Leejam Sports Co.

Consumer Services
LEEJAM AB: Saudi Arabia
30 August 2023

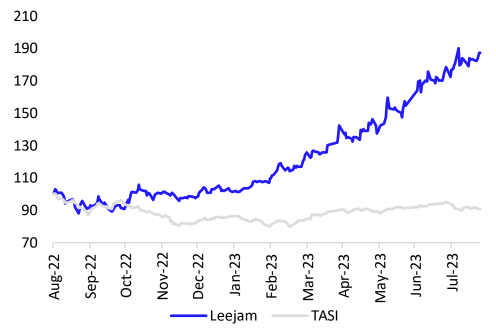
US$2.176bn	48.15%	US$6.34mn
Market Cap	Free Float	Avg. Daily Value

Target price	180.00	15.3% above current
Current price	155.80	as at 29/08/2023

Existing rating

Underweight | Neutral | **Overweight**

Performance (Rebased to 100)



Key Metrics

(SARmn)	2022	2023E	2024E
Revenue	1,066	1,270	1,439
Revenue growth	20.4%	19.2%	13.3%
Gross profit	436	542	600
Gross margin	40.9%	42.6%	41.7%
EBITDA	547	655	723
EBITDA margin	51.3%	51.6%	50.3%
Net profit	257	317	363
Net margin	24.1%	24.9%	25.3%
EPS	4.9	6.0	6.9
DPS	2.7	3.3	3.8
Payout ratio	54.0%	54.1%	55.0%
P/E	31.7x	25.8x	22.5x
RoE	29.5%	31.6%	31.6%

Source: Company data, Al Rajhi Capital.

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TP revised to SAR180/sh; upgraded to OW

Since 1H22, Leejam has managed to positively surprise investors with bumper growth in its memberships in both male and female segments. To put things into perspective, the total members have ballooned from 274k in 2Q22 to 367k in 2Q23. The growth in members can be attributed to several factors, including i) the ramp-up of new centers, ii) the opening of express centers and 24/7 gyms, and iii) consolidation in the industry. Consequently, the company is in line to meet its FY25 targets of 500k members and 250 centers. What's more interesting is that gross margins have significantly improved for the company, from 35.2% in 1H22 to 40.2% in 1H23. As the majority of the company's costs are fixed, any increase in revenue directly benefits the bottom line. We believe the company is likely to continue its upward trajectory in FY23e and post record profits on the back of a healthy membership base as well as improved gross margins. Going forward, we expect revenue revenue/profit to increase by a 3-year CAGR of 15/18% respectively. Hence, we resume our coverage of Leejam after a hiatus with an overweight rating. Our TP of SAR180/sh provides an upside of 15.3% to the last close and a nominal dividend yield of 2.1%.

All set to go big: The company is on course to meet its FY25 targets of reaching 500k members as well as increasing the total number of centers to 250. However, we remain conservative in our assumptions and expect the members to grow at a 3-year CAGR of 12% to 462k by FY25 year-end, while we expect the members to eventually reach 500k by FY26 end. In terms of centers, the company has already secured 50 locations and is gearing up for expansion in the next 12 months. Hence, we believe that the company will not be able to maintain the FY23e level of gross margins next year, and our average margins for FY24–25 are at 41.8%. However, it should be noted that once all the fixed costs are incurred and the ramp-up of new centers takes place, the company will again start to enjoy the fruits of higher margins. This phenomenon was witnessed in 1H22, when initially the margins dropped, but eventually as member growth picked up for newly opened centers, margins improved rapidly.

Targeting new avenues of growth: To further its mission of steering the society towards a healthy lifestyle, Leejam is looking to diversify as well as enhance its business offerings. For this purpose, the company has set up a wholly owned investment subsidiary to capitalize on investment opportunities through joint ventures and acquiring stakes in existing ventures. In June 2023, Leejam acquired Al Tatheer Sports for a value of SAR12mn. Tatheer Sports has 10 concept studios and an FY22 annual revenue of SAR19.5mn.

Additionally, Leejam has signed an MOU with Burjeel Holding Company to establish a new partnership in physiotherapy and sports healthcare services, with Leejam holding a 50% stake. The company has managed to integrate the physiotherapy centers into a few of their branches, and the impact of this will be seen in 3Q23. Leejam has also entered into a non-binding MOU with the Ministry of Investment to expand sports investments.

Most recently, the company established Padel X Sports Company in partnership with World Wide Panel and will look to build and operate Padel Courts in the Kingdom. We believe the above-mentioned projects will not impact the profitability of the company significantly in the short term; however, they will improve the overall offerings of the company.

Excellent growth continues for the second consecutive quarter: Leejam witnessed double-digit top-line growth on a YoY basis for the third consecutive quarter. Group's revenue growth was 30% and 20% in 2Q23 and 1Q23, respectively. The growth is driven by both subscription & membership revenues and personal training revenues. The total number of active members increased by 34% y-o-y in 2Q23 to 367k, with male, female, and corporate membership at 221k, 69k, and 77k, respectively. Leejam has added 17 new centers YTD, taking the total number of centers to 173, which consists of 135 Big Box centers, 28 Xpress centers, and 10 concept studios. The group's gross margin increased to 41% in 2Q23 from 34% and 39% in 2Q22 and 1Q23, respectively. The company's cost structure is largely fixed, with more than 70% of COGS being fixed, resulting in an increase in margins as the group's top line expands. Leejam's 2Q23 net income grew to SAR72mn with a net margin of 24%.

Figure 1 **2Q23 Earnings summary**

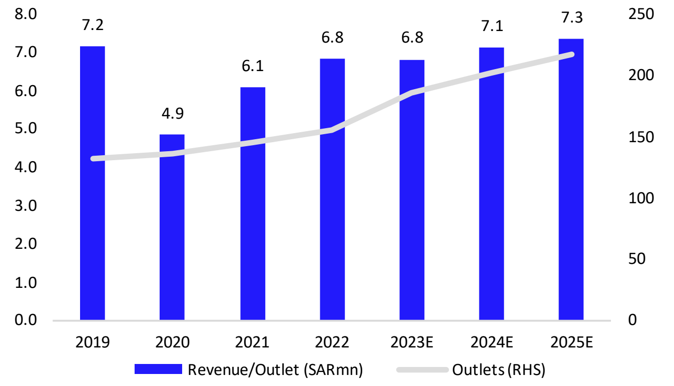
Key metrics (SARmn)	2Q 2023	2Q 2022	y-o-y	1Q 2023	q-o-q	FY22	FY21	y-o-y
Revenue	302	233	*30%*	277	*9%*	1,066	885	*20%*
Gross Profit	124	78	*59%*	109	*14%*	436	373	*17%*
Gross Margin	*41%*	*33%*		*39%*		*41%*	*42%*	
Op. Profit	91	52	*77%*	78	*18%*	317	260	*22%*
Op. Margin	*30%*	*22%*		*28%*		*30%*	*29%*	
Net Profit	72	36	*101%*	63	*16%*	257	206	*25%*
Net Margin	*24%*	*15%*		*23%*		*24%*	*23%*	

Source: Company data, Al Rajhi Capital

Valuations: Our preferred valuation approach is DCF, where we assign a weight of 60% to it while the remaining 40% is assigned to the relative valuation approach. Using the above-mentioned approach, we arrive at a weighted average target price of SAR180/sh. The stock provides an upside of 15.3% from its last closing. For the Discounted Cash Flow (DCF) methodology, our value is SAR187/sh based on the cost of equity assumption of 10.0%, resulting in a WACC of 8.6%, while we have taken a terminal growth rate of 3.0%. For relative valuation, we have applied a price-to-earnings multiple of 25x on discounted FY24e earnings to arrive at the value of SAR169/sh.

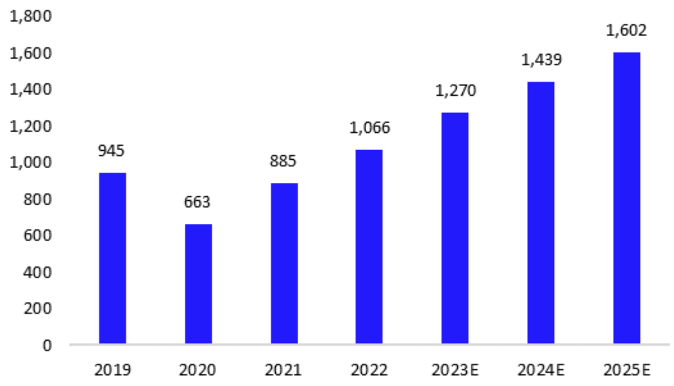
Risks: Key downside risks include**:** i) slowdown in membership growth, ii) rising competition leading to price wars, iii) slowdown in the fitness industry and change in consumer behaviour, and iv) slower than expected ramp up of new fitness centres.

Figure 2 **Outlets and revenue/outlet**



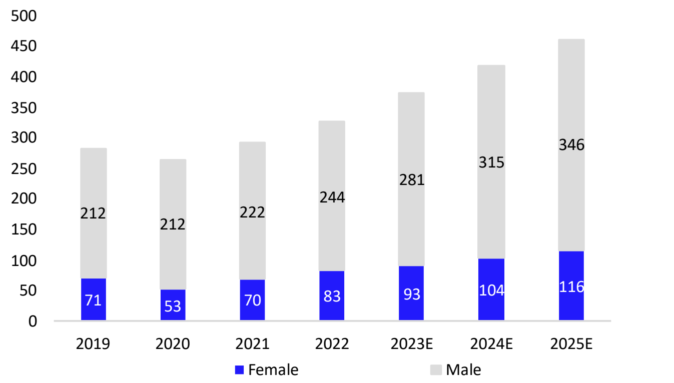
Source: Company Data, Al Rajhi Capital estimates

Figure 3 **Revenue trend (SAR mn)**



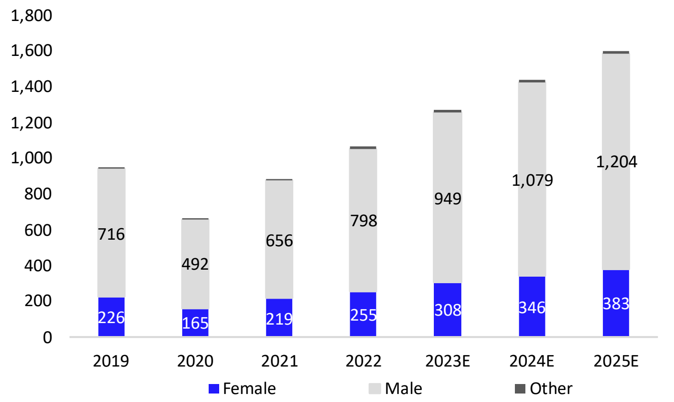
Source: Company Data, Al Rajhi Capital estimates

Figure 4 **Number of members (000's)**



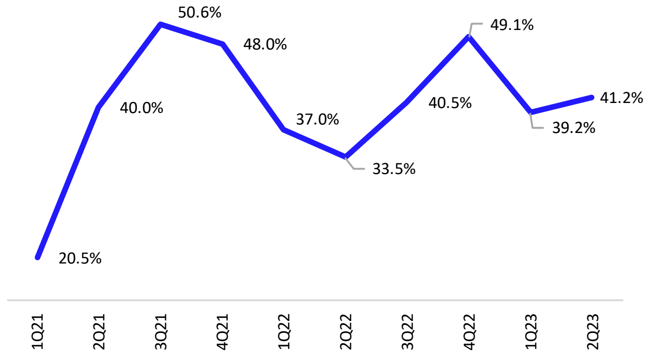
Source: Company Data, Al Rajhi Capital estimates

Figure 5 **Revenue by gender (SARmn)**



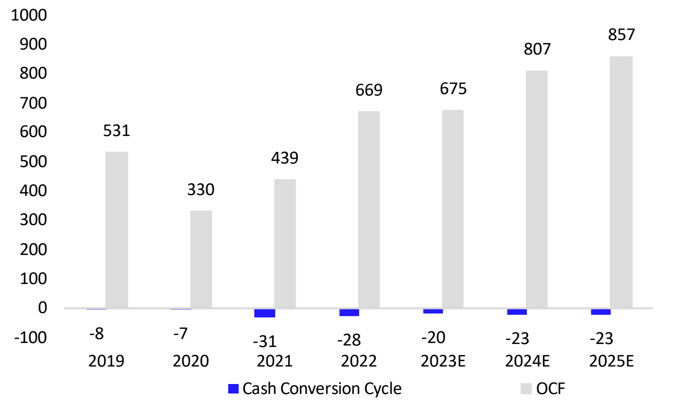
Source: Company Data, Al Rajhi Capital estimates

Figure 6 **Quarterly gross margins (%)**



Source: Company Data, Al Rajhi Capital estimates

Figure 7 **OCF and Cash conversion (SARmn)**



Source: Company Data, Al Rajhi Capital estimates

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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.

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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