Fawaz Abdulaziz Alhokair Co.

Investment Update

الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Fawaz Abdulaziz Alhokair Co. (AlHokair) posted Q4-18 earnings below estimates. Revenue growth is expected to remain subdued in the near term, mainly attributable to sluggish consumer demand driven by decline in customer base. To improve profitability, AlHokair has lowered its store count by closing down non-profitable ones. We expect consumer demand to increase gradually, boosted by an increase in disposable income driven by economic growth and higher employment rate. Margins are expected to remain stable in the medium term, driven by cost-cutting initiatives. We upgrade AlHokair to "**Overweight**" view with a TP of **SAR 24.30/share**.

Revenue growth to remain subdued in near term: AlHokair posted a loss of SAR 141.0mn in Q4-18, below AJC's and the market consensus estimate of SAR 35.5mn and SAR 25.2mn, respectively. Revenue declined 10.1% Y/Y due to subdued consumer demand and reduced store count (net reduction in number of stores in FY18 stood at 170). We expect revenue per store to increase marginally in FY19 as the company closes more non-profitable stores in FY19. However, revenue growth is expected to be relatively flat in FY19. We expect a rebound in demand from FY20, which should benefit AlHokair in the medium term.

Closure of non-profitable stores and cost reduction measures to enhance margins in medium term: AlHokair's GP margin decreased Y/Y in Q4-18 to 3.2% from 3.8%. This was mainly due to higher provision, on inventory shrinkage and slow-moving inventory, which was SAR 145mn in Q4-18 Vs. SAR 78.1mn in Q4-17. The Operating margins improved to -4.9% in Q4-18 from -11.8% in Q4-17 due to the optimization of head-office and back-office expenses, and closure of non-profitable stores. GP margin of AlHokair increased to 20.0% in FY18 Vs. 19.9% in FY17. The provisioning expenses would be lower in FY19 as compared to FY18, as the company has already done close to 90% of its planned store closures. This is expected to result in increase in GP margin in FY19.

Improvement in international business augurs well in the long run: The net loss of international business improved by 52.5% in FY18 (SAR 66mn in FY18 Vs. SAR 139mn in FY17). Key initiatives such as focus on growth potential markets (Egypt, Georgia), development of trade fairs for brands generating good returns, and focusing on profitable brands should turnaround the international operations. We expect that it would take another couple of years for international operations to be profitable.

Portfolio diversification, e-commerce, pick-up in retail demand to drive long-term growth: AlHokair plans to launch its e-commerce platform shortly; it would form a new, modern channel for sales generation. To diversify its portfolio, the company is looking to explore other avenues such as cinemas and restaurants. It is in talks with operators of entertainment cities to increase its presence in upcoming shopping malls. We expect retail demand to pick up in FY20, driven by higher disposable income and a rising employment (due to the Saudization drive).

AJC View and Valuation: We believe AlHokair stands to benefit from increased retail demand, which would be the company's key driver of growth in the long run. We have modeled an increase in store count from 1,694 in FY18 to 1,924 at the end of FY22, coupled with a low-single-digit increase in average revenue per store. AlHokair is close to completing its target of closing non-profitable stores. We expect the company to focus on expansion going forward. We value AlHokair on 50% weight for DCF (3.0% terminal growth and 7.8% WACC), 25% weight each for P/E (18.6x FY19 EPS) and EV/EBITDA (9.8x FY19 EBITDA) based relative valuation. These yield a target price of **SAR24.3 per share**, implying a 11.2% upside from the current levels. The stock is currently trading at a P/E of 17.1x, based on our FY19 EPS estimate. We upgrade AlHokair to '**Overweight**' rating from '**Neutral**'.

Overweight

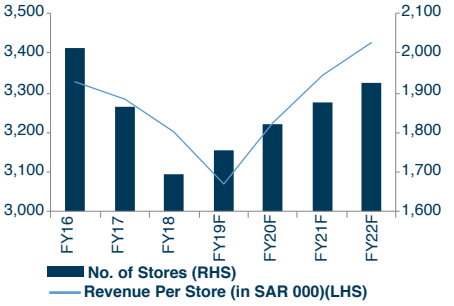
Target Price (SAR)	**24.30**
Upside / (Downside)*	**11.2%**

Source: Tadawul *prices as of 5th of July 2019

Key Financials

SARmn (unless specified)	FY17	FY18	FY19E
Revenue	6,116.5	5,425.8	5,447
Gross Profit	1,214.6	1,084.5	1,223.7
Net Profit	103.5	144.7	268.1
EPS	0.49	0.69	1.28

No.of Stores and Revenue per Store



Source: Bloomberg, AlJazira Capital, Y/E March

Key Ratios

SARmn (unless specified)	FY17	FY18	FY19E
Gross Margin	19.9%	20.0%	22.5%
Net Margin	1.7%	2.7%	4.9%
P/E	54.3x	35.6x	17.1x
P/B	2.6x	2.1x	1.7x
EV/EBITDA (x)	13.3x	10.5x	8.6x

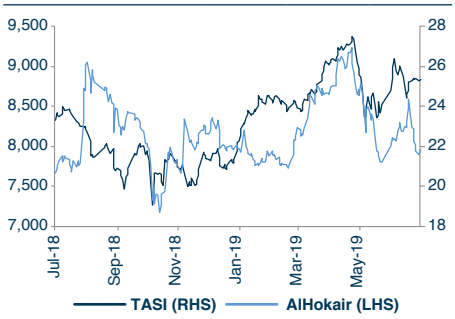
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	4.6
YTD %	-0.70%
52 Week (High)/(Low)	27.1/17.6
Shares Outstanding (mn)	210.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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Key Financial Data

Amount in SAR mn, unless otherwise specified	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Income statement							
Revenues	6,692	6,117	5,426	5,447	5,788	6,118	6,404
Y/Y	*-3.6%*	*-8.6%*	*-11.3%*	*0.4%*	*6.3%*	*5.7%*	*4.7%*
Cost of Sales	(5,175)	(4,902)	(4,341)	(4,223)	(4,494)	(4,747)	(4,970)
Gross profit	**1,517**	**1,215**	**1,084**	**1,224**	**1,294**	**1,370**	**1,434**
Selling and marketing expenses	(254)	(248)	(180)	(192)	(199)	(207)	(214)
General and Administrative exp	(333)	(322)	(281)	(277)	(289)	(302)	(313)
Depreciation and amortization	(310)	(318)	(290)	(310)	(332)	(353)	(377)
Other income	-	(13)	79	45	41	31	32
Operating profit	**620**	**314**	**412**	**489**	**515**	**539**	**563**
YoY growth	*-27.2%*	*-49.4%*	*31.3%*	*18.7%*	*5.3%*	*4.5%*	*4.4%*
Financial charges	(167)	(181)	(201)	(194)	(175)	(128)	(94)
Profit before zakat	**502**	**133**	**193**	**295**	**381**	**441**	**501**
Zakat	(31)	(43)	(55)	(32)	(23)	(26)	(30)
Net income	**434**	**103**	**145**	**268**	**362**	**419**	**475**
Y/Y	*-29.5%*	*-76.2%*	*39.9%*	*85.2%*	*35.0%*	*15.7%*	*13.5%*
Balance sheet							
Assets							
Cash & bank balance	365	331	516	1,437	939	741	762
Other current assets	2,927	2,919	3,038	2,430	2,583	2,729	2,857
Property & Equipment	1,904	2,046	1,752	1,616	1,574	1,508	1,452
Other non-current assets	1,444	1,416	1,401	1,401	1,401	1,401	1,401
Total assets	**6,639**	**6,711**	**6,707**	**6,884**	**6,497**	**6,379**	**6,472**
Liabilities & owners' equity							
Total current liabilities	3,191	2,501	2,112	1,845	1,703	1,611	1,554
Total non-current liabilities	1,346	2,025	2,184	2,359	1,754	1,309	983
Paid -up capital	2,100	2,100	2,100	2,100	2,100	2,100	2,100
Statutory reserves	181	191	206	233	269	311	358
Other reserve	(532.9)	(525.5)	(452.2)	(452.2)	(452.2)	(452.2)	(452.2)
Retained earnings	365	482	624	865	1,191	1,568	1,995
Minority interest	(11)	(64)	(67)	(67)	(67)	(67)	(67)
Total owners' equity	2,102	2,185	2,411	2,679	3,041	3,460	3,935
Total equity & liabilities	**6,639**	**6,711**	**6,707**	**6,884**	**6,497**	**6,379**	**6,472**
Cashflow statement							
Operating activities	624	782	712	652	617	695	786
Investing activities	(236)	(491)	114	30	(289)	(288)	(320)
Financing activities	(320)	(290)	(556)	238	(825)	(606)	(444)
Change in cash	68	1	270	920	(498)	(198)	21
Ending cash balance	**365**	**331**	**516**	**1,437**	**939**	**741**	**762**
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	1.0	1.3	1.7	2.1	2.1	2.2	2.3
Quick ratio (x)	0.5	0.6	0.8	1.3	1.1	1.1	1.2
Profitability ratios							
Gross profit margin	22.7%	19.9%	20.0%	22.5%	22.4%	22.4%	22.4%
Operating margin	9.3%	5.1%	7.6%	9.0%	8.9%	8.8%	8.8%
EBITDA margin	13.9%	10.3%	12.9%	14.7%	14.6%	14.6%	14.7%
Net profit margin	6.5%	1.7%	2.7%	4.9%	6.3%	6.8%	7.4%
Return on assets	6.5%	1.6%	2.2%	3.9%	5.4%	6.5%	7.4%
Return on equity	22.3%	4.7%	6.1%	10.3%	12.4%	12.6%	12.6%
Market/valuation ratios							
EV/sales (x)	1.4	1.4	1.4	1.3	1.2	1.1	1.1
EV/EBITDA (x)	10.4	13.3	10.5	8.6	8.1	7.7	7.3
EPS (SAR)	2.1	0.5	0.7	1.3	1.7	2.0	2.3
BVPS (SAR)	10.0	10.4	11.5	12.8	14.5	16.5	18.7
Market price (SAR)*	32.2	26.8	24.5	21.8	21.8	21.8	21.8
Market-Cap (SAR mn)	6,751.5	5,619.0	5,153.4	4,586.4	4,586.4	4,586.4	4,586.4
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
P/E ratio (x)	15.5	54.3	35.6	17.1	12.7	11.0	9.7
P/BV ratio (x)	3.2	2.6	2.1	1.7	1.5	1.3	1.2

Source: Company financials, AlJazira research (Y/E is March)

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AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
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.

Disclaimer