

Normalized net profit up 12% Y/Y in Q3-23, due to better sales and improvement in margins, retain Neutral

Al Othaim reported net income of SAR 62.4mn in Q3-23, up 12% Y/Y (up 47% Q/Q) excluding the non-recurring SAR 701.2mn and SAR 96.9mn capital gains incurred in Q3-22 and Q2-23, respectively. Company's revenues are up 4.1% Y/Y (up 0.8% Q/Q) in Q3-23, while gross margins have expanded by 155bps due to easing inflationary pressures. There is a reduction in basket size, however, the impact is negated by the double digit growth in the number of transactions. On YTD basis the company has opened 34 new stores, and closed 3 existing outlets in KSA; while net 4 new outlets were opened in Egypt. We expect normalized earnings to grow at a CAGR of 10.1% between 2022-25. At 2024E P/E of 27.3x, we retain our "Neutral" rating on Al Othaim, with a revised TP of SAR 14.6/share implying an upside of 12.6% from current market price.

Al Othaim manages to post normalized earnings growth of 12% Y/Y in Q3-23 due to improvement in margins and higher sales: Al Othaim reported net income of SAR 62.4mn in Q3-23, down 55.3% and 91.8% on Q/Q and Y/Y basis. Net income is up 12% Y/Y (up 47% Q/Q) excluding the non-recurring SAR 96.9mn and SAR 701.2mn capital gains on sales of associate company and land incurred in Q2-23 and Q3-22, respectively, Earnings are in line (+5.2%) with our estimate of SAR 59.2mn, however are 19.3% higher than market consensus of SAR 52.3mn. Revenue is up 4.1% Y/Y (up 0.8% Q/Q), due to new stores openings, better product availability and improved customer service level. Gross margins have expanded by 155bps Y/Y to 22.1% in Q3-23 due to easing of inflationary pressures, while operating margins improved by 77bps Y/Y to 3.6% in Q3-23. The company saw an increase in income from Shariah compliant investments. Note that improvement in earnings came despite increase in selling and marketing expenses and higher lease related finance costs of new stores and lower profitability of associate companies.

Growth in number of transactions limit the impact of reduction in basket size; while loyalty customers continue to expand: Inflationary pressures, high interest rates and increase in cost of living, has impacted Al Othaim in the form of reduction in basket size, which has shrunk by 7.43% in YTD-2023. However, the impact of the aforementioned reduction in basket size is negated to some extent by the solid double digit growth of 19.2% YTD in the number of transactions, essentially customers are making smaller but more frequent purchases. Average revenue per store declined by 8.3% Y/Y to SAR 6.5mn in Q3-23, this can be explained by the 15.3% Y/Y increase in number of stores, note that new stores have a ramp up time of around two years before they break even. We also highlight that LFL sales growth stood at 1.27% in YTD 2023, and Al Othaim's loyalty program customers under IKTISSAB grew by 8.24% in YTD-2023.

Revenue growth expectations are based on 2022-25E medium term store expansion of 10%; note that no. stores have grown by 10% YTD: We expect Al Othaim to post revenue growth of 7.9% in 2023, while we see topline to grow at CAGR of 7.9% in the medium term (2022-25). Our view on revenue growth is premised on the expectation of 10.0% CAGR in total stores over 2022-25. Note that Al Othaim expanded its store footprint by 26 and 30 stores in 2021 and 2022 respectively. On this front we highlight that, the retail giant has opened 14 new branches inside the Kingdom and 2 new branches in Egypt in Q3-23, this takes the cumulative branch network to 385 up 4.3% Q/Q. On YTD basis the company opened 34 new stores, and closed 3 existing outlets in KSA; while net 4 new outlets were opened in Egypt (growth in total no. of stores is 10% YTD). Total area of stores expanded by 6.38% on an YTD basis to 634,000 sqm (615,000 sqm for 373 retail stores and 19,000 sqm for 12 wholesale stores).

Recommendation	Neutral
Target Price (SAR)	14.6
Upside / (Downside)*	12.6%

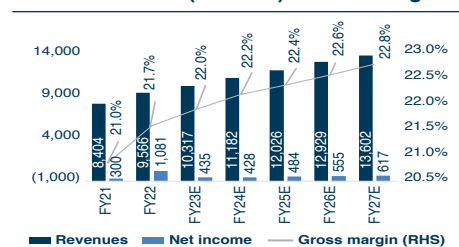
Source: Tadawul *prices as of 19th November 2023

Key Financials

SARmn (unless specified)	FY22	FY23E	FY24E	FY25E
Revenue	9,566	10,317	11,182	12,026
Growth %	13.8%	7.9%	8.4%	7.5%
Gross Profit	2,072	2,266	2,486	2,694
Net Profit	1,081	435	428	484
Growth %	260.3%	-59.8%	-1.6%	13.2%
EPS	12.02	0.48	0.48	0.54
DPS	2.00	0.20	0.24	0.27

Source: Company reports, Aljazira Capital

Revenue/Income (SAR mn) and GP Margin



Source: Aljazira Capital, Company reports

Key Ratios

	FY22	FY23E	FY24E	FY25E
GP Margin	21.7%	22.0%	22.2%	22.4%
Net Margin	11.3%	4.2%	3.8%	4.0%
P/E (x)	8.7x	26.8x	27.3x	24.1x
P/B (x)	6.7	7.0	6.2	5.5
ROE	77.9%	28.3%	24.2%	24.3%
EV/EBITDA (x)	15.2	16.5	14.0	12.9
Div Yield (%)	11.8%	1.5%	1.8%	2.1%

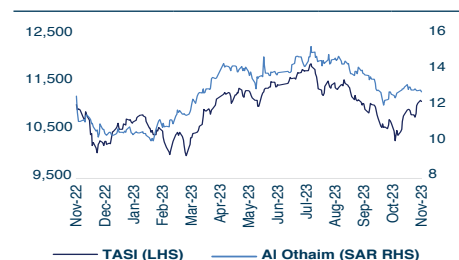
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	11.6
YTD%	23.65%
52 weeks (High)/(Low)	15.6/10.1
Share Outstanding (mn)	900.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

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Slowdown in income from associates and increase in finance cost to dent normalized earnings in 2023:

Despite 9.4% Y/Y and 4.6% Y/Y increase in gross and operating profits, we expect normalized earnings for Al Othaim to decline by 7.4% Y/Y in 2023, thanks to the 61.3% Y/Y decline share of income from associates, 24.8% increase in finance costs and increase in selling and distribution expense. However, we expect normalized income to grow by 27.4% Y/Y in 2024, and at a CAGR of 10.1% between 2022-25. The aforementioned improvement comes on the back of 2022-25 revenue CAGR of 7.9% (due to new store additions), and 74bps expansion in gross margins to 22.4%, as new branches ramp up.

AJC view and valuation: We expect Al Othaim to post normalized income CAGR of 10.1% between 2022-25, our view is premised on the expectation of 10.0% CAGR in total stores over 2022-25. Note that Al Othaim expanded its store footprint by 26 and 30 stores in 2021 and 2022 respectively, and by 35 stores in YTD 2023. We expect revenue per store to improve as stores ramp up, which normally takes two years. We believe that Al Othaim is in a better position in current inflationary environment due to consumer behaviors shifting towards value products, as compared to its peers with premium offerings. Going forward we foresee an increase in the company's top line in the MT driven by impressive store expansions.

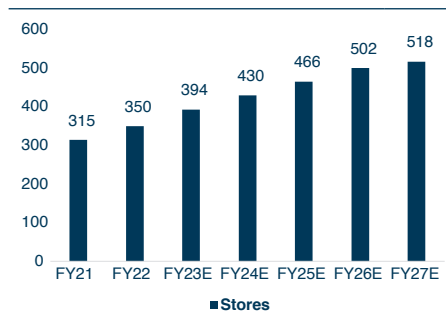
We value Al Othaim with 50% weightage to DCF (RFR 3.5%, terminal growth 2.5%, WACC 7.0%) and 25% each to PE (24.5x) and EV/EBITDA (13.5x) valuation based on 2024E estimates. We arrive at a revised TP of **SAR 14.6/share** implying an upside of 12.6% from current market price, hence we retain our **"Neutral"** rating on Al Othaim.

Blended valuation summary

All figures in SAR, unless specified	Fair value	Weights	Weighted average
DCF based value	17.2	50%	8.6
P/E (2024E)	11.6	25%	2.9
EV/EBITDA (2024E)	12.4	25%	3.1
Weighted average 12-month price target			14.6
Current Price (SAR/share)			13.0
Expected Capital Gain			12.6%

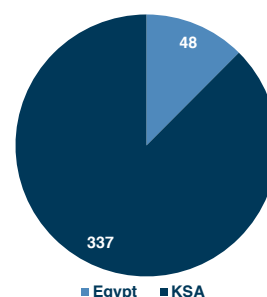
Source: Bloomberg, Aljazira capital research

Fig 1: No. of stores



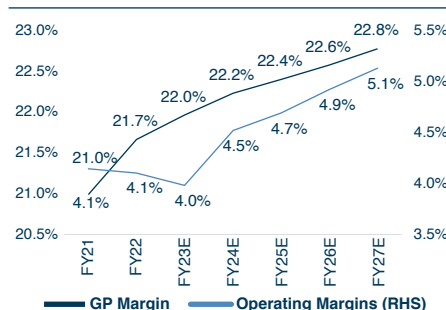
Source: Company accounts, Aljazira Capital

Fig 2: Geographical distribution



Source: Company accounts, Aljazira Capital

Fig 3: Gross and operating margin trend



Source: Company reports, Aljazira capital



Key Financial Data

Amount in SAR mn, unless otherwise specified	FY21	FY22	FY23E	FY24E	FY25E	FY26E	FY27E
Income statement							
Revenues	8,404	9,566	10,317	11,182	12,026	12,929	13,602
Y/Y	-4.6%	13.8%	7.9%	8.4%	7.5%	7.5%	5.2%
Cost of Sales	(6,640)	(7,493)	(8,051)	(8,696)	(9,332)	(10,009)	(10,503)
Gross profit	1,764	2,072	2,266	2,486	2,694	2,919	3,098
Rental income	86	78	86	97	104	112	118
Selling & distribution exp	(1,380)	(1,610)	(1,784)	(1,901)	(2,038)	(2,184)	(2,297)
General & administrative exp	(124)	(150)	(160)	(179)	(199)	(214)	(225)
Operating profit	348	393	411	506	564	636	698
Y/Y	-33.3%	12.7%	4.6%	23.1%	11.6%	12.8%	9.7%
Share in income of associates	32	63	24	28	30	32	34
Other income/(expenses)	8	12	13	11	12	13	14
Financial charges	(71)	(75)	(94)	(102)	(105)	(107)	(107)
Profit before zakat	318	1,112	452	442	501	574	638
Zakat	(11)	(31)	(14)	(14)	(16)	(18)	(20)
Non-controlling interest	(3)	(0)	(4)	(0)	(0)	(1)	(1)
Net income	300	1,081	435	428	484	555	617
Y/Y	-33.4%	260.3%	-59.8%	-1.6%	13.2%	14.6%	11.2%
EPS (SAR)	3.37	12.02	0.48	0.48	0.54	0.62	0.69
DPS (SAR)	2.00	2.00	0.20	0.24	0.27	0.31	0.34
Balance sheet							
Assets							
Cash & bank balance	183	313	306	353	394	446	479
Other current assets	1,123	1,497	1,595	1,690	1,787	1,891	1,970
Property & Equipment	1,393	1,511	1,649	1,795	1,915	2,040	2,160
Other non-current assets	2,398	2,371	2,844	3,050	3,273	3,542	3,813
Total Assets	5,097	5,691	6,394	6,887	7,370	7,919	8,422
Liabilities & owners' equity							
Total current liabilities	2,109	2,424	2,528	2,726	2,911	3,127	3,272
Total non-current liabilities	1,581	1,824	2,164	2,245	2,300	2,355	2,405
Paid -up capital	900	900	900	900	900	900	900
Statutory reserves	140	248	291	334	382	438	500
Other reserve	(9.4)	(8.0)	(8.0)	(8.0)	(8.0)	(8.0)	(8.0)
Retained earnings	338	267	478	649	843	1,065	1,312
Non-controlling interest	37	37	41	41	42	42	43
Total owners' equity	1,406	1,444	1,702	1,916	2,159	2,437	2,746
Total equity & liabilities	5,096	5,691	6,394	6,887	7,370	7,919	8,422
Cashflow statement							
Operating activities	835	1,023	927	977	1,064	1,187	1,245
Investing activities	(274)	360	(1,032)	(800)	(818)	(892)	(939)
Financing activities	(656)	(1,254)	98	(131)	(204)	(243)	(274)
Change in cash	(95)	129	(7)	46	41	52	33
Ending cash balance	183	313	306	353	394	446	479
Key fundamental ratios							
Liquidity ratios							
Current ratio (x)	0.6	0.7	0.8	0.7	0.7	0.7	0.7
Quick ratio (x)	0.2	0.4	0.4	0.4	0.3	0.3	0.3
Profitability ratios							
GP Margin	21.0%	21.7%	22.0%	22.2%	22.4%	22.6%	22.8%
Operating Margins	4.1%	4.1%	4.0%	4.5%	4.7%	4.9%	5.1%
EBITDA Margin	8.2%	7.9%	7.9%	8.5%	8.6%	8.8%	8.8%
Net Margins	3.6%	11.3%	4.2%	3.8%	4.0%	4.3%	4.5%
Return on assets	6.0%	20.1%	7.2%	6.4%	6.8%	7.3%	7.8%
Return on equity	21.0%	77.9%	28.3%	24.2%	24.3%	24.6%	25.8%
Market/valuation ratios							
EV/sales (x)	1.4	1.2	1.3	1.2	1.1	1.0	1.0
EV/EBITDA (x)	16.7	15.2	16.5	14.0	12.9	11.8	11.2
EPS (SAR)	3.4	12.02	0.5	0.5	0.5	0.6	0.7
BVPS (SAR)	15.2	15.6	1.8	2.1	2.4	2.7	3.0
Market price (SAR)*	108.2	104.0	13.0	13.0	13.0	13.0	13.0
Market-Cap (SAR mn)	10,134	10,026	11,664	11,664	11,664	11,664	11,664
Dividend yield	1.8%	11.8%	1.5%	1.8%	2.1%	2.4%	2.6%
P/E ratio (x)	32.1	8.7	26.8	27.3	24.1	21.0	18.9
P/BV ratio (x)	7.1	6.7	7.0	6.2	5.5	4.9	4.3

Source: Company filings, Aljazira Capital Research



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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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