الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Retail Sector Report

Saudi Arabia | September 2019

Executive Summary

An improvement in GDP (2.4% in FY18 Vs. -0.7% in FY17), decrease in the unemployment rate (12.3% in Q2-19 Vs. 12.9% in Q2-18), and a steadily rising Purchasing Managers' Index (PMI) (19-month high in Jun-19) represent positive signs of a rebound in KSA's economic growth. Key domestic consumption indicators (consumer and credit card loans, POS transactions, cash withdrawal, and private consumption expenditure) have shown positive growth in the last year and a half. The government has taken various initiatives such as extending business hours and implementing Saudization. All these factors have led to an improvement in consumption demand and bode well for the retail sector over the long term. Most retail companies have expansion plans in place to cater to potential demand. E-commerce represents a major growth driver for the retail sector, driven by low penetration, high growth potential, and recent government regulations.

Outlook on sector remains Neutral; Al Othaim is our top pick: We maintain our Neutral outlook on the retail sector as most positives appear to have been priced in at current valuations. An increase in labor cost, regulatory reform, competition, and pricing pressure broadly constitute the sector's main downside risks; companies with a higher bargaining power, adaptability to change, low leverage, and revenue mix (high margin products) would emerge as LT winners. We are "**Overweight**" on Al Othaim and Alhokair; Al Othaim being our top pick among peers.

Margin stability and store expansion bodes well for Al Othaim: Revenue is expected to grow in mid-single digits as a result of store expansion, leading to a higher market share. The company plans to open 28 stores in FY19, after a net addition of 36 in FY18. This would enable it to increase its market share and capitalize on the growth opportunity. We expect consumer demand to gain pace with economic growth. GP Margin has consistently increased over the years (from 16.5% in FY15 to 20.4% in FY18 as the company has managed costs despite store expansion. Margins are likely to remain stable driven by cost efficiency. We are "**Overweight**" on Al Othaim.

Alhokair to benefit from restructuring and margin stability: Alhokair had undertaken restructuring activity in the last two years, wherein it closed non-performing stores. This had an adverse impact on its top and bottom lines. We believe the company has completed around 90% of its restructuring activities, and it would be able to reap the benefits of the same from FY19. We expect consumer demand to increase gradually, boosted by an increase in disposable income, which is driven by economic growth and higher employment rate. Margins are expected to remain stable in the medium term, driven by cost-cutting initiatives. We are "**Overweight**" on Alhokair.

Store launches and electronic sales to drive growth for Jarir: Online sales are expected to contribute 5% to gross sales in FY19. We expect margins to remain stable in the medium term. Revenue growth is expected to be driven by higher electronic sales and store launches. An increase in the overall income of Saudis would lead to a structural shift towards modern retail markets benefiting Jarir. We have a "**Neutral**" view on Jarir.

Cost-saving initiatives to enhance GP Margin for SACO: Revenue growth would be driven by the opening of new showrooms, addition of new selling channels, and e-commerce sales. We expect the company to benefit from traction in the residential construction sector. Cost optimization plans, negotiations with suppliers, and tech initiatives are expected to enhance the company's margins going forward. We have a "**Neutral**" recommendation for SACO.

	Recommendation	TP (SAR/share)	CMP (SAR/share)	Upside/(Downside)
Jarir	**Neutral**	168.00	161.60	4.0%
SACO	**Neutral**	65.00	60.40	7.6%
Al Othaim	**Overweight**	88.60	77.00	15.1%
Alhokair	**Overweight**	24.30	23.80	2.1%

*Prices are as of 12th September 2019
Source: Bollommberg, AJC Research

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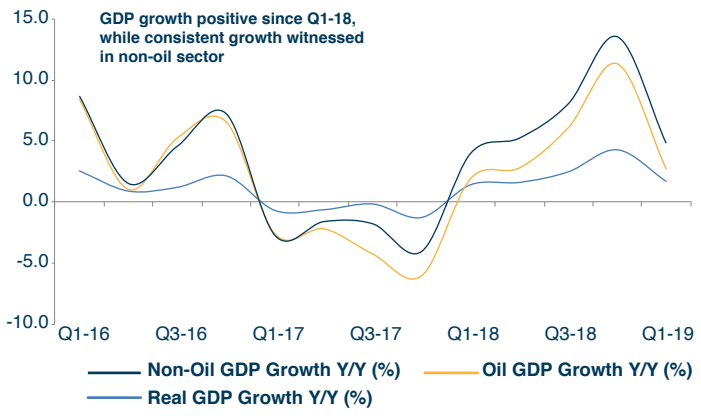
Macroeconomic overview – visible signs of economic recovery

Improvement in GDP over last year – Non-oil GDP posting strong growth

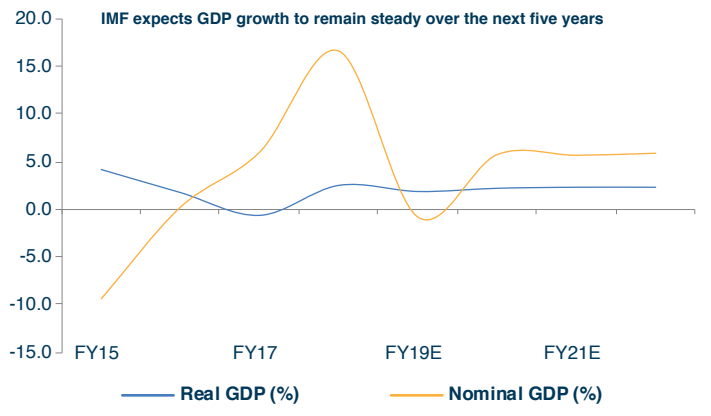
KSA's GDP has witnessed a turnaround since last year, which represents a positive sign for the economy going forward. After declining throughout FY17, real GDP increased 2.4% in FY18. The key highlight of the GDP turnaround was stable growth in non-oil GDP (2.1% in Q1-19 Vs. 0.6% in Q1-17). The IMF mentioned KSA's economic reforms are yielding positive results for the country. It added that growth in the employment and non-oil sectors, which represent one of the key objectives of diversifying the economy, has gained pace. We expect the government to increase its spending in non-oil sectors, which would lead to job creation and improved private consumption.

Figure 1: GDP growth (Oil and non-oil)



Ministry of Statistics Authority, KSA

Figure 2: GDP growth forecast

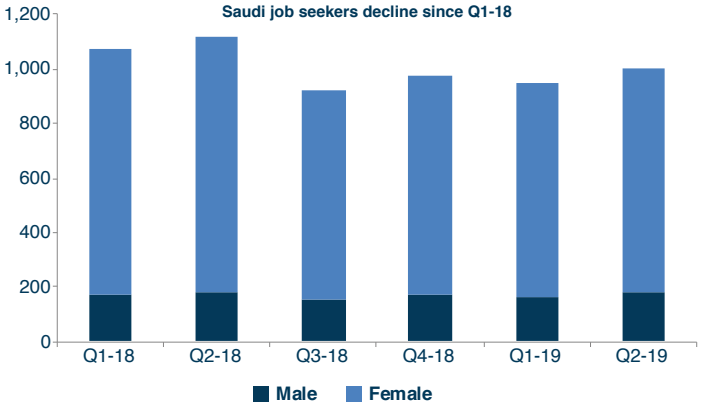


Source: Ministry of Statistics Authority, KSA, IMF

Saudi unemployment rate on the decline – Impact of government initiatives

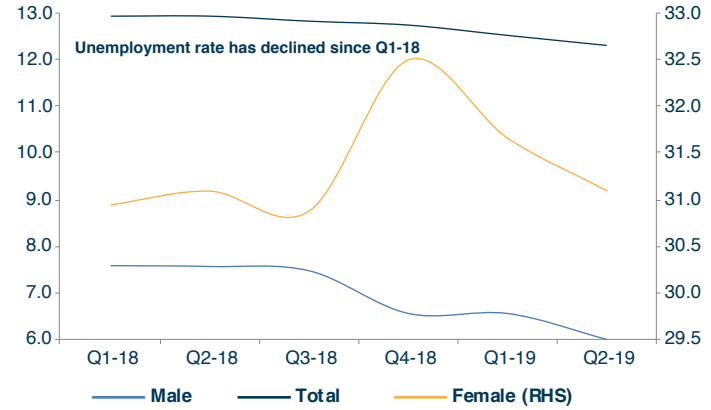
The Government of Saudi Arabia undertook the Saudization initiative (the new Nitaqat program) wherein companies employing a higher number of locals were given privileges, while certain restrictions were imposed on firms in which the majority of employees were expats. Unemployment has improved over the past year. The unemployment rate of Saudi nationals declined to 12.3% in Q2-19 from 12.9% in Q2-18. The average monthly wages paid to Saudi nationals increased 1.0% Y/Y in Q2-19, while the expats employed declined 1.3% Y/Y in Q2-19. Job seekers declined 10.4% Y/Y in Q2-19, and the number of Saudis employed decreased 1.1% Y/Y. The unemployment rate could improve further as more Saudis get employment, supported by increased spending by the government as it strives to achieve the unemployment rate target of 9.0% by FY22.

Figure 3: Job seekers (in 000's) (Saudi nationals)



Ministry of Statistics Authority, KSA

Figure 4: Unemployment rate (%) (Saudi nationals)

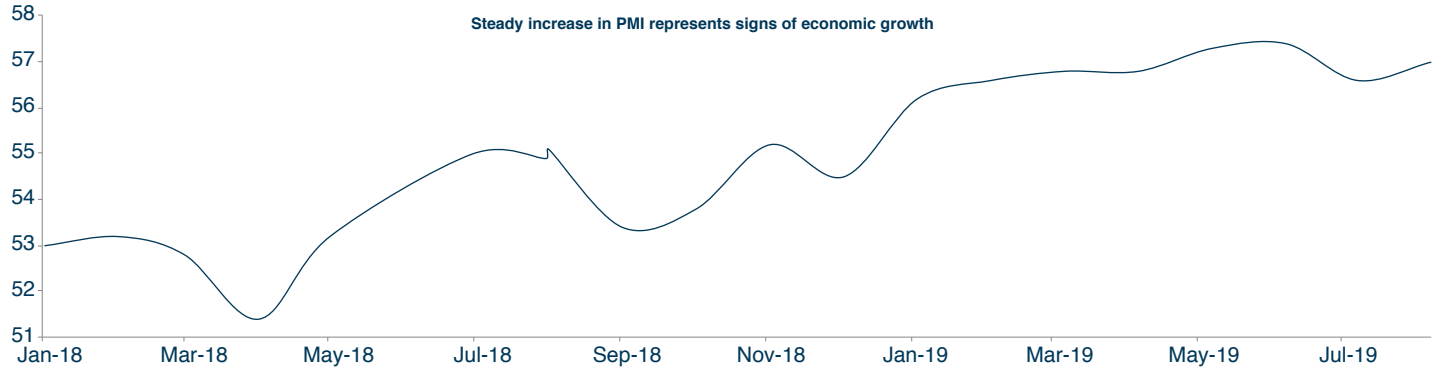


Ministry of Statistics Authority, KSA

Purchasing Managers' Index (PMI) – Steady rise represents positive sign for economic growth

The PMI released by IHS Markit provides insights on the business conditions of the economy based on a survey of senior purchasing executives in leading companies. Saudi Arabia's PMI rose to a 19-month high of 57.4 in Jun-19. New business growth in the non-oil private sector witnessed acceleration. The continued rise in the PMI in the last 18 months is a key indicator of a pickup in economic activity and growth. We believe this supplements the uptrends seen in GDP growth and employment, and serves as a positive sign for economic growth.

Figure 5: Purchasing Managers' Index (PMI)



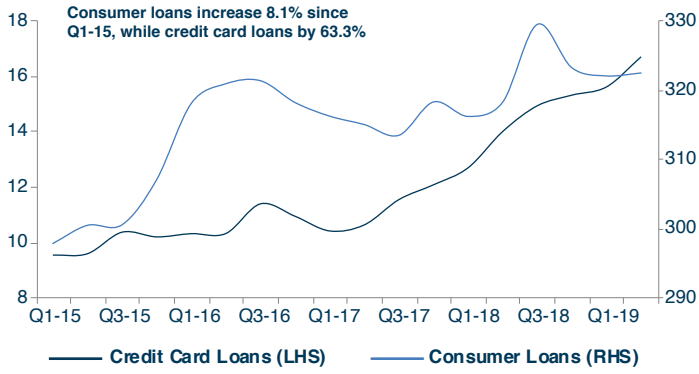
Source: NBD Emirates, IHS Markit, Bloomberg

Domestic consumption – Economic growth aided by positive consumption trends

Consumer spending indicators – Rise in key indicators reflects improvement in consumer spending

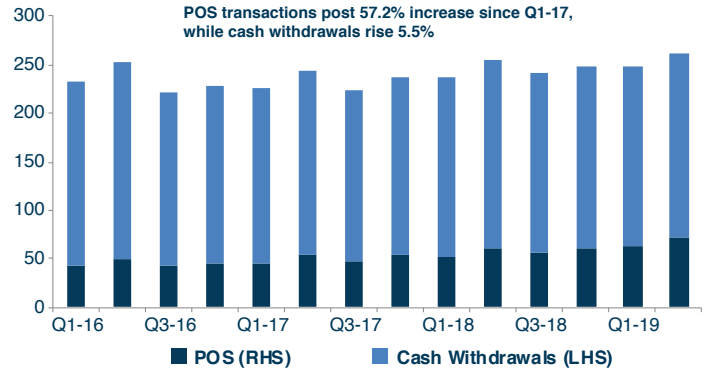
Consumer and credit card loans increased by SAR 12.5bn from Q1-17 to SAR 339.2bn in Q2-19. Point-of-sale (POS) transactions increased by SAR 26.5bn after Q1-17 to SAR 72.7bn in Q2-19. The increase in these indicators signifies consumers are financially better-positioned with a higher confidence level when making big-value purchase decisions, which would in turn drive private consumption demand.

Figure 6: Consumer and credit card loans (SAR bn)



Source: SAMA Monthly Bulletin

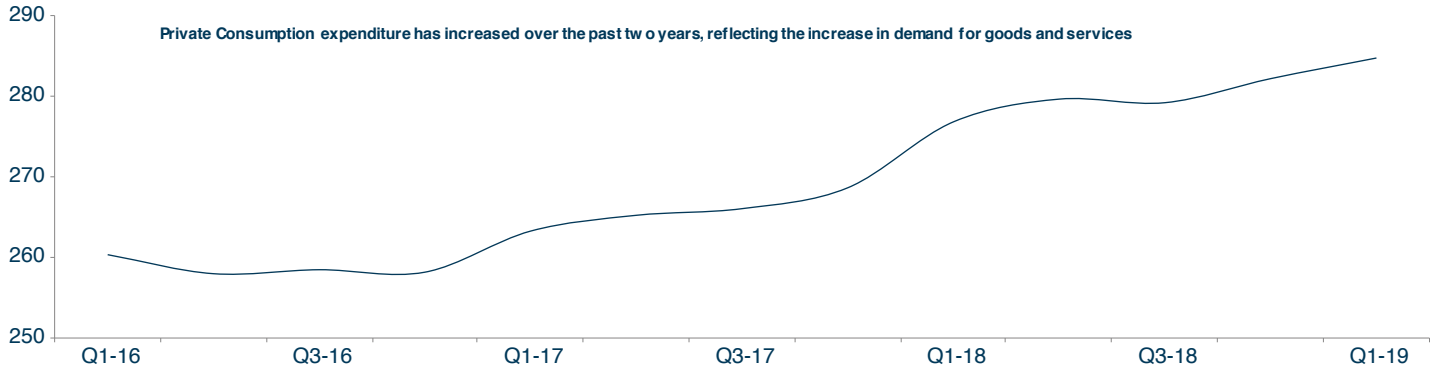
Figure 7: POS transactions and cash withdrawal (SAR bn)



Source: SAMA Monthly Bulletin

The impact of the metrics mentioned above is reflected in private consumption expenditure, which rose to SAR 284.4bn in Q1-19, up 8.1% in Q1-17. We expect these metrics to increase further, aided by government reforms and growth in employment.

Figure 8: Private consumption expenditure (SAR bn)



Source: Ministry of Statistics Authority, KSA

Government support – Undertaking initiatives to drive consumption story

The Government of Saudi Arabia has played a crucial role in the economic turnaround by undertaking various initiatives and introduction reforms. The key ones are listed below.

Reducing unemployment through Saudization: Saudi Arabia plans to create 1.2mn jobs by FY22 to reduce the unemployment rate to 9%, with major focus on the retail sector. The government initiated the employment drive (70% Saudization) in three phases – with the first phase starting in Sep-18, which covered 12 retail subsectors. The second phase started in Nov-18, which covered electronics and electrical shops, optical stores, and watch shops. The third phase came into effect in Jan-19, which saw nationalization of jobs in the fields of medical appliances and equipment, building and construction material, car spare parts, carpet selling, and confectionery shops. These initiatives have contributed to the improvement of the unemployed rate of Saudis (12.3% in Q2-19 from 12.9% in Q2-18).

Introduction of citizen accounts supports low-income group: In Dec-18, the Ministry of Labor and Social Development introduced the Citizen Account Program to assist families with low income to cope with the changes caused by economic reforms. Under the program, direct cash transfer is carried out to the beneficiary's account. As of Jul-19, the number of beneficiaries stood at 12.4mn, with the total cumulative amount at SAR47.1bn. This government initiative gives the low-income group access to basic needs at most times.

Extending business hours to benefit economic growth: Saudi Arabia's cabinet permitted shops and businesses to operate for 24 hours in Jul-19. A charge would be levied in return, which would be decided by the Minister of Municipal and Rural Affairs. We expect this to be positive for economic growth, as it would create additional employment opportunities and boost consumer spending. The retail sector stands to benefit as businesses can remain open for extended hours, thereby drawing higher footfalls.

Women empowerment to bolster retail sector demand: The government has implemented changes to promote women empowerment. Key changes include lifting existing driving restrictions and enabling starting a business and access to education, healthcare benefits, and travel without the consent of a male guardian. This should result in increased female employment. Vision 2030 aims to boost women participation in the workplace from 22% to 30%. We expect the government to introduce further reforms for the benefit of women that would improve their workforce participation, resulting in demand for products in the retail sector.

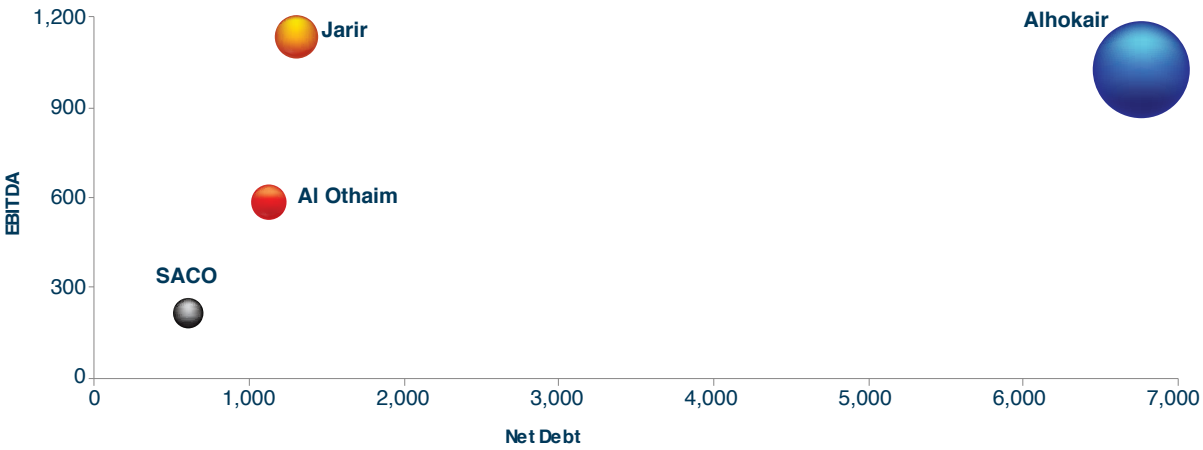
We believe the government would continue to undertake new initiatives, and launch reforms that would play a vital role in job generation, demand creation, and overall economic developmen

Comparison of major private players in KSA retail sector and future trends

Net Debt to EBITDA ratio – Jarir and Al Othaim appear to be best placed

All retail players have expansion plans that would enable them to capitalize on consumption demand. We expect Alhokair and Al Othaim to invest the highest in expansions (SAR 293mn and SAR 280mn, respectively) in FY19. Other players also have expansion plans in place. However, they are not as significant in terms of value when compared with Alhokair and Al Othaim. Jarir and Al Othaim have favorable net debt to EBITDA ratios of 1.15x and 1.91x, respectively, while SACO and Alhokair have net debt to EBITDA ratios of 2.89x and 6.54x, respectively. Debt has increased significantly for certain companies due to inclusion of lease liabilities due to adoption of IFRS-16.

Figure 9: Net Debt/EBITDA



Sector net debt / EBITDA stands at 3.29x. Alhokair stands at the upper range with a ratio of 6.54x. Jarir and Al Othaim appear at relatively favourable positions at 1.15x and 1.91x, respectively.

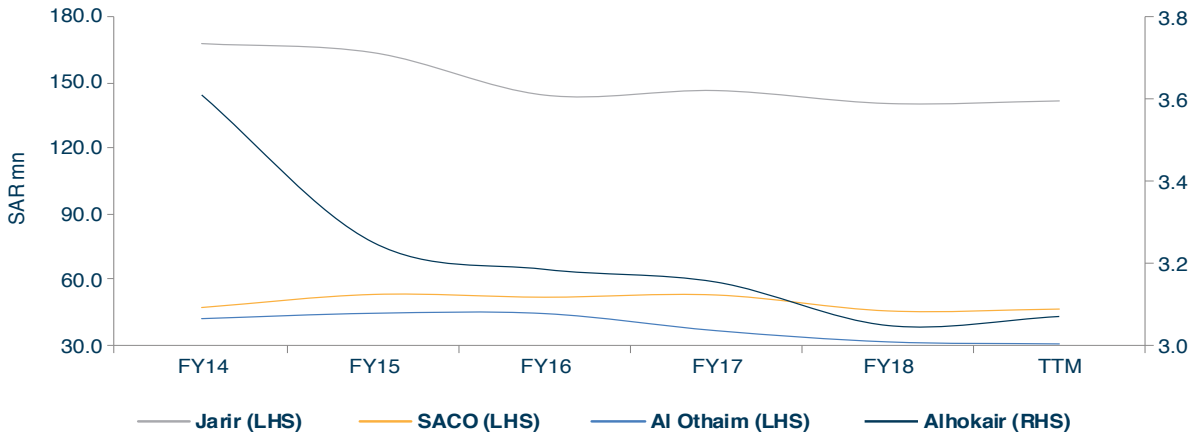
Size Reflects Enterprise Value

Source: Company Reports, Bloomberg, AJC Research

Revenue per store – Trend for most companies is similar with marginal improvement in TTM Q2-19

Revenue/store for most companies declined during FY14–18, which can be attributed to the challenging economic conditions and lower purchasing power during the aforementioned phase. However, a positive turnaround seems to be on the cards, which is evident from the improvement in key economic indicators in Q1-19 (Refer to the Macroeconomic Overview section). Companies that capitalize on this opportunity with the right approach would stand to gain the most. In this aspect, we are the most positive on Alhokair.

Figure 10: Revenue/Store



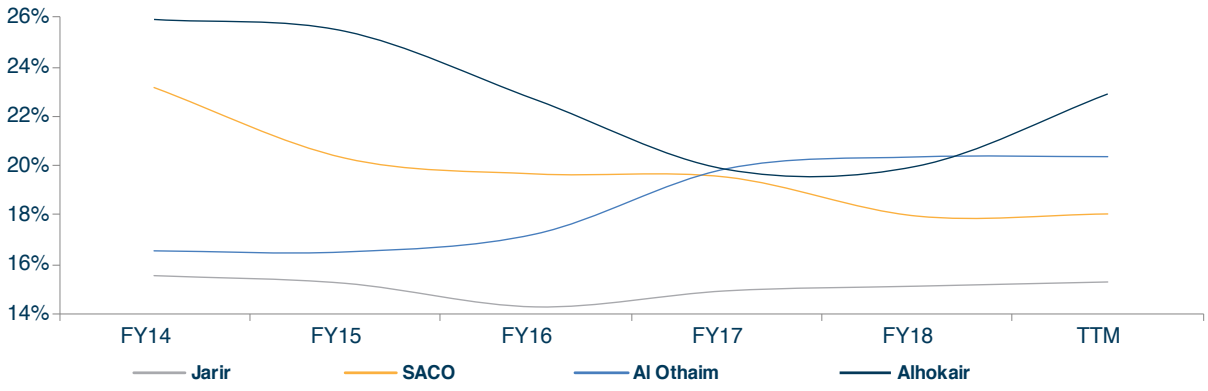
Revenue per store decreased for all companies (except SACO) in TTM compared with FY14. Al Othaim witnessed the highest decline in revenue per store (26.9% decline in TTM compared with FY14.

Source: Company Reports, AJC Research

GP Margin – Improvement visible post FY17 for most companies; GP Margin of Al Othaim most impressive

Almost all companies have been able to improve their GP margins in the last 4–5 quarters. This is mainly due to various efficiency measures undertaken by companies to reduce costs while they await a turnaround in business conditions. Al Othaim has been able to consistently improve its GP Margin, while Alhokair has maintained its GP margin in the last 12 months in the top-half of the peer set. Debt has increased significantly for certain companies due to inclusion of lease liabilities due to adoption of IFRS-16.

Figure 11: GP Margin



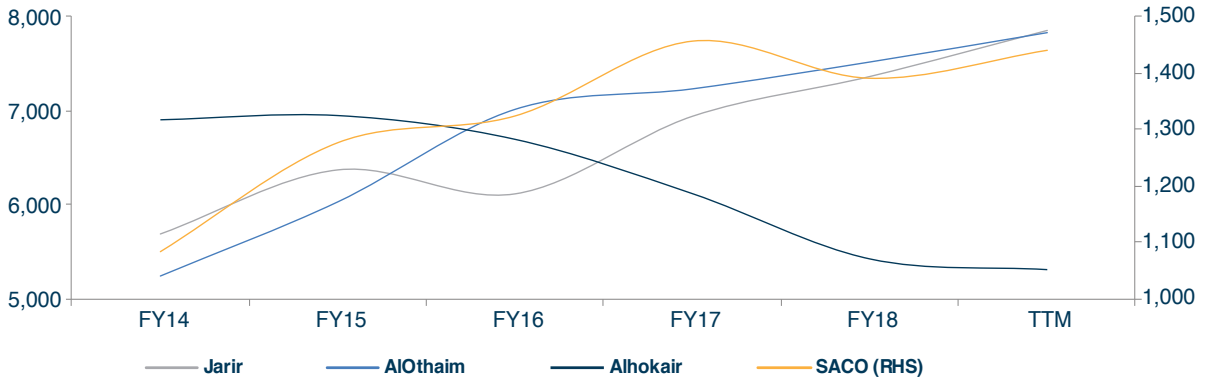
Al Othaim and Alhokair have the best GP margins, while Jarir is the lowest. The GP Margin of all companies (except SACO) have improved after FY17.

Source: Company Reports, AJC Research

Revenue growth – Pickup in revenue post FY16; Al Othaim posts highest CAGR revenue growth

Almost all companies, except Alhokair, have witnessed positive revenue growth over the last four years, with an increase in revenues witnessed after FY16. We expect Alhokair to record positive revenue growth from FY20, as it closes down non-profitable stores and restructures its business. Al Othaim posted the best CAGR growth (9.4%) between FY14-FY18.

Figure 12: Revenue (SAR mn)



Revenues of Al Othaim and Jarir have increased at CAGRs of 9.4% and 6.6% respectively, during FY14-FY18

Source: Company Reports, AJC Research

E-commerce – Key driver for retail sector growth

According to market estimates, online retail market in Saudi Arabia is expected to grow to SAR 37.5bn by FY22, this growth is expected to be driven mainly by high internet penetration (70.49% in FY17) and mobile phone usage.

Highly underpenetrated market: Saudi Arabia's online retail penetration stood at 1.4% in FY17, as per the Delta Partners group. As per Saudi Gazette, there are 12.94mn e-commerce users in the Kingdom, with the figure expected to reach 19.28mn by FY22. It added that Saudi Arabia was in the top ten countries in the world with respect to e-commerce growth exceeding 32%. We believe there exists immense potential for e-commerce growth in Saudi Arabia, which would be a key driver for retail sector growth.

Factors driving e-commerce growth in Saudi Arabia: Some of the world's major e-commerce players, such as Amazon, eBay, and Alibaba Group's AllExpress, are already present in Saudi Arabia's marketplace. Competition in the e-commerce space is expected to increase as existing players, along with potential new entrants, attempt to gain leadership positions through discounts and promotions. POS transactions have been growing significantly in the Kingdom (Refer to the Consumer Spending Indicators section), which should propel e-commerce sales.

Government regulations and key beneficiary companies: The council of ministers approved the E-Commerce Law in Saudi Arabia in FY19 with the objective of improving the reliability of e-commerce, safeguarding consumer rights, and thereby increasing its contribution towards economic growth. Key features of the new law include a return policy of seven days and cancellation if delivery is delayed for more than 15 days. We believe Jarir (targeting more than 5% of overall sales from online sales) would benefit from the regulation. In the long run, this would also benefit SACO and Alhokair, who intend to foray into the e-commerce space.

Attractiveness of Saudi Arabia: Millennials constitute approximately 27% of the population in Saudi Arabia. As per a market study, millennials utilize online and mobile platforms for shopping. As millennials grow up, their economic power is expected to increase, leading to higher online sales. Saudi Arabia's demographics make e-commerce a potential winner in the long term.

Key challenges: As the e-commerce industry grows in Saudi Arabia, it faces various challenges such as delay in delivery, low product-quality, and insufficient discounts. As the market matures, new players enter the market, and regulations become favorable, the market would grow. Companies that tap this potential adapt to changes, and consistently deliver customer delight would benefit the most in the long term.

Conclusion

Most of the positives appear to be priced into the current share price. Hence, we have a "Neutral" view on the retail sector. To remain competitive, companies would need to identify areas to lower costs, and adopt modern techniques such as automation.

Jarir is currently trading at a P/E of 17.4x based on our FY20 EPS estimate, factoring in the expansion through store openings and online sales. Upside and downside risks rest mainly on macro and sector-wide conditions. We remain "**Neutral**" on the company with a PT of **SAR 168.0/share**.

We maintain our "**Neutral**" recommendation on SACO with a PT of **SAR 65.0/share**. The company is currently trading at a forward P/E of 18.1x based on our FY20 EPS estimate. Larger impacts on revenue from pressure on purchasing power and loss of market share to competitors are key downside risks.

We have an "**Overweight**" recommendation on Alhokair with a PT of **SAR 24.3/share**. We believe that the company has completed about ~90% of its restructuring activities, and a good period looms ahead. We expect an improvement in GP Margin and Operating Margins in FY19 due to the cost-saving initiatives undertaken.

Al Othaim is currently trading at a P/E of 18.7x based on our FY20 EPS estimate, factoring in the addition of new stores. We have a positive outlook on the company with an "**Overweight**" rating with a PT of **SAR 88.60/share**, and rate it as our top pick among peer set.

Jarir Marketing Co. (Jarir)

Positive outlook aided by strong revenue growth in Q2-19: Jarir posted Q2-19 in line result of SAR 169mn. This is comparable with AJC's and the market consensus estimate of SAR 176.1mn and SAR 175.9mn, respectively. Revenues grew 11.8% Y/Y, driven by higher electronics sales (smartphones and items from the computer section) and increased store count. We expect this section to continue to drive the company's revenues by adapting to changing consumer preferences.

Expansion through store count increase and online sales: Jarir opened five showrooms in each of the last five years, increasing the store count to 58 at the end of Q2-19 from 40 at the start of Q1-16. We expect the number of stores to increase to 71 by end-FY22 from 56 in Q1-19. The rise in the store count, coupled with adaption to consumer preferences, should enable Jarir to increase its market share in the near future. Deployment of additional employees to its online sales division is expected to propel online sales growth, which is expected to contribute ~5% to total sales in FY19.

Margins to remain stable in the medium term: GP Margin decreased on a Y/Y basis in Q2-19 to 12.4%, compared with 12.6%. This was mainly due to an increase in the sales of low-margin products. We expect margins to remain stable going forward, as the company shifts towards high-margin products.

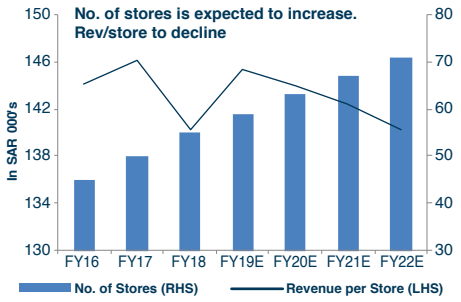
Attractive dividend payout: Jarir is one of the highest dividend paying companies in Saudi Arabia with an average dividend payout ratio of more than 80% over the last five years. The average dividend yield of the last five years is 5.11%.

AJC View and Valuation: We believe Jarir is well-positioned to increase its top-line growth through market share gain, driven by store expansion and rise in online sales. We expect margins to remain under pressure due to higher costs resulting from the employment of Saudis, along with higher selling and marketing expenses as the company aims to increase its market share. Upside and downside risks rest mainly on macro and sector-wide conditions.

We value Jarir on 50% weight for DCF (3.0% terminal growth and 7.9% average WACC), 25% weight each for P/E (17.8x FY20 EPS) and EV/EBITDA (13.6x FY20 EBITDA) based relative valuation, yielding the target price of **SAR 168.0 per share**, implying 4.0% upside from current levels. The stock is currently trading at a P/E of 17.4x based on our FY20 EPS estimate. We maintain a "**Neutral**" rating on Jarir.

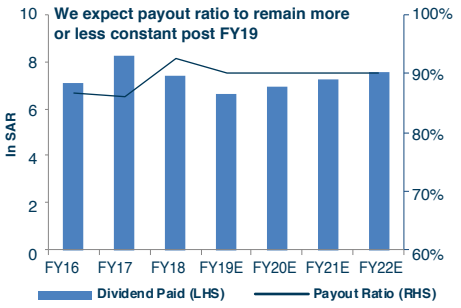
Recommendation	**Neutral**
Price Target	SAR 168.00
CMP	SAR 161.60
Upside/(Downside)	4.0%

Figure 13: Revenue and revenue per store



Source: Company Reports, AJC Research

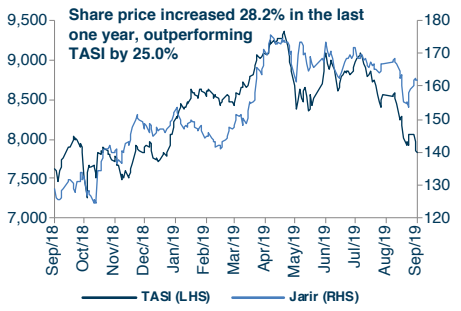
Figure 14: Dividend payout and dividend Yield



Source: Company Reports, AJC Research

Key Market Data	
Market Cap(bn)	19.1
YTD%	10.1%
52 week (High)/(Low)	179.6/129.5
Share Outstanding (mn)	120.00

Figure 15: Price Chart



Source: Bloomberg

Table 2: Key Financial Data

Amount in SARmn, unless otherwise specified	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Income statement							
Revenues	6,122	6,942	7,362	8,282	8,773	9,254	9,676
Y/Y	***-4.0%***	***13.4%***	***6.0%***	***12.5%***	***5.9%***	***5.5%***	***4.6%***
Cost of Sales	(5,247)	(5,905)	(6,248)	(6,990)	(7,405)	(7,821)	(8,178)
Gross profit	**875**	**1,037**	**1,114**	**1,292**	**1,368**	**1,433**	**1,498**
General and Administrative exp	(94)	(105)	(107)	(128)	(144)	(152)	(159)
Selling and marketing expenses	(76)	(98)	(93)	(115)	(122)	(129)	(135)
Other income	50	41	65	36	44	46	48
Operating profit	**705**	**876**	**978**	**1,085**	**1,145**	**1,198**	**1,252**
Y/Y	***-12.8%***	***24.3%***	***11.7%***	***10.9%***	***5.6%***	***4.7%***	***4.5%***
Financial charges	0	(1)	(4)	(64)	(8)	-	-
Profit before zakat	**755**	**875**	**974**	**1,020**	**1,137**	**1,198**	**1,252**
Zakat	(17)	(7)	(14)	(19)	(23)	(34)	(36)
Net income	**738**	**868**	**960**	**1,001**	**1,114**	**1,164**	**1,217**
Y/Y	***-10.9%***	***17.6%***	***10.6%***	***4.3%***	***11.3%***	***4.5%***	***4.5%***
Balance sheet							
Assets							
Cash & bank balance	158	200	146	1,725	1,579	1,640	1,763
Other current assets	1,182	1,298	1,612	1,667	1,766	1,896	1,982
Property & Equipment	1,009	1,076	1,115	1,210	1,300	1,390	1,476
Other non-current assets	285	303	342	342	342	342	342
Total assets	**2,634**	**2,877**	**3,215**	**4,944**	**4,986**	**5,268**	**5,563**
Liabilities & owners' equity							
Total current liabilities	976	1,103	1,364	1,567	1,386	1,448	1,502
Total non-current liabilities	154	148	151	1,477	1,422	1,350	1,287
Paid -up capital	900	900	1,200	1,200	1,200	1,200	1,200
Statutory reserves	297	297	96	196	308	424	546
Other reserve	(73.0)	(71.9)	(73.1)	(73.1)	(73.1)	(73.1)	(73.1)
Retained earnings	380	501	477	577	744	918	1,101
Total owners' equity	1,504	1,626	1,699	1,900	2,178	2,469	2,773
Total equity & liabilities	**2,634**	**2,877**	**3,215**	**4,944**	**4,986**	**5,268**	**5,563**
Cashflow statement							
Operating activities	938	928	696	1,189	1,253	1,293	1,403
Investing activities	(217)	(138)	(134)	(133)	(140)	(167)	(194)
Financing activities	(664)	(748)	(616)	523	(1,259)	(1,066)	(1,087)
Change in cash	57	42	(54)	1,579	(146)	61	123
Ending cash balance	**158**	**200**	**146**	**1,725**	**1,579**	**1,640**	**1,763**
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	1.4	1.4	1.3	2.2	2.4	2.4	2.5
Quick ratio (x)	0.5	0.5	0.5	1.5	1.6	1.6	1.6
Profitability ratios							
GP Margin	14.3%	14.9%	15.1%	15.6%	15.6%	15.5%	15.5%
Operating Margins	11.5%	12.6%	13.3%	13.1%	13.1%	13.0%	12.9%
EBITDA margin	13.0%	13.3%	14.1%	14.8%	14.9%	15.0%	15.1%
Net Margins	12.1%	12.5%	13.0%	12.1%	12.7%	12.6%	12.6%
Return on assets	29.3%	31.5%	31.5%	24.5%	22.4%	22.7%	22.5%
Return on equity	51.3%	55.7%	59.6%	63.9%	51.4%	48.4%	45.1%
Market/valuation ratios							
EV/sales (x)	1.7	1.9	2.5	2.3	2.2	2.1	2.0
EV/EBITDA (x)	12.8	14.2	17.8	15.8	14.7	13.8	12.9
EPS (SAR)	8.2	9.6	8.0	8.3	9.3	9.7	10.1
BVPS (SAR)	16.7	18.1	14.2	15.8	18.2	20.6	23.1
Market price (SAR)*	86.6	110.0	152.0	161.6	161.6	161.6	161.6
Market-Cap (SAR mn)	10,391.0	13,205.0	18,240.0	19,392.0	19,392.0	19,392.0	19,392.0
Dividend yield	8.2%	7.5%	4.9%	4.1%	4.3%	4.5%	4.7%
P/E ratio (x)	14.1	15.2	19.0	19.4	17.4	16.7	15.9
P/BV ratio (x)	6.9	8.1	10.7	10.2	8.9	7.9	7.0

Source: Company Reports, Bollommberg, AJC Research

Saudi Company for Hardware (SACO)

Strong earnings growth driven by margin improvement: SACO posted Q2-19 result of SAR 21.7mn, in line with AJC's and market consensus estimates of SAR 21.5mn and SAR 21.2mn, respectively. Revenue grew 0.2% Y/Y. Earnings growth was driven by the GP Margin which rose to 18.9% in Q2-19 Vs. 16.0% in Q2-18. We expect the GP Margin to improve driven by cost optimization plans, negotiation with suppliers and tech initiatives to reduce costs.

Increase in store count, new product, e-commerce sales to propel sales growth: The company plans to increase the store count to 40 by the end of FY20. Expansions are expected to be funded from operating cash flows and Sharia-compliant financial resources. Store growth would be complemented by additional services for customers and the introduction of product categories that enhance customer experience. Sales from e-commerce and additional sales channels would enable SACO to gain market share and thereby consolidate its market lead position. We have modeled an increase in store count from 32 in Q1-19 to 44 at the end of FY22.

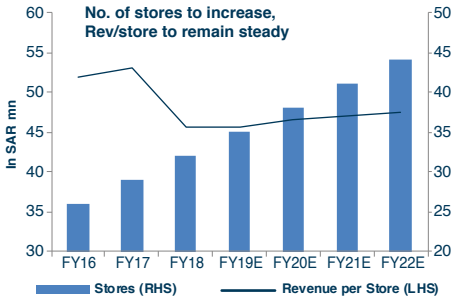
Margins to improve in medium term; new distribution center augurs well for the long run: GP margin increased on Y/Y basis in Q2-19 to 18.9% Vs. 16.0%. The company offered lowered controlled discounts in Q2-19, which contributed to improvement in margins. The Company has started using robotics technology to reduce costs. It is setting up a new distribution center in eastern province, expected to be operational towards end of FY-20. This would replace some of the distribution centers in Riyadh, which would reduce rent and transportation costs, thereby boosting margins.

AJC View and Valuation: We believe SACO has the potential to benefit from growth opportunities (potential increase in residential construction) through store expansion, introduction of new product categories, and increased online sales, all of which could result in higher market share. Margins would increase due to the initiatives undertaken by the company. LT market share gains through expansion in a highly fragmented market remain SACO's main LT positive catalyst. Impact on revenue from pressure on purchasing power and loss of market share to competitors are key downside risks to this valuation.

We value SACO on 50% weight for DCF (3.0% terminal growth and 7.5% average WACC), 25% weight each for P/E (21.1x FY19 EPS) and EV/EBITDA (15.3x FY19 EBITDA) based relative valuation, yielding a TP of **SAR 65.0 per share**, implying 7.6% upside. The stock is currently trading at a P/E of 22.0x based on our FY19 EPS estimate. We maintain a "**Neutral**" rating on SACO.

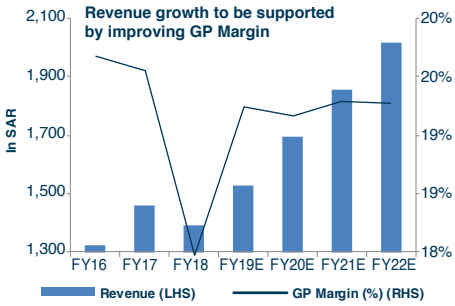
Recommendation	**Neutral**
Price Target	SAR 65.00
CMP	SAR 59.9
Upside/(Downside)	7.6%

Figure 16: Stores and revenue per store



Source: Company Reports, AJC Research

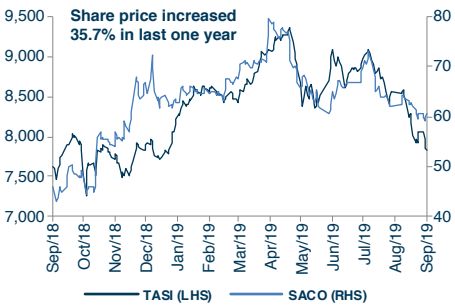
Figure 17: Revenue and GP Margin (%)



Source: Company Reports, AJC Research

Key Market Data	
Market Cap(bn)	2.2
YTD%	-6.0%
52 week (High)/(Low)	83.5/44.0
Share Outstanding (mn)	36.00

Figure 18: Price Chart



Source: Bloomberg

Table 3: Key Financial Data

Amount in SARmn, unless otherwise specified	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Income statement							
Revenues	1,324	1,456	1,390	1,526	1,695	1,854	2,018
Y/Y	***3.7%***	***10.0%***	***-4.5%***	***9.7%***	***11.1%***	***9.4%***	***8.9%***
Cost of Sales	(1,064)	(1,171)	(1,141)	(1,232)	(1,370)	(1,496)	(1,629)
Gross profit	**261**	**285**	**250**	**294**	**325**	**358**	**389**
Selling, general and administrative expenses	(119)	(135)	(138)	(143)	(157)	(172)	(187)
Operating profit	**142**	**150**	**112**	**151**	**168**	**186**	**202**
Y/Y	***7.5%***	***5.7%***	***-25.1%***	***34.0%***	***11.3%***	***10.8%***	***8.7%***
Financial charges	(5)	(7)	(6)	(40)	(37)	(34)	(31)
Profit before zakat	139	**145**	**109**	**115**	**134**	**156**	**175**
Zakat	(10)	(10)	(12)	(12)	(14)	(16)	(18)
Net income	**129**	**135**	**98**	**103**	**120**	**140**	**157**
Y/Y	***6.1%***	***4.6%***	***-27.4%***	***5.5%***	***16.6%***	***16.3%***	***12.4%***
Balance sheet							
Assets							
Cash & bank balance	55	27	16	176	184	187	209
Other current assets	590	679	754	750	833	910	991
Property & Equipment	193	244	255	270	285	302	320
Other non-current assets	53	53	497	462	422	380	336
Total assets	**891**	**1,004**	**1,521**	**1,658**	**1,724**	**1,779**	**1,855**
Liabilities & owners' equity							
Total current liabilities	301	282	420	408	444	465	489
Total non-current liabilities	84	122	550	636	595	545	503
Paid -up capital	240	240	360	360	360	360	360
Statutory reserves	44	58	10	20	32	46	62
Other reserve	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Retained earnings	221	300	180	232	292	362	441
Total owners' equity	507	599	551	613	685	770	864
Total equity & liabilities	**891**	**1,004**	**1,521**	**1,658**	**1,724**	**1,779**	**1,855**
Cashflow statement							
Operating activities	287	83	117	193	198	233	261
Investing activities	(100)	(89)	(56)	(91)	(102)	(111)	(123)
Financing activities	(157)	(21)	(72)	57	(89)	(118)	(116)
Change in cash	30	(27)	(11)	160	8	4	21
Ending cash balance	**55**	**27**	**16**	**176**	**184**	**187**	**209**
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	2.1	2.5	1.8	2.3	2.3	2.4	2.5
Quick ratio (x)	0.4	0.4	0.2	0.6	0.6	0.6	0.6
Profitability ratios							
GP Margin	19.7%	19.6%	18.0%	19.2%	19.2%	19.3%	19.3%
Operating Margins	10.7%	10.3%	8.1%	9.9%	9.9%	10.0%	10.0%
EBITDA margin	13.0%	12.9%	11.2%	17.1%	17.3%	17.4%	17.4%
Net Margins	9.7%	9.3%	7.0%	6.8%	7.1%	7.6%	7.8%
Return on assets	14.7%	14.2%	7.8%	6.5%	7.1%	8.0%	8.7%
Return on equity	25.8%	23.8%	21.4%	17.6%	17.9%	18.5%	18.6%
Market/valuation ratios							
EV/sales (x)	1.6	1.9	2.2	1.8	1.6	1.4	1.3
EV/EBITDA (x)	12.0	14.5	19.3	10.4	9.1	8.1	7.2
EPS (SAR)	5.4	5.6	2.7	2.9	3.3	3.9	4.4
BVPS (SAR)	345.2	480.1	286.2	214.2	191.6	170.7	152.0
Market price (SAR)*	85.4	109.5	66.2	60.4	60.4	60.4	60.4
Market-Cap (SAR mn)	2,048.8	2,628.4	2,383.2	2,174.4	2,174.4	2,174.4	2,174.4
Dividend yield	1.8%	3.0%	2.5%	1.9%	2.2%	2.6%	2.9%
P/E ratio (x)	15.9	19.5	24.3	21.1	18.1	15.5	13.8
P/BV ratio (x)	4.0	4.4	3.8	3.5	3.2	2.8	2.5

Source: Company Reports, Bollommberg, AJC Research

Fawaz Abdulaziz Alhokair Company (Alhokair)

Revenue growth to remain subdued in near term: Alhokair posted a net profit of SAR 224.0mn in Q1-19, which was below AJC's and the market consensus estimate of SAR 250.8mn and SAR 245.6mn, respectively. Revenue declined 6.1% Y/Y due to discontinuation of weak brands and closure of non-performing stores. 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.

Closure of non-profitable stores and cost reduction measures to enhance margins in medium term: Alhokair's GP Margin increased to 37.9% in Q1-19 from 28.4% in Q1-18 due to implementation of IFRS-16, portfolio optimization strategy and cost control efforts. The Operating Margins improved to 20.2% in Q1-19 from 17.1% in Q1-18 driven by marketing strategy based on social media and decline in cost of storage and shipping. On a comparable basis (unadjusted for IFRS-16), Operating Margins improved by 70 basis points Y/Y in Q1-19, while GP Margin declined 40 basis points. We expect an improvement in GP Margin and Operating Margins in FY19 due to the cost saving initiatives undertaken.

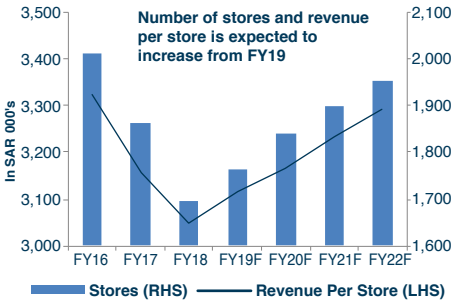
Improvement in international business augurs well in the long run: The net loss of international business improved by 52.5% in FY18 (SAR 66mn in FY18 Vs. SAR 139mn in FY17). Key initiatives such as focus on growth markets (Egypt, Georgia), development of trade fairs for brands generating good returns,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

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 7.9% average WACC), 25% weight each for P/E (22.0x FY20 EPS) and EV/EBITDA (13.2 x FY20 EBITDA) based relative valuation. These yield a target price of **SAR 24.3 per share**, implying 2.1% upside from the current levels. The stock is currently trading at a P/E of 19.8x, based on our FY20 EPS estimate. We maintain "**Overweight**" rating on Alhokair.

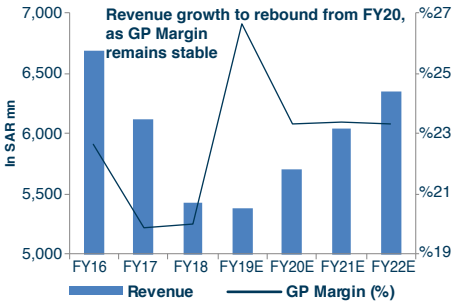
Recommendation	**Overweight**
Price Target	SAR 24.30
CMP	SAR 23.80
Upside/(Downside)	2.10%

Figure 19: Stores and revenue per store



Source: Company Reports, AJC Research

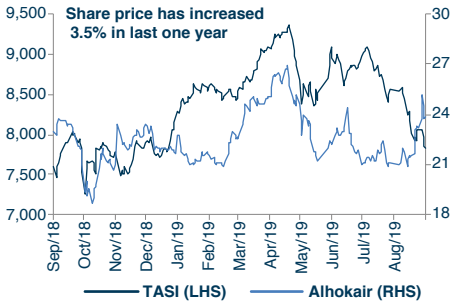
Figure 20: Revenue and GP Margin (%)



Source: Company Reports, AJC Research

Key Market Data	
Market Cap(bn)	5.0
YTD%	8.2%
52 week (High)/(Low)	27.1/17.6
Share Outstanding (mn)	210.00

Figure 21: Price Chart



Source: Bloomberg

Table 4: Key Financial Data

Amount in SARmn, unless otherwise specified	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Income statement							
Revenues	6,692	6,117	5,426	5,389	5,700	6,048	6,346
Y/Y	***-3.6%***	***-8.6%***	***-11.3%***	***-0.7%***	***5.8%***	***6.1%***	***4.9%***
Cost of Sales	(5,175)	(4,902)	(4,341)	(3,952)	(4,371)	(4,635)	(4,864)
Gross profit	**1,517**	**1,215**	**1,084**	**1,436**	**1,329**	**1,413**	**1,482**
Selling and marketing expenses	(254)	(248)	(180)	(180)	(186)	(194)	(200)
General and Administrative exp	(333)	(322)	(281)	(247)	(257)	(270)	(280)
Depreciation and amortization	(310)	(318)	(290)	(454)	(406)	(422)	(438)
Other income	-	(13)	79	17	29	30	32
Operating profit	**620**	**314**	**412**	**572**	**510**	**558**	**595**
Y/Y	***-27.2%***	***-49.4%***	***31.3%***	***38.8%***	***-10.9%***	***9.4%***	***6.7%***
Financial charges	(167)	(181)	(201)	(161)	(118)	(87)	(64)
Profit before zakat	**502**	**133**	**193**	**237**	**265**	**348**	**411**
Zakat	(31)	(43)	(55)	(45)	(16)	(21)	(25)
Net income	**434**	**103**	**145**	**192**	**252**	**330**	**390**
Y/Y	***-29.5%***	***-76.2%***	***39.9%***	***32.9%***	***31.0%***	***31.1%***	***18.1%***
Balance sheet							
Assets							
Cash & bank balance	365	331	516	589	(166)	(209)	(52)
Other current assets	2,927	2,919	3,038	2,379	2,518	2,671	2,802
Property & Equipment	1,904	2,046	1,752	1,631	1,523	1,413	1,291
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**	**5,999**	**5,276**	**5,275**	**5,442**
Liabilities & owners' equity							
Total current liabilities	3,191	2,501	2,112	1,886	1,570	1,528	1,511
Total non-current liabilities	1,346	2,025	2,184	6,205	5,505	5,176	4,933
Paid -up capital	2,100	2,100	2,100	2,100	2,100	2,100	2,100
Statutory reserves	181	191	206	225	250	283	322
Other reserve	(532.9)	(525.5)	(452.2)	(452.2)	(452.2)	(452.2)	(452.2)
Retained earnings	365	482	624	797	1,024	1,321	1,673
Minority interest	(11)	(64)	(67)	(67)	(67)	(67)	(67)
Total owners' equity	2,102	2,185	2,411	2,603	2,855	3,186	3,576
Total equity & liabilities	**6,639**	**6,711**	**6,707**	**10,695**	**9,930**	**9,890**	**10,020**
Cashflow statement							
Operating activities	624	782	712	697	616	675	760
Investing activities	(236)	(491)	114	32	(200)	(212)	(216)
Financing activities	(320)	(290)	(556)	(656)	(1,172)	(507)	(387)
Change in cash	68	1	270	72	(755)	(43)	157
Ending cash balance	**365**	**331**	**516**	**589**	**(166)**	**(209)**	**(52)**
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	1.0	1.3	1.7	1.6	1.5	1.6	1.8
Quick ratio (x)	0.5	0.6	0.8	0.8	0.5	0.5	0.7
Profitability ratios							
GP Margin	22.7%	19.9%	20.0%	26.7%	23.3%	23.4%	23.4%
Operating Margins	9.3%	5.1%	7.6%	10.6%	8.9%	9.2%	9.4%
EBITDA Margin	13.9%	10.3%	12.9%	19.0%	16.1%	16.2%	16.3%
Net Margins	6.5%	1.7%	2.7%	3.6%	4.4%	5.5%	6.1%
Return on assets	6.5%	1.6%	2.2%	2.2%	2.4%	3.3%	3.9%
Return on equity	22.3%	4.7%	6.1%	7.5%	9.0%	10.7%	11.3%
Market/valuation ratios							
EV/sales (x)	1.4	1.4	1.3	1.3	1.2	1.1	1.1
EV/EBITDA (x)	10.4	13.3	10.0	6.7	7.5	7.0	6.6
EPS (SAR)	2.1	0.5	0.7	0.9	1.2	1.6	1.9
BVPS (SAR)	10.0	10.4	11.5	12.4	13.6	15.2	17.0
Market price (SAR)*	32.2	26.8	24.5	23.8	23.8	23.8	23.8
Market-Cap (SAR mn)	6,751.5	5,619.0	5,153.4	4,998.0	4,998.0	4,998.0	4,998.0
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	26.0	19.8	15.1	12.8
P/BV ratio (x)	3.2	2.5	2.1	1.9	1.8	1.6	1.4

Source: Company Reports, AJC Research

Abdullah Al Othaim Markets Company (Al Othaim)

New store openings to drive revenue growth: Al Othaim posted earnings of SAR 58.7mn in Q2-19, below AJC's and the market consensus estimate of SAR 77.2mn and SAR 76.8mn, respectively. Revenue grew 7.4% Y/Y mainly due to the new stores additions. The company has consistently increased its store count over the years (from 142 stores in FY15 to 270 in Q2-19). We have modelled 21 net store in FY19. The company is well positioned to capitalize on the rise in consumer demand due to its expansion plans. We expect revenue growth of 6.5% in FY19 driven by new store additions and a pick-up in consumer demand due to economic recovery in Saudi Arabia.

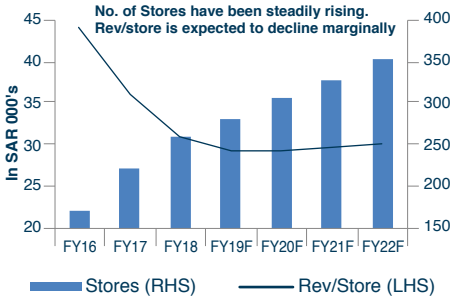
International sales to be remain subdued in the near-term: Less revenue per store from Egypt, a decline in consumer demand in Saudi Arabia, and restatement of revenue in accordance with IFRS 15 led to subdued sales for FY17 and FY18. We anticipate growth revenue per store to remain flattish weighed by lower revenue from Egypt. We believe it would take a few years before the company starts generating profit from international sales, as it tries to establish itself in newer markets.

Pick-up in consumer demand supported by store expansion to drive long-term growth: The Saudi economy is witnessing a rebound in consumer demand, driven by higher disposable income and rising employment (due to the Saudization drive). This would result in higher revenue per customer and benefit Al Othaim. The company's expansion strategy would enable it to expand its footprint and capture market share. The company has a strong presence in larger cities such as Riyadh. Growth could arise from expansion into smaller cities where competition is limited. A higher number of stores would help the company achieve economies of scale, thus boosting margin growth.

GP Margin expansion spurred by cost efficiency: Al Othaim's GP Margin decreased Y/Y in Q2-19 to 18.2% from 18.6%. The decline is mainly due to discounts provided by the company during Ramadan period to boost sales. GP Margin has consistently increased over the years (from 16.5% in FY15 to 20.4% in FY18), which reflects the company's ability to manage costs despite store expansion. We expect the company to increase its bargaining power as it was able to reduce COGS with lower payments to supplier. The improvement in the GP Margin is predicted to continue in FY19 and beyond, as the company benefits from economies of scale, increase in bargaining power and enhancement in the product mix.

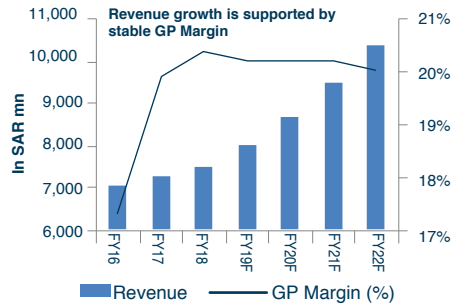
Recommendation	**Overweight**
Price Target	SAR 88.60
CMP	SAR 77.00
Upside/(Downside)	15.10%

Figure 22: Stores and revenue per store



Source: Company Reports, AJC Research

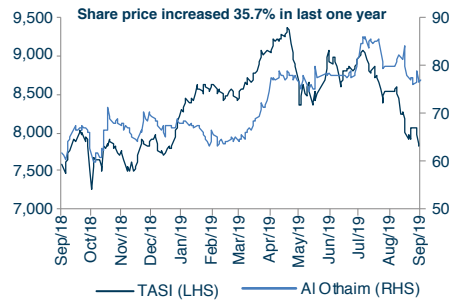
Figure 23: Revenue and GP Margin (%)



Source: Company Reports, AJC Research

Key Market Data	
Market Cap(bn)	6.9
YTD%	14.0%
52 week (High)/(Low)	86.4/59.0
Share Outstanding (mn)	90.00

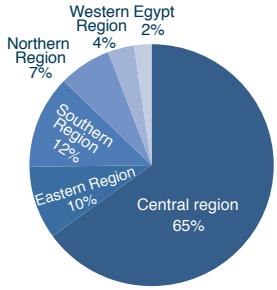
Figure 24: Price Chart



Source: TASI, Bloomberg

Presence across country enables diversification and provides opportunity to tap underpenetrated regions: Al Othaim's key activities include wholesale and retail trade of food, agricultural products, meat, fish, livestock, and household items. The company also operates and manages supermarkets, provides catering services, manages educational and training centers, and acquires land to construct buildings for sale or lease. It has presence across Saudi Arabia, with majority (64.7%) of revenue generated from the central region. Al Othaim can utilize its footprint to expand in regions that are relatively underpenetrated and thereby expand its presence.

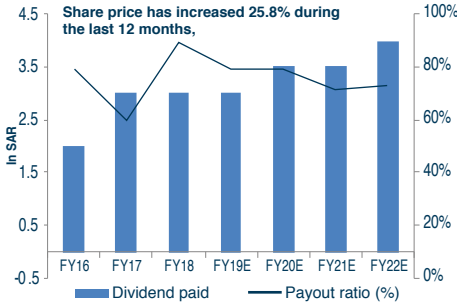
Figuer 25:Sales by region (H1-19)



Source: Company Reports, AJC Research

Strategic partnership with Saudi Exports Development Authority may prove beneficial: Al Othaim inked a strategic partnership with the Saudi Exports Development Authority to promote Saudi exports, products, and services, as well as expand in international markets. The agreement is aimed at supporting Saudi exporters, which include registered factories manufacturing products and labs in Saudi Arabia holding export licenses.

Figuer 26: Dividend Payout Ratio (%)



Source: Company Reports, AJC Research

Attractive dividend payout: Al Othaim has been consistently paying dividend over the years. It has an average dividend payout ratio of more than 70% over the last five years, while the average dividend yield in the last three years is over 4.7%. We expect the company to pay dividend of SAR 3.0/share for FY19, implying an annualized dividend yield of 4.0%. An attractive dividend yield provides downside support to the stock.

AJC View and Valuation: We believe Al Othaim stands to benefit from increased retail demand, which would bolster the company's growth in the long term. We have projected an increase in store count to 357 at the end of FY22 from 270 in Q2-19. The company's strategy of continued expansion augurs well, enabling it to increase its market share and capitalizing on the growth opportunity. Revenue growth is well supported by stable margins, driving net profit growth.

We value Al Othaim on 50% weight for DCF (3.0% terminal growth and 7.0% average WACC), and 25% weight each for P/E (22.5x FY20 EPS) and EV/EBITDA (10.8x FY20 EBITDA) based relative valuation. These yield a target price of **SAR 88.6 per share**, implying a 15.1% upside from the current levels. The stock is currently trading at a P/E of 18.7x based on our FY20 EPS estimate. We have a positive outlook on the company. We maintain "**Overweight**" rating for Al Othaim, and rate is as our top pick among retail peers.

T6:Key Financial Data

Amount in SARmn, unless otherwise specified	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Income statement							
Revenues	7,015	7,231	7,515	8,033	8,764	9,727	10,801
Y/Y	***16.2%***	***3.1%***	***3.9%***	***6.9%***	***9.1%***	***11.0%***	***11.0%***
Cost of Sales	(5,803)	(5,792)	(5,983)	(6,374)	(6,954)	(7,717)	(8,581)
Gross profit	**1,211**	**1,440**	**1,532**	**1,659**	**1,810**	**2,010**	**2,219**
Rental income	66	75	81	79	88	97	108
Selling & distribution exp	(942)	(1,077)	(1,173)	(1,247)	(1,356)	(1,515)	(1,682)
General & administrative exp	(100)	(118)	(118)	(117)	(128)	(142)	(157)
Operating profit	**237**	**322**	**325**	**376**	**416**	**453**	**491**
Y/Y	***12.7%***	***36.4%***	***0.9%***	***15.5%***	***10.8%***	***8.9%***	***8.2%***
Share in income of associates	15	39	36	40	44	49	54
Other income/(expenses)	4	4	(0)	6	8	9	9
Financial charges	(15)	(14)	(5)	(59)	(48)	(42)	(36)
Profit before zakat	**242**	**352**	**319**	**364**	**419**	**469**	**518**
Zakat	(8)	(11)	(9)	(11)	(13)	(14)	(16)
Non-controlling interest	4	(4)	(7)	(7)	(8)	(9)	(10)
Net income	**237**	**338**	**341**	**346**	**399**	**445**	**493**
Y/Y	***2.8%***	***42.2%***	***1.1%***	***1.4%***	***15.2%***	***11.7%***	***10.6%***
Balance sheet							
Assets							
Cash & bank balance	288	264	219	92	181	167	240
Other current assets	891	901	1,037	925	1,018	1,135	1,268
Property & Equipment	1,265	1,428	1,459	1,578	1,695	1,870	2,111
Other non-current assets	907	753	1,889	1,948	1,995	2,052	2,121
Total assets	**3,351**	**3,347**	**4,605**	**4,543**	**4,889**	**5,224**	**5,739**
Liabilities & owners' equity							
Total current liabilities	1,592	1,643	2,733	2,610	2,658	2,677	2,824
Total non-current liabilities	496	176	287	266	292	288	289
Paid -up capital	450	450	900	900	900	900	900
Statutory reserves	68	113	30	65	105	149	199
Other reserve	(5.2)	(6.9)	(9.1)	(9.1)	(9.1)	(9.1)	(9.1)
Retained earnings	720	939	624	665	889	1,155	1,463
Non-controlling interest	31	33	40	46	54	63	74
Total owners' equity	1,263	1,528	1,585	1,667	1,939	2,259	2,626
Total equity & liabilities	**3,351**	**3,347**	**4,605**	**4,543**	**4,889**	**5,224**	**5,739**
Cashflow statement							
Operating activities	585	616	596	736	876	870	1,065
Investing activities	(496)	22	(365)	(490)	(526)	(632)	(756)
Financing activities	(125)	(662)	(275)	(374)	(261)	(251)	(237)
Change in cash	(36)	(24)	(45)	(127)	89	(14)	72
Ending cash balance	**288**	**264**	**219**	**92**	**181**	**167**	**240**
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	0.7	0.7	0.5	0.4	0.5	0.5	0.5
Quick ratio (x)	0.3	0.3	0.2	0.1	0.1	0.1	0.2
Profitability ratios							
GP Margin	17.3%	19.9%	20.4%	20.7%	20.7%	20.7%	20.5%
Operating Margins	3.4%	4.5%	4.3%	4.7%	4.8%	4.7%	4.5%
EBITDA Margin	5.4%	6.8%	6.8%	8.6%	8.9%	8.8%	8.7%
Net Margins	3.4%	4.7%	4.5%	4.3%	4.5%	4.6%	4.6%
Return on assets	7.4%	10.1%	8.6%	7.6%	8.5%	8.8%	9.0%
Return on equity	20.3%	24.8%	22.5%	21.9%	22.7%	21.8%	20.7%
Market/valuation ratios							
EV/sales (x)	0.7	0.8	0.8	1.0	1.0	0.9	0.8
EV/EBITDA (x)	12.4	11.1	12.0	12.2	10.8	9.8	9.0
EPS (SAR)	5.3	3.8	3.8	3.8	4.4	4.9	5.5
BVPS (SAR)	27.4	16.6	17.2	18.0	20.9	24.4	28.4
Market price (SAR)*	45.1	58.2	67.6	75.8	75.8	75.8	75.8
Market-Cap (SAR mn)	4,446.5	5,534.6	6,318.0	7,605.0	7,605.0	7,605.0	7,605.0
Dividend yield	4.4%	5.2%	4.4%	4.0%	4.6%	4.6%	4.6%
P/E ratio (x)	8.6	15.5	17.8	22.0	19.1	17.1	15.4
P/BV ratio (x)	1.6	3.5	3.9	4.7	4.0	3.5	3.0

Source: Company Reports, Bollommberg, AJC Research

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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