

20 July 2008

Recommendation

Buy*

Upside

60.3%

Target Price

SAR65.33

Current Price

SAR40.75**

EPS FY08/09e

SAR3.50

Reuters Code

4240.SE

Bloomberg Code

ALHOKAIR AB

Market Cap

SAR2.9 billion

US\$0.8 billion

Enterprise Value

SAR2.9 billion

US\$0.8 billion

Number of Shares Outstanding

70,000,000

Average Daily Turnover

SAR41 million

Historic-week high/ low

SAR75.50/37.25

Shareholders' Structure

70% | Al Hokair Family and Holding Company

30% | Free Float***



* Refer to back cover for investment ratings

** Closing as at 19 July, 2008

*** 100% open to GCC nationals

100% open to foreign nationals (KSA residents only)



Al Hokair

Fashion Retail | Saudi Arabia

"Growing in Style"

Saudi Arabia's leading fashion retailer...

Al Hokair is the largest fashion retailer in Saudi Arabia with an estimated overall market share of around 50% and sales of SAR1.6 billion in FY07/08. Al Hokair commenced its operations 18 years ago with two menswear stores in 1990. Al Hokair's business premise is simple: obtaining franchises of international fashion brand names that appeal to a large consumer base and selling a wide range of products in fashionable retail outlets, located in prime locations throughout Saudi Arabia. Product categories include clothes for men, women and children, footwear, accessories and home furniture. Over time, the company has built strong relationships with global fashion houses, the most prominent of which are Spain's Inditex Group (owner of the *Zara*, *Massimo Dutti* and *Bershka* brands among others), in addition to the *La Senza*, *Aldo* and *Arcadia*, and more recently *Banana Republic* and *Gap*. Today, the company holds the exclusive rights to 44 international brands and operates 682 stores in prime locations throughout Saudi Arabia.

... supported by the larger unlisted group...

While Al Hokair started its operations as only a fashion retailer, the group has ventured into other businesses to create a well diversified business conglomerate. The larger group's operations span the ownership and management of fashion retail outlets, restaurants and fast food chains, furniture stores, hypermarkets, shopping malls and real estate, amongst others. *It should be noted that the fashion retail subsidiary is the only listed segment of the group and is the focus of this report. However, throughout the report we will be highlighting the synergies created and benefits accruing to the fashion retail subsidiary from the larger group.* Basically, the real estate subsidiary offers a competitive advantage to the fashion retail subsidiary relative to competitors by providing access to retail space in prime locations.

... and well positioned to benefit from the strong local market...

We believe Al Hokair is well positioned to benefit from Saudi Arabia's booming economy and population demographics. The population growth rate is the highest in the region averaging 2.5% over the past 10 years. Moreover, roughly 50% of Saudi Arabia's population is below the age of 25, which is Al Hokair's target market. Additionally, Saudi consumers, especially the young, are becoming more and more brand conscious, and are constantly looking for the latest fashion trends.

We value Al Hokair at SAR65.33, 60.3% above the current market price of SAR40.75

We value Al Hokair using DCF and comparison-based valuation versus peers based on 2009E and 2010 P/E multiples. Our DCF valuation yielded a fair value of SAR77.30 per share, whereas the comparison-based valuation generated a fair value of SAR37.41 per share. By assigning a 70% weight to the DCF valuation and a 30% weight to the comparison-based valuation, we arrived at a target price per share of SAR65.33, 60.3% higher than the current market price of SAR40.75 per share. Accordingly, we assign Al Hokair a 'Buy' recommendation.

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Selected Indicators*

Fiscal Year ending March 31 st	2007A	2008A	2009E	2010F	2011F	2012F
Revenues (SAR mil.)	1,481	1,584	1,872	2,139	2,404	2,676
Revenues Growth (%)	14.5%	6.9%	18.2%	14.3%	12.4%	11.3%
Gross Profit (SAR mil.)	654	675	796	916	1,039	1,172
Gross Profit Margin (%)	44.1%	42.6%	42.5%	42.8%	43.2%	43.8%
EBITDA (SAR mil.)	287	254	303	359	421	484
EBITDA Margin (%)	19.3%	16.1%	16.2%	16.8%	17.5%	18.1%
Net Income (SAR mil.)	247	201	245	296	349	406
EPS (SAR)	3.53	2.88	3.50	4.23	4.98	5.80
P/E (x)	11.5	14.2	11.65	9.63	8.2	7.0
P/B (x)	3.7	3.2	2.8	2.4	2.1	1.8
EV/EBITDA (x)	9.6	11.5	9.7	8.1	7.0	6.0
Total Debt/Equity (x)	0.0	0.1	0.1	0.1	0.1	0.1

Source: Al Hokair published financials, BMG estimates

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Al Hokair – The Story

Profile

The Fawaz Abdul Aziz Al Hokair Group is a leading Saudi Arabian business and retail group. Since it commenced its operations 18 years ago with two menswear stores in 1990, the group has ventured into other businesses to create a well diversified business conglomerate with total group sales of SAR5 billion (US\$1.3 billion) in the FY06/07. Today, the larger group's operations span the ownership and management of fashion retail outlets, restaurants and fast food chains, furniture stores, hypermarkets, shopping malls, real estate, among others. Currently, the group operates a store network north of 1,200; holds exclusive rights for over 65 international brands; serves more than 40 million customers and employs over 9,000 employees. The success of the group's operations is not only evident in its ability to capture the growth in Saudi Arabia's booming consumer market, but also in the way it revolutionized the country's retail market and influenced consumers' shopping habits through the introduction of international mainstream brands. It should be noted that while the group's main operations are in Saudi Arabia, it also has retail operations outside Saudi Arabia, but which are not currently part of the listed local division.

The larger Al Hokair Group is a leading well diversified business conglomerate with sales of SAR5 billion in FY06/07

While the fashion retail segment is the focus of this report, as it is currently the only listed entity, throughout the report we will be highlighting the synergies created and benefits accruing to the fashion retail subsidiary from the larger "Al Hokair" group. In figure 1, we portray the structure of Al Hokair's operations and highlight the fashion retail segment. A detailed description of each subsidiary is presented in Appendix – I, Al Hokair's Business Operations

While the fashion retail segment is the focus of the report, we highlight the relationship with the larger group

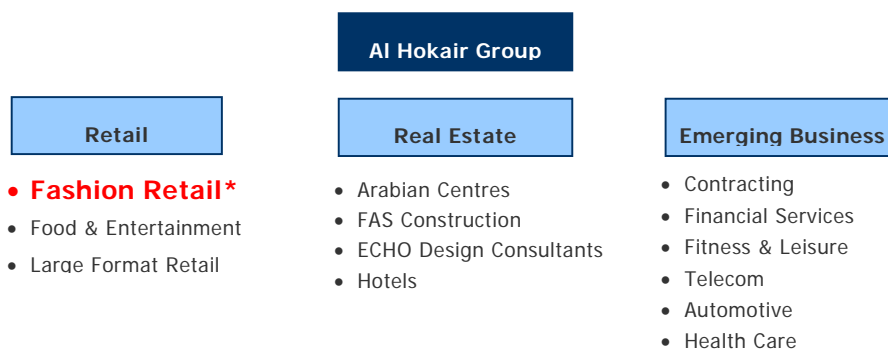
Strengths of the fashion retail division

- Strong knowledge of the local market having been there for more than 18 years
- Biggest player in the Kingdom with roughly a 50% average market share, holding 44 exclusive franchises of renowned international brands and operating 682 stores in prime locations throughout the Kingdom
- Strong local market with a growing economy and high population growth rates
- Competitive advantage accruing to the fashion retail company from the larger group, particularly from the real estate subsidiary, which is active in developing large scale shopping malls in prime locations

Weaknesses of the fashion retail division

- Foreign exchange currency risk directly impacts margins, as the company's major costs are currently mainly in euros
- Exposure to the Saudi market, while regional operations are currently not part of the listed entity
- Concentration of sales with two brands, namely Zara and Promod, representing roughly 29% of total sales in FY07/08
- Possible overlap of operations between the fashion retail listed operations and the larger group

Figure 1 | Al Hokair's Operations



Source: Al Hokair
*Focus of this report, only listed entity

Al Hokair's Fashion Retail

In focus...

Al Hokair has helped transform the fashion retail scene in Saudi Arabia by promoting a modern enjoyable shopping experience offered with the highest standards of service, quality and value to customers. Al Hokair has been, and remains the leading fashion retailer in Saudi Arabia, enjoying an overall market share of roughly 50% and dominant market shares in almost all product categories and sales of SAR1.6 billion (US\$0.4 billion) in FY07/08. Early in its operations, Al Hokair acknowledged that its success lay in its ability to partner with international leaders in the fashion industry and encourage them to enter into the Saudi market. Al Hokair's business premise is simple: obtaining franchises of international fashion brand names that appeal to a large consumer base and selling a wide range of products in trendy retail outlets, located in prime locations throughout the country. Product categories include clothes for men, women and children, footwear, accessories and home furniture. Over the years, the company has built strong relationships with global fashion houses, the most prominent of which are Spain's *Inditex Group*, in addition to the *La Senza*, *Aldo*, *Arcadia* and *Monsoon* groups. Today, Al Hokair holds the exclusive rights to 44 brands and operates 682 stores throughout the country. While the company caters for different segments and age groups, females remain the company's biggest contributor to sales, generating around 44% of the revenues in FY07/08. Al Hokair also exports on a very small scale, representing less than 1% of total sales, basically a few products to other countries in the region.

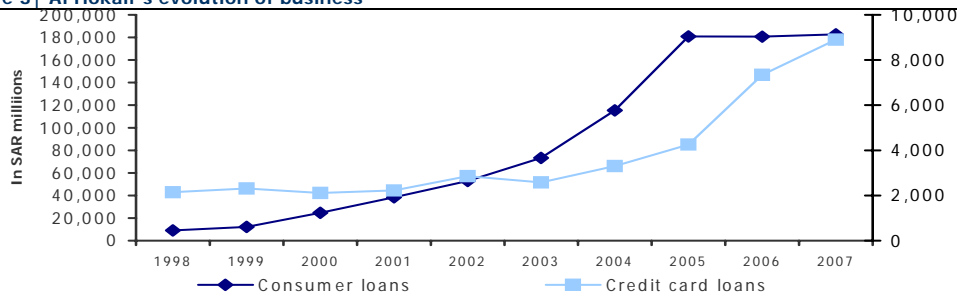
Al Hokair is Saudi Arabia's leading fashion retailer with a 50% market share, 682 stores and 44 franchise brands

Figure 2 | Al Hokair's major brands

Year	Brands
1997	Wallis, Adams
1998	La Senza, Miss Selfridge
1999	Ann Harvey, Promod, Nine West, Barrats
2000	La Senza Girl, Massimo Dutti, Aldo, Colony, Zara
2001	Monsoon, Accessorize, Celio, Kekos, Jennifer, Camaieu's, Marks and Spencer
2002	Vero Moda, Grand Optical, Sergeant Major, Sports City
2003	Exit, Tape A L'oeil, Jack and Jones, Oysho
2004	Pilot, Priceless, Solaris, Spring, Xanaka
2005-2007	Gap, Banana Republic and others

Source: Al Hokair

Figure 3 | Al Hokair's evolution of business



Source: Al Hokair

The number of stores has been increasing steadily through 2006. However, the group decided to embark on a clean-up process which ended up by closing a number of non-performing stores in FY07/08 (see FY07/08 Review). We expect the trend to continue upwards, going forward.

Business model

AI Hokair operates 44 international fashion brands, which are carefully selected to have a higher chance of success in the local market. According to management, only a few brands fail in the local market due to variations in brand perception and taste. AI Hokair's strategy is to terminate the failing brands quickly and focus on the more successful ones. On the other hand, none of AI Hokair's franchisors have terminated their contracts with the company, which is a testimony to its success in managing its portfolio of brands and providing a good service to the brand owners. The company enters into three to five year renewable contracts with its franchisors for the exclusive right to sell their products in Saudi Arabia. Currently, there are three forms of arrangements:

Push model

The push model operates as a consignment arrangement, where AI Hokair sells the products for the franchisor, who retains all the risks involved, including the inventory risk, and payment occurs after the actual sale of the products. AI Hokair's responsibility is limited to performing the logistical work, obtaining the right store locations and ensuring a good presentation for the products. In addition, at the end of the season, AI Hokair has the option to buy the remaining end-stock at a discount. The margins in this model are around 40-42% on average. Of AI Hokair's 44 brands, 11 brands representing 26% of total sales operate under the push strategy. Major brands under this category include *Vero Moda*, *Monsoon*, *JackJones* and *Sergent Major*.

Pull model

Under the pull model, AI Hokair bears all the risks and performs all the operational functions including the selection and marketing of the products and basically pays for the products shortly after their purchase. The pull model includes 31 brands, representing the bulk of AI Hokair's brands and almost 45% of total sales. The pull model's margins are the highest, revolving around 52-55%, to compensate for the higher risk undertaken.

Combo

Zara and *Promod* operate under a unique business model, including aspects from both the push and pull models, given the relative strength and bargaining power of both brands. While AI Hokair does not carry the inventory risk, AI Hokair pays for the products shortly after purchase. The combo model has the lowest margins averaging 28-30%, and constitutes roughly 29% of the company's business with a total of two brands. We believe this represents a major concentration risk for AI Hokair, as it only involves 2 brands versus significantly more brands for the other models.

Figure 4 | AI Hokair's franchise arrangements

Model	Risk	Brand example	Average margins	Percentage of sales*	Cash outflow
Push	Low	Vero Moda, Monsoon	40-42%	26%	After product sale
Pull	High	La Senza, Adams	52-55%	45%	Before product sale
Combo	Moderate	Zara and Promod	28-30%	29%	Before product sale

Source: AI Hokair, BMG estimates
 *as at 2007/2008 fiscal year

Stores

The company leases all its stores for 1-3 years, where 45% are leased from the sister real estate company, while 55% are leased from others. Lease terms with the sister company are done in an arm's length transaction with the only advantage being offered is the opportunity to choose the best locations in the shopping malls.

Financial Analysis and Projections

We only value the fashion retail subsidiary of AI Hokair. The group's publicly-traded entity is the fashion retail subsidiary, and it is this entity on which we focus. The following are our main valuation assumptions:

Main assumptions

- 1) We assume AI Hokair will open 150 new stores in FY08/09, due to both the real launch of its new American brands, as well as the planned roll-out of a number of shopping malls in Saudi Arabia, including the Mall of Arabia in Jeddah, set to open in September 2008. Subsequently, we assume AI Hokair will open 100 stores per annum until 2014, with an average area of 180 m² per store, to reach over 1,300 stores by 2014. This translates into a total store area of roughly 240,000 m² by 2014, which is the end of our forecast period.
- 2) We expect revenues to grow by an average of 12.7% until 2014 and sales per square meters to hover around SAR13,000 on average throughout our forecast period.
- 3) While we maintain the relative mix of the three business models, we expect a slight decrease in the push model, in favour of the pull model, as AI Hokair adds more brands to its portfolio, which we assume will operate under the pull model.
- 4) We expect margins to continue to be pressured in FY08/09 by the strengthening euro, as the company's major costs are currently in euros, while the Saudi currency is pegged to the dollar. We see margins improving gradually thereafter mainly as the group adds more non-European based brand; decreasing the exposure to the currently strong euro. However, the extent of recovery in margins will depend on many factors, including the extent of recovery in the US\$, and AI Hokair's success in controlling costs, and the general economic outlook. It should be noted, however, that while retailers in general have low margins, AI Hokair's margins are relatively higher than other retailers worldwide due to the absence of value added taxes (VAT) in Saudi Arabia, in addition to the higher Pull model margins.

We assume AI Hokair will launch 150 new stores in FY08/09, and 100 per annum stores until 2014...

... and expect new brands to operate under the pull model

Margins to be pressured by strengthening euro in FY08/09 and recover thereafter

Figure 5 | AI Hokair sales and EBITDA margins

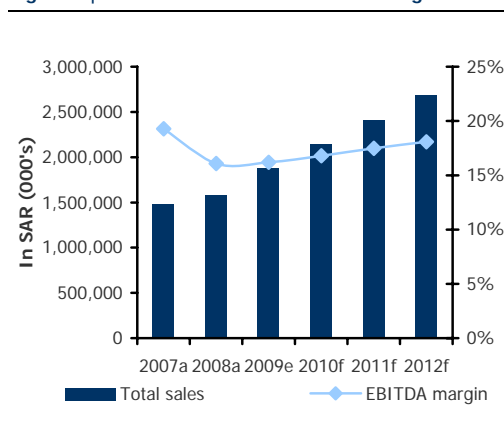
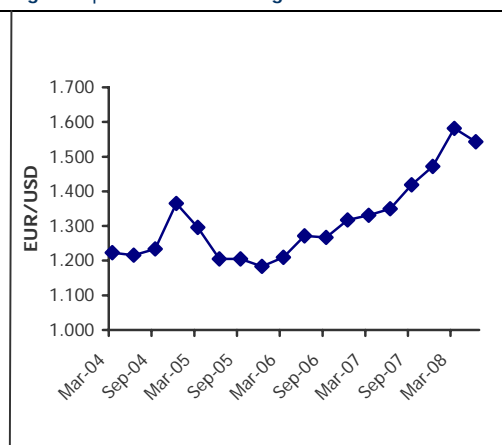


Figure 6 | EUR/USD exchange rate



Source: AI Hokair, Bloomberg and BMG

- 5) The company has currently no long-term debt obligations, a situation we expect to continue in the medium-term, unless AI Hokair acquires other companies or expand regionally under the umbrella of the listed fashion retail subsidiary, (see Appendix - I).

Valuation

We value AI Hokair using DCF and a comparison-based valuation versus peers based on 2009E and 2010E P/E ratio multiples.

Discounted Cash Flow Valuation

To arrive at the DCF value, we used a weighted average cost of capital (WACC) of 11.0% and a terminal growth rate of 5%. The DCF valuation yielded a fair value of SAR77.30 per share.

Comparison-Based Valuation

To arrive at the comparison-based valuation, we calculated the P/E ratios for 2009E and 2010E multiples for AI Hokair's peers. The comparative-based valuation yielded a fair value of SAR37.41 per share accordingly.

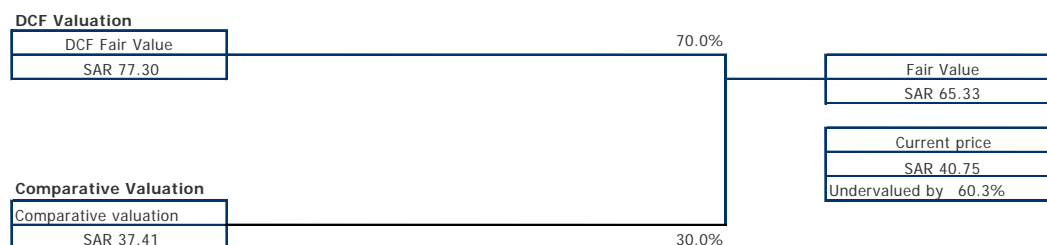
Figure 7 | Comparison-based valuation

Peers*	P/E ratio 09E	P/E ratio 10E
French Connection Group	24.64	13.27
Monnari Trade	18.00	11.80
J Crew Group	16.33	13.83
The Gap	12.07	10.88
Limited Brands	10.17	8.66
Reitmans	10.03	9.11
Pumpkin Patch	9.54	7.74
Abercrombie and Fitch Co.	9.28	8.25
Just Group Limited	8.77	7.62
Sprider Stores	8.74	6.63
Le Chateau	8.35	7.75
Marisa SA	8.06	7.47
Noni B Limited	6.89	6.21
Kappahl Holding	6.35	6.20
Next plc	5.38	5.31
Average P/E	10.84	8.72
AI Hokair P/E	11.61	9.74
AI Hokair eps	3.55	4.23
AI Hokair Comparative Valuation (SAR)	38.49	36.90

Source: BMG estimates, Bloomberg estimates

By assigning a 70% weight to the DCF valuation and 30% weight to the comparison-based valuation as we believe Al Hokair is facing a market with different dynamics than its peers, we arrived at a target price per share of SAR65.33, 60.3% higher than the current market price of SAR40.75 per share. Accordingly, we assign Al Hokair a 'Buy' recommendation.

Figure 8 | Valuation



Source: BMG estimates

What can change our valuation?

The valuation of Al Hokair is currently sensitive to the fact that the Saudi riyal is pegged to the US dollar, while major products' costs are quoted in European currencies. Any weakening of the dollar/strengthening of the Euro would, therefore, be a negative trigger to the rating, and vice versa. On the other hand, if Al Hokair succeeds in securing additional new brands with non-European origins, this would be positive to overall volume and margins. The recently added *Gap* and *Banana Republic* brands could, therefore, be the beginning of a positive trend.

Securing new non-European origin brands would be positive to overall volume and margins

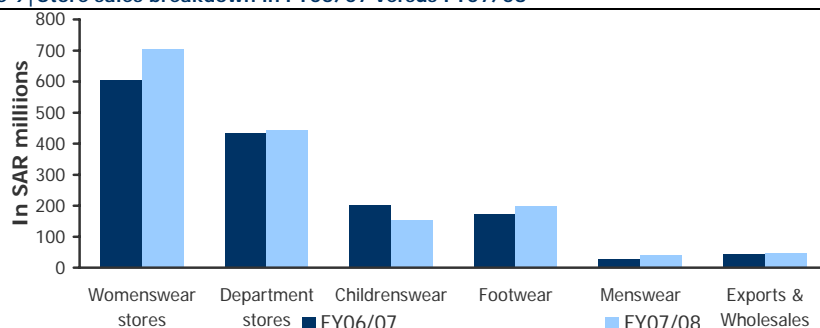
FY07/08 in Review: One tough year...

Slower growth in sales...

The company's sales grew by 6.9% in FY07/08 to reach SAR1.6 billion up from SAR1.5 billion in FY06/07. The growth in sales was weaker than the growth witnessed in FY05/06 and FY06/07 of 29.5% and 14.5%, respectively, as the company was investing in new brands, while terminating other unsuccessful brands, in addition to a prolonged discounted sales period, which continued throughout January and February 2008 in order to sell the season's remaining inventory. On a segmental basis, *womenswear store* sales increased by 16.4% to reach SAR704 million, *department store* sales grew by 2.2% to reach SAR443 million, *footwear store* sales grew by 14.6% to reach SAR199 million and *menswear store* sales grew by 54.2% to reach SAR40 million. Meanwhile, *childrenswear store* sales fell by 24.4% to reach SAR153 million due to a decline in the number of *childrenswear* stores. However, it should be noted that the category *department stores* also sell *childrenswear*, so the decline in *childrenswear* store sales do not fully reflect the performance of the segment. Geographically, sales from the central region comprised 40%, while the western and eastern regions comprised 36% and 24%, respectively.

Slower sales growth in FY07/08 mainly to clean-up and terminating unsuccessful brands

Figure 9 | Store sales breakdown in FY06/07 versus FY07/08



Source: Al Hokair

...and lower margins...

Margins declined as the gross profit margin reached 42.6% versus 44.1% in FY06/07, while the EBITDA margin recorded 16.1% versus 19.3% in FY06/07. The decline in margins is attributed to the stronger euro, as most of the company's costs are euro-denominated. Additionally, the company raised salaries and wages by 22.9% on average to comprise 9.3% of total sales versus 8.1% of total sales in FY06/07 to compensate for rising inflation in the kingdom.

Lower margins due to stronger euro

...with a clean-up process in place...

After having grown its number of stores from 235 stores in 2003 to about 717 stores in 2007, Al Hokair had to naturally clean-up the non-performing stores/brands. As a result, the number of stores declined by 38 in the year ended March 31, 2008.

Decline in number of stores due to clean-up

...leading to a decline in net profits, that we believe will be momentary

Accordingly, the net profit declined by 18.5% to reach SAR201.4 million in FY07/08 versus SAR247.3 million in FY06/07. We believe, however, that the decline is only a result of a combination of factors that hit the company in FY07/08, and we see growth continuing, undisturbed for the years to come, especially with the launch of the new non-Euro brands, and the expansion of the shopping malls.

Leading to a momentary decline in net profits

Launch of 5 new brands... while 6 brands were terminated

Several new brands were launched in 2007 including *Pull and Bear*, *Banana Republic*, *Lady Bird* and *Gap*, the famous US fashion retailer. Al Hokair plans to open 16 new *Gap* stores in FY08/09. Al Hokair also terminated 6 brands, including *Kiabi*, *Thyme Maternity* and *Foschini*.

5 new brands were launched, while 6 were terminated

Capital Increase and cash dividends

In June 2007, the company's general assembly meeting approved increasing the paid-in capital by SAR300 million by distributing 3 free shares for each 4 shares. As a result, the company's total paid-in capital reached SAR700 million up from SAR400 million. Additionally, Al Hokair proposed the distribution of a SAR1.75 per share cash dividend amounting to SAR122.5 million, implying a dividend payout ratio of 60.1%.

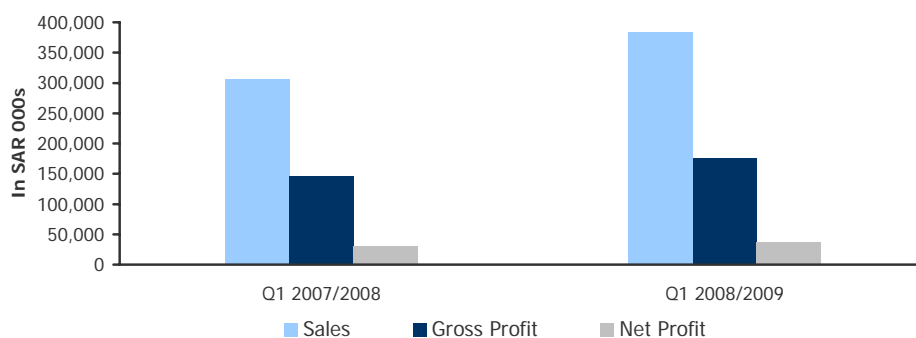
Capital increase and cash dividends approved

But Q1 FY08/09 shows a reversal...

AI Hokair reported its Q1 FY08/09 results ending June 31st, 2008. The results are impressive as the company reported sales of SAR384.0 million, which is a 25.1% growth over Q1 FY07/08. The net profit grew by 19.8% to reach SAR37.2 million, up from SAR31.0 million in Q1FY08/09. The results confirm our views about AI Hokair, as the growth in sales is attributed to the launch of the new brands, which are expected to drive sales in the current year. Moreover, the gross profit margin recorded 45.9% in Q1 FY08/09 versus 42.6% for the FY07/08, which signifies an improvement in profitability as cost control measures, in addition to the launch of the new non-European brands had a positive effect on margins.

*Impressive Q1
FY08/09 results*

Figure 10| Performance in Q1 FY07/08 vs. Q1 FY08/09



Source: AI Hokair published financials

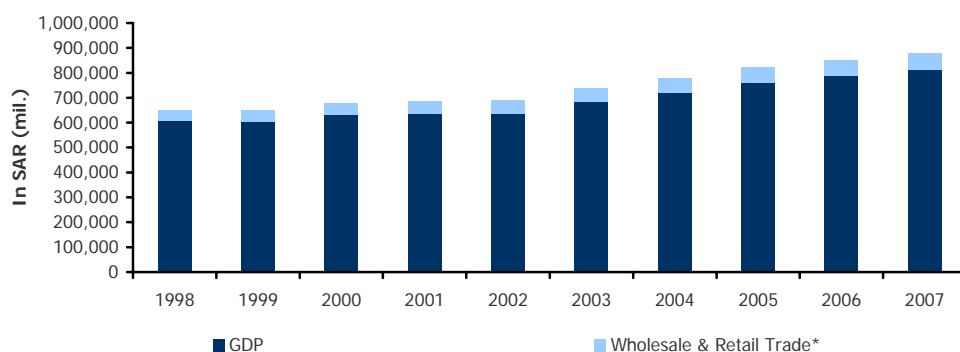
Market Analysis

The local scene

With a large population and a wealthy economy, Saudi Arabia is one of the biggest consumer markets in the MENA region. The growth in the economy over the past few decades has helped build the necessary infrastructure, including roads, ports and shopping malls, to support a well-functioning retail market. Wholesale and Retail trade activities (including restaurants and hotels) grew by a CAGR of 5.8% in the past 10 years and collectively accounted for 8.2% of GDP as at 2007. With regards to trade, Saudi Arabia is considered a net importer of consumer goods. While the market remains highly regulated, we believe the country's recent accession to the WTO should help promote a more open economy.

Saudi Arabia is one of the biggest consumer markets in the MENA region

Figure 11 | Saudi Arabia's GDP and Wholesale & Retail Trade



Source: SAMA
*Includes Restaurants and Hotels

Clothing retail market

Saudi Arabia's total clothing retail market was estimated to be worth around SAR8.6 billion (US\$2.3 billion) in 2005, according to a study by Euro Monitor. The majority of the clothing and textiles products are imported from Asia, in addition to the US and Europe. Of the total clothing market, franchised fashion retail sales, were estimated at SAR2.3 billion (US\$0.6 billion) in 2005, constituting 26.8% of the total clothing retail market and growing by an average 5.1% over the period from 2001 till 2005. The increase in the overall market is mainly driven by a positive economy and a high population growth rate. Franchised fashion retail sales have been growing at a fast rate, as franchising is increasingly becoming the method of choice for many small and medium-sized business start-ups. Franchising has also been successful as foreign businesses are required to team up with local partners in order to do business in Saudi. Thus, partnering with a local entity, rather than investing directly in the market, is the only means for foreign companies to tap the Saudi market. The country has attracted international fashion brands, not only from Europe and the US, but also other areas including the Far East and South Africa. Riyadh, the capital (central region), followed by Jeddah (western region) and Al Dammam (eastern region), are the biggest fashion retail markets in the country, collectively accounting for over 90% of fashion retail sales.

Franchising has been popular as foreign businesses are required to team up with local partners

Riyadh, Jeddah and Al Dammam are the biggest fashion retail markets in the country

Figure 12 | Saudi Arabia's total clothing retail market vs. branded fashion retail market (SAR millions)



Source: Euro Monitor

Real estate boom and shopping malls

Supporting the rise in retail sales is the booming construction and real estate sector, as shopping malls are established in major cities across the country. Malls are not only regarded as places to shop, but as a comprehensive entertainment destination for family members, in the absence of other leisure activities and generally very hot weather conditions in the country, especially during the summer. People flock to the mall to shop, eat and spend time with family and friends. Saudi Arabia has around 2.4 million m² of retail space with approximately 4 million m² expected to be added with the launch of the country's six new economic cities.

Real estate boom supporting the retail sector through the construction of shopping malls

Consumer dynamics

Saudi consumers, especially the younger generation, are becoming more and more brand conscious, as they are increasingly adopting a western lifestyle and are influenced by global media through satellite television. This is evident in the increase of franchised fashion retail sales as a percentage of total clothing retail sales. Moreover, brand awareness and increased westernization is being witnessed across all segments of the Saudi society. In the case of Saudi women, who represent more than 50% of the market, they are very fashion conscious, are constantly in search for the latest fashion trends, and possess a high degree of brand awareness. Moreover, structural and demographic changes, which have been taking place in Saudi Arabia in recent years, are suggesting a higher penetration of fashion brands within the male community, going forward. Childrens' wear is also a very important and growing segment, constituting around 15% of the total market. As such, the Saudi consumer, similar to other consumers elsewhere in the world, is embracing the new face of retail, which is lean retailing. In the lean retailing concept, which is adopted by most of Al Hokair's brands, the goods and accessories are constantly replenished and displays are altered several times within a single season. Consumers are now demanding clothing that is trendy, fashionable, and inexpensive. Al Hokair's brands are capable of satisfying those market needs.

Consumers are becoming more and more brand conscious

Saudi women represent more than 50% of the market

Competition

Al Hokair is the biggest fashion retailer in Saudi Arabia with a 50% share of the franchised fashion market. The remaining 50% of the market is divided amongst several other players with lower market shares. Other major players include Al Shaya, Al Sawany, Al Jedaie and Landmark. While the market is competitive, we expect Al Hokair will remain the single largest player in the market, at least in the medium term. Al Hokair's dominant market share is mainly the result of the company's early venture into the business, in addition to its success in spotting the most appealing, suitable and successful international brands. Thus, competition in the field is mainly over the franchise agreements for the popular brands. Eventually, success is based on companies' ability to acquire new brands that appeal to the consumers and maintain the partnerships with their existing brands. Today's fast-moving fashion industry has made this a continuous process, as new brands are born, while others fade. In the case of Al Hokair, the company enjoys a remarkable track record, having consistently been able to spot and contract with the top brands. This is largely facilitated by the Al Hokair group's growing real estate business, as the larger group provides the retail segment with prime retail locations in its shopping malls situated in the country's major commercial cities.

Al Hokair is Saudi Arabia's biggest fashion retailer with a 50% market share...

... supported by the larger group's real estate segment

Figure 13 | Other major players in the Saudi franchised fashion retail market

Model	Major Brands
Al Shaya	H&M - Next
Al Sawany	Guess
Al Jedaie	Mango

Source: Zawya

Threats to Al Hokair's position

To date, local franchisors have been thriving on the restrictions imposed on foreign investors' ability to invest directly in Saudi Arabia. As we noted earlier, foreign investors are required to partner with a local agent or business in order to penetrate the Saudi market. If the current laws were to change, the foreign companies (owners of brands) might consider starting up their own operations directly, instead of operating through franchise agreements. We, however, believe that if this scenario would occur, the impact on Al Hokair and the other local players, is unlikely to be adverse, as these companies already have the infrastructure and operations in place, in addition to the local market know-how, which makes it unlikely that foreign companies would terminate their contracts and operate independently although it is possible that foreign partners would want to renegotiate the terms of the agreements to increase their returns. However, we do not think the restrictions are likely to be abolished, at least in the medium term.

Removal of restrictions imposed on foreign investment would pose a threat to Al Hokair...

... however, we do not expect regulatory changes at least in the medium term

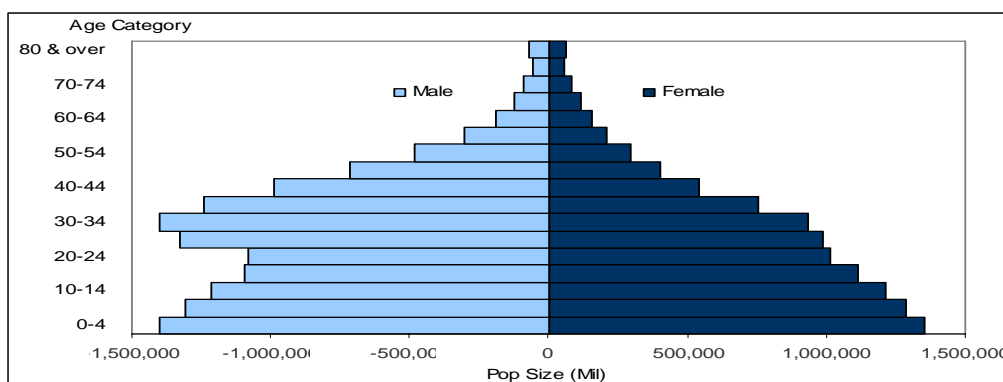
Demand drivers

High population growth rates with young demographic structure

Saudi Arabia's population has been the fastest growing in the MENA region, growing at an average annual growth rate of 2.5% over the past 10 years to reach 23.7 million as at 2006. The growth in the population is fuelled by both high birth rates and the influx of immigrant workers, attracted by a booming economy. Of the total population, around 27% are expatriates, the majority of which are males. This has had an impact on the country's gender structure, as depicted by the figure below, especially on the working age population, which is skewed towards males. The population is also a young one, with more than 50% of the population below the age of 25. Thus, the size of the population and its growth rate, together with its young demographic structure, makes it a lucrative market for consumer products in general, and an ideal one for the local fashion retail industry specifically.

Saudi Arabia's population has been the fastest growing in the MENA region

Figure 14 | Saudi Arabia's population



Source: Central Department of Statistics and Information, Ministry of Economy and Planning

Higher disposable income

The Saudi economy has been booming in recent years, mainly as a result of higher oil prices, which has spurred other sectors of the economy, including the real estate sector. The effects of the boom have trickled down to consumers, albeit with higher inflation, who are enjoying higher disposable incomes, as illustrated by figure 12. We expect the economy to continue its strong performance throughout our forecast period, even if oil price increases slow down.

A booming economy due to higher oil prices has resulted in higher disposable incomes

Figure 15 | Nominal GDP per capita (SAR)

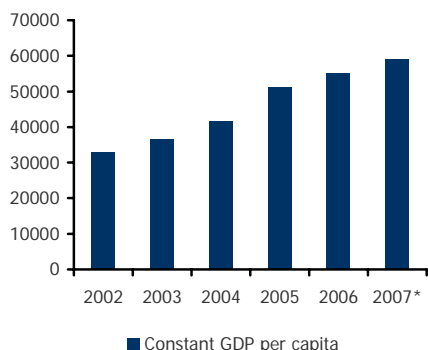
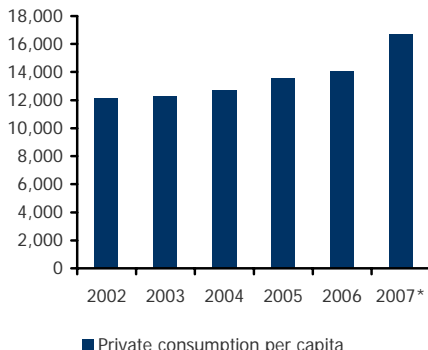


Figure 16 | private consumption per capita (SAR)



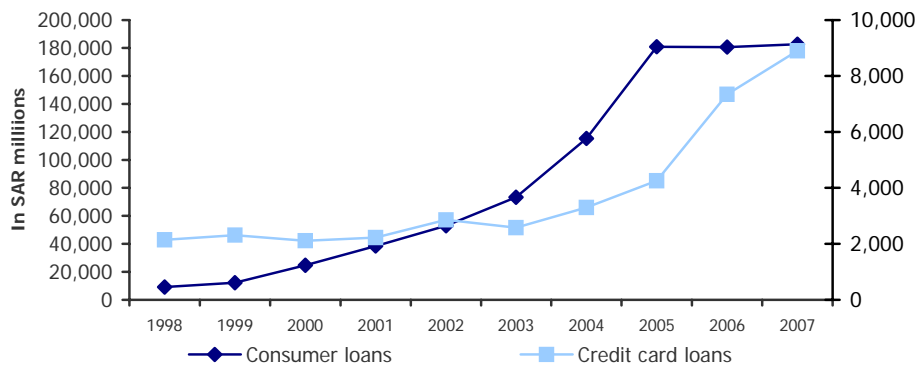
Source: SAMA
*Provisional

Consumer loans

Consumer loans grew by a CAGR of 39.9% over the period from 1998 until 2007 to reach SAR182.6 billion in 2007, while credit card loans grew by a CAGR of 17.1% over the same period to reach SAR8.9 billion. The growth in consumer loans decelerated in 2006, however, as a result of a directive issued by the Saudi Arabian Monetary Agency (SAMA) limiting the amount of loans granted to consumers to one third of their net monthly salary, in addition to setting the maturity of credit to a maximum period of five years. While we believe this would have an adverse effect on retail sales in the short run, we believe in the medium and long term, consumers would be able to adjust to the new regulations and prioritize their spending on necessities, including clothing, rather than borrow to invest in the stock market as was the case previously.

SAMA directive to limit consumer loans growth...

Figure 17 | Consumer loans and Credit card loans



Source: SAMA

Appendix I- Al Hokair's Operations

As explained earlier in the report, and although we are only focusing on the listed fashion retail entity, we believe it is important to put into perspective the full operations of the larger Fawaz Al Hokair group. These operations can be broadly dissected into three distinct segments:

1) Retail

a. Fashion retail

The fashion retail division was the group's primary business undertaking, where Al Hokair inaugurated two menswear stores in 1980. Today, the group holds exclusive rights to 44 international brands, including among others *Zara*, *Massimo Dutti*, *Promod*, *La Senza*, *Adams* and *Gap*, and operates 682 stores across Saudi Arabia. Products offered include clothes, shoes, bags, accessories and home furniture. In 2006, the group offered 30% of the fashion division's shares to the public. Accordingly, the fashion retail division is trading under the name of "Al Hokair" in Saudi Arabia's local stock market. It is important therefore, to note that the traded shares reflect only the operations of the fashion retail division and not the overall group. In the FY06/07, the division's sales grew by 14.5% to reach SAR1.5 billion (US\$0.4 billion), representing around 30% of the group's total revenues, while in FY07/08 revenues grew by 6.9% to SAR1.6 billion (US\$0.4 billion). It should also be noted that Al Hokair has fashion retail operations in several countries in the region, including Egypt, Lebanon and the UAE. However, these operations are currently not under the umbrella of the listed fashion retail segment.

b. Food and Entertainment

The group ventured into the food and entertainment business in 2005 to cater for the growing demand for good quality casual dining experience by Saudi Arabia's young population, who are adopting a more western lifestyle. Currently, the division has 9 franchises under management with 5 more under development, and operates 120 outlets, which serve more than 300,000 customers per month. Major brands in the division include *Cinnabon*, *Carvel*, *Seattle's Best Coffee* and *Tony Roma's*. The group plans to launch more than 400 food outlets over the next 5 years.

c. Large format retail

Al Hokair owns and operates several successful hypermarkets and mega stores through 3 franchises, *Gèant*, *Biggest & Best* and *Kika*, which was introduced in 2007. These giant stores offer customers a unique shopping experience with a wide selection of products under one roof.

-*GEANT* is a French hypermarket chain employing 2,000 employees, serving 10,000 customers per store per day and currently operates 8 branches across Saudi Arabia, with 10 additional stores planned.

-*Biggest & Best* is a multi-brand specialist electronics and home appliances mega store. Launched in 2006, the group currently operates 4 stores in Riyadh with a gross leasable area of 20,000 square meters, with 7 new stores expected to be opened across the country.

-*KIKA* is Austria's largest home specialty store. The group currently operates one store with an area of 30,000 square meters. 2 more stores are planned in the kingdom in 2008, while one store is scheduled to be opened in Dubai by 2010.

2) Real estate

The real estate segment consists of four subdivisions, operating mainly in the design, construction, ownership and management of large shopping malls and hotels. In fact, Al Hokair is the single largest owner and operator of shopping malls in Saudi Arabia. The group expects the assets of the segment to reach around to SAR50 billion (US\$13.3 billion) in the next 5 years. The significance of

the real estate division arises from the fact that it supplements the retail segment, of which the fashion retail division is a part. Basically, the real estate subsidiary offers a competitive advantage to the retail segment relative to competitors by providing retail space in prime locations. The four subdivisions under the real estate segment are:

a. Arabian Centres

Arabian Centres is the mall management arm of the real estate business, operating a network of 12 comprehensive malls in prime locations across the kingdom, housing more than 1,100 stores over an area of almost 1 million square meters and a gross leasable area in excess of 700,000 square meters, which is roughly 30% of the total mall gross leasable area in Saudi Arabia. Moreover, the group is adopting an aggressive expansion plan to establish 4 new malls in the next 5 years, and expand into Egypt and Jordan. Existing malls include *Salam Plaza*, *Mall of Dhahran*, *Khurais Plaza*, *Nakheel Plaza* and *Aziz Plaza*.

b. FAS Construction

FAS Construction was established in 1997 to meet the company's growing construction requirements. The success of the division prompted the group to spin it off from the parent company. The division is involved in building shopping malls, hotels, hospitals and residential compounds.

c. ECHO Design Consultants

This division is the group's architectural team, master planners and design specialists. While the initial focus was mainly directed towards designing shopping malls, the division expanded to include mixed use communities, business parks, residential compounds, hospitals and hotels.

d. Hotels

The hotels division was created in 2006 to hold luxury hotels. The division established a partnership with *Marriot International* to develop 4 luxury hotels and 1 executive apartment property. Additionally, the division has partnerships with the *Sheraton* and more recently the *Ritz Carlton*, with which it has signed an agreement in 2007.

3) Emerging Business

The success of the group in the retail and real estate businesses encouraged it to venture into new business opportunities. Emerging businesses encompass the following diverse businesses: Contracting; Financial services; Fitness & Leisure; Telecom; Automotive; Health Care.

Appendix II- Financial Statements Summary

Income Statement

All figures in SAR 000*	2007A	2008A	2009E	2010F	2011F	2012F
Revenues	1,481,305	1,583,957	1,872,000	2,138,940	2,403,967	2,676,463
COGS	-827,624	-908,970	-1,075,511	-1,222,704	-1,365,261	-1,504,654
Gross Profit	653,681	674,987	796,489	916,236	1,038,706	1,171,809
General & Administrative Expenses	-36,084	-42,414	-51,480	-58,821	-64,907	-72,264
Marketing and selling Expenses	-331,005	-378,300	-441,792	-498,373	-552,912	-615,586
EBITDA	286,592	254,274	303,218	359,043	420,887	483,958
Depreciation and Amortization	-41,529	-46,703	-50,108	-55,233	-60,894	-67,150
EBIT	245,063	207,571	253,110	303,810	359,993	416,808
Net Interest Expense	-1,260	-7,196	-7,770	-6,153	-8,792	-6,699
Other revenues	14,810	12,898	14,040	16,042	18,030	20,073
Profit Before Zakat	258,613	213,273	259,380	313,699	369,230	430,183
Zakat	-11,341	-11,870	-14,436	-17,460	-20,550	-23,943
Net Income after taxes and minority interest	247,272	201,403	244,943	296,240	348,680	406,240

Source: Al Hokair published financials, BMG estimates

*Fiscal year Ending March 31st

Balance Sheet

All figures in SAR 000*	2007A	2008A	2009E	2010F	2011F	2012F
Cash and cash equivalents	95,853	27,566	32,617	37,081	41,404	45,631
Net receivables	12,195	4,000	4,727	5,402	6,071	6,759
Inventories	281,973	353,259	417,983	475,187	530,590	584,763
Other current assets	200,406	284,251	312,881	339,109	357,616	380,290
Total current assets	590,427	669,075	768,208	856,778	935,680	1,017,443
Gross Plant & Equipment	256,655	379,287	437,570	495,795	583,020	661,423
Total assets	962,563	1,233,350	1,403,418	1,564,216	1,811,175	2,019,501
Bank overdrafts	0	101,612	109,711	86,875	124,149	94,591
Current Portion of Long-term Debt	0	0	0	0	0	0
Other Current Liabilities	171,187	203,730	239,422	271,048	302,085	332,849
Total current liabilities	171,187	305,342	349,133	357,923	426,235	427,441
End of service indemnities	17,289	22,520	26,324	30,212	34,520	38,520
Shareholders' Equity	774,087	905,489	1,027,960	1,176,080	1,350,420	1,553,540
Total Liab. and Equity	962,563	1,233,350	1,403,418	1,564,216	1,811,175	2,019,501

Source: Al Hokair published financials, BMG estimates

*Fiscal year Ending March 31st

Cash Flow Summary

All figures in SAR 000*	2007A	2008A	2009E	2010F	2011F	2012F
Cash flow from operations	154,851	119,514	237,631	296,295	357,755	418,374
Cash flow from investment	-91,718	-224,131	-121,043	-127,461	-228,951	-193,713
Cash flow from financing	2,629	406,843	11,903	-18,948	41,582	-25,558

Source: AI Hokair published financials, BMG estimates

*Fiscal year Ending March 31st

Financial Ratios

	2007A	2008A	2009E	2010F	2011F	2012F
Profitability						
Gross Profit Margin	44.1%	42.6%	42.5%	42.8%	43.2%	43.8%
EBITDA margin	19.3%	16.1%	16.2%	16.8%	17.5%	18.1%
Net Profit Margin	16.7%	12.7%	13.1%	13.8%	14.5%	15.2%
ROA	25.7%	16.3%	17.5%	18.9%	19.3%	20.1%
Return on Sales	16.7%	12.7%	13.1%	13.8%	14.5%	15.2%
Coverage						
EBITDA Interest Coverage	227.4x	35.3x	39.0x	58.4x	47.9x	72.2x
Leverage						
Total Debt/EBITDA	0.0x	0.4x	0.4x	0.2x	0.3x	0.2x
Total Debt/Equity	0.0x	0.1x	0.1x	0.1x	0.1x	0.1x

Source: AI Hokair published financials, BMG estimates

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