Fawaz Alhokair and Company

Retail – Industrial
ALHOKAIR AB: Saudi Arabia
1 July 2019

الراجحي المالية
Al Rajhi Capital

US$1.282bn	30%	US$2.691mn
Market cap	Free float	Avg. daily volume

Target price	**20.00**	-13% over current
Current price	**22.90**	as at 30/6/2019

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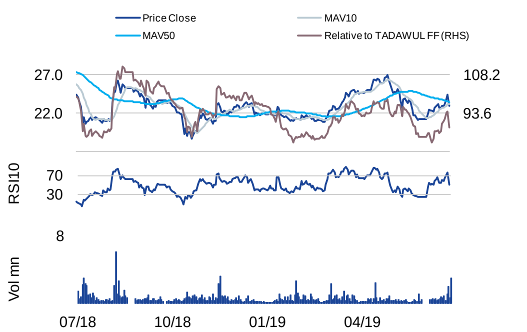
Existing rating

Underweight	Neutral	Overweight

Performance



Earnings

Period End (SAR)	03/18A	03/19A	03/20E	03/21E
Revenue (mn)	6,116	5,425	5,696	6,038
Revenue Growth	*-8.6%*	*-11.3%*	*5.0%*	*6.0%*
EBIT (mn)	314	412	393	423
EBIT Growth	*-53%*	*31.2%*	*-4.6%*	*7.6%*
EPS	0.49	0.69	0.95	1.10
EPS Growth	*-76%*	*40.8%*	*37.7%*	*15.8%*

Source: Company data, Al Rajhi Capital

Fawaz Abdulaziz Al Hokair

Misses estimates; downgrade to underweight

Alhokair reported a net loss of SAR141mn, missing our estimate of SAR13mn profits. Revenue declined 10% y-o-y, likely due to muted consumer spending which led to a lower LFL growth and closure of non-profitable stores. The company continues to follow its cost optimization strategy in a challenging economic environment which has improved its operating margins by reducing the cost of sales. In the near term, we expect Alhokair' s top-line to remain under pressure, largely due to weak consumer demand, driven by changing consumption basket from premium to value products and declining customer base. We expect the gross margin to remain under pressure, mainly due to higher discounts offered to support topline growth. We expect a gradual recovery in international sales and higher demand for value products which could negate the decline in LFL sales in near term. Our long term view on the growth remains optimistic boosted by pick-up in consumer sentiments following an overall economic recovery. The disposable income is expected to increase amidst higher government spending and rising female employment (the unemployment rate among Saudi females declined to 31.7% in Q1 2019 against 32.5% in Q4 2018) which is positive for the company.We downgrade the stock to underweight keeping our target price unchanged at SAR 20 per share.

- **Q4 FY19 Results:** Revenue declined 10% y-o-y to SAR1,072mn (beating our estimate of SAR1,133mn), likely impacted by lower number of stores (due to store closures) as a part of company's cost optimization strategy and weaker discretionary spending by the consumer. Gross profit decreased 22% y-o-y to SAR34mn, with corresponding margin declining by 60bps y-o-y to 3.2%. The company posted a net operating loss mainly due to higher SG&A which due to lower sales had a negative impact on operating profit margin. Consequently due to negative operating income and higher selling and marketing related expenses the company posted a net loss of SAR141mn against SAR184mn in Q4 2018. The cost related to sales was lower in Q4 2019 compared to corresponding quarter in previous year which was mainly a result of company's continuous cost optimization strategies.

- **Risks:** Downside risks include (a) higher-than-expected rise in employment expenses on the back of Saudization, (b) lower than expected rebates on rent, which can result in higher number of store closures and (c) significant decline in expat population. Upside risks include higher-than-expected rise in disposable income driven by Saudization.

- **Valuation:** The stock is currently trading at a P/E of 24.56x, based on our FY20 EPS estimate, significantly higher than its 3-year average P/E of 17x. We value Alhokair based on equal weights for DCF and P/E based relative valuations. Our DCF based target price is SAR22 per share, assuming 9% WACC (35% debt in capital structure) and 3.0% terminal growth. The P/E based relative valuation at 19x FY21 EPS yields a target of SAR18 per share. The equal weighted target price stands at SAR20 per share implying a 13% downside from current price. We downgrade the stock to "underweight".

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Market cap	Free float	Avg. daily volume

Figure 1 Fawaz Al hokair: Summary of Q4 FY19 results

(SAR mn)	Q4FY18	Q3FY19	Q4FY19	% Chg YoY	% Chg QoQ	ARC Est
Revenue	1,193	1,233	1,072	-10%	-13%	1,134
Gross Profit	45	277	35	-22%	-87%	249
Gross Profit margin	3.8%	22.5%	3.3%	-	-	22.0%
Operating Profit	(141)	85	(53)	NM	NM	59
Net Profit	(184)	27	(141.0)	NM	NM	13

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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