

Fawaz Abdulaziz Alhokair

Retail Sector

ALHOKAIR AB: Saudi Arabia

14 December 2011

الراجحي المالية
Al Rajhi Capital



US\$1.008bn Market cap
30% Free float
US\$1.858mn Avg. daily volume

Target price **62.50** 15.7% over current
Consensus price **60.10** 11.3% over current
Current price **54.00** as at 13/12/2011

Research Department
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Underweight

Neutral

Overweight

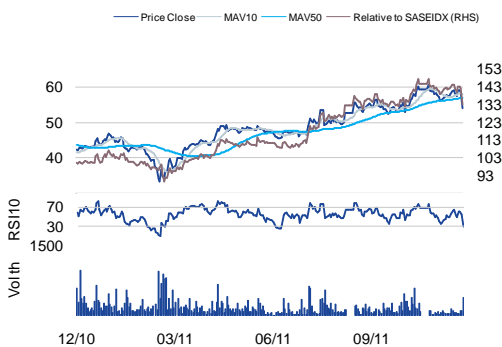
Key themes

Driven by rising population, improving education, and changing lifestyle, we expect the retail sector in Saudi Arabia to continue growing. Alhokair has a very strong position in the Saudi fashion market. The company will continue to grow through M&A activity, opening new stores, and benefiting from new upward trends in electronics.

Implications

Alhokair is one of our picks in the retail sector. It is performing well operationally with strong financials. We expect M&A activity, opening new stores, and healthy same store sales to drive company's growth in the near term. Thus, we rate Alhokair stock overweight as it still offers respectable upside.

Performance



Earnings

Period End (SAR)	03/10A	03/11A	03/12E	03/13E
Revenue (mn)	2,074	2,575	3,130	3,498
Revenue Growth	9.9%	24.1%	21.6%	11.8%
EBITDA (mn)	318	364	501	561
EBITDA Growth	35.8%	14.7%	37.7%	12.0%
EPS	3.31	4.52	5.51	6.46
EPS Growth	14.4%	36.6%	21.9%	17.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Alhokair rally to continue

Alhokair's Q2 (July-September 2011; Alhokair's year end is March) results showed strong year-on-year growth in sales of 16% driven by healthy like-for-like sales growth and new stores. Operating profit grew by 38% on the back of better gross margin and lower SG&A costs. Moreover, net profit was boosted by other unsustainable income (SAR21mn) to reach SAR202mn, well above our estimates as well as consensus. Further, Alhokair announced the acquisition of Strasburg-Jarvis Inc, a clothing company; this is in line with the company's strategy to expand its overseas business. We have thus raised our forecasts and set a new target price of SAR62.5. Our new target offers respectable upside of 16%; we upgrade our rating on the company to Overweight.

New stores and healthy SSS drove top line growth: Alhokair posted year-on-year sales growth of 16%; this was driven by opening new stores (local & international) and strong like-for-like sales growth. Alhokair's total selling space reached roughly 240,000 square meters (excluding the recent acquisition in the US). On that basis, we estimate organic growth of close to 12% in Q2. Benefiting from fast-growing apparel market in the Kingdom, we expect Alhokair to achieve SSS growth above 10% this year.

Overseas business is growing: Alhokair announced recently the acquisition of Strasburg-Jarvis Inc, a wholesaler and retailer of clothing, for US\$2.2mn. The chain has 52 stores with a selling space of roughly 7,000 square meters. Further, Alhokair continues to open new stores in other countries, mainly in Kazakhstan. Overseas selling space reached 30,000sqm while its sales comprise 11% of total revenues. Looking ahead, we expect revenues from overseas to reach 25% by 2013. It is worth noting that Alhokair's international business carries higher gross margin (US: 71%, Kazakhstan 48%) compared to 46% in the kingdom.

Better margins boosted profits: Alhokair's gross margin improved considerably from 42.7% in Q2 last year to 45% in Q2 this year, but declined q-o-q by 120bps due to the seasonality difference. Also, the company was able to contain its SG&A costs at a low level of 25.9% of sales despite overseas expansions; we had expected SG&A costs to be higher due to provisions associated with international start-up businesses. This coupled with the gross margin improvement resulted in a strong operating and net profits. Looking ahead, we expect gross margin to slightly improve due to international expansion which, according to the company, offers higher margins.

Higher cash dividends and possible stock dividends: Alhokair distributed SAR2.5 per share in dividends for the year 2010. On the back of strong performance, we expect the company to increase its dividends to SAR3.0 per share for this year. By our estimates, this implies a payout ratio of 54% and a dividend yield of 5.1%. Moreover, considering the company's strong ROE of 29% and expansion plans, Alhokair might declare stock dividends in the near future.

Conclusion: We have increased our revenue and profit forecasts, which if all other factors had been equal would have pushed our target price substantially. However, considering the growing international business, we have increased our WACC assumptions for Alhokair from 9% to 10.5%. That said, we set a new target price of SAR62.5 (old target: SAR50.4) and hence upgrade our rating to Overweight. Alhokair trades on an attractive PE ratio of 9.8x.



Corporate summary

Fawaz Abdulaziz Al Hokair Company is one of the leading fashion retailers in Saudi Arabia with a market value of US\$1.01bn. Al-Hokair is primarily engaged in the fashion retail industry targeting all the ages in both genders. The company sells a range of fashion items from luxury apparel to classic and trendy and sport wear, in addition, to shoes, bags, and accessories. Al-Hokair acts as a franchiser of more than 50 international brands such as Zara, Gap, Marks & Spencer, and Aldo.

Share information

Market cap (SAR/US\$) 3.780bn / 1.008bn
52-week range 33.40 - 60.50
Daily avg volume (US\$) 1.858mn
Shares outstanding 70.00mn
Free float (est) 30%

Performance: 1M 3M 12M
Absolute -8.5% -0.5% 28.3%
Relative to index -7.4% -2.5% 33.2%

Major Shareholder:
Fas Company 49%
Abdulmajeed Abdulaziz Alhokair 7%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	03/10A	03/11A	03/12E	03/13E
Revenue (SARmn)	2,074	2,575	3,130	3,498
EBITDA (SARmn)	318	364	501	561
Net Profit (SARmn)	232	316	385	453
EPS (SAR)	3.31	4.52	5.51	6.46
DPS (SAR)	2.00	2.50	3.00	3.00
EPS Growth	14.4%	36.6%	21.9%	17.4%
EV/EBITDA (x)	10.5	9.4	6.6	5.8
P/E (x)	16.3	12.0	9.8	8.4
P/B (x)	3.5	3.5	2.6	2.2
Dividend Yield	3.7%	4.6%	5.6%	5.6%

Source: Company data, Al Rajhi Capital

Q3 results: robust performance continues

Below we summarise actual results and our forecasts for Alhokair Q2 2010 (September) and Q3 2011 (December).

Figure 1 Alhokair: 2010Q2A (September) vs. 2011Q2E (September) vs. 2011Q2A (September) & 2010Q3A (December) vs. 2011Q3E (December)

(SAR) mn	2010Q2A (Sep)	2011Q2E (Sep)	2011Q2A (Sep)	YOY % chg.	2010Q3A (Dec)	2011Q3E (Dec)	YOY % chg.
Total Revenues	867.4	971.1	1,008.5	16.3%	593.1	693.6	16.9%
Gross Profit	370.5	417.6	454.1	22.6%	266.9	312.1	17.0%
Gross profit margin	42.7%	43.0%	45.0%		45.0%	45.0%	
Operating Profit	140.2	106.8	193.0	37.6%	42.3	56.9	34.6%
Net Income	174.0	115.6	201.9	16.0%	33.9	54.3	60.1%

Source: Company data, Al Rajhi Capital



We expect revenues to exceed SAR3.1bn this year

Income Statement (SARmn)	03/09A	03/10A	03/11A	03/12E	03/13E
Revenue	1,888	2,074	2,575	3,130	3,498
Cost of Goods Sold	(1,089)	(1,161)	(1,435)	(1,733)	(1,933)
Gross Profit	799	914	1,139	1,396	1,566
Government Charges					
S.G. & A. Costs	(630)	(675)	(877)	(1,004)	(1,123)
Operating EBIT	169	239	262	392	443
Cash Operating Costs	(1,654)	(1,757)	(2,210)	(2,628)	(2,937)
EBITDA	234	318	364	501	561
Depreciation and Amortisation	(65)	(78)	(102)	(109)	(118)
Operating Profit	169	239	262	392	443
Net financing income/(costs)	0	(43)	(32)	(32)	(22)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	42	45	105	47	47
Other Expenses					
Net Profit Before Taxes	211	241	335	407	468
Taxes	(9)	(11)	(15)	(17)	(12)
Minority Interests	-	1	(3)	(4)	(4)
Net profit available to shareholders	202	232	316	385	453
Dividends	(140)	(140)	(175)	(210)	(210)
Transfer to Capital Reserve					

DPS likely to increase this year

	03/09A	03/10A	03/11A	03/12E	03/13E
Adjusted Shares Out (mn)	70.00	70.00	70.00	70.00	70.00
CFPS (SAR)	3.82	4.41	6.03	7.12	8.20
EPS (SAR)	2.89	3.31	4.52	5.51	6.46
DPS (SAR)	2.000	2.000	2.500	3.000	3.000

We expect revenues growth above 20% this year

Growth	03/09A	03/10A	03/11A	03/12E	03/13E
Revenue Growth	19.2%	9.9%	24.1%	21.6%	11.8%
Gross Profit Growth	19.8%	14.4%	24.7%	22.6%	12.2%
EBITDA Growth	-5.4%	35.8%	14.7%	37.7%	12.0%
Operating Profit Growth	-15.7%	41.3%	9.5%	49.6%	13.2%
Net Profit Growth	0.5%	14.4%	36.6%	21.9%	17.4%
EPS Growth	0.5%	14.4%	36.6%	21.9%	17.4%

We expect to see better gross margin due to international business

Margins	03/09A	03/10A	03/11A	03/12E	03/13E
Gross profit margin	42.3%	44.1%	44.2%	44.6%	44.8%
EBITDA margin	12.4%	15.3%	14.1%	16.0%	16.0%
Operating Margin	9.0%	11.5%	10.2%	12.5%	12.7%
Pretax profit margin	11.2%	11.6%	13.0%	13.0%	13.4%
Net profit margin	10.7%	11.2%	12.3%	12.3%	12.9%

Alhokair is attractive on a P/E of 9.8x and EV/EBITDA of 6.6x

Other Ratios	03/09A	03/10A	03/11A	03/12E	03/13E
ROCE	19.6%	16.9%	19.4%	21.0%	21.0%
ROIC	19.8%	27.0%	21.8%	31.7%	31.5%
ROE	22.9%	23.7%	28.9%	29.9%	28.3%
Effective Tax Rate	4.2%	4.4%	4.5%	4.2%	2.5%
Capex/Sales	14.3%	6.0%	2.5%	5.5%	5.1%
Dividend Payout Ratio	69.2%	60.5%	55.3%	54.5%	46.4%

Valuation Measures	03/09A	03/10A	03/11A	03/12E	03/13E
P/E (x)	18.7	16.3	12.0	9.8	8.4
P/CF (x)	14.2	12.2	9.0	7.6	6.6
P/B (x)	4.4	3.5	3.5	2.6	2.2
EV/Sales (x)	1.8	1.6	1.3	1.1	0.9
EV/EBITDA (x)	14.9	10.5	9.4	6.6	5.8
EV/EBIT (x)	20.6	13.9	13.0	8.5	7.4
EV/IC (x)	4.1	2.9	2.9	2.4	2.2
Dividend Yield	3.7%	3.7%	4.6%	5.6%	5.6%

Source: Company data, Al Rajhi Capital



Balance Sheet (SARmn)	03/09A	03/10A	03/11A	03/12E	03/13E
Cash and Cash Equivalents	24	76	107	425	572
Current Receivables	-	-	-	-	-
Inventories	378	476	599	675	746
Other current assets	320	362	494	505	505
Total Current Assets	722	914	1,199	1,605	1,823
Fixed Assets	505	584	613	686	748
Investments	363	260	219	252	252
Goodwill	-	61	61	61	61
Other Intangible Assets	-	78	81	80	80
Total Other Assets	-	-	-	-	-
Total Non-current Assets	868	983	975	1,080	1,142
Total Assets	1,590	1,897	2,174	2,685	2,964
Short Term Debt	370	70	161	187	187
Accounts Payable	154	149	285	281	315
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	175	224	335	308	308
Total Current Liabilities	698	444	782	777	810
Long-Term Debt	-	300	225	350	350
Other LT Payables	-	-	-	-	-
Provisions	29	39	42	46	46
Total Non-current Liabilities	29	339	267	396	396
Minority interests	-	20	31	31	35
Paid-up share capital	700	700	700	700	700
Total Reserves	163	394	395	780	1,023
Total Shareholders' Equity	863	1,094	1,095	1,480	1,723
Total Equity	863	1,114	1,126	1,512	1,758
Total Liabilities & Shareholders' Equity	1,590	1,897	2,174	2,685	2,964

Ratios	03/09A	03/10A	03/11A	03/12E	03/13E
Net Debt (SARmn)	346	294	279	112	(35)
Net Debt/EBITDA (x)	1.48	0.93	0.77	0.22	(0.06)
Net Debt to Equity	40.1%	26.4%	24.7%	7.4%	-2.0%
EBITDA Interest Cover (x)	(522.1)	7.4	11.4	15.7	25.5
BVPS (SAR)	12.33	15.63	15.64	21.15	24.61

Cashflow Statement (SARmn)	03/09A	03/10A	03/11A	03/12E	03/13E
Net Income before Tax & Minority Interest	211	241	335	407	468
Depreciation & Amortisation	65	78	102	109	118
Decrease in Working Capital	59	(88)	(119)	(124)	(37)
Other Operating Cashflow	(7)	38	(46)	(7)	(12)
Cashflow from Operations	329	269	272	385	537
Capital Expenditure	(269)	(124)	(63)	(174)	(180)
New Investments	(90)	(98)	30	(37)	-
Others	4	(6)	23	(3)	-
Cashflow from investing activities	(355)	(228)	(9)	(213)	(180)
Net Operating Cashflow	(27)	42	263	171	357
Dividends paid to ordinary shareholders	(245)	-	(261)	-	(210)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	3	9	(4)	-
Cashflow from financing activities	23	3	(236)	148	(210)
Total cash generated	(3)	45	27	319	147
Cash at beginning of period	28	24	76	107	425
Implied cash at end of year	24	69	103	426	572

Ratios	03/09A	03/10A	03/11A	03/12E	03/13E
Capex/Sales	14.3%	6.0%	2.5%	5.5%	5.1%

Source: Company data, Al Rajhi Capital

Healthy gearing level (Net Debt/EBITDA at 0.8x)

Alhokair enjoys healthy cash flows



Disclaimer and additional disclosures for Equity Research

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"**Overweight**": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"**Neutral**": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"**Time horizon**": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"**Fair value**": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"**Target price**": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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