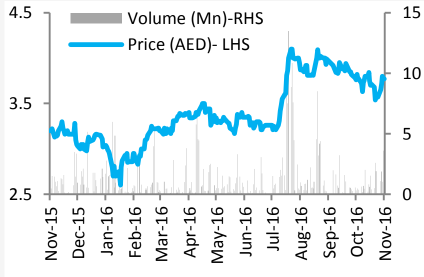
Aramex

Research Update | **Sector - Transportation**

Downgrade to "Neutral" on cloudy near term business outlook

Neutral

CMP 14-Nov-2016	AED 3.88
Target Price	AED 3.66
Upside/Downside	-5.6%



Price Perf.	1M	3M	12M
Absolute	2.9%	0.8%	20.5%
Relative	6.9%	11.0%	22.4%

Stock Data	
Bloomberg Ticker	ARMX DB
Reuters Ticker	ARMX.DU
Last Price (AED)	3.88
MCap (AED Mn)	5,681
EV (AED Mn)	5,516
Stock Performance - YTD (%)	19.3%
PE - 2016E (x)	17.8
EV/EBITDA - 2016E (x)	11.8
Dividend yield - 2016E (%)	3.6%
52-Week Range (AED)	2.60 / 4.10

Sources: KAMCO Research & Bloomberg

2017E EPS lowered by 29%, as Aramex transforms its traditional model

We cut Aramex's 2017E EPS by 29%, as we expect a structural decline in the company's Freight Forwarding business, due to sector-specific headwinds. We expect EPS growth to resume in 2018, as Express revenues pick up the slack of other segments, and the company transforms its business to more ecommerce based and B2C oriented. However, as the stock price is up 23% YTD, we prefer to remain on the sidelines, until early signs of the earnings improvement are evident from the transformation, and downgrade our rating to 'Neutral' until then.

Slowdown & margin compression from freight and B2B segments impede:

The global freight forwarding market contracted by 1.6% in 2015, as both air and sea freight volumes slowed down y-o-y for the year. Freight rates are expected to fall further and contribute to yield dilution in 2016. The medium term outlook of the freight forwarding industry is also fraught with woes related to compression of margins and dilution of yields, which should affect the Freight Forwarding segment at Aramex as well. As a result, we expect revenues of the segment to decline at a CAGR of 2.4% over 2015-2020 and forecast revenue contribution to group revenues to fall to 18% in 2020. (2015: 31%)

B2C ecommerce revenues from Express segments to drive future growth:

Global retail ecommerce sales, a key driver for B2C revenues is estimated to reach USD 1.9 trillion in 2016, growing by 23.7% y-o-y, as per eMarketer. Further, it is expected to increase to USD 4.1 trillion in 2020. The APAC region will remain the world's largest retail ecommerce market and is expected to more than double to USD 2.7 trillion by 2020. The growth in cross border ecommerce and focus on the APAC would contribute to higher Express segments revenues for Aramex and should drive a group revenue growth of over 9% CAGR from 2018 onwards until 2020. Growth from the B2C segment which contributes to over a third of Aramex's group revenues, should also grow in our view. Group gross margins should also improve from 2017 onwards and remain over 55%-57% until 2020, as the revenue mix changes in favor of higher-margin Express revenues. StarTrack would not contribute to gross margins, as the results of the JV are recognized via at-equity participation.

Valuation & Risks – TP of AED 3.66/share

Our revised target price of AED 3.66/share is based on a blend of DCF and relative valuation. The stock currently trades at 2016 EV/EBITDA of 11.8x and a 2016 PE of 17.8x, broadly in line with peer multiples. **Key Downside risks:** 1) Decline in global economic growth and trade 2) Lower consumer confidence leading to lower B2C volumes 3) FX related risks. **Upside risks:** 1) Faster ramp-up of Express revenues 2) Revival in global trade and freight forwarding industry margins.

Forecasts & Ratios	2014	2015	2016E	2017E	2018E	2019E	2020E
Revenue (AED Mn)	3,643	3,837	4,169	4,473	4,869	5,309	5,807
EBITDA (AED Mn)	461	470	523	600	678	747	812
GPM (%)	55.0%	56.5%	55.0%	55.7%	56.5%	57.1%	57.4%
PE (x)	14.5	15.8	17.8	18.7	15.8	13.6	12.2
EV/EBITDA (x)	11.0	11.2	11.8	10.5	9.2	8.1	7.4
Div. yield (%)	3.6%	4.2%	3.6%	3.5%	4.1%	4.8%	5.3%

Sources: KAMCO Research, and Aramex

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Valuation and Risks

Price target cut to AED 3.66/share; downgrade to 'Neutral' rating

Following Q3-16 results, we revisited our model and relooked at our investment case. We cut Aramex's 2016E EPS by 18% from our previous estimates (AED 0.27/share) and now expect an EPS of AED 0.22/share. We cut 2017E EPS by 29%, as we expect a structural decline in the Freight Forwarding segment's revenues over the medium term, due to sectoral headwinds. Our revised target price of AED 3.66/share is based on a blend of DCF and relative valuation.

Weighted Average Fair Value

	Fair value per share (AED)	Weight (%)	Weighted Value (AED)
DCF	3.57	75%	2.67
Relative Valuation	3.96	25%	0.99
Weighted Average Fair Value per Share			**3.66**
Current market price			3.88
Upside/Downside			***-5.6%***

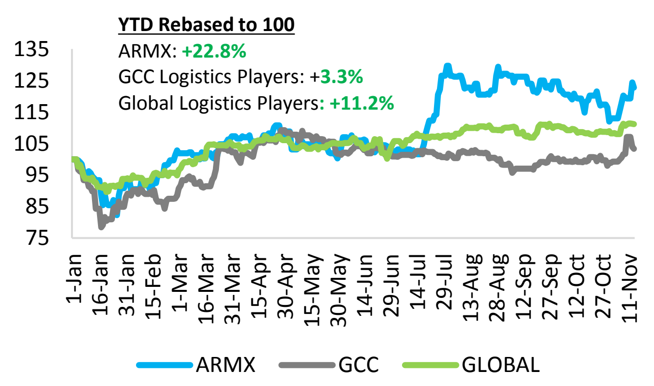
Sources: KAMCO Research and Bloomberg

We downgrade our rating on Aramex from 'Outperform' to 'Neutral', as we expect recurrent earnings in 2016 & 2017 to remain marginally lower than 2015, due to the ongoing transformation of the business, and we see limited upside in the near term from these levels. We expect EPS growth to resume in 2018, but prefer to stay neutral until early signs of the earnings improvement are evident.

Stock price run-up YTD & industry shakeup leave limited room for upside in near term…

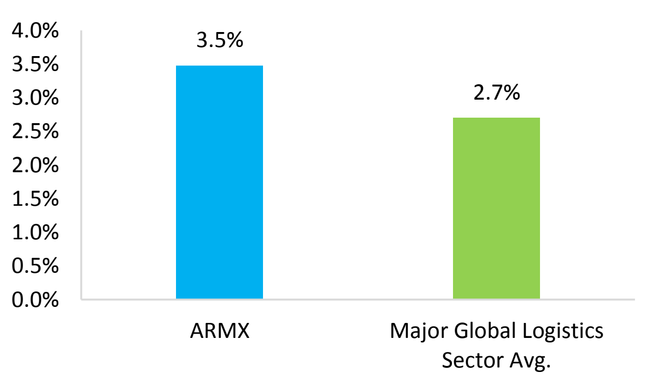
Aramex's share price has outperformed its regional and global peers in 2016 YTD. The share price is up 23% from the start of the year, while global peers gained by only 11%. Aramex's share price moved up by more than 27% from July-16 to Aug-16 due to key share transactions. The increase was due to the sale shares by co-founder Fadi Ghandour, who sold his 9.9% stake held through Levant Logistics Holdings to Cayman Islands-registered Boson Ventures Corporation, in which Mohamed Alabbar was key stakeholder. Alabbar was also a lead investor in Jaona Investment, which acquired a 6.55% stake in the company.

Aramex (ARMX) YTD stock price performance vs. peers



Sources: Bloomberg, KAMCO Research

Aramex 2017E Dividend Yield vs. Sector



Sources: Bloomberg, KAMCO Research

The share price increase along with fundamental factors affecting growth in 2016 and 2017, leave limited room for upside in the near future in our view.

…though dividend yield and future growth should provide share price support

Though the share price has appreciated substantially, Aramex still trades at a 2017E dividend yield of 3.5%, higher than its major global peers' average of 2.7%, which should provide reasonable support for its share price. Our estimates are based on management guidance of 60%-65% dividend payout annually. In addition, growth should resume from 2018 according to our estimates, and would in turn provide a re-rating in the stock, as soon as first indications of growth are visible.

Risks to our rating & forecasts include:

Key downside risks:

- Decline in global economic growth and trade
- Slower development of ecommerce in the Asia Pacific region
- Lower consumer confidence leading to lower than expected B2C volumes
- FX related risks especially pertaining to depreciation of Egyptian Pound (EGP), South African Rand (ZAR) and Australian Dollar (AUD)

Key upside risks:

- Faster than expected ramp-up of Express revenues
- Revival in global trade and freight forwarding industry margins

GLOBAL LOGISTICS SECTOR – PEER COMPARISON TABLE

Company Name	Country	MCap.	EV	EBITDA (USD Mn)			Net Profit (USD Mn)			EBITDA CAGR (%)	Net Profit CAGR (%)	P/E (x)			EV /EBITDA (x)			Dividend Yield (%)	FCF Yield (%)
		(USD Mn)	(USD mn)	TTM	2016E	2017E	TTM	2016E	2017E	2015-17	2015-17	TTM	2016E	2017E	TTM	2016E	2017E	2015	TTM
GCC																			
Agility Public Warehousing Co KSC	Kuwait	2,072	1,950	284	297	334	186	139	155	8.5%	-6.4%	11.2	14.9	13.3	6.9	6.6	5.8	5.5%	5.0%
Gulf Warehousing Co	Qatar	838	1,202	78	88	102	55	55	61	14.7%	9.6%	15.2	15.2	13.7	15.4	13.7	11.7	2.3%	9.6%
KGL Logistics Co KSCC	Kuwait	150	176	32	n.a	n.a	20	n.a	n.a	n.a	n.a	7.4	n.a	n.a	5.5	n.a	n.a	10.5%	0.2%
International																			
United Parcel Service Inc	US	99,683	109,675	10,148	10,504	10,887	5,001	5,163	5,326	5.7%	4.9%	19.9	19.3	18.7	10.8	10.4	10.1	2.7%	3.8%
FedEx Corp	US	48,817	59,610	5,919	8,526	9,133	1,843	3,210	3,559	26.5%	39.8%	26.5	15.2	13.7	10.1	7.0	6.5	0.6%	1.2%
Deutsche Post AG	Germany	37,757	42,840	5,224	5,364	5,704	2,742	2,827	2,924	12.5%	30.8%	13.8	13.4	12.9	8.2	8.0	7.5	3.0%	1.9%
Kuehne + Nagel International AG	Switzerland	15,322	14,604	1,101	1,119	1,192	710	729	778	4.9%	5.2%	21.6	21.0	19.7	13.3	13.1	12.3	4.1%	5.2%
CH Robinson Worldwide Inc	US	10,420	11,498	928	916	930	518	512	517	0.3%	0.8%	20.1	20.4	20.1	12.4	12.6	12.4	2.3%	5.4%
Yamato Holdings Co Ltd	Japan	8,850	8,384	1,055	1,105	1,148	371	399	429	9.3%	14.3%	23.9	22.2	20.6	7.9	7.6	7.3	1.1%	n.a
DSV A/S	Denmark	7,834	9,135	462	593	720	243	330	425	17.3%	17.9%	32.2	23.7	18.4	19.8	15.4	12.7	0.6%	n.a
Expeditors International of Washington Inc	US	9,138	8,099	722	723	750	435	432	449	-1.1%	-0.9%	21.0	21.2	20.4	11.2	11.2	10.8	1.5%	5.7%
Nippon Express Co Ltd	Japan	5,399	7,448	990	1,009	1,047	348	340	358	7.4%	9.8%	15.5	15.9	15.1	7.5	7.4	7.1	1.7%	n.a
Panalpina Welttransport Holding AG	Switzerland	2,932	2,551	144	165	223	68	86	129	12.8%	19.3%	43.4	34.0	22.7	17.7	15.5	11.4	2.3%	6.3%
Singapore Post Ltd	Singapore	2,277	2,720	217	161	182	157	105	121	-10.2%	-17.8%	14.5	21.7	18.8	12.5	16.9	14.9	4.8%	-0.4%
Blue Dart Express Ltd	India	1,752	1,772	59	50	58	29	30	33	-0.9%	5.0%	59.4	58.9	53.9	30.2	35.7	30.8	0.6%	1.8%
Sinotrans Ltd	Hong Kong	2,132	2,545	310	330	350	246	215	232	-0.8%	-1.1%	8.7	9.9	9.2	8.2	7.7	7.3	3.4%	n.a
Simple average										**7.1%**	**8.7%**	**22.1**	**21.8**	**19.4**	**12.8**	**12.6**	**11.2**	**2.4%**	**4.1%**
Weighted average										**11%**	**16%**	**21.1**	**18.3**	**17.2**	**10.8**	**9.9**	**9.3**	**2.2%**	**2.9%**

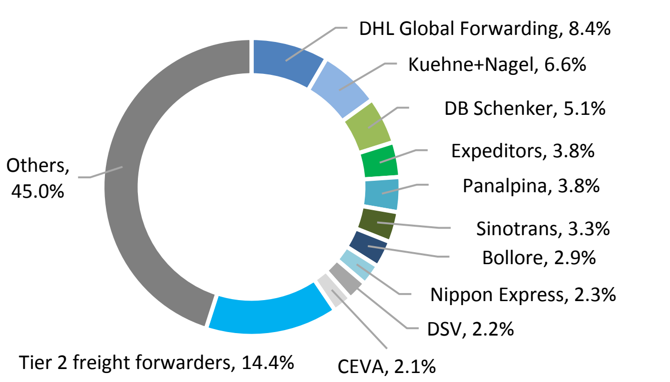
Source: Bloomberg, KAMCO Research

Investment Thesis

Pricing worries and ongoing yield compression in the global freight business

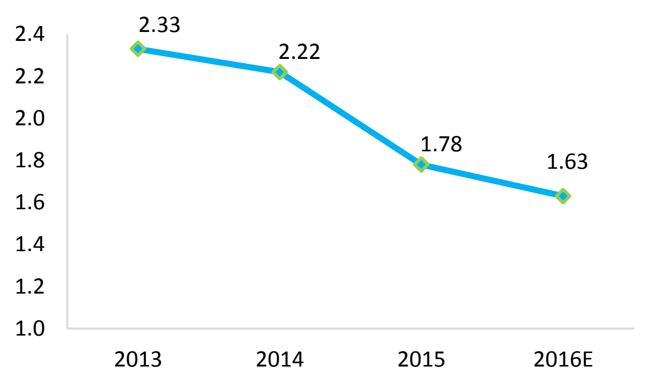
The global freight forwarding market contracted by 1.6% in nominal terms in 2015, as per Transport Intelligence (Ti) forecasts. All global metrics in both air and sea freight pointed towards a y-o-y slowdown in volume growth for the year. Trade was still dominated by intra-regional trade lanes, as it dominated 52% of the global trade, as per Ti. The impact of low global oil prices on corporate freight forwarding industry been twin edged as some companies have been able to increase their profit margin, while other have taken a significant hit to their revenue lines, as a result of declining demand for industrial projects. Focus has more been on improving profitability through cost rationalization rather than targeting growth. As a result of the rationalization, investments into technology, software and emphasis on high value contract opportunities have been keenly looked into by companies in the industry.

Global freight forwarder market share



Sources: Kewill Transport Intelligence, KAMCO Research

Air freight rate progression from 2013 -2016 (USD/kg)



Sources: IATA

The market was still dominated by the 20 leading freight forwarders, as they represented almost 58% of the market, as per Ti. Small forwarders continue to compete against the larger players, on cost optimization initiatives, as economies of scale are no longer the be-all and the end-all of the business. As a result of the lower volumes and quest for scale, M&A activity have disrupted global air and sea freight rankings as well. The most significant recent one was DSV's acquisition of Uti which caused the most impact with combined entity's forwarding revenues estimated to be around EUR 2Bn larger than DSV a year ago, according to Ti. Industry consolidation seems inevitable, as significant deals are likely to alter the landscape of the market even more, as forwarder looks to protect margins.

Three pressure points on forwarder margins

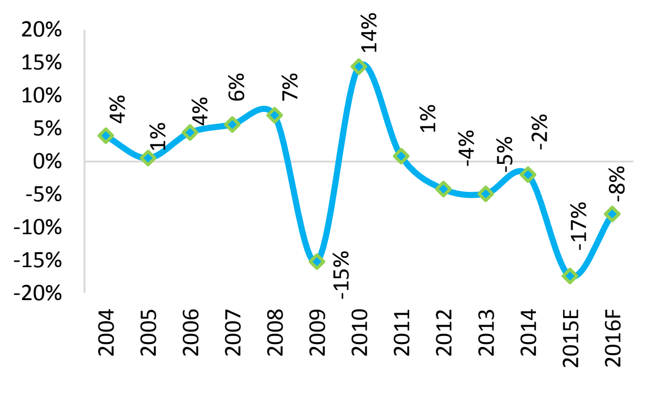
Ti also highlighted three structural shifts which have been impeding forwarder margins in the industry:

- **Yield Dilution:** Global manufacturers now run more efficient supply chains and have learned to de-cost them by utilizing lower cost sea freight as against the more expensive air cargo. The lower volumes in the industry and preference of sea-freight by manufacturers have also put pressure on air freight rates which went down by almost 20% y-o-y in 2015 to USD 1.78/kg, as per IATA. Air freight rates are expected to come down further by over 8% in 2016 to USD 1.63%. Yields which are calculated by dividing freight revenues by freight ton kilometers have continued to dilute, a longer-term trend, which means forwarders would have to work harder to maintain their revenues. Yields are expected to have come down by over 17% in 2015 and are expected to dilute further by 8% in 2016.

- **Structural shift in correlation with global trade:** As per Ti, the relationship between global trade and real GDP was considered to be hard-wired until the global financial crisis in 2009 as global trade grew at twice the rate of real GDP. The ratio has since been replaced with a more like a 1:1 correlation, as trade forecasts were affected by the downturn and secondly by a structural change in market growth. The structural change is ascribed to a slowdown in Europe, developing countries looking at domestic investment to boost economic growth, protectionist policies causing international trade to drag, and limited one-off impact from outsourcing production processes to the Far East. This has caused a strain on cross border economies of scale for forwarders, and in turn margins.
- **Shifts in regionalization, near-sourcing and emerging markets:** Near-sourcing which involves repatriating manufacturing from remote locations to regions closer to the end consumer market have also reduced FTKs. Manufacturing and retailing have therefore been moving to back regionalized supply chains after years of globalizing, a reversal of trend. The impact is likely to be uneven as road freight services are expected to do well at the expense of higher margin international air and sea freight activity, which is expected to add downward pressure on forwarder margins.

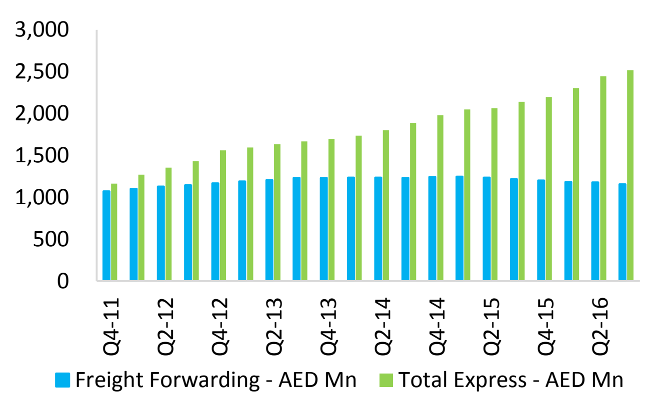
Ti forecasts the global freight forwarding market to grow at a real CAGR of 4.6% over 2015-2019, and expect Europe's market share of contract, while emerging markets would likely gain more share over the period. New trade deals such as the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership are likely to boost trade between APAC and North America, and the EU and the US.

Air cargo yield (%)



Sources: IATA

ARMX FF vs Express segments – rolling TTM revenues

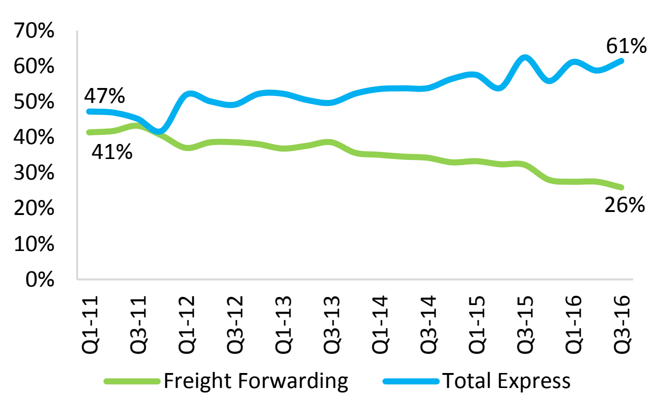


Sources: Aramex, KAMCO Research

Aramex witnessed a slowdown in its Freight Forwarding segment from Q2-15

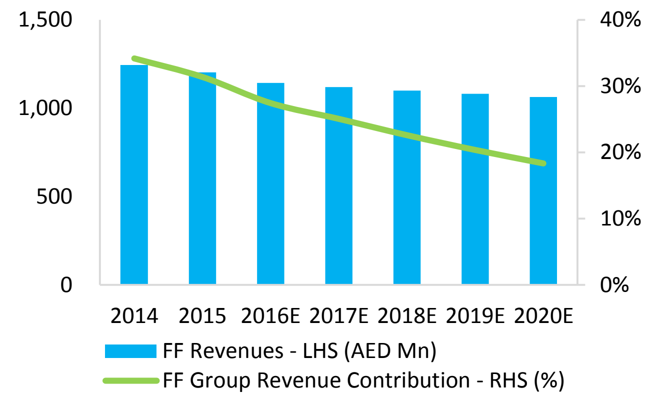
The global slowdown in freight forwarding activity did affect Aramex's Freight Forwarding segment as well. The slowdown was more apparent since Q2-15, as per our analysis, as we looked rolling TTM revenues from Q4-11 to Q3-16. Rolling TTM revenues are down 6.6% in slightly over a year as freight rates have been the biggest contributor to the decline than a slowdown in tonnage. In their Q3-16 call as well the management mentioned that retail airfreight which is usually affected later on cycle was also down, and also highlighted that freight forwarding rates were down significantly over the quarter. However, tonnage in the segment was reported as 8% higher in volumes in Q3-16, which could have resulted in slight increase in global forwarder market share. On the basis of revenue contribution as well, the Freight Forwarding segment showed declining trends as contribution to group revenues declined from 41% in Q1-11 to 26% in Q3-16. The lower contribution was not a function of declining freight forwarding revenues but largely driven by a growth in Express segments (International Express and Domestic Express) revenues as they grew significantly over the period. Gross margins however still remain healthy at over 27% at the end of Q3-16, which could come under pressure going forward due to aforementioned sectoral headwinds.

ARMX FF vs Express segments - Revenue Contribution



Sources: Aramex, KAMCO Research

ARMX Freight Forwarding (FF) revenue forecasts



Sources: Aramex, KAMCO Research

Given the medium term outlook of the freight forwarding industry and the compression of margins and dilution of yields, we expect the Freight Forwarding segment at Aramex to broadly reflect global trends, barring any M&A activity. As a result we expect revenues of the segment to decline at a CAGR of 2.4% over 2015-2020 and revenue contribution of group revenues to fall to 18% in 2020.

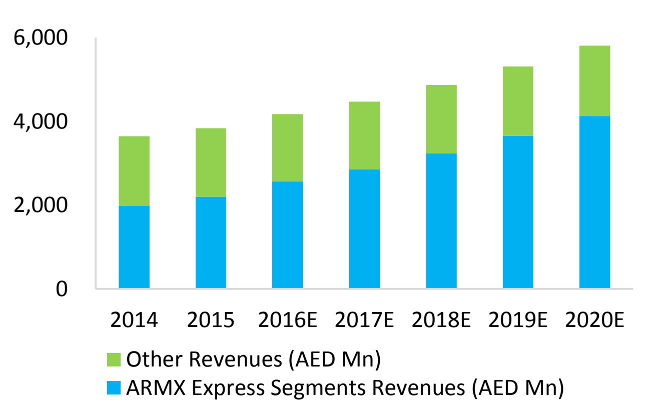
Cross border ecommerce to drive Express growth; and pick up Freight Forwarding slack

On the contrary, cross border ecommerce is expected to contribute significantly to International Express revenues and more than pick up the slack of the dip in Freight Forwarding segment revenues going forward, according to our forecasts. The company's strategy of investing into ecommerce is positive in our view, as the industry moves towards both domestic and cross border purchases being more online and towards the B2C segment, as against over-the-counter and B2B based. An example would be a technology app, which has been developed by Aramex over the last 18 months, which is similar to the UBER model app, where the customer can track the driver in terms of time taken to reach the customer in terms of distance and traffic. As a result, we expect Express segments (International Express and Domestic Express) to grow at a CAGR of over 13% over 2015-2020, while other segments remain mostly flat over the period.

Global Retail Ecommerce industry sales to grow at a CAGR of 21% over 2015 - 2020

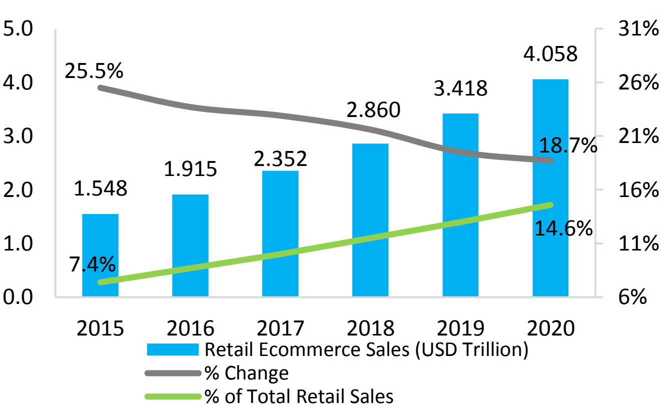
Retail ecommerce sales which dominates ecommerce products and services, will reach USD 1.915 trillion in 2016, accounting for 8.7% of total retail spending worldwide, according to e Marketer.

Aramex Group Revenues Breakup



Sources: Aramex, KAMCO Research

Global Ecommerce Sales Forecasts (2015-2020)



Sources: eMarketer

While the pace of growth for overall retail sales is expected to be subdued at 6.0% in 2016, ecommerce retail sales is expected to expand rapidly, at 23.7% y-o-y. Further, eMarketer expects retail ecommerce sales to increase to USD 4.058 trillion in 2020, contributing to 14.6% of total retail spending that year. Asia-Pacific will remain the world's largest retail ecommerce market and growth region throughout the forecast period, with sales expected to top USD 1 trillion in 2016 and more than double to USD 2.725 trillion by 2020. The region will also see the fastest rise in retail ecommerce sales in 2016, clocking a y-o-y growth of 31.5%. Key drivers for the robust growth is expected to be an expanding middle class population in the region, greater mobile and internet penetration, growing competition of ecommerce players and improving logistics and infrastructure. Retail ecommerce sales in North America is forecasted to rise 15.6% this year to reach USD 423.34 Bn, maintaining the region's status as the world's second largest regional ecommerce market. The consultant expects the region to see consistent double-digit growth through 2020, driven by increased spending from existing digital buyers, expansion into new categories such as grocery, and growing mobile commerce sales. Given the growth of the overall ecommerce market, we are sanguine about the company's strategy of focusing on cross border ecommerce as its key growth driver, which underpins our forecasts for the International Express segment.

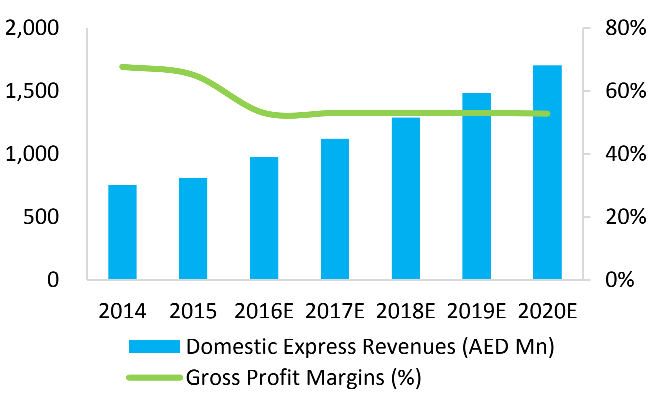
StarTrack - Hybrid model of express and post

The JV with Australia Post where Aramex holds 60% and Australia Post holds 40% is the strongest play on providing cross border ecommerce solutions which should be cheaper for customers than the normal express solutions and is a hybrid model of express and post. The first acquisition under the JV was Star Track International (More details on page 11). Under the business model, typical shipping time would be 5-7 business days with tracking etc. with business nodes at Los Angeles, New York, Miami, Chicago, London & Singapore to capture growth in regions outside. The strategy is to sign MOU's with country specific postal operators while Aramex would be responsible for the pick- and line-holding of consignment which would be eventually dropped off by the postal operator. The venture would not contribute to gross margins at the segment and group level, as the results of the JV are recognized via at-equity participation. Our forecasts do not include the forecasts for StarTrack, as we prefer to wait until 2017 to analyze operational details.

Fastway to contribute to growth, lower margins for Domestic Express

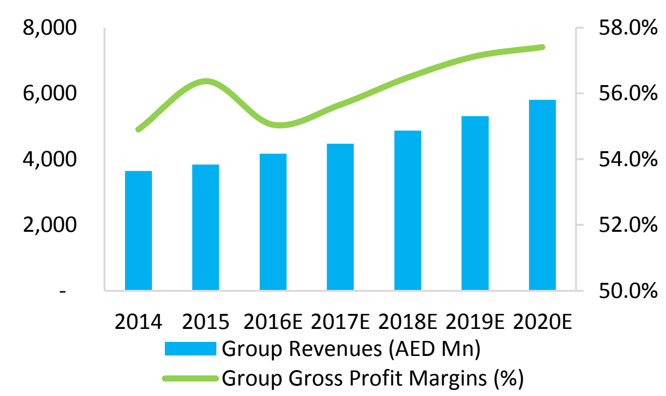
The 100% acquisition of Fastway consolidated under the Domestic Express segment contributed to revenues of AED 225.3 Mn and AED 6.5 Mn as of 9M-16 from the date of acquisition in Feb-16. Q3-16 revenues before FX effects were AED 89 Mn, while Profit before tax (PBT) was AED 3.5 Mn.

Domestic Express Revenues & Gross Profit Margins (%)



Sources: Aramex, KAMCO Research

Group Revenues & Gross Margins (%)



Sources: Aramex, KAMCO Research

We expect Fastway to also fall in line with the company's overall strategy of harnessing growth from the Asia Pacific region and contribute to the revenues of the segment and group revenues going forward. As a result we expect Domestic Express to grow at a CAGR of 16% y-o-y over 2015 - 2020. However, as margins from Fastway are significantly lower than pre-acquisition Domestic Express margins (2015: 65%), we expect the acquisition to result in an overall segment margin of

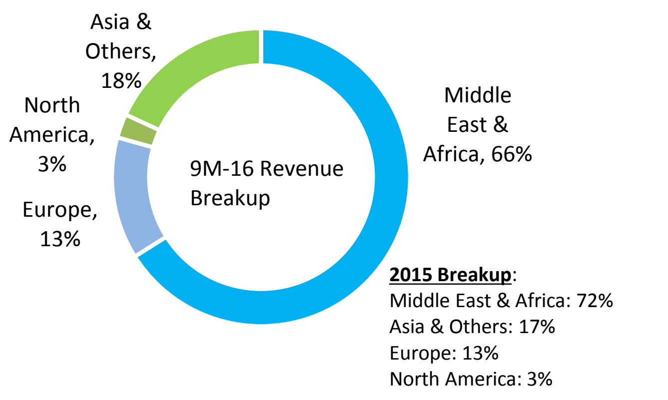
53% in 2016 and remain more or less stable over our forecast period until 2020 (More details on page 11).

Revenue growth & margins from Domestic Express to alter Aramex group trends

As mentioned earlier, we expect growth in cross border ecommerce and higher overall ecommerce market expansion to contribute to higher Express revenues which in turn should drive group revenue growth of over 8% over 2015 -2020 from AED 3.8 Bn in 2015. Nevertheless, we expect 2016 and 2017 to be years of transformation away from its traditional model, and we forecast bulk of the growth to come in post 2017. Growth from the B2C which contributes to over 35% of overall revenues should also grow further in our view. We are also optimistic about the company's focus on the Asia Pacific region as its key growth geography, as the region is expected to be strongest region for growth in the ecommerce segment. This would also ensure that the company moves away from its reliance on revenues from the GCC region which contributes to over 50% of group revenues.

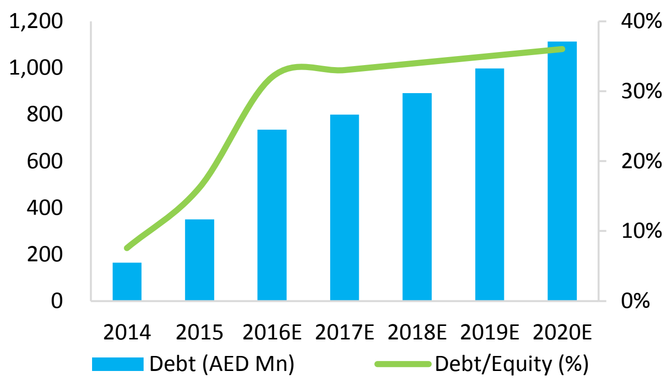
Though gross margins in Domestic Express are likely to be lower in 2016 and going forward due to the consolidation of Fastway, the larger revenue contribution of Domestic Express and lower contribution from the Freight Forwarding segment is expected to have a positive effect on group gross margins. As the revenue contribution mix changes in favor of higher-margin Express revenues, group gross margins are forecasted to improve, albeit marginally from 56% in 2015-2020 by over 100 bps, based on organic growth, as per KAMCO Research forecasts.

Aramex 9M-16 vs 2015 Geographical Revenue Breakup



Sources: Aramex

Aramex Debt Trends



Sources: Aramex, KAMCO Research

Debt levels to remain comfortable; capex more towards technology

The acquisition of Fastway pushed debt-to-equity ratio up from 16% to almost double by the end of 9M-16. The company however clearly mentioned that most of the future acquisitions would be via debt funding. Barring any inorganic activity, we expect debt levels to remain comfortable over 2015-2020 way below the 50% debt-to-equity ratio. Capex is likely to be more focused on IT & ERP investments, mainly for the courier app and consumer app. The cost of the ERP would be in the region of USD 7-10 Mn which would amortized over the next 5 years.

50% of the remaining Phantom share plan to vest in 2019

Aramex mentioned that 50% of 37 Mn phantom shares have been vested, and the next payment would be in Q3-17 subject to the 12% y-o-y growth in net income. Aramex also mentioned the rest of the 50% of shares would vest in 2019. In Q3-16 the company incurred additional overhead costs as the share price rallied from AED 3.20/share to AED 3.85/share (More details on page 10).

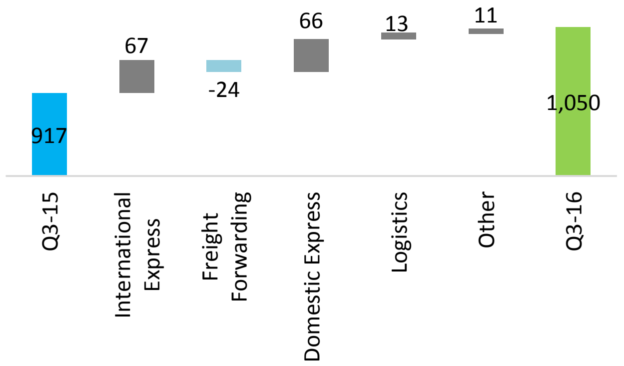
Q3-16 Review & Conference Call Takeaways

Q3-16 & 9M-16 Results Review

Aramex reported 9M-16 of AED 3184.7 Bn, up 15% from the AED 2772.8 Bn in 9M-15, as the growth was largely ascribed to higher Express revenues. Both International Express & Domestic Express registered double-digit growth rates as compared to 9M-15. Net Profit was up 16.2% y-o-y in 9M-16 to AED 294.8 Mn. However, 9M-16 net profit included a bargain purchase gain of AED 41 Mn on account of fair value consolidation of transfer of assets from the logistics business in Egypt. Adjusting for the bargain purchase gain, net profit for 9M-16 remained flat y-o-y at AED 254 Mn.

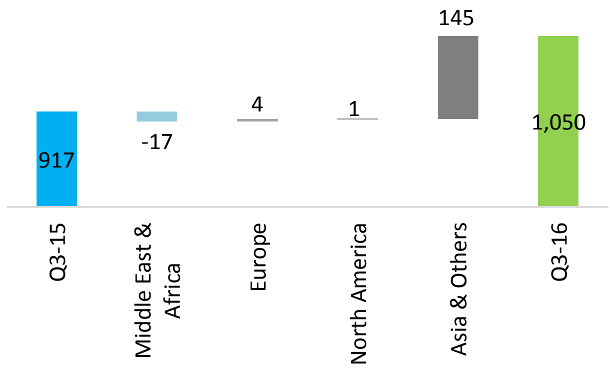
The company reported Q3-16 revenues of AED 1.05 Bn, up 15% from the AED 917 Mn reported in Q3-15. Domestic Express grew substantially on a y-o-y basis, mainly as a result of consolidation of Fastway post its acquisition, as it contributed to 11% of growth group revenues. Key driver for growth in International Express revenues was cross border ecommerce revenues, which grew especially from Asia & Europe. Freight forwarding declined however y-o-y by 8% as ongoing industry weakness continued in Q3-16 as well.

Revenue Bridge y-o-y – Segment wise (AED Mn)



Sources: Aramex

Revenue Bridge y-o-y – Region wise (AED Mn)



Sources: Aramex

Region wise, the largest contributor to revenue growth in Q3-16 was the Asia Pacific region, as 16% of the growth y-o-y came in from the region, adding AED 145 Mn. Middle East & Africa saw a dip y-o-y as revenues were lower by AED 17 Mn, due to a slowdown in the GCC mainly, and ascribed lower number of working days due to the holiday season.

Gross profits for the group also grew by 11% y-o-y from AED 519.1 Mn to AED 577.5 Mn due to the increase in revenues. However, group gross margins compressed over 160 bps from 56.6% in Q3-15 to 55.0% in Q3-16 due to the consolidation of lower margins from Fastway in Domestic Express. Overhead expenses also increased by 13% y-o-y, out of which 40% of increase was from organic business, while the rest was from acquisition, as per Aramex. Overhead expenses also grew due to expenses accrued from the phantom share plan, which was USD 4 Mn as per Aramex. The expense was recorded as a result of the 20% run-up in share price during the Q3-16. EBIT for the group came in at AED 91 Mn for the quarter, a growth of 5% as compared to the same quarter in the previous year. Group net profit were down 3.1% in Q3-16 as compared to Q3-15 due to weaker activity in the GCC, and higher income tax expense and finance costs, which brought down net income in the current quarter. Finance cost grew substantially from AED 2.4 Mn to AED 7.8 Mn, as a result of an increase in debt which almost doubled since 2015. Income tax expense grew c.77% as a result of higher revenues from outside the GCC, from Asia and Europe where tax rates are higher.

Key Points from Conference Call

We attended the Q3-16 conference call with the management, which confirmed our investment thesis and outlook for Aramex and gave finer level details on the outlook of key segments and future initiatives, which helped us fine-tune our estimates. Below are the key discussion points from the conference call along with take:

- **Domestic Express:** Though the margins in Domestic Express dipped from 65.1% in 2015 to 53.8% in 9M-16, and close to 51% in Q3-16 alone, the management guided that the drop was mostly due to the acquisition of Fastway, which has lower margins, while they guided that the margins in the organic business in the segment was still above 60%. The management in the near term sees no improvement in margins either. Moreover, the sale of Mail Call, which was Domestic Express business, was consolidated until August-16 and reported YTD gross margins of c.41%. The sale would result in forgone sales of USD 25 Mn to USD 30 Mn per year as per Aramex. The sale of Mail Call would result in forgone sales of 10%-11% for Domestic Express on annualized basis, in our view. In addition, margins in the segment should dip additionally in Q4-16 and 2017, albeit marginally in our view, as this would entail higher revenue contribution of Fastway results, where margins are significantly lower.
- **Freight Forwarding:** Tonnage was up 8% in Q3-16, however freight forwarding rates witnessed a decline, leading to an 8% decline in revenues. The number of business days was also lower by 4-5 days as against Q3-15, due to holidays. Retail airfreight, particularly in the GCC region was down for the quarter. Main markets affected were Saudi Arabia and the UAE. The sector would continue to remain under pressure, as pricing and competition would continue to depress the scale and the margins of the segment within Aramex, in our view.
- **StarTrack:** Under the JV with Australia Post, the first acquisition 'StarTrack International' would give an immediate contribution of AUD 70 Mn per year, through at-equity participation for Aramex. The margins for acquired entity is barely 5%. Target clients for StarTrack would be the big retailers, and management at Aramex remains optimistic about the potential, and expect JV to be operational by Q1-17.
- **Logistics:** Capacity addition in Logistics segment has been doubled to 100,000 sq.m in Dubai Logistics City and should result in incrementally better results in the coming quarters. The 28% growth in the segment revenues in 9M-16 as against the previous year was also contributed by the consolidation of the Egypt logistics business.
- **Acquisitions & future target markets:** Asia would continue to be the preferred market for acquisitions going forward, as per the management. Ecommerce related businesses within the region would be of particular interest, given the lower penetration of ecommerce in the region, accounting to 44%, as against a penetration rate of 74% in Europe and the US.

2016 Outlook – KAMCO Research broadly in line with guidance

Aramex released specific revenue guidance for 2016 at the group level and for individual segments. The management guided for a considerable increase in 2016 revenues, with International Express and Domestic Express expected to post double-digit growth as compared to 2015. Our new forecasts are broadly in line with management guidance, as we expect revenues for International Express to grow by 15% y-o-y in 2016. We expect the acquisition of Fastway to contribute to a y-o-y revenue growth of 34% for the Domestic Express segment 2016, as against 2015. We forecast a 5% decline in Freight Forwarding segment revenues as increased competition and lower pricing are likely drivers for the decline.

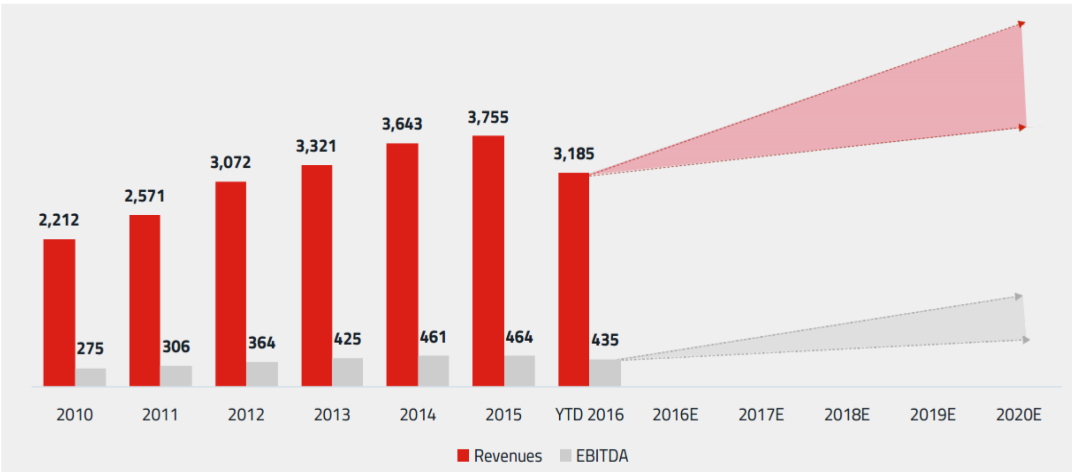
2016 KAMCO Forecasts vs. Aramex Guidance

Revenues (AED Mn)	2015	2016 Guidance: Aramex	KAMCO Research Forecasts: 2016	Y-o-Y (%)	KAMCO Research Forecasts Rationale
Segmental					
International Express	1,387	Double-digit growth	1,595	15%	We expect continued growth in cross border ecommerce and new initiatives to translate into a revenue growth of 15% y-o-y in 2016
Freight Forwarding	1,203	Slight decrease	1,143	-5%	Industry headwinds in terms of continued pressure in pricing and margins, and retail air freight slowdown would lead to a 5% decline in revenues
Domestic Express	729	Double-digit growth	974	34%	Consolidation of Fastway would contribute to 34% y-o-y increase in revenues, despite loss of revenues from the sale of Mail Call in H2-16
Logistics	206	Slight increase	216	5%	Based on management guidance & 9M-16 trends
Other	229	Slight increase	241	5%	Based on management guidance & 9M-16 trends
Group Revenues	**3,755**	**Considerable increase**	**4,169**	**11.0%**	**Express revenues would continue to buoy group revenues and register a y-o-y growth of 11% for 2016**

Source: Aramex, KAMCO Research

Aramex further released a roadmap until 2020 in their Q3-16 presentation that included revenue and EBITDA bands for the period, seen in the exhibit below.

Outlook & Guidance – Projected Roadmap to 2020



Source: Aramex Q3-16 presentation

2016E & 2017E EPS cut by 18% and 28% respectively from previous update

Following Q3-16 results, we revisited our model and reworked our estimates. We trimmed our revenue forecasts for 2016E and 2017E lower by 4% and 5% respectively and now expect revenues of AED 4.17 Bn for 2016E and 4.47 Bn for 2017E. Our forecasts are lower than consensus estimates of AED 4.30 Bn for 2016E & AED 4.64 Bn for 2017E as well. We now also expect gross margins for 2016E to lower by 120 bps at 55.0%, while higher revenue contribution of Domestic Express would push the 2017E gross margins higher compared to 2016 by 70bps to 55.7%.

We cut 2016E EPS by 18% from our previous estimates (AED 0.27/share) and now expect an EPS of AED 0.22/share. We cut 2017E EPS by 29%, given that revenue growth should come in from Asia and other regions outside the GCC region, where taxes would be higher. We also factor in a marginal increase in cost of borrowing in response to hikes in interest rates in Aramex's operating regions, following the potential for a rate hike from the Federal Reserve in the following year.

2016 & 2017 Forecasts - KAMCO Research vs. Consensus Estimates

	2016					2017				
Aramex - Group	KAMCO - Previous Estimates	KAMCO - Current Estimates	KAMCO Change (%)	Consensus	KAMCO vs. Consensus	KAMCO - Previous Estimates	KAMCO - Current Estimates	KAMCO Estimates - Change (%)	Consensus	KAMCO vs. Consensus
Revenues (AED Mn)	4,326	4,169	-4%	4,297	-3%	4,705	4,473	-5%	4,644	-4%
Gross Margins (%)	56.2%	55.0%	-1.2%	55.7%	-0.7%	56.7%	55.7%	-1.0%	56.5%	-0.8%
EBITDA (AED Mn)	579	466	-20%	581	-20%	632	523	-17%	644	-19%
Net Income* (AED Mn)	390	319	-18%	360	-11%	430	304	-29%	374	-19%
EPS*(AED/share)	0.27	0.22	-18%	0.27	-18%	0.29	0.21	-29%	0.30	-31%

*Source: Aramex, KAMCO Research, *Net Income and *EPS are before any adjustments to maintain parity with consensus estimates*

Financial Indicators

Balance Sheet (AED Mn)	2013	2014	2015	2016 E	2017E	2018E	2019E	2020E
Assets								
Cash and cash equivalents	657	620	707	610	707	1,009	1,320	1,623
Receivables	604	687	731	829	889	968	1,056	1,155
Total current assets	1,388	1,498	1,602	1,695	1,853	2,255	2,679	3,109
Net property, plant and equipment	542	531	703	979	972	970	972	978
Goodwill	974	1,076	1,038	1,208	1,208	1,208	1,208	1,208
Other assets	83	102	103	253	242	232	222	212
Total assets	**2,986**	**3,207**	**3,445**	**4,135**	**4,274**	**4,665**	**5,081**	**5,508**
Liabilities								
Long-term debt	128	97	229	735	800	892	997	1,113
Accounts payable and other liabilities	163	179	176	250	212	258	285	291
Total liabilities	**896**	**1,042**	**1,284**	**1,838**	**1,850**	**2,042**	**2,233**	**2,417**
Shareholders' Equity								
Share capital	1,464	1,464	1,464	1,464	1,464	1,464	1,464	1,464
Retained earnings	587	708	786	900	996	1,159	1,343	1,538
Total Shareholders Equity	**2,090**	**2,165**	**2,162**	**2,297**	**2,424**	**2,623**	**2,848**	**3,090**
Total liabilities and equity	**2,986**	**3,207**	**3,445**	**4,135**	**4,274**	**4,665**	**5,081**	**5,508**

Income Statement (AED Mn)	2013	2014	2015	2016 E	2017E	2018E	2019E	2020E
Revenue	3,321	3,643	3,837	4,169	4,473	4,869	5,309	5,807
Cost of goods sold	(1,518)	(1,639)	(1,668)	(1,874)	(1,983)	(2,119)	(2,276)	(2,473)
Gross profit	**1,802**	**2,004**	**2,169**	**2,295**	**2,490**	**2,750**	**3,033**	**3,334**
General and administrative expenses	(737)	(833)	(955)	(1,034)	(1,114)	(1,217)	(1,333)	(1,463)
Other operating expenses	(636)	(706)	(741)	(792)	(850)	(930)	(1,019)	(1,121)
Other operational Income/Loss	(5.0)	(4)	(3)	(3)	(3)	(3)	(3)	(3)
EBITDA	**425**	**461**	**470**	**466**	**523**	**600**	**678**	**747**
Depreciation and amortization	(81)	(81)	(87)	(106)	(134)	(142)	(151)	(161)
EBIT	**344**	**380**	**383**	**360**	**389**	**458**	**527**	**585**
Finance costs	(8.5)	(7.1)	(7.8)	(16.6)	(25.4)	(30.2)	(36.2)	(43.2)
Interest/investment income	6.3	7.7	6.1	7.0	10.1	15.4	23.9	34.0
Other Income/Loss	5.9	4.2	4.9	48.3	7.1	7.6	8.1	8.7
Net profit before taxes	**348**	**384**	**386**	**399**	**381**	**451**	**523**	**585**
Provision for Income Taxes	(32)	(37)	(40)	(53)	(50)	(60)	(69)	(77)
Net profit after taxes	**316**	**348**	**346**	**346**	**330**	**392**	**454**	**508**
Minority interest	(37)	(29)	(34)	(28)	(26)	(31)	(36)	(41)
Net profit attributable to parent	**279**	**319**	**312**	**319**	**304**	**360**	**418**	**467**
EPS (AED)	**0.19**	**0.22**	**0.21**	**0.22**	**0.21**	**0.25**	**0.29**	**0.32**

Source : KAMCO Research and Aramex

Key Financial Ratios

Key Ratios	2013	2014	2015	2016 E	2017E	2018E	2019E	2020E
Asset Structure and Leverage Ratios								
Total Liabilities / Total Assets (%)	30.0%	32.5%	37.3%	44.4%	43.3%	43.8%	43.9%	43.9%
Total Debt / Total Assets (x)	0.06	0.05	0.10	0.18	0.19	0.19	0.20	0.20
Total Debt / Equity (x)	0.08	0.08	0.16	0.32	0.33	0.34	0.35	0.36
Interest Coverage Ratio (x)	41	54	49	22	15	15	15	14
Liquidity Ratios								
Current Ratio (x)	2.2	1.9	1.9	1.8	2.2	2.4	2.7	3.0
Quick Ratio (x)	2.0	1.6	1.8	1.6	1.9	2.1	2.4	2.7
Cash Ratio (Cash & Eq./Current Liabilities) (x)	1.0	0.8	0.9	0.7	0.8	1.1	1.3	1.6
Operating Efficiency Ratios								
Receivables Turnover (x)	5.6	5.6	5.4	5.3	5.2	5.2	5.2	5.3
Days sales outstanding	69	71	70	66	70	70	70	69
Accounts Payable Turnover (x)	9.5	9.6	9.4	8.1	8.4	7.8	7.9	7.9
Days payable outstanding	41	38	38	42	39	44	40	41
Total Assets Turnover Ratio (x)	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1
Cash conversion cycle	28	32	32	25	31	26	30	29
Profitability Ratios								
Return on Average Assets (%)	9.8%	10.3%	9.4%	8.4%	7.2%	8.1%	8.6%	8.8%
Return on Average Equity (%)	13.5%	15.0%	14.4%	14.3%	12.9%	14.3%	15.3%	15.7%
ROIC (%)	17.1%	18.7%	17.6%	13.3%	12.6%	14.5%	16.5%	17.9%
Margins								
Gross profit margin (%)	54.3%	55.0%	56.5%	55.0%	55.7%	56.5%	57.1%	57.4%
EBITDA margin (%)	12.8%	12.7%	12.2%	11.2%	11.7%	12.3%	12.8%	12.9%
EBIT margin (%)	10.4%	10.4%	10.0%	8.6%	8.7%	9.4%	9.9%	10.1%
Net profit margin (%)	8.4%	8.7%	8.1%	7.6%	6.8%	7.4%	7.9%	8.0%
Payout Ratio								
Dividend Payout (%)	52.7%	52.9%	65.8%	65.0%	65.0%	65.0%	65.0%	65.0%
Market Data and Valuation Ratios								
Share Price (AED)	2.45	3.16	3.36	3.88	3.88	3.88	3.88	3.88
Number of Shares (Mn)	1464.1	1464.1	1464.1	1464.1	1464.1	1464.1	1464.1	1464.1
Market Capitalization (AED Mn)	3,581	4,629	4,919	5,681	5,681	5,681	5,681	5,681
Enterprise Value (AED Mn)	4,061	5,085	5,276	5,516	5,516	5,516	5,516	5,516
Earnings Per Share (AED)	0.19	0.22	0.21	0.22	0.21	0.25	0.29	0.32
Book Value Per Share (AED)	1.43	1.48	1.48	1.57	1.66	1.79	1.95	2.11
Dividend Per Share (AED)	0.10	0.12	0.14	0.14	0.13	0.16	0.19	0.21
PE (x)	12.9	14.5	15.8	17.8	18.7	15.8	13.6	12.2
EV/EBITDA (x)	9.6	11.0	11.2	11.8	10.5	9.2	8.1	7.4
PB (x)	1.7	2.1	2.3	2.5	2.3	2.2	2.0	1.8
Dividend Yield (%)	4.1%	3.6%	4.2%	3.6%	3.5%	4.1%	4.8%	5.3%

Source : KAMCO Research and Aramex
Note : Forward Valuation ratios are based on current market prices

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