Leejam Sports Co

Recreation Facilities – All Sectors
LEEJAM AB: Saudi Arabia
28 November 2019

الراجحي المالية
Al Rajhi Capital

US$0.986bn	40%	US$3.412mn
Market cap	Free float	Avg. daily volume

Target price	95.00	33% over current
Current price	71.50	as at 27/11/2019

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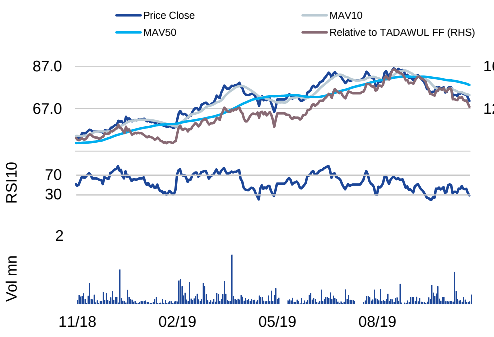
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

Period End (SAR)	12/18A	12/19E	12/20E	12/21E
Revenue (mn)	800	983	1225	1416
Revenue Growth	9.2%	22.8%	24.7%	15.6%
Gross Profit	305	383	478	524
Gross Profit Margin	38%	39%	39%	37%
EBITDA (mn)	305.5	380.8	462.3	487.0
EBITDA Growth	7.6%	24.6%	21.4%	5.4%
Net Profit	180.1	240.4	315.9	340.6
Net Profit Margin	22.5%	24.5%	25.8%	24.0%
EPS	3.4	4.6	6.0	6.5
EPS Growth	3.4%	33.5%	31.4%	7.8%
DPS	1.72	2.30	3.02	3.25
Payout Ratio	50%	50%	50%	50%
ROE	25.2%	29.4%	33.2%	31.2%

Source: Company data, Al Rajhi Capital

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Inline Results; Strong Upside Potential

Leejam reported strong Q3 19 results, the bottom-line came mostly in line with our estimates of SAR59mn after adjusting for one of provisions amounting to SAR11m. The one off charges were related to depreciation(SAR7.2mn, the previous practice was to pause the depreciation during the time centres were getting converted from male to female, the current management is including the depreciation for the conversion period), repairs and maintenance (SAR2mn) and provision for legal charges(SAR1.77mn, there are legal cases pending against construction companies so based on prudence management has taken a provision of amount mentioned above). The top-line grew 13% y-o-y to SAR238mn driven by 12% y-o-y growth in subscription income and 38% y-o-y growth in personal training segment. Gross margins fell by 500bps y-o-y to 35.7% slightly lower than our expectations due to 25% y-o-y rise in salaries and related benefits. We revise our forward looking estimates and accordingly revise our target price upwards to SAR95/share (earlier SAR90/sh implying 40% upside from current market price) thus maintaining "overweight" rating.

Key investment themes : The company has reached a total subscription base of 292,000 members of which 26% are females, this is way ahead then what we predicted for the entire 2019e.In the female segment the industry is still facing supply demand mismatch and there is a still a room for premium pricing in the market. Leejam currently have a gross margin of 40% in the female segment. Going forward company is planning to add 15 more centres (8 female and 7 male) in 2020e and is expected to introduce various value added services like spas, manicure, hospitality to members as well as non-members which should directly have a positive impact on bottom-line. To sustain the competition from small players it is planning to launch "small box express" concept which will be relatively smaller clubs typically thousand sqm and will focus more on group classes competing with the likes of orangetheory, Nine realms and cross fit. We are extremely bullish on Leejam due to its dominant position in the fitness industry, increasing consumer spending towards fitness and government's initiatives to increase the physical activities among locals to combat various diseases. Though there are lot of small competitors in the market but we feel that it will be difficult for them to sustain in the longer term as Leejam forays its steps into every aspect of fitness industry delivering high quality service and building customer loyalty which should help them in gaining a larger share of market.

Fig 1: Summary of Q3 2019 Earnings

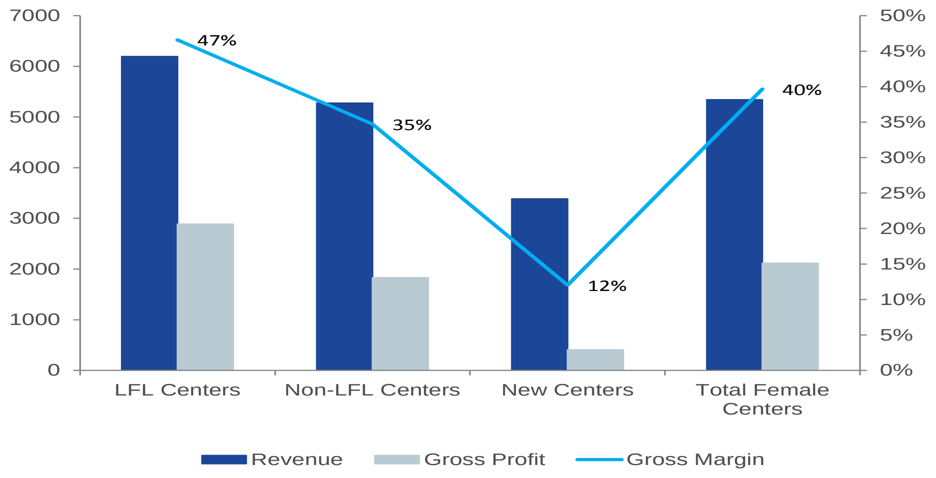
(SARmn)	Q3 2019	Q2 2019	Q3 2018	% chg y-o-y	% chg q-o-q	ARC est
Revenue	238.4	219.0	210.3	13.4%	8.8%	258
Gross profit	85.0	81.5	85.8	-0.9%	4.3%	95
Gross margin	35.7%	37.2%	40.8%	NM	NM	37%
Operating profit	62.0	62.9	58.9	5.3%	-1.4%	70
Net profit	48.8	49.6	53.8	-9.2%	-1.6%	59
Net profit margin	20%	23%	26%	NM	NM	23%

Source: Company data, Al Rajhi Capital

Centre expansion plans intact with higher run rate in male and female subscribers: Leejam has opened 4 new centres and converted some female centres during 9M2019 and there are still six clubs in pipe-line which is about to open this year. Total number of centres are expected to be 140 by the end of 2019e out of which 36 are expected to be female and 104 male. The number of subscribers have increased 35% from 217,000 to 292,000 in 9M2019. The female subscribers almost doubled from 38,000 in 2018 to 75,920 in 9M2019 and the growth in male subscribers was 21% in 9M2019. We are expecting the total subscribers to reach 338,094 by the end of 2020e. As per our calculations the number of female members will be ~26% of the total members and will contribute ~25% of the total revenue in 2020e. The growth in male segment has also been better than expected in 9m2019 and we expect it to continue as Leejam' s service offering is unique which is driving members to its club. We have incorporated a 5% increase in average revenue per member for male segment as per the company's guidance in 2020e and project the total revenue from male segment to reach SAR830mn by 2020e.

Personal training segment is witnessing huge growth specially in female centres: The PT segment is another area where we have witnessed huge growth potential specially among female subscribers. The total revenue from PT segment in Q3 19 was SAR21.5mn (+38% y-o-y) and SAR63mn for 9m2019 and we are expecting it to reach SAR84mn by the end of 2019e. Currently the company offers PT in 95 centres but it is planning to increase this service by hiring more trainers. For Q3 2019 the run rate for PT segment in female was 282% y-o-y and for male it was 12% y-o-y. The contribution of PT segment to the overall revenue is growing at a faster pace and the net income from PT segment flows directly to the bottom-line which should enhance the net profit margin going forward.

Fig 2: Female centres ramp-up evolution for 9M2019



Source: Company data, Al Rajhi Capital

Secondary services to enhance the margins without much impact on cost: The company is planning to launch value added services like spas, selling apparels, manicure and relaxation facilities for ladies. It will be built in the existing centres by transforming non-productive areas such as basketball courts in female segments to treatment centres. This will be separately paid services (even for existing members) and will target non-member predominantly. We believe these value added services to generate a good stream of side revenues. The company is in talks with Nike and under armour to enter into brand association for apparel business. These services should compensate slightly for the loss in margins due to price reduction in female subscriptions.

Valuation: We continue to value Leejam using equal weights for DCF and P/E based relative valuation methods. Our DCF based target price is SAR94 per share, assuming 9% WACC and 2% terminal growth. Our P/E based target price (18x FY20e earnings) stands at SAR96 per share. Accordingly, the equal weighted target price stands at SAR95, implying 33% upside from the current price of SAR71.40 implying an "Overweight" rating. Recent decline in share price presents a good buying opportunity for the medium as well as long term.

Key downside risks:1) Increasing competition in the female segment which might lead to pricing pressure and ultimately impact gross margins.2) Any further governmental levies which reduces the disposable income of the people will have a negative impact on the company's topline as spending on gym subscription is discretionary in nature.3)Any slowdown in centre expansion will impact the growth of subscribers and impact the revenue growth.4)Slower revamping of non LFL clubs might create a pressure on margins and poses a downside risk to our target price.

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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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