Cenomi Retail

Retail – Industrial
CENOMI RETAIL AB: Saudi Arabia
21 Aug 2023

US$0.62bn	37%	US$3.87mn
Market Cap	Free Float	Avg. Daily Volume

Target price	19.00	5.5% below current
Current price	20.10	as at 20/08/2023

Existing rating

Underweight | **Neutral** | Overweight

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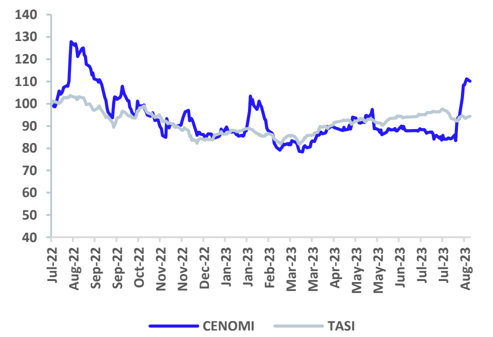
Performance (Rebased to 100)



Earnings

SARmn	FY22	FY23E	FY24E
Revenue	5,930	5,744	5,750
Revenue growth	0.3%	-3.1%	0.1%
Gross profit	891	998	1,051
Gross margin	15.0%	17.4%	18.3%
EBITDA	507	768	694
EBITDA Margin	8.5%	13.4%	12.1%
Net income	58	194	141
Net margin	1.0%	3.4%	2.5%
ROE	20.5%	27.7%	16.6%
ROA	0.7%	2.7%	2.0%
P/E	40.9	12.1	16.7
EV/EBITDA	14.4	9.5	10.5

Source: Company data, Al Rajhi Capital

Cenomi Retail

Margin improvement on lower cost; We revise TP to SAR19/sh and maintain neutral.

Cenomi Retail reported strong 2Q23 results supported by the ongoing transformation with a focus on rationalizing its portfolio and operational efficiency. As part of its store optimization program, the company closed around a net of 287 stores as of 2Q23 compared to 2Q22 in its effort to lower operating expense. Cenomi retail managed to limit the sales decline to only 5.4% at SAR1.6bn as of 2Q23 despite closing such many stores. Revenue per store improved in the quarter which reflect the optimization the company is trying to achieve. Cost of revenue declined by 10.5%, driving growth in gross profit by 21.4% to SAR329mn. This reflects a margin of 20.4% vs 15.9% in 2Q22. The company recorded during the quarter 174.3% increase in other operating income (to SAR118mn which we understood is variable and not fully recurring) which boosted growth at the operating income level to SAR274mn. EBITDA surged 79.2% to SAR317mn. The growth at the net profit level further increased to 173.3%, despite a 54.4% increase in financial costs. Given the improvement in the business we revise our target price for Cenomi Retail from SAR15/sh to SAR19/sh while the current market price is SAR20.1/sh (5.5% lower).

Figure 1: 2Q23 earnings (SAR mn)

(SAR mn)	2Q 2023	2Q 2022	Y-o-Y	1Q 2023	Q-o-Q	ARC est	vs ARC
Revenue	1,613	1,706	-5.4%	1,421	13.6%	1,740	-7.3%
Gross profit	329	271	21.4%	157	109.8%	249	32.3%
Gross margin	20.4%	15.9%		11.0%		14.3%	
Operating profit	274	136	101.7%	26	936.7%	102	167.3%
Operating margin	17.0%	8.0%		1.9%		5.9%	
Net profit	169	62	173.3%	(55)	NA	17	872.6%
Net margin	10.5%	3.6%		-3.9%		1.0%	

Source: Company data, Al Rajhi Capital

2Q23 performance analysis:

Cenomi retail reported strong 2Q numbers, way above our and consensus estimate with improvement in gross margin to 20.4% vs 11.0% in 1Q23. The improvement in margin came mainly from the ease in cost of revenue and we believe the margin could be sustained in the short term. Multiple reasons support maintaining the margin within the 18-20% range. The normalization of cost of goods sold as % of sales back to around 58% vs 60% last year (8.5% decline y-o-y). The decline of both employee cost and RoU depreciation to 10.5% and 7.6% of sales respectively, mainly due to the lower number of stores (1,389 stores vs 1,676 stores at end of Jun-22). More efficient inventory management was seen in the 2Q23, total inventory % of sales declined to 14.8% from 20% the previous quarter. All of the mentioned factors signal positive changes and improvements. However, in the second quarter, the company reported SAR118.2mn as other operating income as they received huge payment labeled as “income from owners of new malls” which the majority came from Cenomi Centers (a related party). That payment inflated the earnings otherwise the adjusted earnings, based on our estimate, should have been only SAR77mn (0.67 Adj.EPS vs 1.46 EPS reported).

Figure 2: Cost of revenue items % of sales

	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23
Cost of revenue	59.3%	59.8%	58.5%	58.2%	63.3%	57.8%
Employee Cost	12.3%	11.3%	12.7%	12.0%	11.4%	10.5%
RoU Depreciation	10.2%	8.2%	9.8%	8.4%	8.0%	7.6%
Gross Margin	13.1%	16.3%	14.0%	16.3%	11.7%	20.4%
Sales	1,387	1,706	1,373	1,465	1,421	1,421

Source: Company data, Al Rajhi Capital

Stores closure and cashflow enhancement:

In the first half, the company closed 176 stores In line with the company strategy of closing weak-performing stores and focus on improving sales per store and expanding strong brands. Sales for the 1H was only 1.9% down y-o-y despite closing 176 stores. This closure of stores will help in reducing operating cost as head count will reduce which we expect to go down by around 1,000 employees with an estimated average salary of 6,000 (SAR72mn annual salary savings expected). Moreover, lease payment declined by around 28% y-o-y or SAR96mn which further improved the business cashflow.

Concerns:

Our major concern is the rising interest rate where the company pays SAIBOR + 2.7%. In 2Q23, the company paid 8.9% on its debt and that is not the peak last interest hike was seen in July. Cenomi retail has SAR2.95bn debt and SAR2.29bn leases as of 2Q23 (6.3x net debt/ebitda). Given the high leverage and interest rate we believe the company's earnings will face pressure in the coming years. Other key concern is the related party receivables which amounts to SAR451.8mn (63% of total receivables) as of Dec 2022.

Valuations:

We reviewed our coverage on Cenomi Retail and maintained our rating to neutral with a TP of SAR19/sh. We have valued Cenomi Retail using a blended approach of DCF and P/E relative valuation (assigned equal weights). We arrived at the DCF approach-based target price of SAR20/sh based on a 2% terminal growth and a WACC of 9.9%, while the P/E valuation-based TP of SAR18/sh is based on 18x multiple and 2024E EPS. Key upside risks to our valuations are higher sales growth than anticipated, better-than-expected improvement in gross margin coming from favourable product mix, or lower-than-expected capex spending. Downside risks are higher competition in the retail sector, or more pressure on consumer's wallet leading to lower spending.

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"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 12 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 12 month time horizon.

"Target price": We estimate target 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.

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