Earnings Review Note

United Electronics Co. (eXtra)| 3Q 2017

Saudi Arabia | Equity

10 October 2017

Momentum continues; earnings beat estimates

Maintain BUY; TP revised upwards to SAR 51.0 per share (previous TP: SAR 42.4/share)

- **3Q17 earnings beat consensus by 10%:** eXtra's 3Q17 revenue increased 4% YoY to SAR 778mn (down 23% QoQ), broadly in line with consensus. The YoY growth in top-line was ascribed to increase in sales, as the retailer continues to benefit from the underlying trend in consumption. Net income in 3Q17 was up 321% YoY at SAR 26mn (down 40% QoQ; BEAT: +10% vs. consensus). The solid earnings beat in 3Q17 was led by (i) higher gross profit (could be due to lower discounts); (ii) increase in margin on some products and services; and (iii) lower SG&A expenses.
- **Margin improvement remains the highlight:** eXtra's gross margin (GPM) improved by 146bps YoY (+227bps QoQ) to 19.3% in 3Q17 due to the shift in the sales mix towards higher margin products (details awaited). Operating margin (OPM), on the other hand, came in at 3.6% in 3Q17 (+195bps YoY, down 83bps QoQ), indicating that cost control initiatives are paying off. The drop in revenue and earnings on sequential basis was attributed to seasonality effect.
- **CEO attributes a strong 3Q to improvement in sales mix:** eXtra's CEO Mohammed Galal Ali Fahmy emphasized that the company had recorded highest-ever third-quarter GPM this year. He mentioned a number of enablers including improved sales mix, sales of services and sales by installments; and also disclosed that eXtra's market share has crossed the 12% mark recorded in first seven months of 2017.
- **9M17 performance shows a steady upturn:** The total sales in 9M17 stood at SAR 2,597mn, up 10% YoY. Gross income for the period was reported at SAR 457mn, up 22% YoY. Net profit for the period stood at SAR 83mn, compared to a net loss of SAR 29mn in 9M16.

3Q 2017 Earnings summary table

In SAR mn	3Q17A	3Q17E*	Deviation	2Q17	%QoQ	3Q16	%YoY
Revenue	778	792	-2%	1,014	-23%	746	+4%
Gross profit	150	NA	NA	173	-13%	133	+13%
Operating profit	28	12	NA	45	-38%	12	+131%
Net Profit	26	24	+10%	43	-40%	6	+321%
EPS (SAR)	0.62	0.57	+10%	1.02	-40%	0.15	+321%

Source: Tadawul; *Bloomberg estimates

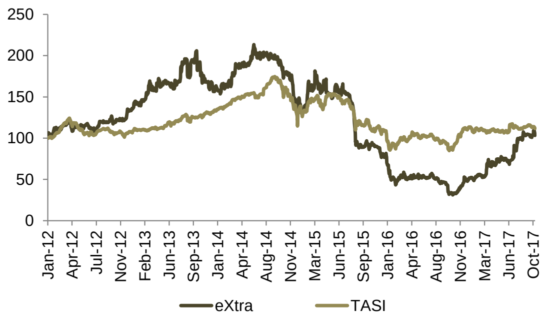
Recent developments

- In September 2017, eXtra unveiled a new showroom in Riyadh, taking the total number of stores in GCC to 43. The store occupies an area of 1,550sqm and totals an investment of just over SAR

Stock Rating

Price (09 Oct 2017)	SAR 45.2
Target price	SAR 51.0
Recommendation	BUY

Share Price vs. Index (rebased)



Price performance

1m	-1%
3m	22%
12m	214%
52 Week Range (SAR/share)	13.33-49.10

Forecasts

In SARmn (Except Per Share)	2016	2017E	2018E
Revenue	3,752	4,149	4,516
Gross Profit	585	714	795
Operating profit	24	138	154
Net profit	2	129	144
EPS	0.05	3.07	3.42
DPS	-	1.50	2.00

Valuation ratios

	2016	2017E	2018E
P/E	NM	14.7 x	13.2 x
EV/Sales	0.3 x	0.4 x	0.4 x
EV/EBITDA	14.6 x	9.9 x	8.7 x
EV/EBIT	42.0 x	13.2 x	11.7 x
Dividend Yield (%)	0.0%	3.3%	4.4%

Key ratios

	3Q17	2Q17	3Q16
Gross Margin	19.3%	17.0%	17.9%
Operating Margin	3.6%	4.4%	1.6%
Net Income Margin	3.4%	4.3%	0.8%

Source: Tadawul; ARANCA Analysis

12mn. eXtra's CEO disclosed that the company does not plan to open any additional showrooms this year and added that new store launches would be announced in 2018 post the board meeting.

Maintain "Buy"; Upgrade Target Price to SAR 51.0

- We maintain BUY rating on eXtra with revised target price at SAR 51.0 per share (previous TP: SAR 42.4 per share); implying an upside potential of 13% from the last close (SAR 45.2/share as of October 09, 2017). We continue to like eXtra as a turnaround story, justified by a steady margin recovery. eXtra has been a prime beneficiary of the changing retail dynamics in KSA (trend towards organized retail). The company's growing market share further strengthens its position in Saudi retail landscape and provides the requisite scale to negotiate effectively with most major brands. In April 2017, government decided to roll back the wage/benefit cuts that were introduced in September 2016, a step that has improved the short-term discretionary spending outlook. We expect 4Q results to be another short-term catalyst, as 4Q has traditionally been a strong quarter for eXtra due to its "Mega Sale" event. Additionally, a clean balance sheet, a cash generative business, and an improving ROE profile support a positive outlook on eXtra.

Changes to Estimates

- The net store addition in 2017 remains one (as against our forecast of three new stores), which indicates a moderate pace of expansions. This prompted us to revise our store expansion forecast. We now project the total number of stores to reach 52 by 2021 from 43 stores currently, which is lower than our previous forecast of 55 stores for the long term. On the other hand, we expect average revenue per outlet to reach SAR 107mn by 2021 from SAR SAR 89mn recorded in 2016. This compares with the previous long-term revenue per outlet forecast of SAR 97mn. The revision in the assumption of average revenue per outlet comes on the back of: (i) Strong LFL growth demonstrated in recent quarters; (ii) recovery in discretionary consumer spending, (iii) boost to sales through online channel (eXtra is currently upgrading its e-commerce platform). We have revisited the margin assumptions to reflect a faster-than-expected recovery as evident from the 9M 2017 results. The TP revision also reflects changes to the risk profile (WACC revised from 11.3% to 11.1%), as the risks associated with the operational turnaround have moderated.

Earnings Revision

	New Estimates			Old Estimates			Deviation		
In SARmn	**FY 2017E**	**FY 2018E**	**FY 2019E**	**FY 2017E**	**FY 2018E**	**FY 2019E**	**FY 2017E**	**FY 2018E**	**FY 2019E**
Revenue	4,149	4,516	4,845	4,020	4,374	4,678	3%	3%	4%
Operational profit	138	154	181	122	140	164	13%	10%	10%
Net Profit	129	144	170	114	131	153	13%	10%	10%
EPS	3.07	3.42	4.04	2.71	3.12	3.65	13%	10%	10%

Source: ARANCA Analysis