

**Al-Othaim reported Q1-2018 earnings below AJC estimates and consensus. Net income came at SAR 67.2mn (SAR 0.75 EPS) against our estimates of SAR 80.6mn. The reported deviation is mainly due to higher than estimated SG&A and marginally lower than estimated top-line growth. The company accelerated the pace of expansions throughout FY2018, which pressured operating margins for the quarter. Al-Othaim started the year with 187 stores in KSA, and currently has a store count of 201. We estimate a year-end store count of 210. Our forward estimates include flat growth in LFL sales. The accelerated expansion sets the tone for a better Q2-2018 set of results. We maintain our "Neutral" recommendation with an updated PT of SAR 81.0 per share.**

- Al-Othaim Q1-2018 earnings came below estimates for the quarter. The mass grocery retailer reported net income at SAR 67.2mn (EPS SAR 0.75) compared to our estimates of SAR 80.6mn and SAR 60.2mn for the same quarter last year, recording 11.8% growth YoY. The deviation from estimates is mainly due to: i) lower than expected top-line. ii) Higher than estimated SG&A, partially due to expansions during the quarter.
- Revenue for the quarter stood at SAR 1,798.2mn compared to SAR 1,696.2mn for the same quarter last year; an increase of 6.0% YoY and a seasonally QoQ decline of 8.8%. Revenues grew on the back of the retailer's accelerated expansion efforts in FY2017 and throughout FY2018. Al-Othaim started the year with 187 stores in the Kingdom, adding 14 stores YTD. The push in Egypt have reached 40 stores as of May-2018. LFL sales growth for the quarter appear to have been flat YoY. This comes on the back of VAT 2018 implementation, which caused an added push to Q4-2017 results. This push, along with other factors, could have been behind the flat growth YoY on LFL sales for Q1-2018. This pattern of an increase in Q4-2017 at the expense of growth in Q1-2018 has been observed in retail results, which sets the sector for improved Q2-2018 performance. Our forward estimates include flat growth in LFL sales. Revenue trajectory is expected to continue the positive trend, supported by ongoing expansion plans. Revised FY2018 revenues are estimated at SAR 8,700mn, an 8.2% growth YoY.
- Gross profit for the quarter stood at SAR 341.5mn compared to SAR 319.7mn for the same quarter last year, recording a 6.8% increase YoY. Gross margins for the quarter stood at 18.99% compared to 18.84% in Q1-2017, marking a 15bps expansion YoY. Operating Income came below estimates, at SAR 64.1mn for the quarter, posting a 0.5% decline YoY. The marginal decline can be attributed to an increase in SG&A on the back of recent store opening.

**AJC View:** We maintain our positive outlook on the non-discretionary retail sector, backed by sustainable top line growth and expanding gross margins going forward. In response to the relative tighter regulatory environment on retailers, the sector is expected to exhibit higher concentration levels among competitors, in favor of the organized players in the market. Our forward estimates account for slightly higher contribution from operations in Egypt. Al-Othaim currently operates 40 stores in Egypt, which makes around 1% of total retail sales. The estimated flat LFL sales growth YoY was partially due to the push in sales that took place in Q4-2017 pre VAT implementation which came at the expense of Q1-2018 sales. In addition to an estimated decline in total purchasing power. The marginal decline in operating income came on the back of higher SG&A, posting an increase of 8.7% YoY, which can be attributed to the relatively large number of store opening during the quarter. Upside and downside risks to valuation rest mainly on macro and industry wide conditions. Revised FY2018 EPS stands at SAR 4.41 per share. The company currently trades at an estimated forward PE multiple of 18.82x compared to a historical quarterly 3-year average TTM PE of 19.5x. We maintain our "Neutral" recommendation with an updated PT of SAR 81.0 per share.

## Results Summary

SARmn (unless specified)	1Q-2017	Q4-2017	Q1-2018	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	1696.2	1971.2	1798.2	6.0%	-8.8%	-16.3
Gross Profit	319.7	445.0	341.5	6.8%	-23.2%	-16.9%
Gross Margin	18.8%	22.6%	19%	-	-	-
EBIT	64.4	150.2	64.1	-0.5%	-57.3%	-
Net Profit	60.2	167.5	67.2	11.8%	-59.8%	-16.6%
EPS	0.67	1.86	0.75	-	-	-

Source: Company reports, Aljazira Capital

Recommendation	<b>Neutral</b>
Current Price* (SAR)	83.0
Target Price (SAR)	<b>81.0</b>
Upside / (Downside)	<b>-2.4%</b>

Source: Tadawul \*prices as of 6<sup>th</sup> of May 2018

## Key Financials

SARmn (unless specified)	FY16	FY17	FY18E
Revenue	7,014.5	7,861.8	8,700.0
Gross Profit %	1,211.3	1,440.5	1,597.0
Net Profit	228.0	448.8*	397.6
EPS	2.53	4.99	4.41

Source: Company reports, Aljazira Capital \*Non-recurring item of SAR100.8mn

## Key Ratios

SARmn (unless specified)	FY16	FY17	FY18E
Gross Margin	17.2%	18.3%	18.3%
Net Margin	3.2%	5.58%	4.8%
P/E	19.5x	12.4x	18.8x
P/B	3.6x	2.9x	18.8x
Dividend Yield	2.0%	4.0%	2.2%

Source: Company reports, Aljazira Capital \* Adjusted price

## Key Market Data

Market Cap (bn)	7,470.0
YTD %	35.0%
Shares Outstanding (mn)	90.0
52 Week (High)	92.0
52 Week (Low)	51.7

Source: Company reports, Aljazira Capital

## Price Performance



Source: Bloomberg, Aljazira Capital

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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.

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