



US\$1.848bn Market cap
30% Free float
US\$2.754mn Avg. daily volume

Target price **40.0** 34.3% over current
Current price **29.8** as at 7/11/2017

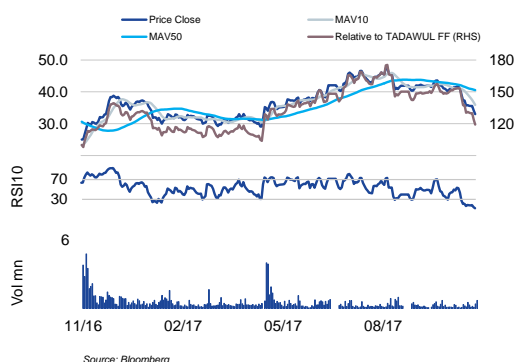
Existing rating

Underweight

Neutral

Overweight

Performance



Earnings

Period End (SAR)	03/16A	03/17A	03/18E	03/19E
Revenue (mn)	6,944	6,706	6,276	6,563
Revenue Growth	0.7%	-3.4%	-6.4%	4.6%
EBIT (mn)	852	592	597	590
EBIT Growth	0.7%	-30.5%	0.8%	-1.2%
EPS	2.93	1.86	1.66	2.11
EPS Growth	-22.8%	-36.5%	-10.7%	26.8%

Source: Company data, Al Rajhi Capital

Valuation

Period End (SAR)	03/16A	03/17A	03/18E	03/19E
P/E (x)	10.2	16.0	17.9	14.1
P/B (x)	2.4	2.2	2.1	1.9
EV/EBITDA (x)	7.6	9.5	9.7	9.6
RoE (%)	23.6%	13.5%	11.6%	13.7%

Source: Company data, Al Rajhi Capital

Fawaz Al Hokair

Q2FY18: In-line operating performance

Fawaz Al Hokair Q2FY18 operating results were mostly in-line with our estimates while net profit was impacted by certain provisions and forex losses. Revenue at SAR1,503mn (down 9.7% y-o-y) was higher than our estimate of SAR1,423mn, implying lower than expected LFL decline. By our calculations, LFL decline for KSA stores was -15% y-o-y (our estimate was -20%). Gross profit at SAR300mn was also marginally higher than our estimate of SAR294mn. 100bps y-o-y gross margins expansion in an environment of lower consumer spending and double digit revenue decline implies strong execution. Better merchandizing, focus on value brands, lower rents, and low inventory provisions led to gross margin expansion in our view. Despite healthy operating performance, net profit was mainly impacted by **a)** Higher SG&A expenses at SAR134mn (our estimate SAR114mn), **b)** SAR18mn one-off provision for foreign subsidiaries after an external audit, and **c)** SAR26mn forex loss (our estimate SAR5mn loss) due to appreciation of Euro and Pound sterling. Consequently, SAR6.8mn reported net profit was lower than our SAR41mn estimate (refer figure 1). Based on our revised estimates and roll-forward in valuation to Dec-2018, our target price stands at SAR40.0 per share (earlier Dec-2017 TP of SAR44.0 per share). The stock corrected 38% from the time of Q1FY18 results, which is overdone in our view. Our TP implies 34.3% upside from the current price, we upgrade the stock to Overweight.

- Valuation:** Our DCF based target price is SAR42.8 per share, assuming 8.38% WACC (35% debt in capital structure) and 3.0% terminal growth. Our target P/E is 18x FY19e earnings. We expect earnings to bottom out in FY18e and RoE/ RoCE to reach 16%/17% by FY20e. Our P/E based target price stands at SAR37.2. The equal weighted target price stands at SAR40.0 per share (earlier SAR44.0/sh). Upgrade to Overweight (earlier Neutral).
- Outlook:** Gradual lifting of energy/ utility prices (negative for discretionary consumption, even assuming Citizen account program) and mall Saudization will weigh on revenue and margins in the short term. However, the company's efforts at better sourcing, closing unprofitable stores, adjusting premium/ value brand portfolio mix to reflect current environment and turning around international operations will drive better long term profitability. Stable working capital and short term loans recast (completed in Q2FY18) have strengthened the balance sheet position. We expect net debt/ equity to improve to 0.7x by FY19e from 1.0x in FY17, led by sustained FCF generation going forward.

Figure 1 Al Hokair: Summary of Q2 FY18 results

(SAR mn)	Q2FY17	Q1FY18	Q2FY18	% Chg YoY	% Chg QoQ	ARC Est
Revenue	1,665	2,070	1,503	-10%	-27%	1,423
Gross Profit	317	550	300	-5%	-45%	294
Gross Profit margin	19.1%	26.6%	20.0%	-	-	20.6%
Operating Profit	102	306	86	-15%	-72%	100
Net Profit	59	232	6.8	-88%	-97%	41

Source: Company data, Al Rajhi Capital



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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.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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