Fawaz Abdulaziz Alhokair and Company

Retail Sector

ALHOKAIR AB: Saudi Arabia

Al Rajhi Capital

US$0.797bn	50%	US$2.671mn
Market cap	Free float	Avg. daily volume

Target price	49.90	17.0 % over current
Consensus price	47.00	10.1% over current
Current price	42.70	as at 12/2/2011

Research Department

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Underweight | Neutral | **Overweight**

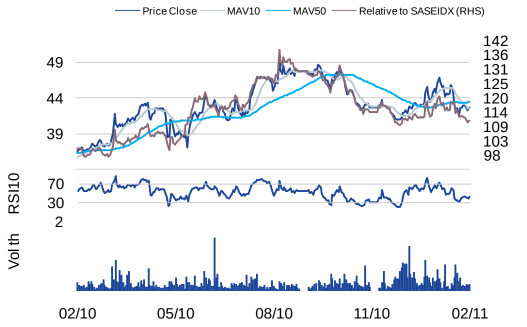
Key themes

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 our second pick in the retail sector. It is performing well operationally and offers growth in the near term at a reasonable valuation. We expect M&A activity, healthy same store sales growth, and a handsome dividend yield to support Alhokair's share price.

Performance

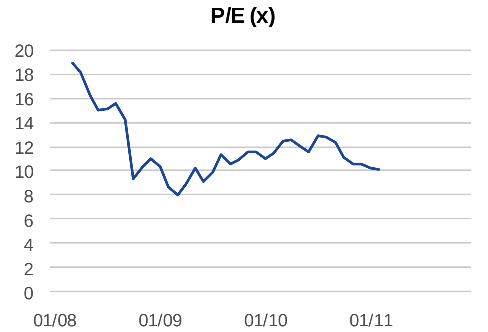


Earnings

Period End (SAR)	03/10A	03/11E	03/12E	03/13E
Revenue (mn)	2,074	2,545	2,888	3,255
Revenue Growth	9.9%	22.7%	13.5%	12.7%
EBITDA (mn)	318	359	411	469
EBITDA Growth	35.8%	13.1%	14.4%	14.1%
EPS	3.31	4.30	4.55	5.20
EPS Growth	14.4%	29.9%	5.9%	14.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Alhokair

Attractive despite dull profits

Alhokair's Q3 results showed strong year-on-year growth in sales of 28% driven by strong like-for-like sales and new stores. However, net income fell by 20%. Revenue growth was far above our forecast of 15%, but net income of SAR33mn was far below our forecast of SAR50mn. The decline in gross margin coupled with high SG&A costs and unusually high zakat squeezed Q3 profits. In Q4, we expect Alhokair to achieve strong top and bottom line growth of 18% and 43% respectively. It is worth highlighting that Alhokair's exposure to Egypt is negligible, at less than 1% of total revenues. Therefore, we remain Overweight and maintain our target price of SAR49.9, implying 17% upside.

Outstanding top line growth supports our stance: For its financial Q3 (October-December 2010; Alhokair's year end is March), Alhokair posted year-on-year sales growth of 28%. This was far above our estimate of 15%. We think that three factors in particular helped drive sales growth: 1) a continued strong performance by department stores like ZARA, 2) new store openings, and 3) new international operations such as Kazakhstan and Jordan. Alhokair increased its stores in Kazakhstan from four stores in 2009 to 18 stores by the end of 2010. Driven by new store openings and strong same store sales growth, we expect Alhokair to achieve strong revenue growth of above 18% in Q4 (Q1 2011).

High SG&A and zakat impair net profit: Alhokair's gross margin declined considerably from 48.9% in financial Q3 last year to 45% in financial Q3 this year. SG&A of 37.9% of sales was close to the level of Q3 last year but much higher than last quarter's level of 26.5% and level for last year as a whole of 32.5%. The company attributed the increase in SG&A costs to higher provisions associated with international start-up businesses. The zakat charge of SAR8mn was also much higher than the typical quarterly level of SAR4mn. We do not know why this was, and in our model are currently assuming that zakat will return to a more normal level; this assumption could prove mistaken. Looking forward, we expect the gross margin to improve due to international expansion which, according to the company, offers higher margins. However, we expect SG&A expenses to remain higher than the typical level hitherto due to start-up operating costs internationally.

Healthy same-store sales (SSS) growth: By our estimate, Alhokair achieved organic growth of close to 8% in Q3. Alhokair is benefiting from the fast-growing apparel market in the Kingdom, especially children's clothing. It has also benefited from rationalising some of its stores and from shutting down underperforming ones. The moderately weak results of the year to March 2010 as a basis for comparison have also made some contribution to the strong growth so far in this year. Looking forward, we expect Alhokair to achieve SSS growth of above 7.0% in the fourth quarter and of above 6% next year.

Conclusion: Alhokair reported strong sales growth but weak profits for Q3. Net profit dropped due to higher SG&A and zakat costs, but we think the decline can be justified by the company's international expansion and strong growth. In our view, Alhokair is still underpriced on an EV/EBITDA multiple of 7.9x and a P/E ratio of 9.9x compared to other retail groups such as Jarir and Alothaim. We expect strong like-for-like sales growth, the dividend yield of 4.7% and the reasonable valuation to support Alhokair's share price. We remain Overweight and retain our target price of SAR49.9, implying 17% upside potential.

Corporate summary

Fawaz Abdulaziz Al Hokair Company is one of the leading fashion retailers in Saudi Arabia with a market value of $US0.7bn. 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$)	2.989bn / 0.797bn
52-week range	36.50 - 49.70
Daily avg volume (US$)	2.671mn
Shares outstanding	70.00mn
Free float (est)	50%

Performance:	1M	3M	12M
Absolute	-7.6%	0%	19.9%
Relative to index	-6.4%	-3%	13.3%

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

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	03/10A	03/11E	03/12E	03/13E
Revenue (SARmn)	2,074	2,545	2,888	3,255
EBITDA (SARmn)	318	359	411	469
Net Profit (SARmn)	232	301	318	364
EPS (SAR)	3.31	4.30	4.55	5.20
DPS (SAR)	-	2.00	2.10	2.21
EPS Growth	14.4%	29.9%	5.9%	14.4%
EV/EBITDA (x)	8.5	7.9	7.2	6.6
P/E (x)	12.9	9.9	9.4	8.2
P/B (x)	2.7	2.4	2.1	1.8
Dividend Yield	0.0%	4.7%	4.9%	5.2%

Source: Company data, Al Rajhi Capital

Looking forward: strong sales & profits growth

Below we summarise our forecasts for Alhokair Q1 2011 and 2011 full year.

Figure 1. Alhokair: 03/2010Q4A vs. 03/2011Q4E & FY03/2010A vs. FY03/2011E

(SAR) mn	Q4 (Mar2010)	Q4 (Mar2011)	YOY % chg.	FY 03/2010A	FY 03/2011E	YOY % chg.
Total Revenues	**492.5**	**583.3**	**18.4%**	**2,074.4**	**2,545.2**	**22.7%**
Gross Profit	**187.8**	**245.0**	**30.5%**	**913.8**	**1,127.8**	**23.4%**
Gross margin	38.1%	42.0%		44.1%	44.3%	
Operating Profit	**34.7**	**40.8**	**17.8%**	**239.1**	**266.9**	**11.6%**
Net Income	**27.7**	**39.9**	**43.7%**	**231.5**	**300.8**	**29.9%**

Source: Company data, Al Rajhi Capital

We expect revenues to reach SAR2.5 this year

We expect revenues growth to remain above 12%

We expect to see better gross margin due to international business

Alhokair is attractive at P/E of 9.9x and EV/EBITDA of 7.6x

Income Statement (SARmn)	**03/09A**	**03/10A**	**03/11E**	**03/12E**	**03/13E**
Revenue	**1,888**	**2,074**	**2,545**	**2,888**	**3,255**
Cost of Goods Sold	(1,089)	(1,161)	(1,417)	(1,604)	(1,807)
Gross Profit	**799**	**914**	**1,128**	**1,284**	**1,449**
Government Charges					
S.G. & A. Costs	(630)	(675)	(861)	(990)	(1,117)
Operating EBIT	**169**	**239**	**267**	**293**	**332**
Cash Operating Costs	(1,654)	(1,757)	(2,186)	(2,477)	(2,786)
EBITDA	234	318	359	411	469
Depreciation and Amortisation	(65)	(78)	(92)	(118)	(137)
Operating Profit	**169**	**239**	**267**	**293**	**332**
Net financing income/(costs)	0	(43)	(16)	(22)	(14)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	42	45	69	51	51
Other Expenses					
Net Profit Before Taxes	**211**	**241**	**320**	**322**	**368**
Taxes	(9)	(11)	(18)	(8)	(9)
Minority Interests	-	1	(1)	4	5
Net profit available to shareholders	**202**	**232**	**301**	**318**	**364**
Dividends	-	-	(140)	(147)	(154)
Transfer to Capital Reserve					

	03/09A	**03/10A**	**03/11E**	**03/12E**	**03/13E**
Adjusted Shares Out (mn)	70.00	70.00	70.00	70.00	70.00
CFPS (SAR)	3.82	4.41	5.63	6.17	7.09
EPS (SAR)	2.89	3.31	4.30	4.55	5.20
DPS (SAR)	0.000	0.000	2.000	2.100	2.205

Growth	**03/09A**	**03/10A**	**03/11E**	**03/12E**	**03/13E**
Revenue Growth	19.2%	9.9%	22.7%	13.5%	12.7%
Gross Profit Growth	19.8%	14.4%	23.4%	13.8%	12.8%
EBITDA Growth	-5.4%	35.8%	13.1%	14.4%	14.1%
Operating Profit Growth	-15.7%	41.3%	11.6%	9.9%	13.2%
Net Profit Growth	0.5%	14.4%	29.9%	5.9%	14.4%
EPS Growth	0.5%	14.4%	29.9%	5.9%	14.4%

Margins	**03/09A**	**03/10A**	**03/11E**	**03/12E**	**03/13E**
Gross profit margin	42.3%	44.1%	44.3%	44.5%	44.5%
EBITDA margin	12.4%	15.3%	14.1%	14.2%	14.4%
Operating Margin	9.0%	11.5%	10.5%	10.2%	10.2%
Pretax profit margin	11.2%	11.6%	12.6%	11.2%	11.3%
Net profit margin	10.7%	11.2%	11.8%	11.0%	11.2%

Other Ratios	**03/09A**	**03/10A**	**03/11E**	**03/12E**	**03/13E**
ROCE	19.6%	16.9%	16.3%	14.5%	14.9%
ROIC	16.1%	18.5%	17.0%	16.3%	15.1%
ROE	22.9%	23.7%	25.6%	23.8%	23.8%
Effective Tax Rate	4.2%	4.4%	5.6%	2.5%	2.5%
Capex/Sales	14.3%	6.0%	6.4%	12.0%	11.0%
Dividend Payout Ratio	0.0%	0.0%	46.5%	46.2%	42.4%

Valuation Measures	**03/09A**	**03/10A**	**03/11E**	**03/12E**	**03/13E**
P/E (x)	14.8	12.9	9.9	9.4	8.2
P/CF (x)	11.2	9.7	7.6	6.9	6.0
P/B (x)	3.5	2.7	2.4	2.1	1.8
EV/Sales (x)	1.5	1.3	1.1	1.0	1.0
EV/EBITDA (x)	12.1	8.5	7.9	7.2	6.6
EV/EBIT (x)	16.7	11.3	10.6	10.1	9.3
EV/IC (x)	2.3	1.8	1.6	1.4	1.3
Dividend Yield	0.0%	0.0%	4.7%	4.9%	5.2%

Source: Company data, Al Rajhi Capital

Balance sheet is expanding due to international expansion

Balance Sheet (SARmn)	03/09A	03/10A	03/11E	03/12E	03/13E
Cash and Cash Equivalents	24	76	139	265	188
Current Receivables	-	-	-	-	-
Inventories	378	476	583	639	716
Other current assets	320	362	444	444	444
Total Current Assets	**722**	**914**	**1,166**	**1,348**	**1,349**
Fixed Assets	505	584	707	936	1,157
Investments	363	260	238	238	238
Goodwill	-	61	61	61	61
Other Intangible Assets	-	78	85	85	85
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**868**	**983**	**1,091**	**1,320**	**1,542**
Total Assets	**1,590**	**1,897**	**2,257**	**2,669**	**2,890**
Short Term Debt	370	70	123	123	123
Accounts Payable	154	149	187	213	228
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	175	224	273	273	273
Total Current Liabilities	**698**	**444**	**583**	**609**	**624**
Long-Term Debt	-	300	350	568	568
Other LT Payables	-	-	-	-	-
Provisions	29	39	41	41	41
Total Non-current Liabilities	**29**	**339**	**391**	**608**	**608**
Minority interests	-	20	30	25	20
Paid-up share capital	700	700	700	700	700
Total Reserves	163	394	554	726	937
Total Shareholders' Equity	**863**	**1,094**	**1,254**	**1,426**	**1,637**
Total Equity	**863**	**1,114**	**1,284**	**1,451**	**1,658**
Total Liabilities & Shareholders' Equity	**1,590**	**1,897**	**2,257**	**2,669**	**2,890**

Healthy gearing level (Net Debt/EBITDA at 0.9x)

Ratios	03/09A	03/10A	03/11E	03/12E	03/13E
Net Debt (SARmn)	346	294	335	426	503
Net Debt/EBITDA (x)	1.48	0.93	0.93	1.04	1.07
Net Debt to Equity	40.1%	26.4%	26.1%	29.4%	30.3%
EBITDA Interest Cover (x)	(522.1)	7.4	22.1	18.7	32.6
BVPS (SAR)	12.33	15.63	17.92	20.37	23.39

Cashflow Statement (SARmn)	03/09A	03/10A	03/11E	03/12E	03/13E
Net Income before Tax & Minority Interest	**211**	**241**	**320**	**322**	**368**
Depreciation & Amortisation	65	78	92	118	137
Decrease in Working Capital	59	(88)	(179)	(29)	(62)
Other Operating Cashflow	(7)	38	(9)	(8)	(9)
Cashflow from Operations	**329**	**269**	**224**	**402**	**434**
Capital Expenditure	(269)	(124)	(163)	(347)	(358)
New Investments	(90)	(98)	36	-	-
Others	4	(6)	(12)	-	-
Cashflow from investing activities	**(355)**	**(227)**	**(139)**	**(347)**	**(358)**
Net Operating Cashflow	**(27)**	**42**	**85**	**55**	**76**
Dividends paid to ordinary shareholders	(245)	-	(138)	(147)	(153)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	3	10	-	-
Cashflow from financing activities	**23**	**3**	**(24)**	**71**	**(153)**
Total cash generated	(3)	45	61	126	(77)
Cash at beginning of period	28	24	76	139	265
Implied cash at end of year	**24**	**69**	**137**	**265**	**188**

Ratios	03/09A	03/10A	03/11E	03/12E	03/13E
Capex/Sales	14.3%	6.0%	6.4%	12.0%	11.0%

Source: Company data, Al Rajhi Capital

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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