



Rating	NEUTRAL
Target price	SAR111.7 (-7.7%, downside)
Current price	SAR121.0

Key themes & implications

Alhokair reported stronger than expected results for Q1 FY2015E. The company is expanding rapidly through both organic and inorganic methods. We have raised our estimates on the company after the recent results. We have also lowered our cost of equity assumption government's decision to allow foreign institutions to invest directly in the Saudi market. As a result, we have raised our target price on the company to SAR111.2 per share. The stock is currently trading at a FY15E PE of about 26x and FY16E PE of 21.5x. At current valuations, we do not foresee further scope for multiple expansion. Thus, we reiterate our Neutral rating.

Share information

Market cap (SAR/US\$)	25.43bn / 6.78bn		
52-week range	58.75 - 123.5		
Daily avg volume (US\$)	9.2mn		
Shares outstanding	210.0mn		
Free float (est)	30%		

Performance	1M	3M	12M
Absolute	12.4%	26.6%	75.5%
Relative to index	4.5%	18.7%	45%

Major Shareholder:

Fas Company	49.0%
Abdulmajeed Abdulaziz Alhokair	7.0%

Valuation

	03/13A	03/14A	03/15E	03/16E
P/E (x)	41.1	33.5	25.9	21.5
P/B (x)	6.3	10.5	8.8	7.4
EV/EBITDA (x)	33.0	25.6	19.4	16.0
Dividend Yield	2.5%	1.9%	2.2%	2.6%

Source: Company data, Al Rajhi Capital

Performance



Source: Bloomberg, Company data, Al Rajhi Capital

Company summary

Fawaz Abdulaziz Alhokair Company is a leading fashion retailer in Saudi Arabia, with a market capitalization of around US\$7bn. The company primarily sells a wide gamut of fashion items such as luxury apparel, sport wear, shoes, bags, and fashion accessories. Alhokair is a franchisee for more than 80 international brands such as Zara, Gap, Marks & Spencer, and Aldo.

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Fawaz Abdulaziz Alhokair & Co. Limited upside potential

Alhokair reported a strong set of Q1 FY2014 (quarter ending June 2014) results, supported by the recent acquisition of Blanco. We have raised our estimates marginally, following the better-than-expected quarterly numbers. We have also changed our cost of equity assumptions for the company taking in to account the government's decision to allow foreign institutions to invest directly in the Saudi market. Based on our revised estimates, we have arrived at a fair value of SAR111.7 per share for Alhokair. The stock has surged about 25% over the last one month to SAR121.0 currently. The stock is currently trading at a FY2015E PE of 26x, and FY2016E PE of 21.5x. At current valuations we believe there is limited scope for further expansion in valuation multiples. Thus, we reiterate our Neutral rating on Alhokair.*

Strong top line growth to continue for 2-3 years: Owing to the company's aggressive expansion through organic as well as inorganic methods, we believe Alhokair will continue to witness strong growth over the next two to three years. The company plans to open around 400 stores this year (our estimate: 375). Further, the management is also focussing on improving its operational efficiencies to increase profit margin. Moreover, turnaround in its operations in countries like the US would also boost the company's bottom line. However, post this period of expansion, growth is expected to taper off to normal levels.

Raising our estimates: Taking into account the strong Q1 FY2015 results, we have raised our estimates slightly for Alhokair. We believe the company will be able to achieve a net profit of about SAR1bn this financial year. We expect net profit to grow at a CAGR of 23.6% to SAR1.46bn by FY2017E. Revenues are also expected to grow at a CAGR of about 24% during the same period.

Valuation: Alhokair is currently trading at 26x times its FY15E earnings, while its peer group from GCC and BRIC countries are trading at an average adjusted 2015E PE of 19.5x (adjusted for March ending fiscal year). Though we believe Alhokair does deserve to trade at a premium to the average peer group due to its strong expected growth rate, we do not think the company should trade at such a high premium. We have valued Alhokair at a 20% premium to its global peer average. For our DCF valuation, we have lowered our cost of equity assumption (details below), resulting in a higher valuation for the company. Based on our new estimates and assumptions, we have arrived at a fair value of SAR111.7 per share. As our revised target price provides a potential downside of a nominal 7.7%, we reiterate our Neutral rating on Alhokair.

Period End (SAR)	03/12A	03/13A	03/14A	03/15E	03/16E
Revenue (mn)	3,203	4,659	5,482	7,656	9,102
Revenue Growth	24.4%	45.5%	17.7%	39.6%	18.9%
Gross profit margin	24.7%	24.3%	25.5%	25.3%	25.8%
EBITDA margin	17.3%	16.3%	17.3%	16.9%	17.5%
Net profit margin	14.0%	13.3%	13.8%	12.8%	13.0%
EPS	2.14	2.94	3.61	4.68	5.63
EPS Growth	41.8%	37.9%	22.6%	29.7%	20.2%
ROE	35.9%	36.1%	34.1%	37.1%	37.6%
ROCE	25.3%	20.0%	23.9%	24.5%	26.1%
Capex/Sales	8.6%	10.6%	6.9%	9.4%	7.1%

Source: Company data, Al Rajhi Capital (* Alhokair follows April to March fiscal year)

Disclosures Please refer to the important disclosures at the back of this report. Note: Please note the change in our rating definitions. Our overweight rating imply an upside of more than 10% (earlier 15%), and Underweight rating imply a downside of more than 10% (earlier 5%) from the current price. Companies with an expected variation of -10% to +10% (earlier -5% to +15%) are assigned a Neutral rating.



Change in our assumptions: The government’s recent decision to allow foreigners to invest directly in the Saudi market will lead to increased interest in the market. We had earlier assumed a 1% additional risk premium for the Saudi market due to its limited access to foreign investors. However, with this development, we have reduced this risk premium by 50bps to 0.5% due to the improved integration with global markets. As a result of the change in this assumption, our cost of equity has come down from 9.1% to 8.7%.

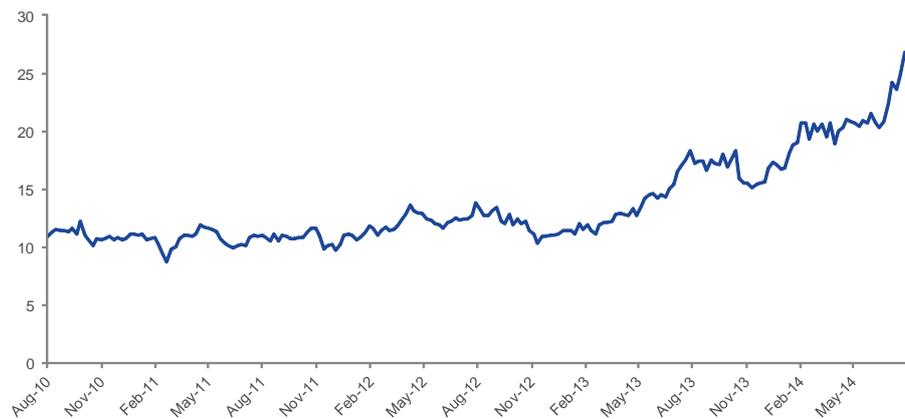
Figure 1 Change in assumptions

	Old assumption	New assumption
Additional Risk Premium (a)	1.0%	0.5%
US Market Equity Premium (b)	4.6%	4.6%
Equity Market Risk Premium (a+b)	5.6%	5.1%
Risk-free Rate	4.1%	4.1%
Cost of Equity	10.5%	10.0%
WACC	9.1%	8.7%
Target price	107.8	111.7

Source: Company data, Al Rajhi Capital

Valuations: Alhokair is currently trading at a 12-month forward PE of 26.4x, which is the highest forward PE level the stock has traded at (chart below). At current valuations, we believe the market is ignoring the risks of the company not being able to meet its expansion plans and other targets. Though we expect the company to continue to post strong earnings growth, we believe current valuations leave limited scope for further upside. Thus, we reiterate our Neutral rating on Alhokair with a fair value target of SAR111.7 per share.

Figure 2 12-month forward PE



Source: Bloomberg, Al Rajhi Capital

Upside / Risk to our rating:

- **Other income** – Alhokair receives a significant portion of its profit from “other income”. Other income accounted for more than 16% of its profit before zakat and minority interests in FY2014 (15% in FY2013). We have estimated this to fall going forward to about 11% in FY2015 and 9% in FY2016. However, if the contribution from other income rises or remains at current levels, it will boost the company’s bottom line and the stock price. Any further decline poses risk to the bottom line.
- **Execution of plans** – If the company is able to execute its expansion plans as well as improves its operational efficiency earlier than expected, the company’s results may beat our estimates, which can push the stock price higher. On the other hand, a slower than expected execution can adversely affect the company’s performance and stock price.



Income Statement (SARmn)	03/12A	03/13A	03/14A	03/15E	03/16E
Revenue	3,203	4,659	5,482	7,656	9,102
Cost of Goods Sold	(2,413)	(3,528)	(4,084)	(5,719)	(6,759)
Gross Profit	790	1,130	1,398	1,937	2,344
Government Charges					
S.G. & A. Costs	(351)	(546)	(678)	(933)	(1,118)
Operating EBIT	439	584	720	1,004	1,226
Cash Operating Costs	(2,650)	(3,901)	(4,536)	(6,361)	(7,508)
EBITDA	553	758	946	1,295	1,594
Depreciation and Amortisation	(114)	(174)	(226)	(291)	(368)
Operating Profit	439	584	720	1,004	1,226
Net financing income/(costs)	(18)	(34)	(50)	(81)	(96)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	64	97	131	115	118
Other Expenses					
Net Profit Before Taxes	485	648	800	1,038	1,248
Taxes	(36)	(31)	(42)	(53)	(63)
Minority Interests	(1)	1	(0)	(2)	(2)
Net profit available to shareholders	448	618	758	983	1,182
Dividends	(140)	(315)	(473)	(550)	(661)
Transfer to Capital Reserve					
	03/12A	03/13A	03/14A	03/15E	03/16E
Adjusted Shares Out (mn)	105.0	105.0	210.0	210.0	210.0
CFPS (SAR)	2.68	3.76	4.69	6.08	7.40
EPS (SAR)	2.14	2.94	3.61	4.68	5.63
DPS (SAR)	1.333	3.000	2.250	2.617	3.147
	03/12A	03/13A	03/14A	03/15E	03/16E
Growth					
Revenue Growth	24.4%	45.5%	17.7%	39.6%	18.9%
Gross Profit Growth	-30.7%	43.1%	23.7%	38.6%	21.0%
EBITDA Growth	51.9%	37.0%	24.9%	36.9%	23.1%
Operating Profit Growth	67.7%	32.9%	23.3%	39.4%	22.1%
Net Profit Growth	41.8%	37.9%	22.6%	29.7%	20.2%
EPS Growth	41.8%	37.9%	22.6%	29.7%	20.2%
	03/12A	03/13A	03/14A	03/15E	03/16E
Margins					
Gross profit margin	24.7%	24.3%	25.5%	25.3%	25.8%
EBITDA margin	17.3%	16.3%	17.3%	16.9%	17.5%
Operating Margin	13.7%	12.5%	13.1%	13.1%	13.5%
Pretax profit margin	15.1%	13.9%	14.6%	13.6%	13.7%
Net profit margin	14.0%	13.3%	13.8%	12.8%	13.0%
	03/12A	03/13A	03/14A	03/15E	03/16E
Other Ratios					
ROCE	25.3%	20.0%	23.9%	24.5%	26.1%
ROIC	34.3%	36.6%	22.9%	27.8%	26.9%
ROE	35.9%	36.1%	34.1%	37.1%	37.6%
Effective Tax Rate	7.4%	4.7%	5.2%	5.1%	5.1%
Capex/Sales	8.6%	10.6%	6.9%	9.4%	7.1%
Dividend Payout Ratio	31.2%	50.9%	62.3%	55.9%	55.9%
	03/12A	03/13A	03/14A	03/15E	03/16E
Valuation Measures					
P/E (x)	56.7	41.1	33.5	25.9	21.5
P/CF (x)	45.2	32.2	25.8	19.9	16.4
P/B (x)	9.1	6.3	10.5	8.8	7.4
EV/Sales (x)	6.9	5.4	4.4	3.3	2.8
EV/EBITDA (x)	39.9	33.0	25.6	19.4	16.0
EV/EBIT (x)	50.3	42.9	33.6	25.0	20.8
EV/IC (x)	7.3	4.2	7.1	5.8	5.2
Dividend Yield	1.1%	2.5%	1.9%	2.2%	2.6%

Source: Company data, Al Rajhi Capital



Balance Sheet (SARmn)	03/12A	03/13A	03/14A	03/15E	03/16E
Cash and Cash Equivalents	198	134	101	196	195
Current Receivables	-	-	-	-	-
Inventories	746	1,103	1,534	1,906	2,206
Other current assets	457	665	877	1,138	1,327
Total Current Assets	1,401	1,903	2,512	3,240	3,729
Fixed Assets	790	1,350	1,616	2,047	2,325
Investments	245	239	260	260	260
Goodwill	61	479	479	479	479
Other Intangible Assets	78	99	149	149	149
Total Other Assets	-	-	-	-	-
Total Non-current Assets	1,174	2,168	2,504	2,935	3,213
Total Assets	2,575	4,070	5,016	6,175	6,942
Short Term Debt	227	438	773	691	716
Trade Payables	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	789	1,090	1,927	2,009	2,183
Long-Term Debt	313	872	566	1,191	1,241
Other LT Payables	-	-	-	-	-
Provisions	49	66	70	70	70
Total Non-current Liabilities	362	938	636	1,261	1,311
Minority interests	23	21	27	29	32
Paid-up share capital	700	700	1,050	1,050	1,050
Total Reserves	702	1,322	1,376	1,825	2,366
Total Shareholders' Equity	1,402	2,022	2,426	2,875	3,416
Total Equity	1,425	2,043	2,453	2,905	3,448
Total Liabilities & Shareholders' Equity	2,575	4,070	5,016	6,175	6,942
Ratios	03/12A	03/13A	03/14A	03/15E	03/16E
Net Debt (SARmn)	341	1,176	1,238	1,685	1,761
Net Debt/EBITDA (x)	0.62	1.55	1.31	1.30	1.10
Net Debt to Equity	23.9%	57.6%	50.5%	58.0%	51.1%
EBITDA Interest Cover (x)	31.2	22.6	18.8	16.1	16.6
BVPS (SAR)	13.35	19.26	11.55	13.69	16.27
Cashflow Statement (SARmn)	03/12A	03/13A	03/14A	03/15E	03/16E
Net Income before Tax & Minority Interest	485	648	800	1,038	1,248
Depreciation & Amortisation	114	174	226	291	368
Decrease in Working Capital	(181)	(441)	(171)	(468)	(341)
Other Operating Cashflow	(23)	(36)	(127)	(53)	(63)
Cashflow from Operations	396	345	729	808	1,213
Capital Expenditure	(276)	(494)	(376)	(722)	(647)
New Investments	(31)	(660)	(5)	-	-
Others	(6)	(26)	(61)	-	-
Cashflow from investing activities	(313)	(1,180)	(442)	(722)	(647)
Net Operating Cashflow	82	(836)	286	86	566
Dividends paid to ordinary shareholders	(140)	-	(368)	(550)	(661)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(9)	(1)	6	-	-
Cashflow from financing activities	4	770	(333)	(7)	(586)
Total cash generated	86	(65)	(46)	79	(20)
Cash at beginning of period	107	198	134	101	196
Implied cash at end of year	194	133	88	180	176
Ratios	03/12A	03/13A	03/14A	03/15E	03/16E
Capex/Sales	8.6%	10.6%	6.9%	9.4%	7.1%

Source: Company data, Al Rajhi Capital



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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 10% 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 10% below the current share price and 10% above the current share price on a 6-9 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 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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