KAMCO INVEST

Investment Strategy & Research

Aramex

Equity Research Update | **Sector - Transportation**

Front runner in a game of scale

Market share priority increases as Covid-19 disruption alters growth drivers

We cut our group EPS forecasts for Aramex (ARMX) by 42% and 30% respectively for 2020E and 2021E, reflecting the impact of Covid-19, and the change in growth drivers for the company. We expect the Domestic Express segment to drive ARMX's market share and scale ambitions over 2020E-2022E, while replacing International Express as the core engine of growth for the company, and contributing to +78% of the incremental growth in group revenues over the period. However, we highlight that the industry has become less differentiated in their service offering, leading to price competition in favor of incremental market share gains. Nevertheless, ARMX remains one of the best listed plays in the GCC on the growing e-commerce market, with dominant market share, revenue recovery visibility, and healthy ROCEs going into 2021, leading us to retain our Outperform rating.

Domestic Express segment to emerge as ARMX's new scale champion

The Domestic Express segment benefitted from Covid-19 related lockdowns in its core markets, as e-tailing volumes soared, mainly from grocery and pharma product lines. Further strategic partnerships with government entities and large hypermarkets to support the delivery of goods and essential supplies will aid business volumes going forward. ARMX's digital transformation initiatives prior to the onset of Covid-19, like Aramex Fleet – the crowdsourcing model, and Aramex Spot – its pickup dropoff (PUDO) service for adhering to higher scale, and solving last mile peak demand challenges will also see demand. As a result, we forecast the segment to grow by 10% y-o-y growth to AED 1.22 Bn in 2020E, and a 6% y-o-y growth thereafter to AED 1.29 Bn in 2021E.

Commoditized industry adds pricing pressure; balance sheet flexibility helps

From 2019 onwards, revenue growth for ARMX's segments were achieved by a growth in volumes, which came at the cost of lower revenue-per-shipment, as industry offering became competitive, and more commoditized. This trend of attaining higher volumes on aggressive pricing terms will continue in our view as more VC backed industry competitors enter to capture market share. As a result, we forecast GP-EBIT conversion to trend lower by 150bps from 2019-2020E and contribute to lower net profit margins. Although, there are no balance sheet or working capital concerns so far, we believe related metrics such as the company's higher receivables days, working capital intensity (%) etc. have room for improvement when compared to industry leading peers.

Valuation & Risks – TP of AED 4.15/share, upside of 20.9%

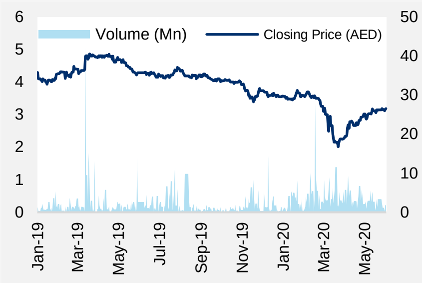
Our revised TP of AED 4.15/share is based on a blend of DCF and fully normalized FY-21 EV/EBIT valuation. *Key Downside risks:* 1) Covid-19 continuing to impact global economic & trade recovery, along with shipment growth 2) Higher price competition from pursuing market share gains limiting revenue growth 3) Rise of further restrictions from border security and increasing customs duty in the region 4) Trade protectionism and conflict escalation 5) FX related risks

Key Financials	2018	2019	2020E	2021E	2022E
Revenue (AED Mn)	5,086	5,246	5,034	5,411	5,579
GP Margins (%)	54.5%	53.0%	52.7%	52.4%	52.0%
EBITDA (AED Mn)	831	1,012	858	998	1,029
EPS (AED)	0.34	0.34	0.24	0.32	0.33
Consensus EPS (AED)	-	-	0.23	0.26	0.29
PE (x)	10.2	10.1	14.1	10.6	10.5
EV/EBITDA (x)	5.7	5.6	5.7	5.7	5.4
Div. yield (%)	4.1%	4.4%	4.4%	4.7%	5.0%

Sources: Kamco Invest Research, and Aramex

Outperform

CMP 07-Jun-20:	**AED 3.43**
Target Price:	**AED 4.15**
Upside/Downside:	**+20.9%**



Price Perf.	1M	3M	12M
Absolute	13.2%	14.3%	-19.9%
Relative	2.8%	27.6%	-1.3%

Stock Data	
Bloomberg Ticker	ARMX DB
Reuters Ticker	ARMX.DU
Last Price (AED)	3.43
MCap (AED Mn)	5,022
MCap (USD Mn)	1,368
EV (AED Mn)	5,167
Stock Perfromance - YTD (%)	-10.9%
PE - 2020E (x)	14.1
EV/EBITDA - 2020E (x)	5.7
Dividend yield - 2020E (%)	4.4%
52-Week Range (AED)	2.01 / 4.45

Sources: KAMCO Invest Research & Bloomberg

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Valuation and Risks

Target price cut to AED 4.15/share; Maintain 'Outperform'

We reworked our forecasts post attending ARMX's detailed Covid-19 analyst update call and Q1-20 earnings conference call. We cut our group EPS forecasts of ARMX by around 42% and 30% respectively for 2020E and 2021E, reflecting the impact of Covid-19 on business segments, changing demand environment, and the transformation of the Domestic Express segment replacing International Express as the core engine of growth. Our revised TP of AED 4.15/share is based on a blend of DCF and fully normalized FY-21 EV/EBIT valuation. We maintain our Outperform rating on the stock as ARMX remains one of the best listed plays in the GCC on the growing e-commerce market, with dominant market share, revenue recovery visibility and healthy ROCEs going into 2021.

Weighted Average Fair Value

	Fair value per share (AED)	Weight (%)	Weighted Value (AED)
DCF	4.00	70%	2.80
FY-21 EV/EBIT	4.50	30%	1.35
Weighted Average Fair Value per Share			**4.15**
Current market price			3.43
Upside/Downside			***20.9%***

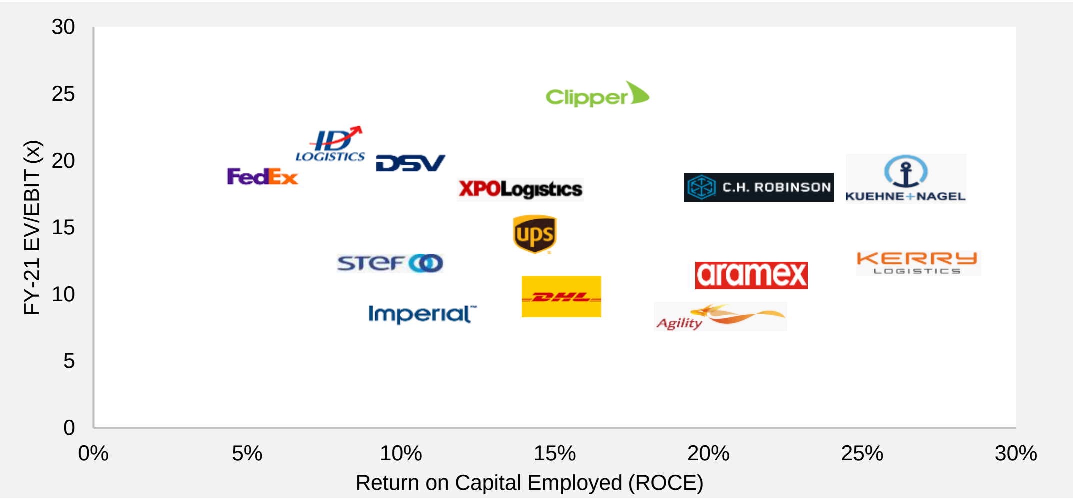
Sources: Kamco Invest Research and Bloomberg

In our DCF valuation, we have assumed a terminal growth rate of 2.0%, and average WACC of 9.1% over our forecast period, which we believe adequately represents the sustainable long-term growth rate for the company, given the nature of technological advancement and disruption in the sector. We also model the impact of IFRS-16 'Leases on all operational metrics for our financial forecasts. For the terminal value, we have assumed a return on new investment capital (RONIC) that is comparable to the terminal year WACC.

ARMX undervalued vs. global logistics peers

At current levels, we believe ARMX looks attractive when compared to its major international peers. The company is able to churn out one of the highest ROCEs in the industry at over 20%+, despite the company pursuing higher scale. We feel this is not fully reflected in the current market price of ARMX stock.

Aramex global logistics peers on FY-21 EV/EBIT (x) and ROCE (%)



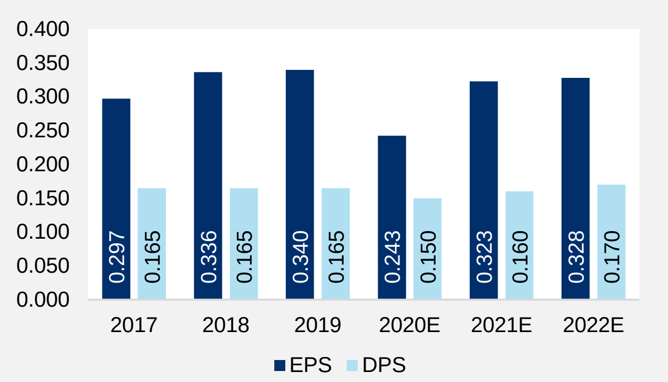
Source: Kamco Invest Research, Bloomberg, Company Financials

Also, our valuation based on full potential FY-21 EV/EBIT derives a price of AED 4.50/share based on a multiple of 10x, which is conservative in our view when compared with industry peers, but more in line with historical trends. There is an overhang in terms of the lower foreign ownership (FOL) limit allowed in the stock for international investors (49%), which if lifted could see more EM funds looking to take positions in the stock, in our view.

ARMX share price recovery ahead of broader market

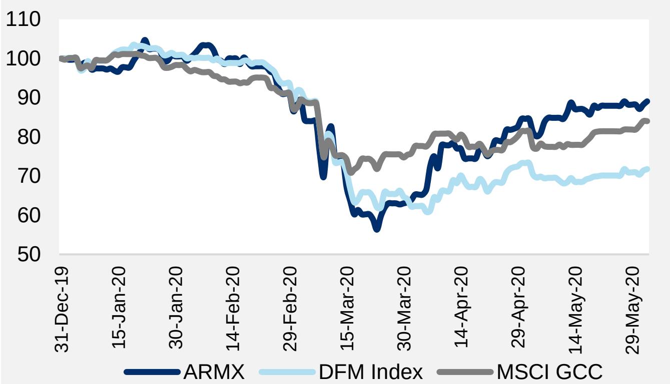
Although ARMX fell more in comparison to the broader market during mid Mar-2020, the recovery has been stronger as well. ARMX gained 58% from its lows as compared the DFM index (+18%) and the MSCI GCC index (+18.5%) which tracks the more liquid stocks in the region. We expect the stock to continue to recover faster than the broader market going forward.

ARMX EPS & DPS – AED/share



Source: Kamco Invest Research, Aramex

ARMX vs. DFM & MSCI GCC indices



Source: Kamco Invest Research, Bloomberg

In the backdrop of some corporates cancelling 2019 dividend payouts, ARMX still paid out their full proposed dividends (AED 0.165/share), which reflects the strength of the company's business and the outlook for the company. We forecast ARMX to pay dividends of AED 0.150/share and AED 0.160/share for 2020E and 2021E representing dividend yields of 4.4% and 4.7% respectively on current market prices.

Downside risks to our rating & forecasts include:

- Covid-19 continuing to impact global economic recovery, trade and global shipment growth
- Protection and trade conflict escalation leading to higher tariffs
- Lower revenue growth for ARMX, from higher price competition for services that are not fully compensated by a pick-up in volumes
- Rise of further restrictions from border security and increasing customs duty in the region
- Sustained lower consumer confidence, leading to lower than expected B2C volumes
- FX related risks

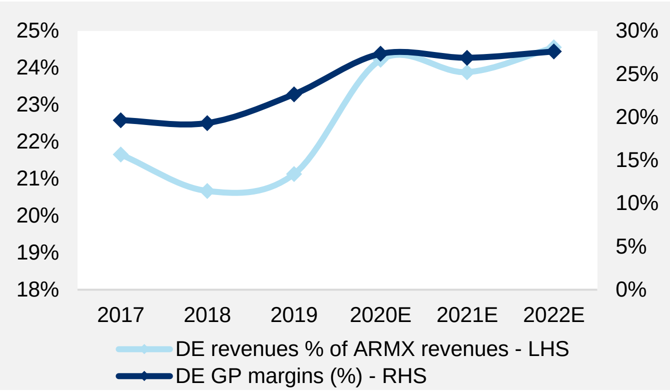
Investment Thesis

Domestic Express to replace International Express as core growth driver

Onset of Covid-19 affects International Express: International Express historically was the main driver of both growth and margins for ARMX, as segment revenues grew at around +14% CAGR over 2014-2019, and contributed to over 70% of group revenue growth at margins of +65% over the period. Although revenue growth in 2019 was lower mainly due to pricing pressure from competition, prior to the onset of Covid-19, international cross-border ecommerce into the GCC continued to grow in high double digits in percentage terms. The onset of Covid-19 however brought significant challenges, starting with business from China (from where high shipment volumes originated historically) witnessing a complete lockdown, causing volumes to drop by around 40% in Q1-20. Volumes dropped thereafter in Europe and UK from the impact of Covid-19, while aggregators such as Amazon in the US temporarily stopped international shipments to cater to domestic business. Moreover, line-haul costs jumped significantly from pre-Covid-19 costs of USD 1-1.5/kg reaching USD 6-9/kg, making it unviable to do business, which along with a surcharge introduced dampened demand volumes, as per the management. Although, with the steady opening of economies, these challenges will alleviate, we do not see full potential volumes recovering until 2021, and forecast the International Express segment revenues to decline by 10% y-o-y in 2020 to AED 2.11 Bn (2019: AED 2.35 Bn). Our model now incorporates a revenue recovery to AED 2.37 Bn in 2021, driven by higher volume growth from a lower base in 2020, and as the impact of Covid-19 recedes.

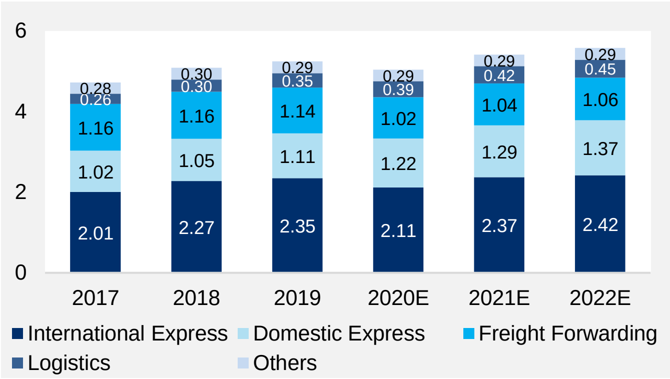
(Our detailed ARMX segment drivers rationale, revenue and financial forecasts for 2020E and 2021E are on page 7).

Domestic Express revenues & margins (%)



Source: Kamco Invest Research, Aramex

ARMX group revenue mix (AED Bn)

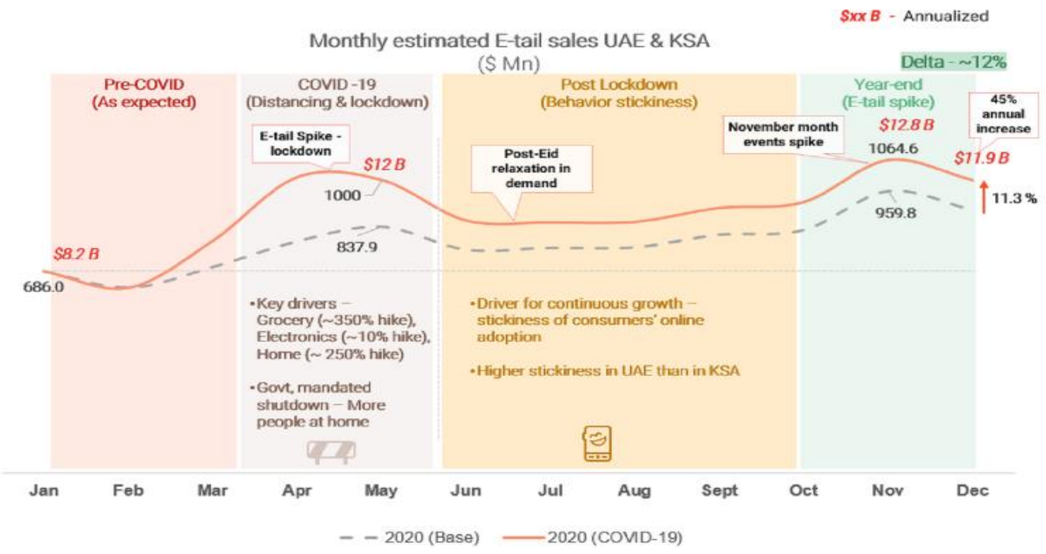


Source: Kamco Invest Research, Aramex

Domestic Express picks up from Grocery and Pharma e-tailing: The Domestic Express segment benefitted on the other hand from Covid-19 related lockdowns in its core markets in the GCC and the region, which led e-tailing volumes to soar, mainly from deliveries related to grocery and pharma product lines. As per RedSeer Management Consulting, during the lockdown e-tailing in the larger markets of UAE and Saudi Arabia grew by ~20% in volumes and ~40% in value, resulting in an annualized gross merchandise (GMV) of GMV of USD 11 Bn. They mentioned that the e-grocery product line witnessed the biggest spike of +500% due to panic buying and increased cooking at home, leading its category share in e-tail GMV to jump from 6% during pre-lockdown to +25% post lockdown.

The aforementioned trends led Domestic Express revenues in Q1-20 to grow by 12.6% y-o-y to reach AED 288.99 Mn from AED 256.65 Mn in Q1-19. In their Covid-19 business update call, the management mentioned that they were able to deliver 15%-30% of the total e-tailing shipments from hypermarkets in the UAE. We forecast the aforementioned new drivers of growth for the segment to contribute to a 10% y-o-y growth to AED 1.22 Bn in 2020E, and a 6% y-o-y growth thereafter to AED 1.29 Bn in 2021E. Some of the other important signings of the segment came from Dubai's Department of Economic Development (DED), as they coordinated a strategic collaboration between Dubai Taxi Corporation (DTX), Aramex, and Carrefour, which is operated by Majid Al Futtaim in the UAE, to support the delivery of goods and essential supplies. Further, the segment should aid from ARMX's digital transformation initiatives prior to the onset of Covid-19, like Aramex Fleet – the crowdsourcing model and Aramex Spot – its pickup dropoff (PUDO) service for adhering to higher scale and solving last mile challenges, especially around peak periods.

E-tailing GMV to be 11% higher in UAE & KSA combined in 2020



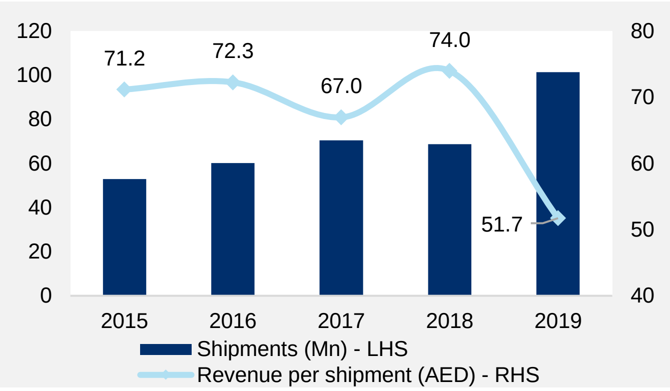
Source: RedSeer IP

International-to-domestic express growth transformation expedited: The transformation of the growth of express revenues from international shipments towards more domestic-led was imminent in our view in the medium term, due to two reasons: 1) Prior to the onset of Covid-19, e-tailing contribution to total retail sales was only around 3.5%-4% and was largely from electronics, fashion and beauty product lines, with e-grocery and pharma lagging behind significantly. The impact of Covid-19 drove multifold increases in the latter product lines, and is expected to continue driving higher volumes and revenues for the segment. 2) Corporates continue to setup have backup fulfillment centers which can fulfil locally, regionally and will certainly reduce delivery times, as against cross-border delivery. We expect ARMX's Domestic Express segment to drive its market share and scale ambitions over 2019-2022E and expect the segment to become the core engine of growth for ARMX, and contribute +78% of the growth in group revenues over the period.

Commoditized industry drives fierce competition and lower pricing

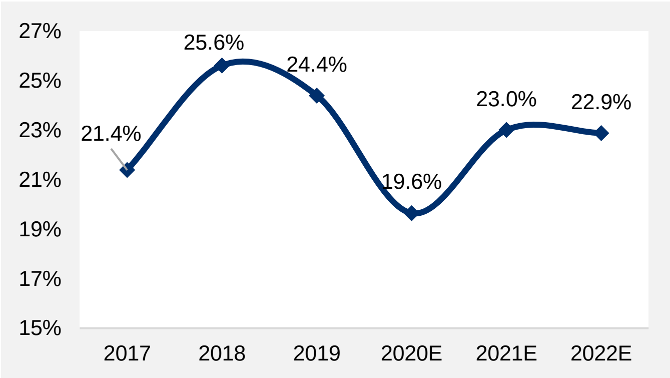
Revenue growth for ARMX's segments were mainly derived by a growth in volumes. However, this growth in volumes was achieved by lowering achieved pricing, as industry offering became less differentiated and more commoditized.

ARMX shipments & average revenue per shipment



Source: Kamco Invest Research, Aramex

ARMX group GP-EBIT conversion (%)



Source: Kamco Invest Research, Aramex

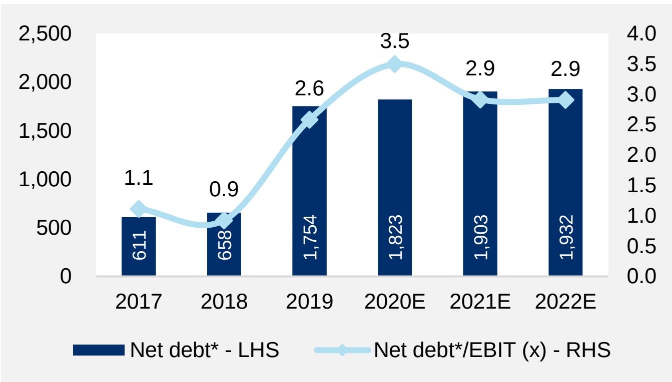
This is evident from average revenue per shipment derived by ARMX. The total number of shipments increased over 47% y-o-y from 2018 to 2019 to reach 101.4 Mn shipments, while on a per shipment basis, average revenues dropped 30% y-o-y over the same period to AED 51.7 per shipment. We expect this trend of attaining higher volumes at the cost of lower pricing to continue going forward in the industry, typical of an industry where competitive advantages are lower, and more related to scale as industry competitors look to capture market share. We expect this trend to continue for all of ARMX's express segments in particular, as barriers to entry remain low, allowing VC funded startups to foray into the express delivery market by providing their delivery services on competitive pricing terms. Nevertheless, we believe Aramex is well positioned, as attaining scale and realizing market share gains become more important for industry players given high fixed costs in setting up business. Also, the migration to more e-comm related transactions, should aid ARMX disproportionately given strong track record for ramping up scale, strategic tie-ups and brand equity.

Lower GP-EBIT conversion (%): Although we believe ARMX is well positioned to gain market share in the growing e-comm driven market, we forecast lower group margins over the medium term, due to a number of reasons. Firstly, the migration of growth towards the Domestic Express business would drive lower margins as revenue-per-shipment is higher for International Express, while the contribution to group gross profit mix alters towards lower margin domestic business. The management also guided that, for the Freight forwarding segment, ARMX's GP margins (Q1-20: +28%) are significantly higher than the industry average of 17%-18%, and in order to attract more volumes, they would need to bring down price more aggressively. As a result, we forecast GP-EBIT conversion to trend lower by over 150bps from 2019-2020E and contribute to lower net profit margins. We forecast average EBIT margins of 11.4% over the aforementioned period and think this is more than par for the course, given the company's ambitions to attain dominant market share in its core markets.

Balance sheet and working capital flexibility needed in new paradigm

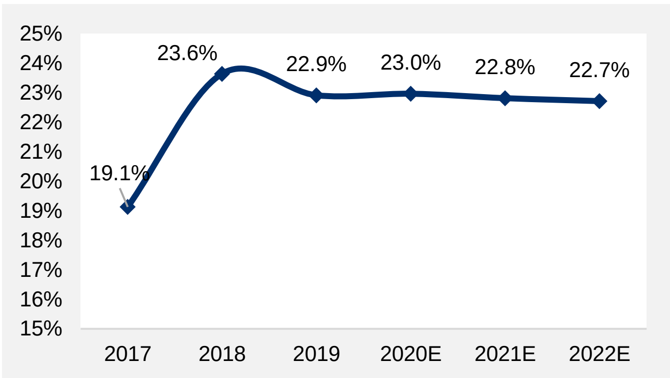
We do not foresee any challenges from the balance sheet side for ARMX, but we do see scope for improvement. Our model now incorporates the impact of IFRS-16 'Leases, and its impact on gross debt to equity ratios. The management however guided that ARMX continues to comply with the terms of the major borrowing facilities and their embedded covenants.

ARMX net debt (AED Mn) & net debt-to-EBIT (x)



*Source: Kamco Invest Research, Aramex, * net debt from 2019 onwards includes IFRS-16 impact of lease liabilities*

ARMX working capital intensity (%)



Source: Kamco Invest Research, Aramex

Improving working capital management tougher when trying to attain scale: ARMX historically has lagged behind international industry peers on tighter working capital management, as working capital intensity for the company remains elevated above +22% (2019), while the industry average for other market leaders is in-mid single digits percentages. We believe this ties in with their efforts to attain scale, by providing clients with more relaxed terms for collection of receivables and also due to the business environment in ARMX's core markets. The management also mentioned that they are keenly monitoring their 12-month expected credit loss (ECL) breaching acceptable limits across segments, which is assuring in our view. Although there is room for improvement, and there is the additional challenge of managing working capital while scaling up, we remain confident on ARMX's management track record and capabilities in managing working capital effectively.

Aramex Financial Forecasts

Full potential 2021E now in focus

Our detailed financial forecasts for 2020E and 2021E factor in the loss of revenues from the impact of Covid-19 in 2020E, our expectations of a return to full potential business environment in 2021E, and the changing dynamics of Domestic Express segment emerging as the new engine growth for ARMX's core markets.

Kamco Invest Research's ARMX group & segmental revenue forecasts

Segment Revenues (AED Mn)	2019	2020E	Y-o-Y (%)	2021E	Y-o-Y (%)	Kamco Invest Research Forecasts Rationale
International Express (IE)	2,349	2,114	*-10.0%*	2,368	*+12.0%*	*Higher line haul costs, along with lower demand from consumers following additional surcharges, and specific product line preferences during Covid-19 to lead to lower volumes in 2020E. Our 2021E forecasts factor in rebound in volumes, driving segment revenues to 2019 levels, but at the cost of lower pricing.*
Domestic Express (DE)	1,108	1,219	*+10.0%*	1,292	*+6.0%*	*Segment to be the new growth driver for ARMX as grocery and pharma product lines contribute to incremental growth, along with strategic tie-ups with government entities and leading hypermarkets in core markets.*
Freight Forwarding (FF)	1,138	1,024	*-10.0%*	1,040	*+1.5%*	*Slower trade, freight volumes along with restrictions from border security and customs dampens outlook for 2020E, with no meaningful recovery in 2021E. Land freight likely more stable than other forms of freight transport.*
Logistics	355	390	*10.0%*	422	*8.0%*	*Division to benefit from retailers looking to diversify their inventory storage in warehousing creating additional demand for such spaces, while temperature-controlled warehouse facilities see a spike in demand from higher strategic reserves of grocery and pharma*
Other	295	286	*-3.0%*	289	*1.0%*	*Based on previous trends*
Group Revenues	5,246	5,034	*-4.0%*	5,411	*+7.5%*	*DE and Logistics divisions picks up the slack from IE and FF to an extent in 2020E, and drives a 7.5% y-o-y growth in group revenues in 2021E.*

Source: Aramex, Kamco Invest Research

We remain ahead of consensus on most of the key financial forecasts, as we expect volumes to rebound in H2-20 driving stability for our net income and EPS estimates. We forecast ARMX DPS of AED 0.150/share for 2020E and AED 0.160/share.

2020 & 2021 Forecasts – Kamco Invest Research vs. Consensus Estimates

	2020E			2021E		
Aramex Group	**Kamco Invest**	**Consensus**	Δ (%)	**Kamco Invest**	**Consensus**	Δ (%)
Revenues (AED Mn)	5,034	4,994	*+1%*	5,411	5,355	*+1%*
GP Margins (%)	52.7%	47.4%	*+5%*	52.4%	49.2%	*+7%*
EBIT (AED Mn)	521	472	*+10%*	652	504	*+29%*
Net Income (AED Mn)	355	331	*+7%*	473	380	*+24%*
EPS (AED)	0.243	0.225	*+8%*	0.323	0.26	*+24%*
DPS (AED)	0.150	0.140	*+7%*	0.160	0.162	*-1%*

Source: Kamco Invest Research, Bloomberg, Consensus net income and EPS estimated are on adjusted basis

Aramex Financials

Balance Sheet (AED Mn)	2017	2018	2019	2020E	2021E	2022E
Assets						
Cash and cash equivalents	728	837	1,000	1,024	1,211	1,395
Receivables	934	1,141	1,196	1,149	1,234	1,273
Total current assets	1,911	2,330	2,469	2,447	2,738	2,969
Net property, plant and equipment	912	950	1,005	1,010	1,062	1,104
Goodwill	1,164	1,125	1,128	1,125	1,125	1,125
Other assets	417	300	1,141	1,174	1,238	1,308
Total assets	**4,404**	**4,704**	**5,743**	**5,756**	**6,163**	**6,506**
Liabilities						
Current Liabilities	1,050	1,394	1,349	1,224	1,281	1,289
Total debt	611	623	891	952	1,041	1,127
Other Liabilities	224	255	870	844	852	855
Total liabilities	**1,885**	**2,272**	**3,110**	**3,020**	**3,175**	**3,272**
Shareholders' Equity						
Share capital	1,464	1,464	1,464	1,464	1,464	1,464
Retained earnings	1,113	1,317	1,520	1,634	1,887	2,132
Minority Interest	19	22	15	15	15	15
Other Equity	-77	-371	-367	-377	-377	-377
Total Equity	**2,519**	**2,432**	**2,633**	**2,736**	**2,989**	**3,234**
Total liabilities and equity	**4,404**	**4,704**	**5,743**	**5,756**	**6,163**	**6,506**

Income Statement (AED Mn)	2017	2018	2019	2020E	2021E	2022E
Revenue	4,721	5,086	5,246	5,034	5,411	5,579
Cost of goods sold	(2,161)	(2,315)	(2,463)	(2,381)	(2,575)	(2,677)
Gross profit	**2,560**	**2,771**	**2,782**	**2,653**	**2,836**	**2,902**
General and administrative expenses	(1,118)	(1,057)	(801)	(944)	(977)	(999)
Other operating expenses	(781)	(888)	(974)	(856)	(866)	(879)
Other operational Income/Loss	(4.5)	4.0	4.5	4.5	4.5	4.5
EBITDA	**656**	**831**	**1,012**	**858**	**998**	**1,029**
Depreciation and amortization	(109)	(121)	(333)	(337)	(346)	(365)
EBIT	**548**	**710**	**679**	**521**	**652**	**664**
Finance costs	(24.7)	(27.6)	(83.8)	(87.6)	(92.7)	(99.4)
Interest/investment income	7.9	9.0	12.1	8.9	9.2	9.6
Other Income/Loss	6.5	-66.6	-24.5	6.0	6.3	6.4
Net profit before taxes	**537**	**624**	**583**	**449**	**575**	**581**
Provision for Income Taxes	(81)	(100)	(82)	(90)	(98)	(96)
Net profit after taxes	**456**	**524**	**501**	**359**	**477**	**485**
Minority interest	(20)	(32)	(4)	(4)	(5)	(5)
Net profit attributable to parent	**436**	**492**	**497**	**355**	**473**	**480**
EPS (AED)	**0.30**	**0.34**	**0.34**	**0.24**	**0.32**	**0.33**

Cash Flow (AED Mn)	2017	2018	2019	2020E	2021E	2022E
Net cash from operating activities	508.2	494.5	859.9	674.5	843.0	876.2
Net cash (used in) from investing activities	(183.7)	(91.3)	(673.6)	(390.3)	(446.1)	(460.1)
Net cash from (used in) financing activities	(333.2)	(310.1)	(252.0)	(260.4)	(209.4)	(232.6)
Change in cash and cash equivalents	(8.7)	93.0	(65.7)	23.8	187.4	183.5
FX and other adjustments	29.2	16.0	229.1			
Cash at the end of the year	**728**	**837**	**1,000**	**1,024**	**1,211**	**1,395**

Source : Kamco Invest Research and Aramex

Valuation & Financial Ratios

Ratios	2017	2018	2019	2020E	2021E	2022E
Profitability Ratios						
Return on Average Assets (%)	10.3%	10.8%	9.5%	6.2%	7.9%	7.6%
Return on Average Equity (%)	18.3%	20.1%	19.8%	13.3%	16.6%	15.5%
ROIC (%)	18.7%	24.2%	23.0%	15.2%	18.6%	18.0%
Margins						
Gross profit margin (%)	54.2%	54.5%	53.0%	52.7%	52.4%	52.0%
EBITDA margin (%)	13.9%	16.3%	19.3%	17.0%	18.4%	18.5%
EBIT margin (%)	11.6%	14.0%	12.9%	10.4%	12.1%	11.9%
Net profit margin (%)	9.2%	9.7%	9.5%	7.1%	8.7%	8.6%
Per Share Data and Valuation Ratios						
Earnings Per Share (AED)	0.30	0.34	0.34	0.24	0.32	0.33
Book Value Per Share (AED)	1.72	1.66	1.80	1.87	2.04	2.21
Dividend Per Share (AED)	0.16	0.17	0.17	0.15	0.16	0.17
PE (x)	11.5	10.2	10.1	14.1	10.6	10.5
EV/EBITDA (x)	7.3	5.7	5.6	5.7	5.7	5.4
PB (x)	2.0	2.1	1.9	1.8	1.7	1.6
Dividend Yield (%)	3.4%	4.1%	4.4%	4.4%	4.7%	5.0%

Source : Kamco Invest Research and Aramex

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