal growth. Our P/E based target price (18x FY20e earnings) stands at SAR93 per share. Accordingly, the equal weighted target price stands at SAR90, implying 13% upside from the current price of SAR79.50 implying an "Overweight" rating. Recent decline in share price due to QFI selling presents good buying opportunity for the medium as well as long term.

United Electronics Co (10% Upside)

Key investment themes: Extra reported a robust top-line growth of 14% y-o-y driven by higher sales of smart devices, pick up in overall consumer spending and higher penetration of EMI sales. Going forward, we expect online sales (as they recently re launched their electronic store) and stores expansion to aid the company in gaining market share which should result in a healthy top-line growth. Moreover, we expect gross margins to improve as the company ramp-up its stores and improve its operational efficiency. The increasing mortgage lending suggests that there will be construction of new houses which in turn will boost the demand for household appliances and smart home devices. We like Extra over other players due to its strong brand image, wider product mix and increasing pick up of EMI sales.

Herfy estimates

Period End (SAR mn)	12/18A	12/19E	12/20E
Revenue	1227	1321	1413
Revenue Growth	6%	8%	7%
EBITDA	288	300	333
EBITDA Margin	23%	23%	24%
Net profit	204	224	255
Net profit growth	2%	10%	14%
EPS	3.16	3.47	3.95
DPS	2	2	3
Payout ratio	68%	65%	67%
Dividend Yield	4%	3%	4%
P/E	16.54	19.33	16.97
EV/EBITDA	13.37	12.82	11.57

Source: Company data, Al Rajhi Capital

Valuation: We continue to value Extra based on equal weights for DCF (SAR 78.2/sh.) and P/E based relative valuation (18.5x FY19 EPS), yielding a target price of SAR80 per share, The stock is currently trading at SAR73 and as per our target price it provides an upside of 10% and we maintain our "overweight" rating .

Herfy Food (33% Upside)

Key investment theme: Herfy reported a top-line growth of 8% y-o-y mainly driven by store expansion, we like the company mainly because of its strong brand image and product offering which aligns with the new consumer behavior focusing more on value products. The overall trend of fast food consumption has increased in the kingdom and the company is on top of the race by expanding its stores into new regions to increase its market share. Apart from other growth drivers, we believe that the increasing penetration of online food delivery app provides a strong opportunity for Herfy's to expand its sales as hamburger meals is the most preferred food ordered online. Herfy being an oldest player in hamburger should benefit from this due to strong knowledge of the local market as well brand image. Going forward we are bullish on the long term story of Herfy even though currently average sales per store is subdued. This is because, normally in a QSR (Quick service restaurant) business model, the yield per store starts improving once the stores mature and capex decreases. Further there are new regulations proposed which would allow retailers to operate for 24 hrs. Both of these factors should have a positive impact on QSRs.

Valuation: Herfy has a solid payout history, a dividend payout of ~70% over the previous four years (except 2018), thereby implying a dividend yield of ~4% for FY19E. We continue to value Herfy based on equal weights for DCF and P/E based relative valuation. Our DCF based target price is SAR 62 per share, assuming 9% WACC (20% debt in capital structure) and 3% terminal growth. The P/E based relative valuation at 20x FY20 EPS yields a target price of SAR74 per share. The equal weighted target price stands at SAR68 per share, implying a 33% upside from current price of SAR51. We remain "Overweight" on Herfy.

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

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