Fawaz Abdulaziz Alhokair and Co
Retail – Industrial
ALHOKAIR AB: Saudi Arabia
03 September 2019

الراجحي المالية
Al Rajhi Capital

US$1.204bn	30%	US$3.955mn
Market cap	Free float	Avg. daily volume

Target price	22.00	1.38% over current
Current price	21.70	as at 1/9/2019

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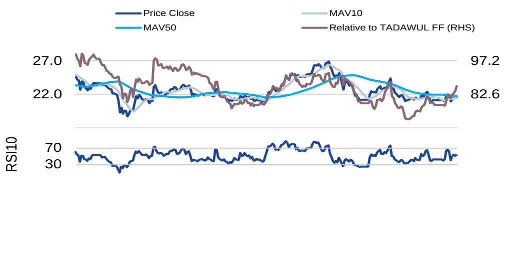
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings (Post IFRS 16 adjustment)

SAR(mn)	03/19A	03/20E	03/21E
Revenue	5426	5291	5450
Revenue Growth	-11%	-2%	3%
Gross Profit	1084	1765	1873
Gross Margin	20%	33%	34%
EBIDTA	702	1366	1431
EBIDTA margin	13%	26%	26%
Net Profit	145	131	159
Net Margin	2.67%	2.48%	2.91%
EPS	0.69	0.95	1.10
DPS	0	0	0
Payout Ratio	NA	NA	NA
EV/EBIDTA	10.37	9.34	8.92
P/E	31.48	22.84	19.73
ROE	5.0%	5.35%	6.07%

Source: Company data, Al Rajhi Capital

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Store closure shrinks top-line but margins improve

Alhokair reported a net profit of SAR225mn, missing our estimate of SAR263mn mainly due to higher interest cost resulting as a result of IFRS16 implementation. Revenue declined 6% y-o-y mainly due to 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 SG&A. The key focus remains in improving the operating efficiency by rationalizing the stores and promotions. Though the top-line shrinked during the quarter, the major positive was improvement in net margin by 110 basis points led by reduction in overall overhead cost. In the near term, we expect Alhokair' s top-line to remain under pressure, largely due to weak consumer demand and store closure. Another key achievement during the quarter was LFL growth (+1% y-o-y) reaching in positive territory for the first time in the last 24 months. We expect the operating margin to improve on the back of improving LFL growth and cost optimization strategy undertaken by the company. Fawaz Alhokair recently announced 100% acquisition of food & entertainment co. which allows it to enter into restaurant segment. Given the higher EBIDTA margin of the acquired business compared to the existing business we believe that this acquisition will have a positive impact on the company's financials going forward. Our long term view on the growth remains optimistic boosted by pick-up in consumer sentiments following an overall economic recovery and increase in disposable income, however in near term we remain wary about the loss of market share due to store closure. Accordingly we revise our forward looking estimates and upgrade the stock to "neutral" from "downgrade" changing our target to SAR 22 per share (earlier SAR20/share).

Q1 FY20 Results: Revenue declined 6% y-o-y to SAR1,732mn (in-line with our estimate of SAR1,734mn) impacted by store closures as a part of company's cost optimization strategy. Gross profit increased 25% y-o-y to SAR656mn mainly due to IFRS 16 adjustment, without this adjustment the gross profit declined 7% y-o-y mainly due to lower sales. Gross margin remained stable without taking into account the IFRS 16 adjustment. As a result of cost cutting initiatives the SG&A declined 24% y-o-y (including the impact of IFRS 16 the SG&A declined 34% y-o-y). Due to lower expenses the net operating margin improved by 100 basis points (without the IFRS 16 adjustment) resulting in a net profit of SAR250mn (SAR225mn including IFRS 16 adjustment) compared to SAR246mn in Q1 FY19.

Valuation: The stock is currently trading at a P/E of 22.84x, based on our FY20e 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 SAR28 per share, assuming 9% WACC (35% debt in capital structure) and 3.0% terminal growth. The P/E based relative valuation at 19x FY20 EPS yields a target of SAR16 per share. The equal weighted target price stands at SAR22 per share implying a 1.38% upside from current price of SAR21.70. We upgrade the stock to "neutral".

Fig 1: Impact of IFRS 16 implementation

SAR(mn)	Q1 2019	Q1 2020 (without IFRS16)	Q1 2020 (with IFRS16)
Revenue	1,846	1,732	1,732
Cost of revenue	1,322	1,248	1,076
Gross Profit	523	484	656
GPM	28.33%	27.94%	37.88%
Depreciation	78	64	212
Operating Income	315	308	350
Operating Margin	17.06%	17.78%	20.21%
Finance Cost	57	46	113
Net Income	246	250	225
Net margin	13.33%	14.43%	12.99%

Source: Company data, Al Rajhi Capital

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 compared to our expectations. Key upside risk is higher-than-expected rise in disposable income driven by Saudization.

Figure 2: Summary of Q1 2020 results

(SAR mn)	Q1FY19	Q4FY19	Q1FY20	% Chg YoY	% Chg QoQ	ARC Est
Revenue	1,846	1,193	1,732	-6%	45%	1,734
Gross Profit	523	45	656	25%	1358%	675
Gross Profit margin	28.3%	3.8%	37.9%	NM	NM	38.9%
Operating Profit	315	(141)	350	11%	NM	370
Net Profit	246	(184)	225.0	-9%	NM	263

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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