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SPOTLIGHT

Aramex: Betting on e-growth – raise TP to AED4.03/share, recommend ACCUMULATE

- **We recommend an ACCUMULATE on ARMX and raise our TP to AED4.03/share (from AED2.52/share)**
- **Fuelled by growing E-commerce exposure, top-line is forecasted to grow at a five year CAGR of 7.1%, with expected improvement in near-term margins**
- **While lower oil prices do raise concerns over GCC spending patterns and sentiments, we expect Aramex to be on a favourable footing – because of its asset-light model and geographic diversification**

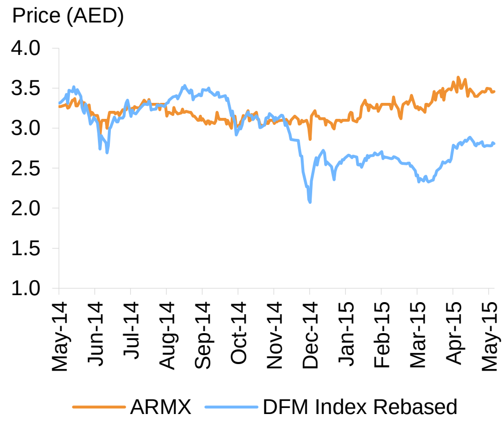
We revisit our valuation on Aramex (ARMX), raising our target price to AED4.03/share from AED2.52/share and upgrade recommendation to ACCUMULATE from HOLD. E-commerce growth, coupled with ARMX's commitment and focus towards expanding (organically and inorganically) in the express business are the main catalysts for growth going forward – translating into higher earnings in the years to come. ARMX currently trades at a P/E 2015E of 12.5x – a 37.6% discount to the peer average of 20.0x. In addition, with its B/S being under-leveraged (with a net cash position), capitalising on its strong liquidity profile could also unlock significant returns.

Top-line forecasted to grow at a five year CAGR of 7%, with expected improvement in near-term margins; owing to a favorable sales mix, lower costs. Our top-line growth assumptions are backed mainly by growth expectations from the relatively high-margin international and domestic express segments (which include E-commerce) - forecasted to grow at a five year CAGR of 8.15% and 8.22%, respectively. The change in the sales mix, coupled with increased capacity and cost declines of cargo & freight rates (on account of lower oil prices), is expected to have a favorable impact on margins during 2015 – 2016. However, with competition in the E-commerce space expected to intensify (given low barriers to entry), margins beyond 2016 are expected to consolidate.

Freight and conventional express segments to grow at a normal pace. Taking into consideration global trade growth, and growth in the air freight industry (inferring forecasts from IATA, Boeing and Airbus), we revise our growth estimates downwards for the freight forwarding segment, and at the same time, aligning our growth expectations for the conventional non- E-commerce part of the business (within the domestic and international express segments) to the industry growth expectations. Traffic from emerging to advanced economies and from advanced to emerging, is expected to grow at 5% and 4.9% p.a. in the next 20 years.

Risks persist: 1) The current oil price dilemma should have an impact on GCC economies and in turn, affecting consumer sentiments & spending patterns. The GCC accounts for about 50% of sales. 2) We also expect tough competition going forward as new companies attempt to ride the E-commerce growth wave. 3) High multiple acquisitions, mainly a result of increased completion, are a concern as ARMX had to pay top dollar for some of its latest acquisitions.

ARMX vs. DFM Rebased



Source: Bloomberg, NAEEM Research

Market Price (AED)	3.46
Target Price (AED)	4.03
Upside Potential (%)	16.5
Recommendation	ACCUMULATE
P/E 2015e	12.5x
Market Cap. (AEDm)	5,065
Market Cap. (USDm)	1,379
Reuters Code	ARMX.DU
Bloomberg Code	ARMX UH

Year to December	2013a	2014a	2015e	2016f	2017f
Revenue (AED)	3,321	3,650	3,925	4,216	4,521
Revenue (% Δ)	8.1	9.9	7.5	7.4	7.2
EBITDA (AED)	427	460	564	569	582
EBITDA Margin (%)	12.8	12.6	14.4	13.5	12.9
EPS (AED)	0.19	0.22	0.28	0.28	0.29
EPS (% Δ)	13.9	14.5	27.6	2.3	3.5
P/E	18.2	15.9	12.5	12.2	11.8
P/FCF	13.8	16.6	12.7	10.9	10.7
Yield (%)	3.4	4.1	5.2	5.3	5.5
ROE (%)	13.5	14.8	17.9	17.3	16.9

Source: Company data, NAEEM estimates
Closing price as of 20 May 2015

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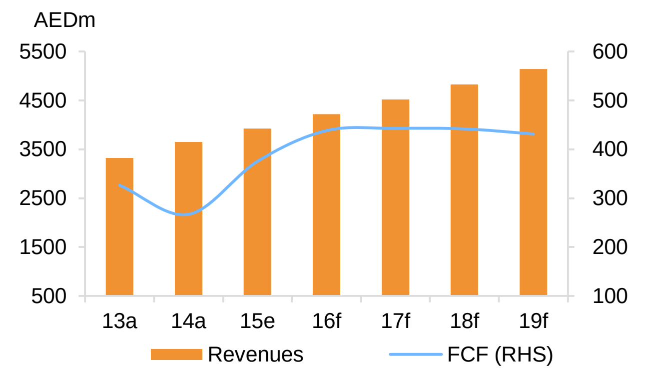
Aramex is an emerging-market logistics and supply chain management company. It was established in 1982, and went public on the Dubai Financial Market in 2005. The company's main service offerings are international and domestic express services, all mode of freight transport, supply chain management and record management. It currently operates in most regions of the world, with operations currently focused in the Middle East and Africa. An asset-light model offers financial and operating flexibility. ARMX is cash-rich and seeks acquisitions, joint ventures and franchising opportunities to expand its reach into newer markets, as well as to build on its operations in existing core markets.

We value ARMX at AED4.03/share with an ACCUMMULATE rating.

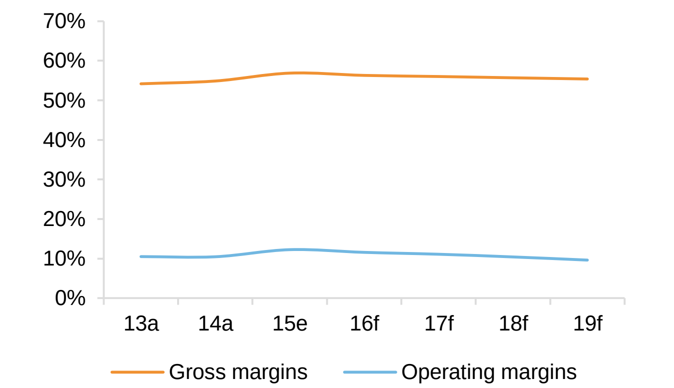
We raise our target price to AED4.03/share and recommend ACCUMULATE. Our valuation applies an 80% weight to the three-stage DCF model, with a 15-year fade period plugged-in (between the growth and terminal phase); mainly expecting growth and FCF margins to consolidate to normalised levels. The model assumes a WACC of 10.7%, and a terminal growth rate of 3%. We allot 20% weight to the relative value – applying average P/E multiples of peers over ARMX's one year- and two year-forward earnings estimates. On a relative P/E basis, ARMX trades at a 37.6% discount to peers. We compare ARMX to selected global peers (a combination of freight forwarders and express carriers). Our main arguments – 1) Aramex's aim is to capitalise on E-commerce growth; a fast growing and underpenetrated industry with huge potential for growth - through its continued focus on developing and expanding current trade networks - demonstrated by its strategy towards acquisitions and joint ventures, 2) Relatively higher growth in the high-margin express segments, driven by E-commerce exposure resulting in better sales mix and improvement in overall margins. However downside risks to our valuation could come from – 1) Lower oil prices and its effect on the GCC economies, which currently contribute about 50% to the topline, in our opinion, 2) Intensifying competition as new companies look to ride the e-commerce wave and 3) Overpaying for acquisitions, as competition intensifies in the e-commerce industry; thus compelling ARMX to pay expensive multiples.

Revenue versus FCF



Source: Company data , NAEEM estimates

Gross and operating margins



Source: Company data , NAEEM estimates

Company Name	Country	Market Cap. (USDm)	P/E 15e	P/E 16F
Fedex Corp	United States	50,372	19.9	16.3
Expeditors Intl Wash Inc	United States	9,042	21.3	19.4
United Parcel Service-Cl B	United States	91,891	19.7	17.8
Uk Mail Group Plc	Britain	429	16.5	16.3
Deutsche Post Ag-Reg	Germany	38,630	16.3	14.7
Mainfreight Ltd	New Zealand	1,166	18.9	16.4
C.H. Robinson Worldwide	United States	9,320	19.3	17.6
Panalpina Welttransport	Switzerland	3,277	27.6	20.1
Sinotrans Air Transport-A	China	4,138	27.9	24.7
Sinotrans Limited-H	China	3,559	14.4	12.9
Freightways Ltd	New Zealand	701	18.4	16.8
Average			**20.0**	**17.5**
Aramex	**UAE**	**1,379**	**12.5**	**12.2**

E-commerce, the prime catalyst for growth

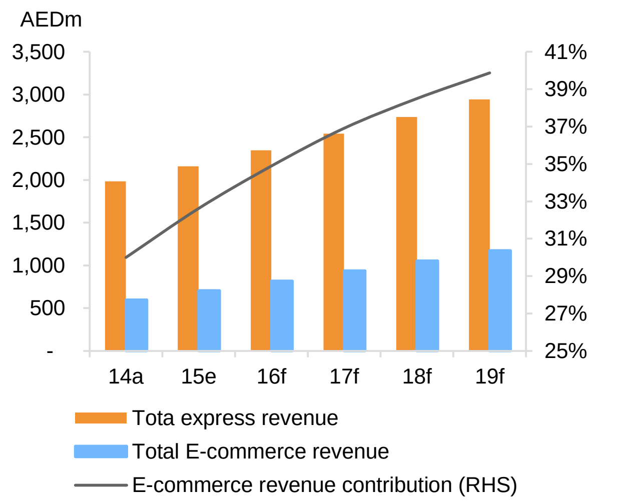
E-commerce is basically the buying and selling of goods and services through electronic channels like the internet. The main categories are B2B (Business to Business), B2C (Business to Consumer), C2B (Consumer to business), and (Consumer to Consumer), with the B2C category specifically on the rise. The E-commerce industry has been fast growing over the years; with growth been driven by broadband connections, both fixed and mobile, internet and smartphone penetration.

The B2C category has been rapidly growing globally, with sales supposedly up 19.3% YoY in 2014. However, with internet penetration, e-shopping and average spending (per e-shopper) having a long way to go in some of the markets, ARMX (like other E-commerce players) would look to capitalise on these opportunities.

From ARMX's perspective - e-shopper penetration rates in MENA and Asia-Pacific stood at just 10.6% and 15.9%, respectively in 2013; lower than the global average of 21.2% and significantly lower than the more developed regions of Europe and North America; which stand at 46.7% and 69.6%, respectively. E-shopper growth is driven by an array of factors - mainly internet access growth and a growing middle class. According to stats, broadband connections are expected to grow at a five year CAGR of 17.5% globally.

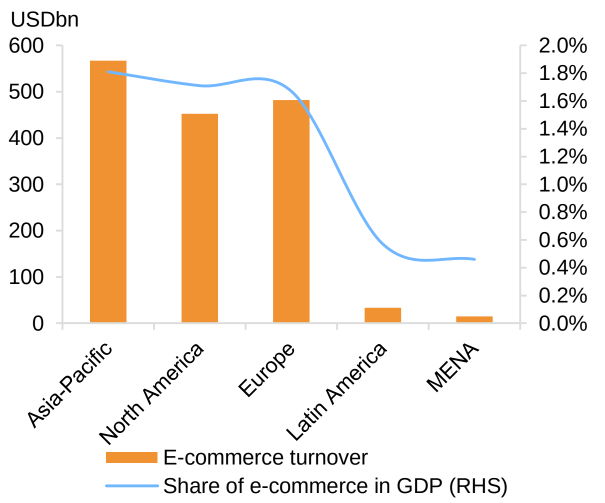
According to ARMX, E-commerce currently constitutes about 30% of express revenues, growing at a rate of 25% YoY; with the company expecting E-commerce to constitute majority of revenues in domestic and international express segments. Aramex has made its intentions clear of capitalising on the fast growing industry. While the company has focused on developing and expanding its B2C networks through acquisitions in Africa and Asia-Pacific, it has at the same time emphasised on organic growth initiatives - launching IShopTheWorld, an online market connecting retailers all over the world with customers, enabling customers to tap into global markets from their home and providing them with a wide selection of products. The company for instance, has invested in a local system solution, partnering with a Polish company (Integer) to develop a new locker system; which is expected to take the load off ground fleet (operations).

Express revenues and E-commerce revenue contribution



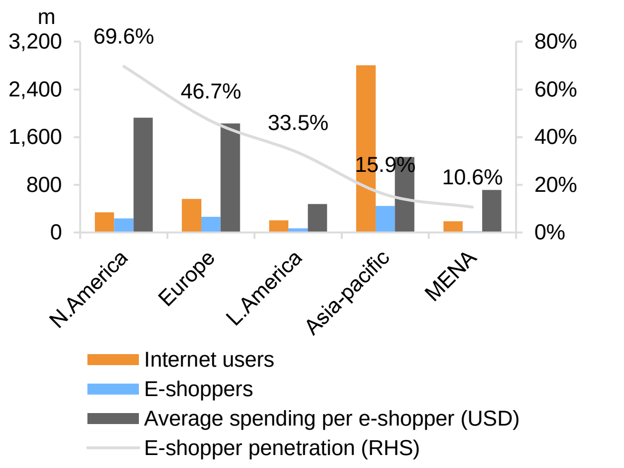
Source: Company data , NAEEM estimates

E-commerce turnover & share of E-commerce in GDP



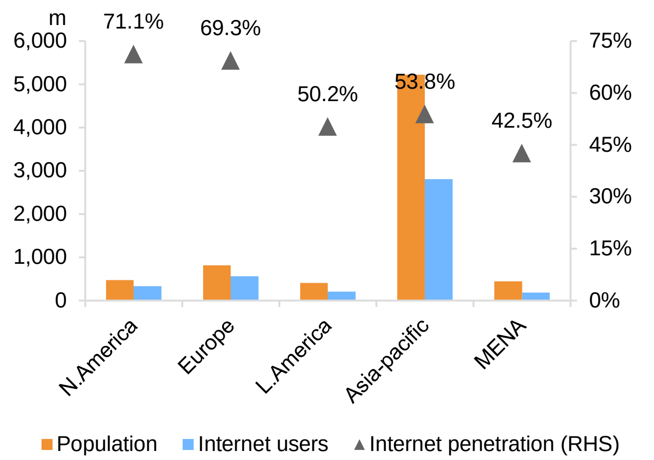
Source: EuropeanB2CE-commerceReport2014,E-commerce Foundation, NAEEM Research

Regional internet users, and e-shoppers



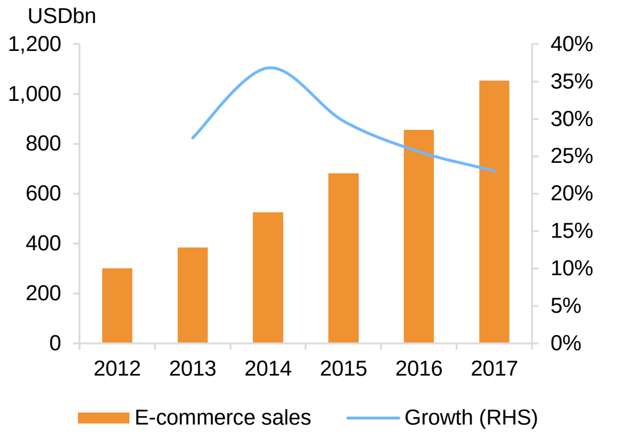
Source: EuropeanB2CE-commerceReport2014,E-commerce Foundation, NAEEM Research

Regional population, internet users, and internet penetration



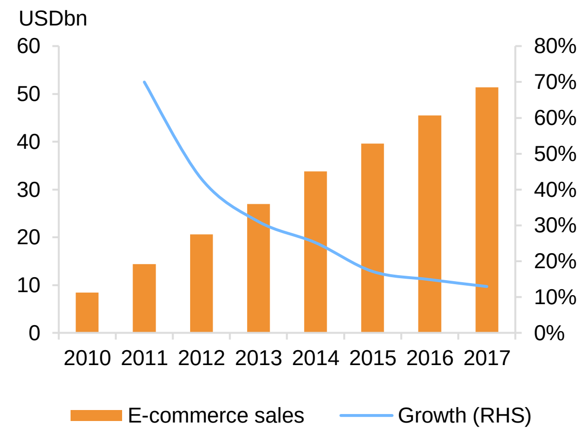
Source: EuropeanB2CE-commerceReport2014,E-commerce Foundation, NAEEM Research

B2C E-commerce sales Asia Pacific



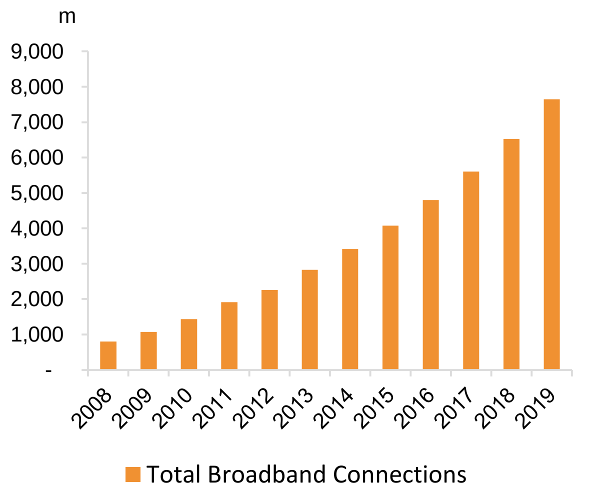
Source: eMarketer, NAEEM Research

B2C E-commerce sales MENA



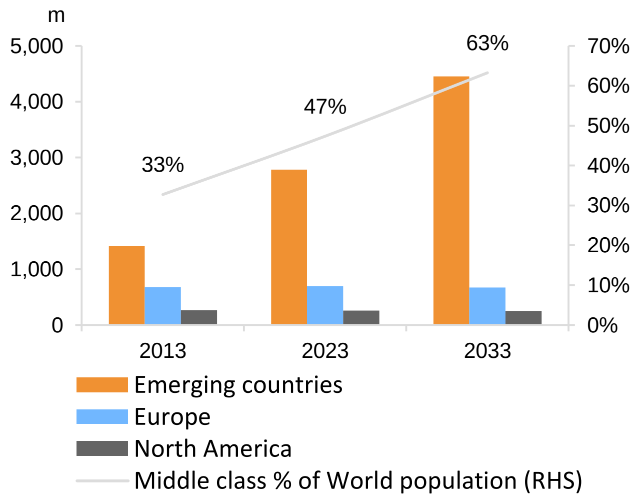
Source: eMarketer, NAEEM Research

Fixed & Mobile broadband connections



Source: Bloomberg estimates, NAEEM Research

Global middle class evolution



Source: Airbus global market forecast, NAEEM Research

Top-line expectations bolstered by e-growth, with improvement in margins on the back of a favourable change in sales mix

We forecast Aramex's top-line to grow at a CAGR of 7.1% in the coming five years, with the international and domestic express segments, forecasted to grow at a CAGR of 8.15% and 8.22%, respectively in the next five years; with growth in the express segments, driven to a large extent by 14.5% CAGR in E-commerce revenue. Overall, E-commerce revenue contribution in the express segments is expected to reach 40.8% by 2019 from the current c. 30%.

The relatively high-margin express segments currently contribute 54.4% to ARMX's consolidated top-line and are expected to contribute about 57.2% by 2019; surpassing the low-margin freight forwarding segment as the top revenue contributor. The favorable change in anticipated sales mix should in our opinion bode well for company profitability; given the disparity between express and freight forwarding margins, which currently stand at 66.8% and 26.8%, respectively, in terms of gross margin. Overall, net-to-net, we expect lower oil prices to have some positive impacts on margins; anticipating a decline in rates charged by airlines offsetting pricing pressures (from ARMX's perspective). According to IATA, a 5.8% decline in cargo costs are expected for 2015, with ARMX further indicating that it had renegotiated fright rates with major airliners. Taking these two factors into consideration - the change in sales mix and cost declines in cargo & freight rates, we expect improvement in gross margins going forward, nonetheless with the oil effect being more of a short-to-medium term impact.

Margin assumptions

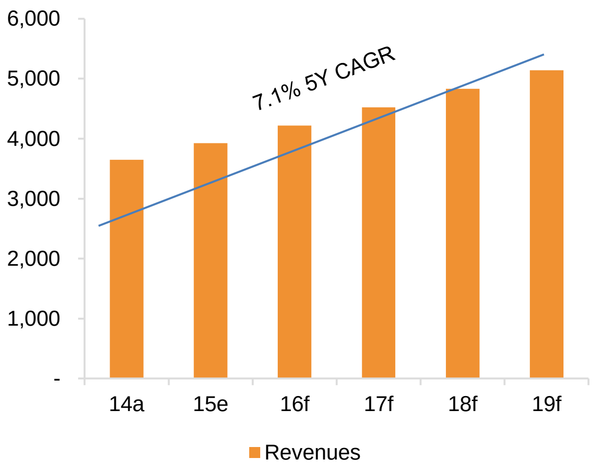
Gross margin	2015e	2016f	2017f	2018f	2019f
Revised gross margin estimates (%)	56.9	56.3	56.0	55.7	55.4
Previous gross margin estimates (%)	53.5	53.3	53.2	53.0	na

Revenue growth assumptions

Sales growth	2015e	2016f	2017f	2018f	2019f
Revised revenue growth rates (%)	7.5	7.4	7.2	6.8	6.5
Revised revenue growth rates (%)	11.5	10.1	9.7	9.8	na

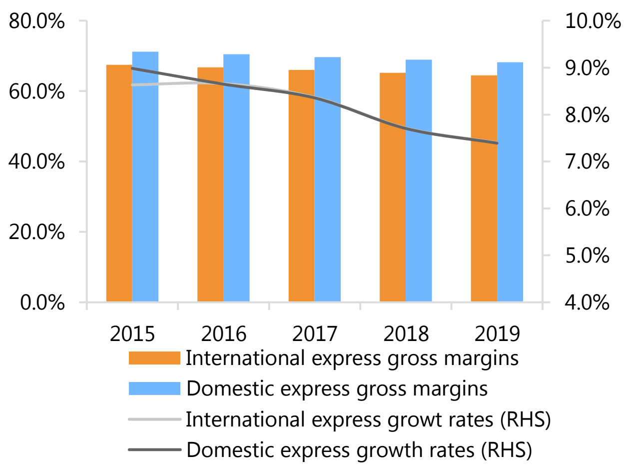
Source: NAEEM Research

Forecasted growth in revenues



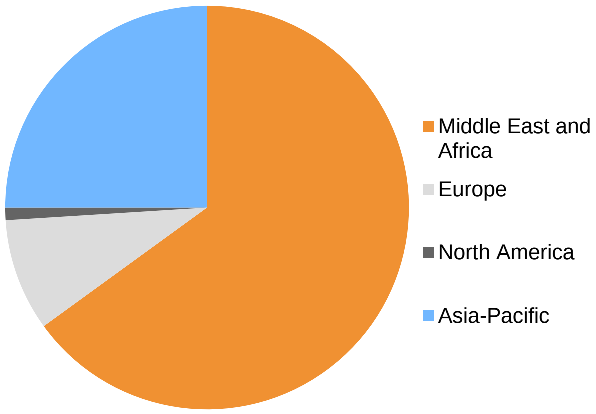
Source: Company data , NAEEM estimates

Express segments margins and growth rates



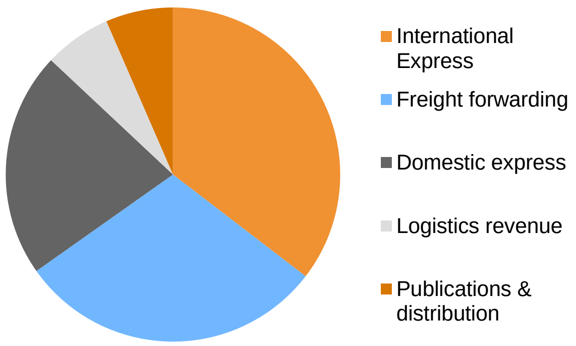
Source: Company data , NAEEM estimates

ARMX geographical revenue breakdown 2019f



Source: Company data , NAEEM estimates

ARMX segmental sales breakdown 2019f



Source: Company data , NAEEM estimates

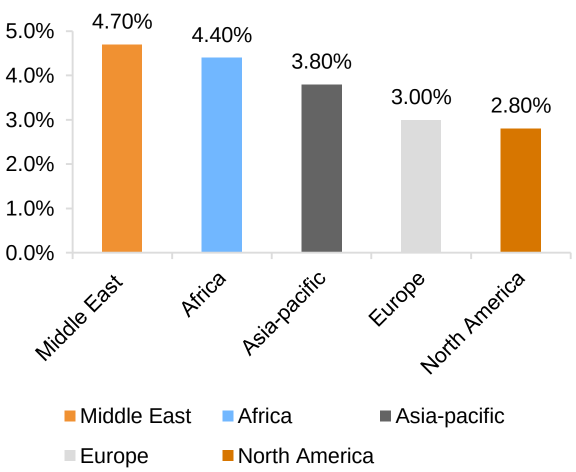
Freight and conventional express segments to grow at a normal pace

Taking into consideration global trade growth, and growth in the air freight industry (inferring forecasts from IATA, Boeing and Airbus), we revise our growth estimates downwards for the freight forwarding segment, and at the same time, aligning our growth expectations for the conventional non E-commerce part of the business (within the domestic and international express segments) to the industry growth expectations.

According to Airbus Global Market forecast, global trade is forecasted to grow at 4.3% p.a, down from the previously estimated 4.6% p.a., throughout the 20-year period between 2013 - 2033. In turn, air freight growth measured in FTK is expected to grow at 4.5% p.a., revised down from an initial 4.8% p.a. According to Boeing's World Air Cargo forecast, air freight, including express traffic, is expected to grow at an average of 4.8% p.a. during the next 20 years.

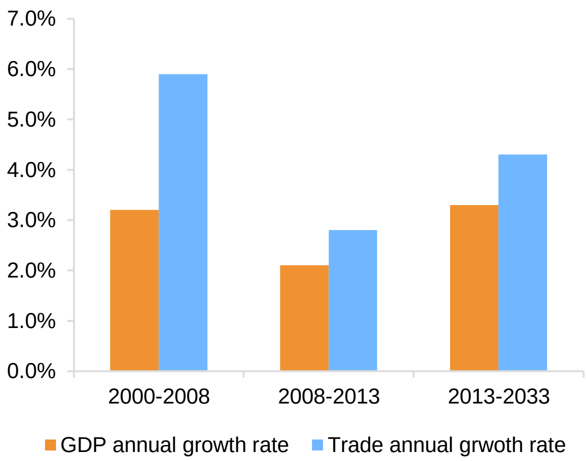
Emerging markets are expected to be the main growth stimulant for the air freight market going forward. According to IATA, Middle East, Africa and Asia are expected to exhibit high growth rates among the regions. Traffic from emerging to advanced economies and from advanced to emerging is expected to grow at 5.0% and 4.9% p.a. in the next 20 years between 2013 - 2033 and will represent 30% and 28% of total freight traffic, respectively, by 2033.

International freight volumes 5-year CAGR



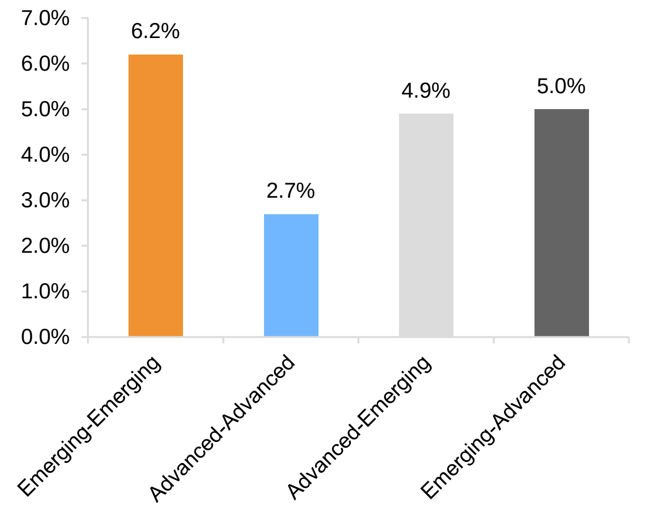
Source: IATA press release , NAEEM Research

GDP and Trade annual growth rates



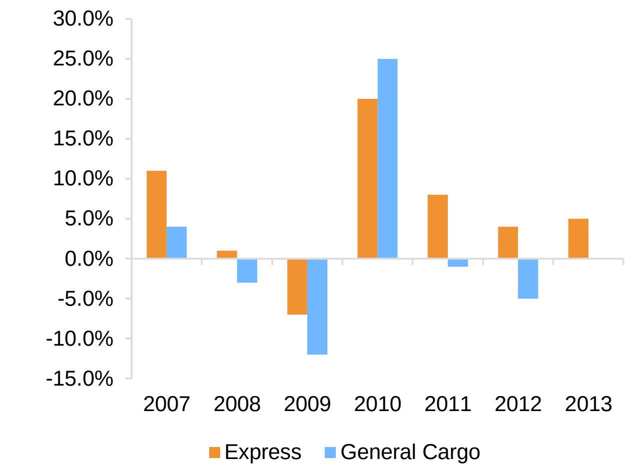
Source: Airbus global market forecast, NAEEM Research

Air freight growth between economies



Source: Airbus global market forecast, NAEEM Research

Express and General cargo historical growth rates



Source: Airbus global market forecast, NAEEM Research

More acquisitions on the horizon

Acquisitions to give ARMX increased access to e-growth markets. Aramex's continued focus on E-commerce expansion, has led it to also emphasize on inorganic growth opportunities –both in emerging as well as developed markets; with the strategy to also realise synergies, enhance existing platforms, product offerings, and develop on its global network of clientele.

During the past year, the company has already made inroads into markets such as Australia (acquiring Mail Call), Africa (acquiring Postnet) and Thailand (JV with Leo Global Logistics) – implying management focus towards geographical diversification through both acquisitions, as well as organic means. We expect the company to continue being focused on its expansion spree going forward and diversify away from its regional (GCC) and conventional product exposure (as against being solely a logistics provider); a common phenomenon among most players in the global E-commerce space.

Acquisition and expansion strategy: The company would usually target acquisitions at multiples (P/E) in the range of 8x-12x. However, premium multiples could sometimes be justified, given the expected synergies and the anticipated benefits of growing its network bandwidth. The recent acquisition in Africa (Postnet) came at premium multiples (P/E 17x-18x) - mainly because of increased competition in the industry and, expected positives from synergies justifying the premium. ARMX continues to be keen on expanding its operations into new and existing markets; it sees a lot of potential for growth in markets such as Africa and Australia. While new acquisitions are mostly expected to be at a smaller scale (or bolt-on by nature), we expect the same (targets) to be technology driven, to enhance Aramex's existing E-commerce platform and product offerings.

ARMX has a strong balance sheet with net cash of AED455.8m, giving it the freedom to raise debt in order to finance future inorganic expansion opportunities. Going by our own analysis and taking indications from the company, ARMX should be eligible to secure additional financing of up to USD300m and, at reasonable terms - given its strong price bargaining power arising from its solid B/S. Going forward, we also expect the company's capital structure to reflect added leverage. ARMX seeks to achieve a targeted 40: 60 debt-to-equity within the next 2-3 years, as it continues to expand both through acquisitions, as well as through organic means. While our forecasts on Aramex solely take into account organic growth for now, an upside re-rating could loom in the occasion of the company making lucrative, strategically larger acquisitions.

Latest acquisitions

Company name	Country	Acquisition cost (USDm)	Implied P/E	Implied P/S
Mail Call Couriers	Australia	30.9	12.2x	1.2x
Post Net	South Africa	15.8	17.3x	4.1x

Source Company data:, NAEEM Research

Weaker oil prices and spillover impact on GCC spending the main downside risk

The recent oil price slide, if persistent, could definitely have an impact on GCC economies; impeding government spending and, causing a domino effect - thus having a toll on private spending, purchasing power and impacting consumer sentiments.

With roughly 50% of its sales being exposed to the GCC market, ARMX's business vulnerability to oil price cyclicality, is something which is yet to be discovered and assessed. Till date however, we infer a small portion of the company's business having had a significant negative impact; i.e. billing rates pertaining to oil & gas activity (constituting 4%-5% of consolidated revenue). The company expects this segmental weakness to continue in the foreseeable future. As a precaution, ARMX has already taken measures (laying off 180 employees in 1Q15) in order to buffer company profitability; expecting negative impacts on the retail front as well.

While we do acknowledge the concurrent risks of weakening oil prices in the GCC markets, ARMX seems inclined towards buffering itself by going aggressive on its expansion plans and, exposing itself to new growth markets. In addition, what needs to be taken into consideration is the expected positive impact on margins as a result of the decreased cost of air freight; which the company would look to exploit to the maximum extent. Crucial to note that ARMX's asset-light model helps it withstand and adapt to market shocks, which was exhibited in its resilient performance in the years of 2008-2009. Top-line growth in 2008 amounted to 17% YoY with gross margins improving 3.1pps YoY; leading to bottom-line growth of 21.2% YoY and although 2009 witnessed a decline in the top-line of 5.7% YoY; with margins witnessing an improvement of 6.5pps YoY.

	Daily Oil production (000s bbl)	Daily Gas production (000s bbl)	Total oil reserves (bn boe)	Total gas reserves (bn boe)	Fiscal break-even oil price (USD/barrel)	Current acnt. break-even oil price (USD/barrel)	Hydro-carbons % of export earnings	Gross external debt (% of GDP)	FX reserves (USD bn)	Government exp. (% GDP)
KSA	9,637	1,890	266	55	86	60	85%	12%	775	36%
UAE	2,820	1,260	98	40	74	62	33%	38%	84	26%
Qatar	690	3,600	25	163	71	61	46%	76%	47	32%
Kuwait	2,930	260	102	12	52	33	95%	20%	29	43%
Iran	2,400	3,190	158	224	131	61	63%	2%	111	15%
Iraq	3200	NA	144	21	109	97	100%	11%	80	45%
Algeria	1,222	1,400	102	30	113	89	68%	2%	192	38%
Egypt	720	902	4	14	na	na	24%	16%	16	38%

Company profile

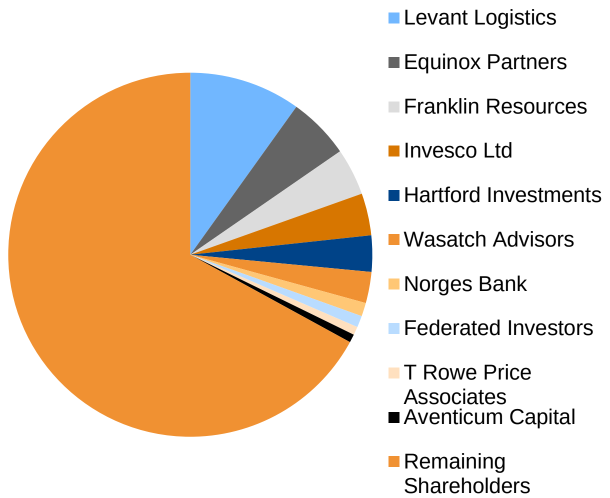
Aramex is an emerging-market logistics player and supply chain management company. Established in 1982, during 1997 ARMX was the first Arab-based company to list its shares on the NASDAQ stock exchange, before going private in 2002, and then listing on the Dubai Financial Market in 2005. ARMX is cash-rich and seeks acquisitions, joint ventures and franchising opportunities to expand its reach into emerging markets and build upon its operations in existing core markets.

The company's main service offerings include - international and domestic express services, all modes of freight transport, supply chain management & record management, international and domestic express segments. The company currently operates in most regions of the world, however, with most operations currently centered in Africa and the Middle East. However, there is growing emphasis to expanding its reach into new markets; mainly Asia-Pacific which currently constitutes 10.1% of revenue; so we expect this share to grow going forward as the company implements its expansion plans.

ARMX has consistently reiterated its commitment towards its historical dividend policy; targeting a payout of 60%-65%. The company recommended a dividend of 14% of paid up capital - amounting to AED0.14/share for 2014; implying a payout of 64.4%. The dividend payout was approved in April 2015.

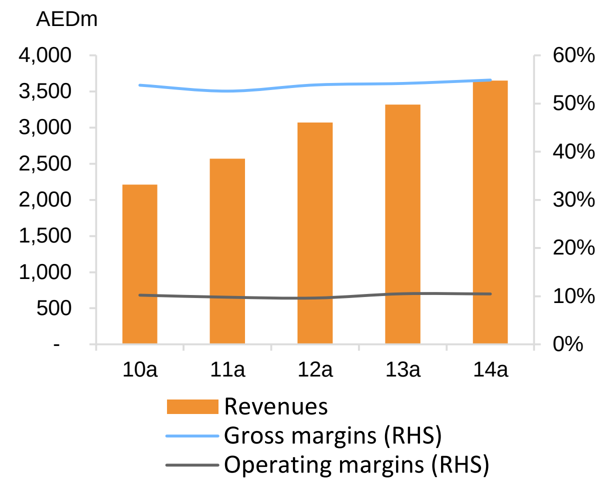
Aramex at a glance

Top five shareholders



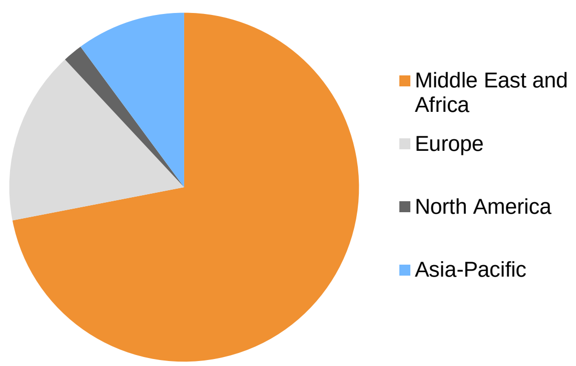
Source Company data:, NAEEM estimates

Historical revenues and margins



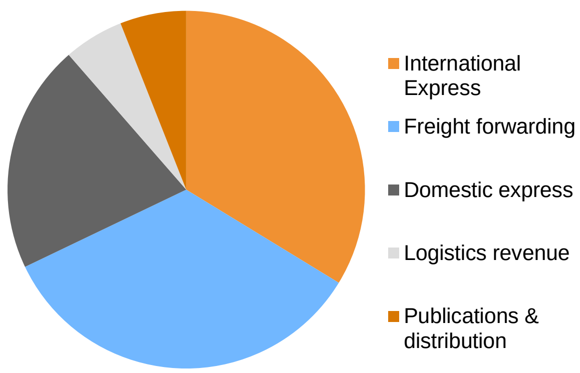
Source Company data:, NAEEM Research

Geographical revenue breakdown 2014



Source Company data:, NAEEM Research

Segmental revenue breakdown 2014



Source Company data:, NAEEM Research

Disclosure Appendix

Disclaimer

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ACCUMULATE	>10% to 20%	11%
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SELL	< -20%	4%

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