Fawaz Abdulaziz Alhokair and Company

Retail Sector

ALHOKAIR AB: Saudi Arabia

الراجحي المالية

Al Rajhi Capital

US$0.879bn	50%	US$2.953mn
Market cap	Free float	Avg. daily volume

Target price	**50.40**	6.97% over current
Consensus price	**47.00**	-0.2% over current
Current price	**47.10**	as at 16/5/2011

Research Department

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Underweight | **Neutral** | Overweight

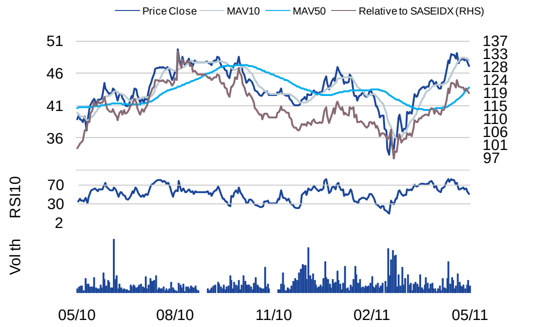
Key themes

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. However, the share price has recently rallied and currently offers limited upside.

Performance



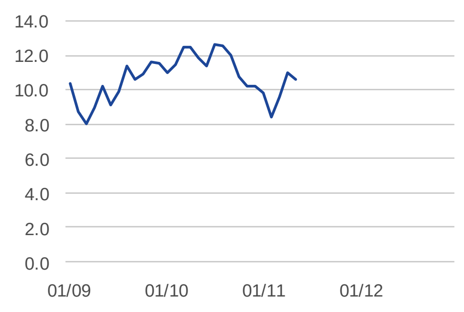
Earnings

Period End (SAR)	03/11A	03/12E	03/13E	03/14E
Revenue (mn)	2,575	2,902	3,198	3,491
Revenue Growth	24.1%	12.7%	10.2%	9.2%
EBITDA (mn)	364	381	411	432
EBITDA Growth	14.7%	4.5%	8.0%	5.2%
EPS	4.52	4.03	4.61	5.38
EPS Growth	36.6%	-10.8%	14.5%	16.7%

Source: Company data, Al Rajhi Capital

Valuation

P/E (x)



Source: Company data, Al Rajhi Capital

Alhokair

Priced in despite good results

Alhokair's Q4 (January-March 2011; Alhokair's end year is March) results showed strong year-on-year growth in sales of 24% driven by strong like-for-like sales and new stores. However, operating profit grew by 3% only to reach SAR36mn, below our forecast of SAR40mn. Lower than expected gross margin coupled with noticeably high SG&A costs squeezed Q4 profits. Nevertheless, driven by other unsustainable income, net profit of SAR55mn was far above our estimates of SAR40mn. In 2011, we expect Alhokair's international operations, mainly Kazakhstan, coupled with local new brands, FG4, to drive the company growth. We have revised our forecasts and set a new target price of SAR50.4. Our new target offers limited upside potential as the current share price stands at SAR47.1. Therefore, we rate Alhokair Neutral.

New stores and healthy SSS support top line: Alhokair posted year-on-year sales growth of 24%. This was far above our estimates of 18%. We think that this was driven by new stores (local & international) and strong like-for-like sales growth. Alhokair increased its stores in Kazakhstan from four stores in 2009 to 20 stores by the end of the financial year 2010 (March 2011). We expect Alhokair to at least double its number of stores in year 2011. Locally, Alhokair continues to open new stores with the focus on its new brand, FG4. It opened 25 FG4 stores last year and we think that it will increase it to 60 stores this year. By our estimate, Alhokair achieved organic growth of close to 7% in 2010, benefiting from fast-growing apparel market in the Kingdom. Looking forward, we expect Alhokair to achieve SSS growth of above 6.0% this year.

High SG&A costs impair operating profit: Alhokair's gross margin improved considerably from 38.1% in financial Q4 last year to 41.8% in financial Q4 this year, but declined q-o-q by 320 bps. This contraction can be attributed to the seasonality difference (Q4 is usually discounts season). SG&A of 36% of sales was close to the level of Q3 this year but much higher than that in Q4 last year of 31.1% 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. Looking forward, we expect gross margin to slightly 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 international start-up operating costs.

Continuous improvement in working capital: Alhokair's working capital as a proportion of sales improved remarkably from about 22.4% in financial year 2009 to 18.3% in 2010. This can be attributed to better management over payables and strong inventory controls. Looking forward, we expect working capital to remain close to this level as a proportion of sales.

Conclusion: Alhokair reported strong sales growth but weak operating profits for Q4. Net profit significantly improved due to other income from the company investment in Riyadh Gallery mall and Kingdom tower. We have marginally revised our forecasts earnings and hence set a new target price of SAR50.4 (old target: SAR49.9). After the recent rise in Alhokair's share price, we believe that the company's attractions are already priced in (current price SAR47.1). Thus, we downgrade our rating from Overweight to Neutral. Alhokair trades on an EV/EBITDA multiple of 7.9x and a PE ratio of 11.7 x, and offers dividend yield of 5.3%.

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$)	3.297bn / 0.879bn
52-week range	33.40 - 49.70
Daily avg volume (US$)	2.953mn
Shares outstanding	70.00mn
Free float (est)	50%

Performance:	1M	3M	12M
Absolute	5.4%	11.3%	20.8%
Relative to index	5%	9%	19.2%

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

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	03/11A	03/12E	03/13E	03/14E
Revenue (SARmn)	2,575	2,902	3,198	3,491
EBITDA (SARmn)	364	381	411	432
Net Profit (SARmn)	316	282	323	377
EPS (SAR)	4.52	4.03	4.61	5.38
DPS (SAR)	2.00	2.50	2.50	2.80
EPS Growth	36.6%	-10.8%	14.5%	16.7%
EV/EBITDA (x)	8.2	7.9	7.2	7.0
P/E (x)	10.4	11.7	10.2	8.7
P/B (x)	3.0	2.7	2.4	2.1
Dividend Yield	4.2%	5.3%	5.3%	5.9%

Source: Company data, Al Rajhi Capital

Below we summarise actual results and our forecasts for Alhokair Q4 2010 (March) and Q1 2011 (June).

Figure 1. Alhokair: 2010Q4A (Mar) vs. 2011Q4E (Mar) vs. 2011Q4A (Mar) & 2010Q1A (June) vs. 2011Q1E (June)

(SAR) mn	2010Q4A (March)	2011Q4E (March)	2011Q4A (March)	YOY % chg.	2010Q1A (June)	2011Q1E (June)	YOY % chg.
Total Revenues	**492.5**	**583.3**	**612.7**	**24.4%**	**501.5**	**582.4**	**16.1%**
Gross Profit	**187.8**	**245.0**	**256.3**	**36.5%**	**245.5**	**278.9**	**13.6%**
Gross profit margin	38.1%	42.0%	41.8%		49.0%	47.9%	
Operating Profit	**34.7**	**40.8**	**35.8**	**3.3%**	**43.6**	**66.4**	**52.2%**
Net Income	**27.7**	**39.9**	**55.4**	**99.6%**	**53.0**	**62.9**	**18.7%**

Source: Company data, Al Rajhi Capital

Income Statement (SARmn)	03/10A	03/11A	03/12E	03/13E	03/14E
Revenue	**2,074**	**2,575**	**2,902**	**3,198**	**3,491**
Cost of Goods Sold	(1,161)	(1,435)	(1,617)	(1,781)	(1,945)
Gross Profit	**914**	**1,139**	**1,284**	**1,417**	**1,547**
Government Charges					
S.G. & A. Costs	(675)	(877)	(995)	(1,097)	(1,191)
Operating EBIT	**239**	**262**	**289**	**320**	**356**
Cash Operating Costs	(1,757)	(2,210)	(2,521)	(2,787)	(3,059)
EBITDA	318	364	381	411	432
Depreciation and Amortisation	(78)	(102)	(91)	(91)	(76)
Operating Profit	**239**	**262**	**289**	**320**	**356**
Net financing income/(costs)	(43)	(32)	(33)	(20)	(0)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	45	105	41	41	41
Other Expenses					
Net Profit Before Taxes	**241**	**335**	**297**	**340**	**397**
Taxes	(11)	(15)	(7)	(9)	(10)
Minority Interests	1	(3)	(8)	(9)	(10)
Net profit available to shareholders	**232**	**316**	**282**	**323**	**377**
Dividends	-	(140)	(175)	(175)	(196)
Transfer to Capital Reserve					

	03/10A	03/11A	03/12E	03/13E	03/14E
Adjusted Shares Out (mn)	70.00	70.00	70.00	70.00	70.00
CFPS (SAR)	4.41	6.03	5.45	6.04	6.62
EPS (SAR)	3.31	4.52	4.03	4.61	5.38
DPS (SAR)	0.000	2.000	2.500	2.500	2.799

We expect revenues growth to remain above 12% this year

Growth	03/10A	03/11A	03/12E	03/13E	03/14E
Revenue Growth	9.9%	24.1%	12.7%	10.2%	9.2%
Gross Profit Growth	14.4%	24.7%	12.7%	10.3%	9.1%
EBITDA Growth	35.8%	14.7%	4.5%	8.0%	5.2%
Operating Profit Growth	41.3%	9.5%	10.4%	10.5%	11.4%
Net Profit Growth	14.4%	36.6%	-10.8%	14.5%	16.7%
EPS Growth	14.4%	36.6%	-10.8%	14.5%	16.7%

We expect to see better gross margin due to international business

Margins	03/10A	03/11A	03/12E	03/13E	03/14E
Gross profit margin	44.1%	44.2%	44.3%	44.3%	44.3%
EBITDA margin	15.3%	14.1%	13.1%	12.8%	12.4%
Operating Margin	11.5%	10.2%	10.0%	10.0%	10.2%
Pretax profit margin	11.6%	13.0%	10.2%	10.6%	11.4%
Net profit margin	11.2%	12.3%	9.7%	10.1%	10.8%

Other Ratios	03/10A	03/11A	03/12E	03/13E	03/14E
ROCE	16.9%	19.4%	18.2%	18.3%	18.3%
ROIC	27.0%	21.8%	23.8%	25.0%	27.1%
ROE	23.7%	28.9%	24.6%	25.3%	26.1%
Effective Tax Rate	4.4%	4.5%	2.5%	2.5%	2.5%
Capex/Sales	6.0%	2.5%	3.0%	3.0%	4.0%
Dividend Payout Ratio	0.0%	44.3%	62.0%	54.2%	52.0%

Alhokair trades on a P/E of 11.9x and EV/EBITDA of 8.1x

Valuation Measures	03/10A	03/11A	03/12E	03/13E	03/14E
P/E (x)	14.2	10.4	11.7	10.2	8.7
P/CF (x)	10.7	7.8	8.6	7.8	7.1
P/B (x)	3.0	3.0	2.7	2.4	2.1
EV/Sales (x)	1.4	1.2	1.0	0.9	0.9
EV/EBITDA (x)	9.2	8.2	7.9	7.2	7.0
EV/EBIT (x)	12.3	11.5	10.4	9.3	8.5
EV/IC (x)	2.6	2.5	2.4	2.3	2.1
Dividend Yield	0.0%	4.2%	5.3%	5.3%	5.9%

Source: Company data, Al Rajhi Capital

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

Balance Sheet (SARmn)	03/10A	03/11A	03/12E	03/13E	03/14E
Cash and Cash Equivalents	76	107	285	407	428
Current Receivables	-	-	-	-	-
Inventories	476	599	652	712	768
Other current assets	362	494	494	494	494
Total Current Assets	**914**	**1,199**	**1,431**	**1,613**	**1,689**
Fixed Assets	584	613	608	612	675
Investments	260	219	219	219	219
Goodwill	61	61	61	61	61
Other Intangible Assets	78	81	81	81	81
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**983**	**975**	**969**	**973**	**1,037**
Total Assets	**1,897**	**2,174**	**2,401**	**2,586**	**2,726**
Short Term Debt	70	161	161	161	161
Accounts Payable	149	285	272	301	244
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	224	335	335	335	335
Total Current Liabilities	**444**	**782**	**768**	**797**	**741**
Long-Term Debt	300	225	350	350	350
Other LT Payables	-	-	-	-	-
Provisions	39	42	42	42	42
Total Non-current Liabilities	**339**	**267**	**392**	**392**	**392**
Minority interests	20	31	39	48	58
Paid-up share capital	700	700	700	700	700
Total Reserves	394	395	502	650	836
Total Shareholders' Equity	**1,094**	**1,095**	**1,202**	**1,350**	**1,536**
Total Equity	**1,114**	**1,126**	**1,241**	**1,397**	**1,594**
Total Liabilities & Shareholders' Equity	**1,897**	**2,174**	**2,401**	**2,586**	**2,726**

Ratios	03/10A	03/11A	03/12E	03/13E	03/14E
Net Debt (SARmn)	294	279	226	104	83
Net Debt/EBITDA (x)	0.93	0.77	0.59	0.25	0.19
Net Debt to Equity	26.4%	24.7%	18.2%	7.4%	5.2%
EBITDA Interest Cover (x)	7.4	11.4	11.5	20.1	4,687.3
BVPS (SAR)	15.63	15.64	17.17	19.28	21.94

Cashflow Statement (SARmn)	03/10A	03/11A	03/12E	03/13E	03/14E
Net Income before Tax & Minority Interest	**241**	**335**	**297**	**340**	**397**
Depreciation & Amortisation	78	102	91	91	76
Decrease in Working Capital	(88)	(119)	(67)	(31)	(112)
Other Operating Cashflow	38	(46)	(7)	(9)	(10)
Cashflow from Operations	**269**	**272**	**314**	**392**	**351**
Capital Expenditure	(124)	(63)	(86)	(95)	(140)
New Investments	(98)	30	-	-	-
Others	(6)	23	-	-	-
Cashflow from investing activities	**(228)**	**(9)**	**(86)**	**(95)**	**(140)**
Net Operating Cashflow	**42**	**263**	**228**	**297**	**212**
Dividends paid to ordinary shareholders	-	(261)	(175)	(175)	(191)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	3	9	-	-	-
Cashflow from financing activities	**3**	**(236)**	**(50)**	**(175)**	**(191)**
Total cash generated	45	27	178	122	21
Cash at beginning of period	24	76	107	285	407
Implied cash at end of year	**69**	**103**	**285**	**407**	**428**

Ratios	03/10A	03/11A	03/12E	03/13E	03/14E
Capex/Sales	6.0%	2.5%	3.0%	3.0%	4.0%

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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