

Aramex (ARMX)

STRONG BUY
TP AED4.07
+23%

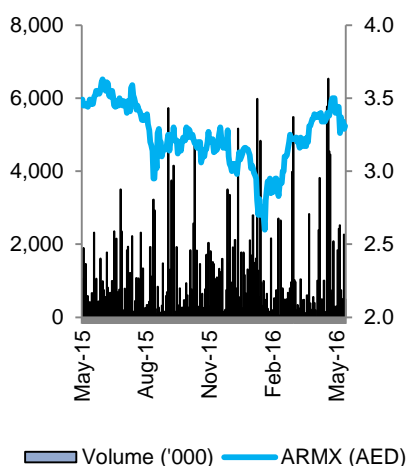
Market Data

Bloomberg Code	ARMX.UH
Reuters Code	ARMX.DU
CMP (16 May 2016)	AED3.31
O/S (mn)	1,464.6
Market Cap (AED mn)	4,846
Market Cap (USD mn)	1,319
52 Week High (AED)	3.63
52 Week Low (AED)	2.60
3m ADVT (USD mn)	1.1

Price Performance

	1m	3m	12m
Absolute (%)	(0.90)	12.97	(5.16)
Relative (%)	6.34	5.61	13.94

Price Volume Performance



Source: Zawya

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- Earnings to grow by more than 19% in 2016
- New acquisition is expected to add 3% to bottom-line
- The stock offers earnings growth and a good dividend yield

Favorable shift in revenue mix driven by e-commerce growth in GCC and Oceania. Aramex, as a courier service provider, is exposed to e-commerce and is subjected to the massive growth in the GCC and Oceania. Moreover, this growth in e-commerce is driving a shift in Aramex's revenue mix toward high margin businesses.

Aramex's biggest acquisition to add around 3% to the bottom-line. In January, Aramex acquired Fastway Limited, a leading courier service provider headquartered in New Zealand with a major market presence in Australia, marking its biggest acquisition in history. The transaction, which amounts to AED296mn, involves a 100% buyout of the company's business in Australia and New Zealand. In 2015, Fastway Limited had total sales of ~AED250mn with a net profit margin of ~7%. The deal was financed fully by debt. We expect the deal to boost Aramex's 2016 bottom-line by ~3%.

Positive forex impact on a large chunk of revenues is expected in 2017. We believe that more than 25% of Aramex's revenues are subjected to currency fluctuations. All the major currencies, with the exception of the South African Rand, are expected to strengthen during 2016 according to market consensus. We have incorporated these expectations in our forecast and believe that FOREX will have a positive impact on the company's growth numbers beyond 2016.

1Q16 profits grew by 7% despite a one-off expense; expected to grow by 19% in 2016. Excluding the acquisition cost the growth in 1Q16 bottom-line would have been 13%. Gross margin was enhanced in 1Q16 by 50bps as the revenue mix shifted further this year from Freight forwarding which has the lowest margins in the company, 27% in 1Q16 vs. 32.5% in 1Q15. We expect profits to grow by a staggering 19% YoY in 2016 after a provision hindered the growth in bottom-line in 2015. However, the adjusted earnings growth for 2016 is expected to be 4% YoY affected by a margin squeeze by the recent acquisition.

Investment Indicators

	2014	2015	2016e	2017e	2018e
Revenue	3,650	3,837	4,312	4,741	5,214
EBITDA	465	475	590	692	776
EBITDA margin	12.7%	12.4%	13.7%	14.6%	14.9%
Net Profit	318	311	370	427	484
EPS (AED)	0.22	0.21	0.26	0.30	0.34
Dividend Yield	3.9%	4.4%	4.6%	5.3%	6.0%
P/E (x)	13.6	14.9	13.1	11.3	10.0
EV/EBITDA (x)	9.3	9.7	8.2	7.0	6.2

Source: Company financials & Global Research (2016)

1Q16 profits grew by 7% after a one-off expense; expected to grow by 19% in 2016

We expect profits to grow by a staggering 19% YoY in 2016 after a provision hindered the growth in bottom-line in 2015. However, the adjusted earnings growth for 2016 is expected to be 4% YoY affected by a margin squeeze from the recent acquisition. Profits fell by 0.4% in 2015 due to a provision, an incentive scheme called “Phantom shares”, which amounted to AED46mn. Excluding the provision, Aramex’s 2015 profit grew by 12%. Moreover, 1Q16 profits grew by 7% YoY affected by a one-off acquisition cost of AED5.5mn. Excluding the acquisition cost the growth would have been 13%. Gross margin was enhanced in 1Q16 by 50bps as the revenue mix shifted further this year from Freight forwarding which has the lowest margins in the company, 27% in 1Q16 vs. 32.5% in 1Q15.

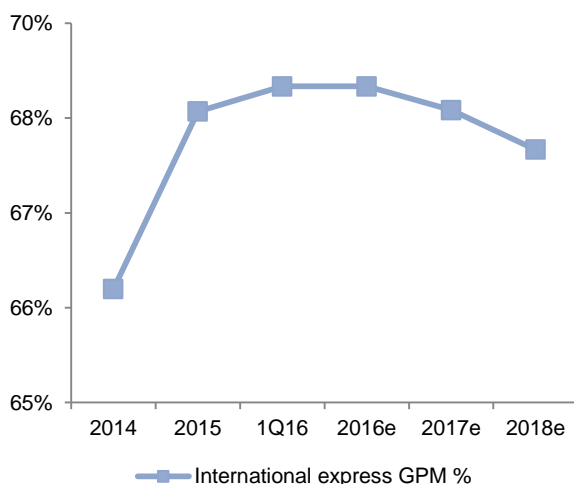
Nothing spooky about the phantom shares

According to management, the provision charges are expected to be AED11mn for 2016 and AED5.5mn each for 2017 and 2018 respectively. In late 2015, the company started to implement Phantom shares, an employee incentive scheme tied to the Aramex’s stock price. The provision expenses is expected to normalize going forward.

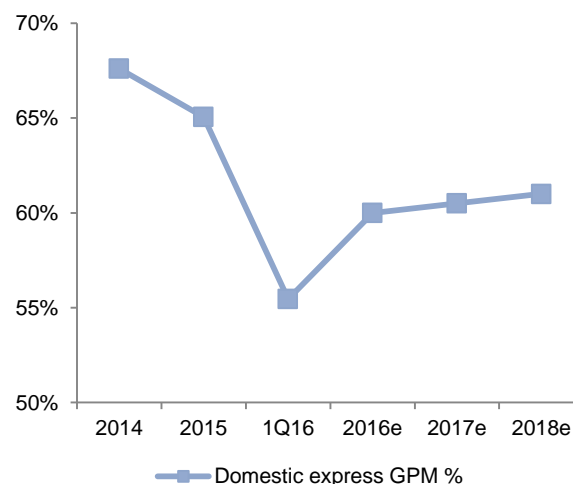
Forex losses is eating away the growth

According to our recent talk with the management, currency fluctuations caused the company to lose 3% of the top-line in 1Q16 and 3.5% of the top and bottom-line in 2015. In 1Q16, Europe contributed to total sales with AED133mn, which represents a 0.4% increase YoY, reducing its share in total sales primarily due to the slowdown in Freight forwarding and the fall of Euro in relative of the US Dollar. Nevertheless, sales grew in MENA & Africa by 5.5% YoY despite the effect of the depreciating South African Rand.

International express margins improve in the short term then start diminishing after a rebound in oil prices



Domestic express's is affected negatively by the recent acquisition but expected to bounce back



Source: Company financials & Global Research (2016)

Aramex's biggest acquisition

In January, Aramex acquired Fastway Limited, which is a leading courier service provider headquartered in New Zealand with a major market presence in Australia, marking its biggest acquisition in history. The transaction, which amounts to AED296mn, involves a 100% buyout of the company's business in Australia and New Zealand. In 2015, Fastway Limited had total sales of ~AED250mn with a net profit margin of ~7% compared to Aramex's 8.1%. The deal was financed fully by debt. We expect the deal to boost Aramex's 2016 bottom-line by ~3%. Moreover, Fastway added around AED40mn to the company's topline since its consolidation, late January to early February, and mostly through the domestic express business.

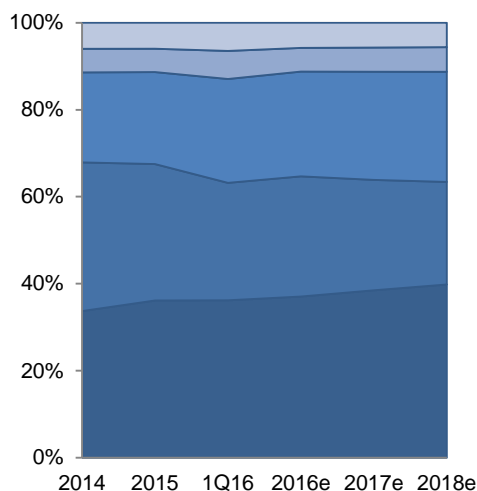
The appetite for Non-organic growth is still strong

With expansions in Africa and Asia in mind, Aramex is targeting 2-3 acquisitions if opportunities arise. Back in 2015, the company announced that it had secured USD150mn in debt, which to date had not utilized fully, to fund its acquisitions. On top of that, the company can secure another USD150mn from a group of banks, which it can draw on when needed.

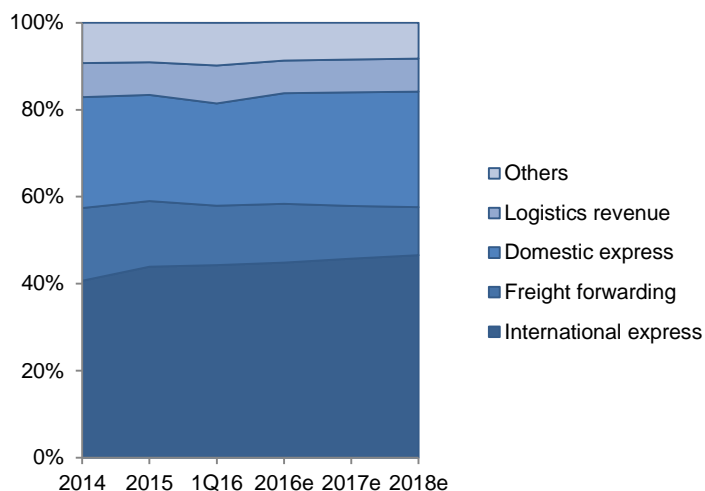
Shifting revenue mix to push the margins upward

We expect the company's gross margins to expand by more than 320bps from 2015 to the end of our forecast period. The improvement will come as a consequence of the change in Aramex's revenues mix in favor of higher margin businesses. This shift is powered by a slowdown in the freight forwarding business, due to lower oil prices and depreciating European currencies against the US Dollar, and the company's strategy to focus on ecommerce to drive its courier business. The courier business, International & Domestic express, grew at a faster rate in the past years than other business due to the robust growth numbers coming from the Ecommerce sub segment which posted a growth between 20% and 30%. Between 2012-2015, gross margins improved by more than 250bps.

Express to contribute the lion's share to the revenue mix...



...While freight forwarding contribution is expected to continue diminishing



Source: Company financials & Global Research (2016)

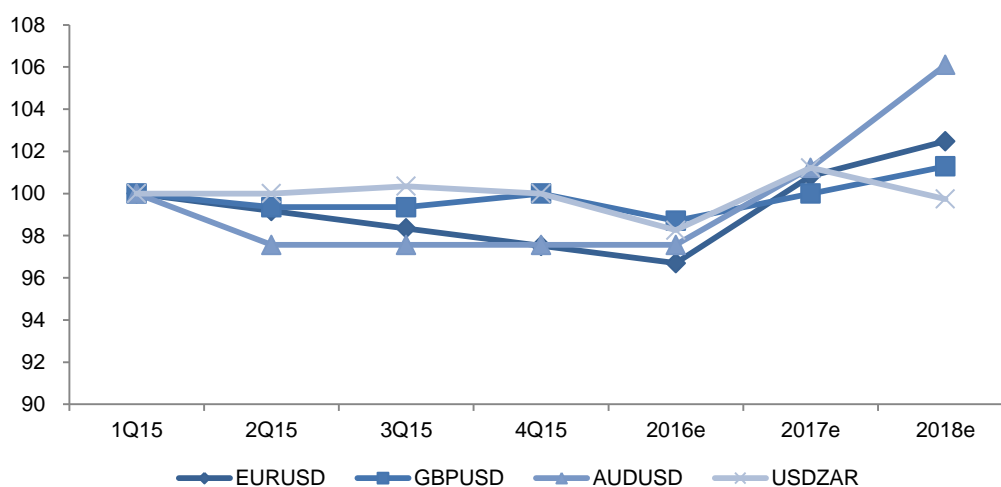
Cost cutting initiatives expected to improve operating margin by 100bps by 2017

In line with management views, we expect to see operating margin improvements as high as 100bps by 2017 from 2015 from implementing new cost saving technologies. Aramex is implementing an array of technological initiatives such as an Enterprise Resource Planning (ERP) system, which will help with better resource allocations and improved operational efficiency. Furthermore the company is also focusing on ways to incorporate technology to their last mile delivery such as a business model they acquired from Mail Call Couriers which operates on a platform similar to that of Uber. Also, what we have learned from the management is that the company's strategy is to transform itself into a technologically leading courier service provider and they plan to do so by acquiring companies that will help them reach that goal.

Positive Forex impact on more than 25% of revenues is expected in 2017

We believe that more than 25% of Aramex's revenues are subject to currency fluctuations. All the major currencies, with the exception of the South African Rand, are expected to strengthen during 2016 according to Bloomberg's consensus. We have incorporated these expectations in our forecast and we expect that FOREX will have a positive impact on the company's growth numbers beyond 2016

All major currencies are expected to appreciate against USD except ZAR



Source: Bloomberg & Global Research (2016)

Valuation Methodology

We are using the blended price by allocating a weight of 70% to the value of DCF and 30% to the value from Relative Valuation, which is the average of the two methods used.

	Weightage	Value (AED)
Price based on DCF (AED)	70%	4.28
Price based on Relative Valuation (AED)	30%	3.60
<i>P/E Based Valuation</i>	50%	3.81
<i>EV/EBITDA Based Valuation</i>	50%	3.39
Weighted Average Value (AED)		4.07
<i>Upside / (Downside)</i>		23.1%

Source: Global Research

Discounted cash flow (DCF)

The DCF method is based on a 4-year forecast of free cash flows. The free cash flows are forecasted along with the terminal value then it gets discounted at the weighted average cost of capital (WACC) to arrive to the net present value (NPV) of the company. In order to compute the cost of equity for the DCF method, we have used the buildup method as the summation of the following:

1. US 10 Year Treasury Yield currently taken as 1.91%
2. US Risk Premium currently taken as 7.58%
3. Dubai Risk Premium over US Risk Premium as 1.5%
4. Add company specific discount of 1%

AEDmn	2016e	2017e	2018e	2019e	Key Calculations	
Recurring Net Profit	461	532	605	703	WACC	10.6%
Depreciation	115	140	154	169	Growth Rate	3.0%
Working Capital Changes	(22)	(47)	(39)	(60)	Terminal Value	7,592
Operating Cash Flows	554	625	719	811	Enterprise Value (AEDmn)	6,252
Capex/ Investments	(451)	(209)	(206)	(230)	Add: Investments	15
Add: Interest (after tax)	18	24	23	21	Add: Net Cash	28
Others	(25)	(18)	(33)	(43)	Less: Non-controlling interests	33
FCFF	96	422	504	560	Equity Value (AEDmn)	6,262
Discount Factor	0.90	0.82	0.74	0.67	Shares Outstanding	1,464
Discounted Cash Flow	87	345	372	374	Per Share Value (AED)	4.28
PV of Terminal Value (AEDmn)				5,074		

Source: Global Research

Valuation risks

- **Foreign exchange risk:** We expect that currency fluctuations will be adding 1% to the top and bottom lines from 2017 to 2019. Any further additions will provide an upside risk.
- **A strong rebound in freight forwarding:** We have assumed a CAGR of 2% in the next 5 years. However, a strong rebound in the freight forwarding business will have a strong effect on the profit margin.

Relative Valuation multiples of the peer group

In order to incorporate the impact of market forces into our valuation we have employed the use of averages of P/E and EV/EBITDA multiples of a peer group as an indicator for price discovery. We have selected global logistics and courier companies for the task due to the lack of comparable companies in the region.

Peer Valuation

Name	Market Cap USDmn	Country	P/E			Ev/EBITDA			Dividend Yield			ROE Last Filling	
			2015	2016e	2017e	2015	2016e	2017e	2015	2016e	2017e		
Aramex	ARMX UH	1,331	UAE	14.9	13.1	11.3	9.7	8.2	7.0	4.4%	4.6%	5.3%	14.4%
Deutsche Post	DPW GR	35,826	Germany	15.5	13.3	12.2	8.3	6.6	6.2	3.4%	3.7%	4.0%	15.1%
FedEx	FDX US	43,562	USA	18.2	15.0	13.2	7.1	6.5	6.0	0.5%	0.6%	0.7%	6.6%
UPS	UPS US	90,748	USA	19.4	17.7	16.5	10.3	9.6	9.1	2.8%	3.0%	3.2%	N/A
BPOST	BPOST BB	5,598	Belgium	15.8	15.2	15.1	7.3	7.1	7.0	5.2%	5.4%	5.4%	38.5%
Transforce	TFI CN	1,738	Canada	11.6	13.4	11.5	6.0	7.1	6.7	2.9%	3.2%	N/A	52.8%
Gulf Warehousing	GWCS QD	1,021	Qatar	17.3	17.7	16.2	14.5	13.7	11.9	2.5%	2.4%	2.9%	17.3%
Average		25,689		16.1	15.1	13.7	9.0	8.4	7.7	3.1%	3.3%	3.6%	24.1%

Source: Company financials & Global Research (2016)

According to our estimates combined with data extracted from Bloomberg, Aramex is trading lower than its global peers in 2016 at the current price levels. Aramex is trading at P/E of 12.9x in 2016 compared to its global peer's 15.0x while its EV/EBITDA is expected to be at 8.1x in comparison to its peer's 8.4x. Compared to its peers, Aramex offers a fairly solid dividend yield, which might give it an added edge at a time of falling markets and higher appreciation for dividends. Aramex's dividend policy to give out 60-65% DPO suggests, according to our estimates, that the company will have a dividend yield of 4.8% in 2016 and 5.4% in 2017 compared to the peers' 3.4% and 3.7% in 2016 and 2017 respectively.

On the other hand, Aramex has one of the highest earnings growth in the last 5 years sporting a 9.3% CAGR. The company also has one of the lowest ROE among the peers but that is because of the unleveraged balance sheet, compared to its peer group. However, recently the company started to add more debt to its balance sheet. As a result of that we expect that the ROE to reach 16.9% at the end of this year and 18.2% by 2017.

P/E Multiple Valuation	2016e	Ev/EBITDA Multiple Valuation	2016e
EPS for year ending 2016	0.25	EBITDA for year ending 2016	590,106
Average Sector Forward P/E	15.1	Average Sector Forward EV/EBITDA	8.4
Premium / (Discount)	0.0%	Premium / (Discount)	0.0%
Price based on Sector average P/E (AED)	3.81	Price based on Sector average EV/EBITDA (AED)	3.39
Upside / (Downside)	15%		2%

Source: Global Research

With a DCF value of AED4.28 and a relative value of AED3.60, we have concluded that the fair value for Aramex's stock is AED4.07. This fair value suggests an upside potential of 23.1% and give a signal of a STRONG BUY.

Financial Statements

(AED mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement							
Total Revenues	3,325	3,650	3,837	4,312	4,741	5,214	5,745
Cost of Services	(1,524)	(1,647)	(1,674)	(1,861)	(2,010)	(2,182)	(2,370)
Gross Profit	1,801	2,003	2,163	2,451	2,731	3,032	3,375
Other Operating Expenses	(665)	(736)	(771)	(867)	(960)	(1,059)	(1,169)
Selling Expenses	(153)	(180)	(190)	(224)	(247)	(271)	(299)
General and Administrative Expenses	(635)	(704)	(816)	(888)	(977)	(1,085)	(1,195)
Other Income / (Expenses)	6	4	5	6	7	7	8
Share of Results of Joint Ventures	(5)	(4)	(3)	(3)	(3)	(3)	(3)
Total Operating Income	349	383	388	475	552	622	717
Finance Income	6	8	6	7	8	8	9
Finance Costs	(8)	(7)	(8)	(21)	(27)	(26)	(24)
Profit Before Tax	347	384	386	461	532	605	703
Taxation	(32)	(37)	(40)	(50)	(59)	(68)	(79)
Minority Interest	(37)	(29)	(34)	(41)	(47)	(53)	(62)
Net Profit Attributable to Parent	278	318	311	370	427	484	562
Balance Sheet							
Cash & bank balances	657	620	707	749	789	920	1,043
Trade receivables	604	687	731	797	876	964	1,062
Other current assets	127	192	163	198	228	250	287
Total Current Assets	1,388	1,498	1,602	1,744	1,893	2,133	2,392
Available for sale investments	-	-	-	-	-	-	-
Investments in Joint Ventures	50	48	47	47	47	47	47
Deferred tax assets	2	3	4	4	4	4	4
Intangible assets	24	33	49	47	43	40	35
Goodwill	974	1,088	1,038	1,038	1,038	1,038	1,038
Net fixed assets	542	531	703	1,042	1,114	1,170	1,235
Other non-current assets	7	7	2	9	7	10	11
Total Assets	2,986	3,207	3,445	3,930	4,146	4,442	4,763
Trade payables	129	163	156	163	179	176	196
Other Borrowings	177	164	350	562	491	461	411
Employee indemnity provision	67	80	91	103	118	130	140
Other Liabilities	415	557	589	648	695	749	807
Paid-up Capital	1,464	1,464	1,464	1,464	1,464	1,464	1,464
Retained Earnings	587	708	786	893	1,018	1,159	1,324
Other Reserves	39	(7)	(88)	(51)	(9)	40	96
Shareholders' Equity	2,090	2,165	2,162	2,306	2,473	2,663	2,885
Minority Interest	37	24	38	79	126	179	240
Total Equity & Liability	2,986	3,207	3,445	3,930	4,146	4,442	4,763
Cash Flow							
Cash from Operating Activities	445	459	463	525	593	677	757
Cash from Investing Activities	(60)	(250)	(301)	(451)	(200)	(201)	(221)
Cash from Financing Activities	(40)	(245)	(73)	(32)	(354)	(347)	(411)
Change in Cash	345	(37)	90	42	40	130	124
Net Cash at End	657	620	707	749	789	920	1,043
Ratio Analysis							
Gross Profit Margin	53.9%	54.2%	56.4%	56.8%	57.6%	58.2%	58.7%
Operating Margin	9.6%	10.5%	10.1%	11.0%	11.6%	11.9%	12.5%
EBITDA Margin	12.9%	12.7%	12.4%	13.7%	14.6%	14.9%	15.4%
Net Profit Margin	8.4%	8.7%	8.1%	8.6%	9.0%	9.3%	9.8%
Current Ratio (x)	1.9	2.2	1.9	1.8	1.9	2.0	2.1
Total NFA Turnover (x)	6.1	6.0	6.2	4.9	4.4	4.6	4.8
ROAA	9.4%	9.8%	9.4%	10.0%	10.6%	11.3%	12.2%
ROAE	12.6%	13.5%	14.4%	16.6%	17.9%	18.8%	20.3%
Dividend Payout Ratio ^	30.0%	52.7%	65.8%	60.0%	60.0%	60.0%	60.0%
Adjusted EPS (AED)	0.17	0.19	0.21	0.25	0.29	0.33	0.38
Adjusted BVPS (AED)	1.38	1.43	1.48	1.58	1.69	1.82	1.97
Market Price (AED) *	3.05	2.96	3.16	3.31	3.31	3.31	3.31
Dividend Yield ^^	2.5%	3.3%	4.4%	4.6%	5.3%	6.0%	7.0%
P/E Ratio (x)	12.0	16.1	14.9	13.1	11.3	10.0	8.6
EV/EBITDA (x)	10.1	9.3	9.7	8.2	7.0	6.2	5.5

Source: Company Accounts & Global Research

* Market price for 2016 and subsequent years as per closing prices on DFM on May 16th, 2016

Disclosure

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist					
Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Aramex PJSC	STRONG BUY	ARMX UH	ARMX.DU	AED3.31	1,10

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Global Rating	Definition
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BUY	Fair value of the stock is between +10% and +20% from the current market price
HOLD	Fair value of the stock is between +10% and -10% from the current market price
SELL	Fair value of the stock is < -10% from the current market price

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