ALJAZIRA CAPITAL الجزيرة للأسواق المالية

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Saudi Food & Beverage Industry: Although short-term economic challenges, the sector stays defensive watch out for recovery. The food & beverage industry positioned to absorb most of the impact from VAT, while inflationary impacts would be minimal on consumer price index. The industry in Saudi Arabia remains one of the most attractive in the region. Restoring bonuses and allowances for public sector employees retroactively as of September 27, 2016 to support food retailing growth .“AlMarai” “Halwani” are Included in MSCI Saudi Arabia Index.

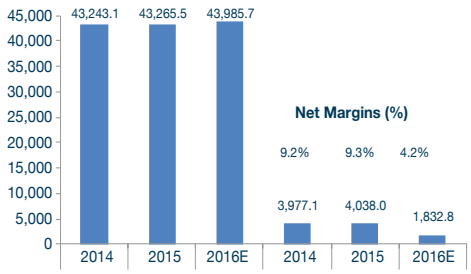
Despite short-term economic challenges and cautions spending, Food Industry in Saudi Arabia stays defensive and waiting for recovery in 2018: the sector index rose 25.9%YTD and 42.3% on a 52-week performance, significantly outperforming the TASI index of 2.3%YTD. Despite short-term economic headwinds, Saudi Arabia's food industry remains defensive. Beside the pressured macroeconomic condition due to low level of oil prices, the regional food and beverage industry witnessed low purchasing power over 2016/2017 as the non-oil economy suffered due to fiscal reforms and changes such as wage cuts and higher unemployment rate. These factors has weighed on household spending over 1Q2017 resulting in falling sales volume, enforcing some food retail players in the market to provide high discounts on products at the cost of margins. The unemployment rate for Saudis reached 12.3% in 4Q2016, the highest level since 2012, which translated into lower household spending, further impacting the non-oil economy. According to the Saudi general Authority for statistics, KSA reported deflation at -0.7% in May 2017 (deflation for fifth consecutive month). The cost of living index fell to 136.6 points in May compared to 137.6 points in the same period last year. The food and beverage group fell the most at 2.3%. Furthermore, other macroeconomic factors affecting the food & beverage industry included higher fuel prices, water and electricity prices, which had direct impact on production cost, transport and distribution cost. Moreover, a slowdown in the labor market has added an unfavorable factor for the local consumption in 2016/2017.

However, we expect the domestic food industry to witness recovery beyond 2017 with expectation of oil market rebalance (IEA source), which will increase spending power for consumer and bringing back confidence. We believe the governments' National Transformation plans (NPT) are encouraging private investment in order to enhance and diversify the total revenues of the country. Furthermore, we believe that the Royal decree of reversing the allowance cut for governmental employees are the key catalyst to increase the householders spending. Moreover, favorable demographic, and the increasing participation of Saudi nationals in the private sector (Saudization programme) are expected to benefit food industry and boosting households purchasing power.

The Food & beverage industry in Saudi Arabia remains one of the most attractive in the region: KSA's food industry remains one of the most attractive in the region, with strong sales growth expectation over our forecast period. On an average, KSA imports ~80% of its food requirement where food accounts for ~15% of its total imports. Based on the governments' initiatives (NPL) to overcome obstacles on foreign investment, Saudi Arabia's food processing sector is expected to attract strong investment, particularly in the key segments, which are contributing to the growth in local food consumption. The expansion of the big organized food retailing and producer such as AlMarai and Savola will continue to strengthen internal trade systems and local food production, which is expected to contribute to lower cost, that can be passed on to consumers partially offsetting impact of value added tax (VAT). Although we believe the labour market is under pressure, the food sector will benefit from a sizeable population of around 31.74mn, with an average household of 6.4 persons. This will boost the demand for consumer goods amid a weak consumer spending environment.

Saudi Arabia's population is expected to reach 33.0mn by 2021, making it the only market in the Gulf region that can realistically provide investors with long-term volume growth potential. Thus, we forecast real household spending and private consumption to grow in 2Q2017 due to reversal of suspended bonuses/salaries and the enhancement of economic condition.

Earnings Performance (SAR mn)



Source: Company reports, Aljazira Capital, Bloomberg

Key Earnings (SAR mn)

	2016	1Q2017
Revenues (mn)	43,985.7	10,017.4
Growth% (YoY)	1.7%	-6.7%
Net Income (mn)	1,832.8	338.32
Growth% (YoY)	-54.6%	-36.0%

Source: Company reports, Bloomberg, Aljazira Capital

Key Ratios

SARmn (unless specified)	
PE (12TTM):	93.88x
Est PE:	28.7x
P/B:	3.66x
Price/sales:	1.98x
EPS (12TTM):	65.74
Est EPS	210.27
ROE	3.4%
ROA	1.5%

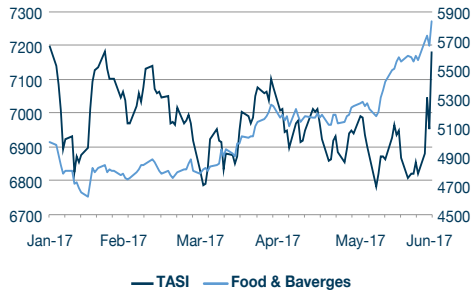
Source: Company reports, Bloomberg estimates,, Aljazira Capital

Key Market Data

Number of companies	12
52 Week (High)/ (Low)	6324/4498
Dividend Yield:	1.14%
Market Cap(bn)	101.43
YTD%	25.9%

Source: Company reports, Aljazira Capital, Bloomberg

Sector Performance



Source: Bloomberg, Aljazira Capital

Updated key financials & investment recommendations

	Company Name	12month TP (SAR)	Investment recommendation
2280	AlMarai	73.50	**Underweight**
6070	AlJouf Agri	34.20	**Overweight**
6001	Halwani Bro.	55.10	**Neutral**

Source: Bloomberg, Aljazira Capital

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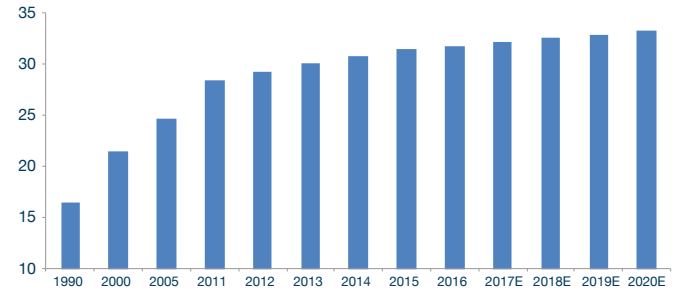
Food & Beverage industry represents one of the largest shares of the total household spending. We expect that sales growth will recover slightly in 2017 as compared to 2016 due to steady improvement in the local economy (2017 projected budget). Thus, we anticipate the growing trend of food industry to become more visible, in Saudi Arabia, in 2018. In addition, the sub-sector will continue to provide the food retailers with impressive growth opportunities, where hypermarket and supermarket continue to be largely supportive, that accounts for more than half of market share of grocery retail.

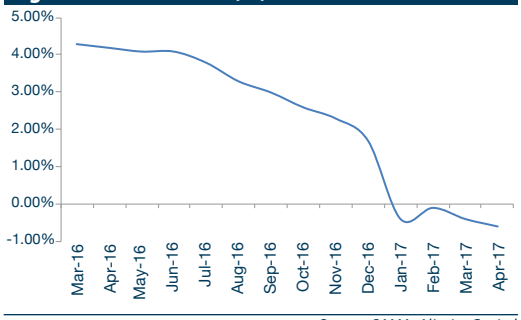
KSA's food industry remains one of the most attractive in the region, with strong sales growth figures forecast over our forecast period to 2019, where on an average Saudi Arabia imports ~80% of its food requirement and food accounts for ~15% of its total imports by the country.

Figure1: Population- Saudi Arabia



Source: General authority for statistics , AlJazira Capital

Figure1: Inflation rate (%) – Saudi Arabia

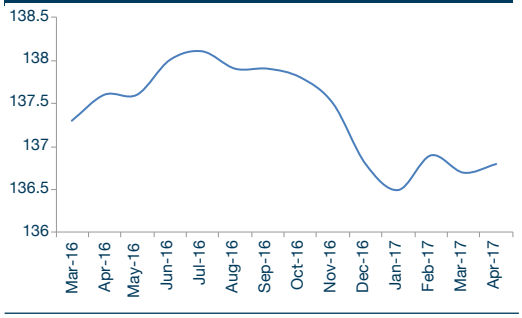


Source: SAMA, Aljazira Capital

The food & beverage industry positioned to absorb most of the impact of VAT, while inflationary impacts would be minimal on consumer price index basket: the kingdom had already imposed tax (2017, 10th June) on selective goods and beverages such as tobacco products, soft drinks, and other harmful products. While 5% value added tax (VAT) will be applied by January 2018, on most goods and services in order to increase the country non-oil revenues and to help the economy adjusting to the low oil prices. We believe that the introduction of 5% VAT will have minimal short-term negative impact on consumers' purchasing power, with little impact on food and agriculture companies, as taxes on production would be passed by companies to the end consumers, which means 5% increase in prices of selective goods and services that might lead to short-term negative impacts on spending till households adjust to the new implied tax. However, we expect that consumer spending will remain stable and wouldn't see a significant impact on our spending forecasts over next few years, with robust growth to 2022. Furthermore, the recent subsidy cuts and VAT implementation in Saudi Arabia are expected to have a mixed impacts on consumption habits, where higher impacts would be on non-essentials and luxury products while less impact on food products due to VAT-exemption for almost 94 food products.

Although we believe the labour market is under pressure, the food sector will benefit from a sizeable population of around 31.74mn and the comparably large size of Saudi family in the kingdom. This will boost the demand for consumer goods amid a weaker consumer spending environment.

Figure2: Consumer price index (CPI) – Saudi Arabia



Source: SAMA, Aljazira Capital

We believe that the inflationary impact from 5% value added Tax will be minor due to the tax exemption for major component of Saudi CPI basket (Consumer Price Index) and especially food and beverage. Moreover, the expectation of interest rate hikes by US Federal Reserve and US dollar appreciation will keep inflation down due to its contribution to lower cost and imported raw material that can be passed on to consumers and local response to US interest rate hikes. Consequently, we believe that the "Citizens Account" that was established by the government to help low/middle income Saudis is a key factor to rebalance the impact of austerity measures and subsidy cuts. To sum up, The relative latest reversing salary and bounces cuts in the kingdom, combined with "Citizens Account", economy picking up and low current inflation environment will ensure that purchasing power is not going to be significantly impacted.

The recent subsidy cuts and VAT implementation in Saudi Arabia are expected to have a mixed impacts on consumption habits, where more impacts would be on non-essentials and luxury products while less impacts on food products due to VAT-exempt for almost 94 food products

Food Industry is highly exposed to volatility in grains and feed prices, however expansion in poultry segment with better expected performance of local producers: Saudi Arabia will gradually be reliant more on grains imports, as the country has decided to phase out domestic grains production in a bid to preserve the country's water supply. On the other hand, the government will keep its strategy of self-sufficiency in poultry that has been ramping up incentives to expand production capacity. This strategy encouraged the three major producers in the sector to invest heavily in poultry. However, the country will remain highly vulnerable to volatility in grains and feed prices. Recent spikes in feed prices have turned us more cautious on margins for some dairy and livestock producers in the country, especially after 2019.

The country is also trying to increase agricultural investments abroad, targeting wheat, rice, barley, yellow corn and green forage in order to re-export these grains back to Saudi Arabia. Producing grains abroad with Saudi companies will help the country count on more stable supplies. The creation of a joint-venture in April 2015 between state-owned Saudi Agricultural & Livestock Investment Company (Salic) and the agricultural trading house Bunge to acquire 50.1% of CWB, Canada's wheat and barley marketing organization, is a clear feature of this strategy to secure stable sources of food imports.

We believe the impact of stopping domestic production of green fodder will be limited to some dairy, meat, and green fodder farming companies like Al-Marai, where more Impact is expected on green fodder producer such as AlJouf Agri.

Saudi Arabia initiatives to entirely dependent on imports for its grain needs and phasing out the local wheat production led to 73% decline in AlJouf Agri sales of wheat to stand at SAR 15mn in 2016 from SAR 54mn in 2015.

The relative latest reversing salary and bounces cuts in the kingdom, combined with "Citizens Account", economy picking up and low current inflation environment will ensure that purchasing power is not going to be highly impacted.

The increase in customs duties on poultry, and partly suspension of poultry imports are expected to be in favor of local poultry producer.

Rising levels of grain imports will continue to raise the cost of poultry.

Poultry	Brief	The government will continue to ramp up poultry production and is encouraging investments in poultry sector along with securing further imports from a growing number of destinations. Recent spikes in feed prices have made us more cautious on margins for dairy and livestock producers in the country, especially those that import inputs from abroad
	Update	In 2016, Al-Marai imported 80.0% of forage requirements from their own farms outside Saudi Arabia. In 2017, Jan: The Saudi General Customs Authority of Saudi Arabia raised customs duties on poultry by 15% from 5% to 20%. In 2017, March: The Saudi Food and Drug Authority has suspended the importation of beef and poultry products from 4 Brazilian enterprises.
	Impacts	Rising levels of grain imports will continue to raise the cost of poultry. The increase in customs duties and partly suspension of poultry imports are expected to be in favor of local poultry producer.
Green Fodder Alfalfa	Brief	In Dec 2015 the Saudi government has taken policy initiatives to stop domestic production of green fodder after 2019 for the purpose of water conservation. In the near term, this could pose challenges for the domestic food industry since companies will have to import green fodder to feed livestock and stop farming green fodder for sales.
	Update	In 2016, Almarai managed to import 52% of its alfalfa needs from various regions, including Argentina. This import process has resulted in a cost increase of SAR 160mn.
	Impacts	We believe the impact will be limited to some dairy, meat, and green fodder farming companies like Al-Marai due to 80.0% of forage requirements came from their own farms in Argentina, Europe and the USA. However, more Impact is expected on green fodder farming such as AlJouf Agri, where almost 34% of total sales in 2016 came from green fodder.
Wheat Production	Update	Wheat production will be almost completely phased out in the ongoing seasons 2016/2017 and Saudi Arabia will become entirely dependent on imports for its grain needs. The government stated it was to end its programme of purchasing local wheat in 2015/16. Grains consumption growth will remain robust in 2017, amidst the ongoing boom in the poultry industry. The government is in the process of restructuring the Grain Silos and Flour Mills Organization, and privatizing the flour mills. AlJouf Agri: reportedly reduced their wheat production to result in only SAR 15mn sales in 2016 from SAR 54mn in 2015.

Source: multiple governmental sources, companies announcement and reports, Aljazira Capital

Key risks:

Dairy sector to grow, but government subsidies is a key risk: The dairy sector will continue to grow in Saudi Arabia. However, the risks posed to the Saudi economy by low oil prices may darken the outlook for production and consumption should the government decide to cut its support for the sector. Beyond these issues, dairy production will be held back by the country's dependence on grains imports, environmental constraints and elevated production costs.

Expatriates leaving and lower income are key risks: expatriates are considered as a key risk for food industry, due to a hit to their spending power after government plan to impose fees on expatriates and the government Saudization efforts. The private sector's dependence on expatriates labour is quiet heavy for spending as a potential for food consumption.

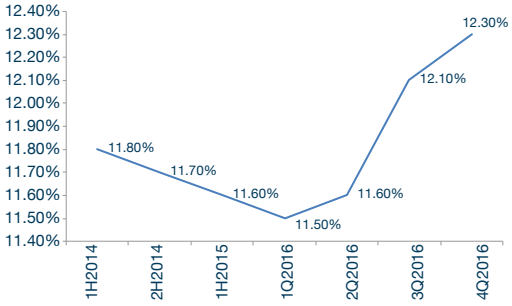
Possible fuel, electricity, water price hikes: We believe sustained low global oil prices and continued government spending on infrastructure could keep the government's balances in deficit in 2017. Consequently, as a measure to recover these losses, the government could again push for a similar price hike in fuel, electricity, and water, which would impact the companies' margins.

Declining global oil prices: We believe continuing low oil prices could negatively affect government spending thus depressing businesses and consumer confidence. Based on IMF forecast, the GDP growth of Saudi Arabian economy will fall to 0.4%YoY in 2017, as fiscal consolidation and oil production cuts hit economic activity. The Saudi consumer will be hit hard as a result, with private consumption.

High interest expenses as SAIBOR between banks rose sharply in the last period: The Interbank Rate in Saudi Arabia (SAIBOR 3 Month) has been steadily increasing again from the middle-June 2017. The SAIBOR 3 Month rate rose from 1.72% to 1.78% during June 2017. The Federal Reserve raised rates for the third time in nine years by another 25 bps to 1.0% in June 2017, which also led to the rise in the SAIBOR 3 Month rate. The rise in SAIBOR would negatively impact particularly companies with high leverage on the balance sheet.

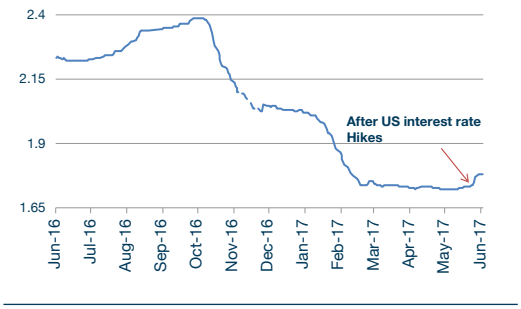
Valuation summary: The Food and beverage sector currently trades at a PE of 93.88x and a PB of 3.6x, significantly above market T12 PE of around 17.4x due to non-recurring impacts and provisions during 2016. According to Bloomberg, the sector is expected to trade at PE of 28.7x based on forward earning forecast for FY2017. We maintain our "**Overweight**" recommendation on **AlJouf Agriculture Co.** based on revised earnings forecast with a PT of **SAR 34.20/share**. We update our recommendation on **AlMarai Co.** to "**Underweight**" due to unjustified market price with a upgraded PT to **SAR 73.50/share**. The upgraded PT is based on revised forward earnings and expected higher free cash flow due to revised CAPEX plan. However, 9.3% upside potential with "**Neutral**" recommendation on **Halwani Bros.** with a PT of **SAR 55.10/share**.

Figure 3: Unemployment Rate (%) – Saudi Arabia



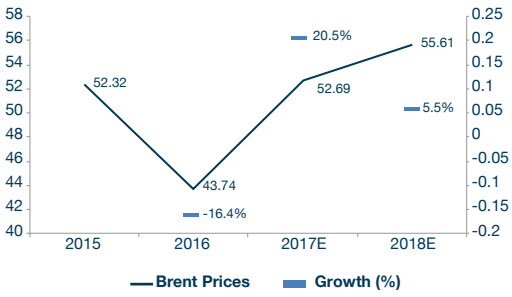
Source: General authority for statistics, Aljazira Capital

Figure 4: Saudi Sibor Rate 3 Months



Source: Bloomberg, Aljazira Capital

Figure 5: Oil Price - US Energy Information Administration



Source: US Energy Information Administration, Aljazira Capital

Updated key financials & investment recommendations

	Company Name	12month TP (SAR)	Investment recommendation	Profitability (SAR in mn)		EPS (SAR mn)		PE (x)*		PBV (x)*		Dividend yield*
				2016	2017E	2016	2017E	2016	2017E	2016	2017E	2016E
2280	AlMarai	73.50	Underweight	2,135	2,196	2.67	2.75	25.6	33.7	4.84	5.85	1.1%
6001	Halwani Bro.	55.10	Neutral	53.9	85.6	1.89	2.99	33.1	16.8	3.4	2.7	5.0%
6070	AlJouf Agri	34.20	Overweight	77.71	92.3	2.59	3.08	13.4	9.4	1.27	0.99	3.5%

Source: AlJazira Capital* we have taken respective December closing prices for 2016, while for years 2017 we used closing price of 2nd July 2017.

Almarai: Q1-2017 earnings below our estimate due to higher than expected impact on Dairy & Juice Sales; however, Production efficiencies and improving inputs costs in 1Q2017 supported gross margin with 140 bps increase. Poultry sector continue to improve, FY2017 to reach breakeven. Lower CAPEX plan is likely to raise Free cash flow and stock valuation. "AlMarai" included in Saudi MSCI index. 'Underweight' recommendation due to unjustified market price, with higher TP of SAR 73.50/share.

Recommendation	Underweight
Current Price* (SAR)	93.80
Target Price (SAR)	73.50
Upside / (Downside)	-21.7%

*prices as of 3rd of July 2017

Almarai Company posted net income of SAR 328.3mn; indicating an increase of 13.7%YoY and a fall of 39.7%QoQ. The company attributed the YoY growth to i) Lower cost of sales due to better cost management, lower commodity costs and enhanced production efficiencies. ii) Decline in Poultry losses by 72.1% to SAR 29.1mn compared to last year corresponding quarter losses of SAR 104.3mn iii) Decline in OPEX by SAR 28.mn driven by higher cost control iv) an increase in Foreign Exchange gain by SAR 13.8mn. On the other hand, the deviation of 1Q2017 earnings with our estimates is attributed mainly to the impact of i) the implementation of IFRS accounting policies ii) higher funding cost of SAR 27.2mn due to higher SAIBOR rate. iii) Higher other expenses by SAR 29.3mn due to lower selling price of bull calves. iv) 3.2%YoY decline in Dairy & Juice sales. The company reported a 0.28%YoY increase in revenue for 1Q2017 to SAR 3,383.5mn. We believe the sales growth of Bakery and Poultry were offset by 3.2% decline in its largest segment (dairy & Juice) due to lower selling prices and devaluation of the Egyptian Pound. Its other key segments registered significant growth in net profit, where Bakery led with a 19.6%YoY rise, followed by decline in poultry losses from SAR 104.3mn to losses of SAR2 29.1mn down 72.1%YoY. On the other hand, the implementation of 20% custom fees on imported poultry will help the local producer in becoming more competitive.

The company's gross margin expanded 140 bps YoY to 34.8% despite lower costs in the comparison period. Almarai Company reported a 4.4%YoY rise in gross profit for 1Q2017 to SAR 1.18bn. This is due to lower cost of sales, lower commodity costs, despite the higher alfalfa cost to support its dairy business, which resulted in higher costs by SAR 160mn in FY2016 according to the company.

Poultry sector continued marked improvement, FY2017 to reach breakeven: The Company managed In 1Q2017 to reduce the operating losses at the poultry segments by 72.9% to SAR 29.1mn, down from loss of SAR 104.3mn in 1Q2016; indicating higher operating efficiency and a sign of recovery in the near future. Almarai has stopped its expansion in poultry segment after reaching capacity of 200mn birds by adding the 3rd production line in 2014; raising its market share of fresh chicken in Saudi Arabia to about 36%. It seems that the company was able to partially overcome the problem of mortality rate. Furthermore, the poultry division is expected to gradually improve, to reach breakeven in FY2017 and turning profitable in 2018 to increase the company's exposure in non-dairy products.

Bakery: the bakery segment was a key revenue growth driver in FY2016 for Almarai with 16.3%YoY increase and 17.6% net margin. The new Hail facility, that commercially started in 3Q2016, in addition to the new products are expected to support the Bakery segment growth. We believe the existing plants are operating at high capacity. Bakery is expected to continue its growth trajectory in FY2017, with sale increasing 7.5%YoY to SAR 2.03bn.

Fresh Dairy & Juice: fresh dairy remains the company's largest segment for the company and will support the total revenue growth in the mid/long-term. However, fresh dairy revenue declined in 1Q2017 for the third consecutive quarters (-3.2%YoY in 1Q2017). This could be ascribed to the change in individual spending habits on some products with the current purchasing power condition. Thus, we expect dairy & juice sales to decline -2.4%YoY to SAR 11.0bn and return to the growth story beyond 2017, along with expected improvement in household spending after the reversal of the suspended bounces and salaries.

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	13,795	14,339	14,729
Growth %	9.4%	3.9%	2.7%
Net Income	2,046	2,135	2,196
Growth %	23.8%	4.3%	2.9%
EPS	2.39	2.67	2.75

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	38.3%	38.4%	38.2%
Net Margin	14.8%	14.9%	14.9%
P/E	32.67x	25.67x	34.17x
P/B	6.04x	4.84x	5.93x
ROE	15.8%	16.4%	15.5%
ROA	7.5%	7.6%	7.3%
EV/EBITDA (x)	19.34	15.28	19.48
Dividend Yield	1.0%	1.3%	1.1%

Source: Company reports, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Savola Group Co.	36.52%
Prince Sultan M. AlSaud	23.69%
Public	39.79%

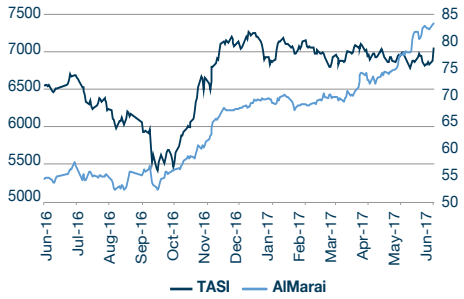
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	75.04
YTD %	37.7%
52 Week (High)	98.30
52 Week (Low)	51.50
Shares Outstanding (mn)	800.0

Source: Company reports, Aljazira Capital

Figure1: Tasi & Almarai price performance



Source: Company reports, Aljazira Capital

The Saudi government passed a resolution to suspend the domestic production of green fodder in the country. It indicated that all fodder requirements would be met through imports by January 2019. Almarai Company recorded an annual increase of about SAR 160mn in input costs in 2016. However, we believe the company would continue to focus on business efficiency and cost optimization to mitigate the impact of high costs due to their agricultural investment outside the country. Based on our revised assumptions, Almarai's net income by our estimates would increase by about 2.9% in 2017. Consequently, the net income of AlMarai for 2017 stands revised to SAR 2,196.2mn from earlier estimate of SAR 2,095mn.

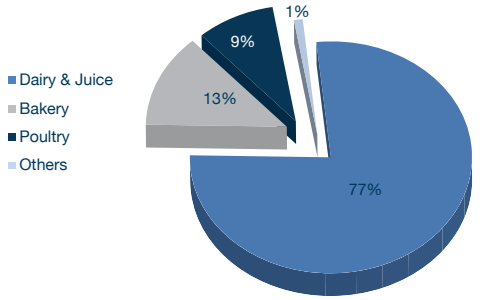
Lower CAPEX plan likely to raise Free cash flow, stock valuation and adding more flexibility for dividend policy: Almarai announced a revised 5 years CAPEX plan, with a target of SAR 12.5bn in its FY2018-22E plan, which is lower than our estimates of SAR 15.5bn and the previous SAR 14.5bn announced by the company. We believe that the reduction in CAPEX is basically due to the current economic conditions. CAPEX reduction is likely to result in strong FCF growth, which we believe is reflected on higher valuation for the company. We anticipate a 15-20% reduction in CAPEX 2018-22E plan, in-line with the 14% cut announced by AlMarai. Moreover, lower CAPEX is likely to positively affect its dividend payout policy beyond 2018. The company is expected to generate Free cash flows of over SAR 650mn from FY2017, which is expected to exceed SAR 1.0bn from 2019. Thus, strong cash flow generation would help AlMarai fund it's part of long-term strategic CAPEX plans without weighing down its balance sheet.

High interest on debt led to 38.8%YoY increase in finance charges for 1Q2017: The Interbank Rate in Saudi Arabia (SAIBOR 6 Month) has been steadily increasing from the beginning of 2015. The Federal Reserve raised rates for the third time in nine years by 25 bps to 1.0% in June,2017, which also led to the rise in the SAIBOR 6 Month rate. The rate is expected to continue rise because ower petro dollar inflow into the banking system, courtesy the weak oil price will continue to imbalance the budget. The governments plans to raise sukkuk through local market, to balance the budget deficit, will weight down on the systems liquidity, hence pushing the discount rates. The rise in SAIBOR has negatively impacted AlMarai due to highly leveraged balance sheet with long-term obligation of SAR 10.08bn. The company reported a finance charge of SAR 100.18mn in 1Q2017; indicating an increase of 38.8%YoY which is expected to exceeds finance charge of SAR 400mn, for 2017, compared to SAR 351mn in 2016. Almarai Company's debt/equity ratio increased to 0.93x in 1Q2017 from 0.90x in 1Q2016.

AlMarai proposes capital hike via 25% bonus issue: Almarai's capital will be hiked from SAR 8bn to SAR 10bn, through issuing 1 bonus shares for each four outstanding shares. The capital increase will be funded by SAR 2bn from retained earnings.

Our estimates and valuation summary: We value AlMarai using a 5-year DCF model. We discounted the company's cash flows using a WACC of 6.7% and a terminal growth rate of 2.5%. We arrive at our WACC using a risk free rate of 3.29% and equity risk premium of 7.7%. We believe that the company will continue to focus on business efficiency and cost optimization to mitigate the impact of future high fuel/electricity costs. In addition, the company would be able to phase out local consumption of Alfalfa production by 2019 and importing all of its animal fodder needs without any major impact on margins due to the company's higher control on inputs cost. The Company In 1Q2017 managed to reduce operating losses in the poultry segments by 72.1%; indicating higher operating efficiency and a sign of recovery in the near future. We believe restoring bonuses and allowances for public sector employees retroactively as of September 27, 2016 would support food retailing growth. We revised our recommendation to "**Underweight**" on Almarai with a PT of SAR 73.50/share indicating a potential downside of 21.7%. Based on our estimates, Almarai trades at forward PE and PB multiples of 34.1x and 5.9x, respectively, for FY17E, and the expected dividend yield for FY2017 is 1.1% (SAR 1.0 DPS)

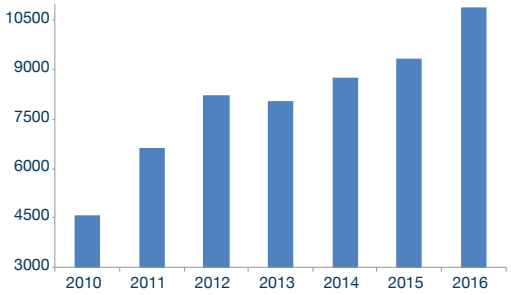
Figure2: Revenues breakdown by product - 2016



Source: Company reports, Aljazira Capital

The company is expected to generate Free cash flows of over SAR 650mn from FY2017, which are expected to exceed SAR 1.0bn from 2019. Thus, strong cash flow generation would help AlMarai fund it's a part of long-term strategic CAPEX plans without weighing down its balance sheet.

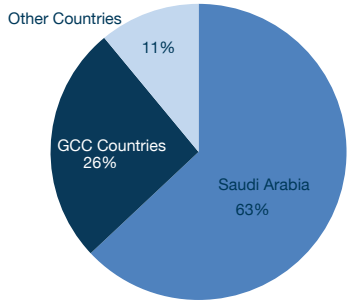
Figure3: Net Debt (in SAR mn) – 2010/2016



Source: Company reports, Aljazira Capital

The company reported a finance charge of SAR 100.18mn in 1Q2017; indicating an increase of 38.8%YoY and expected to exceeds finance charge of SAR 400mn compared to SAR 351mn in 2016

Figure4: Sales Analysis by Region by Country - 2016



Source: Company reports, Aljazira Capital

AlJouf Agriculture: Highly exposed to wheat cultivation decline, expansion in Olive oil and green fodder in 2016; gross margin increased to 35.9% from 33.2% in 2015 supported by lower COGS of olives oil sales. Low risk story with strong balance sheet to support more expansion in olives oil project; "Overweight" recommendation reiterated with PT of SAR 34.20/share.

Recommendation	'Overweight'
Current Price* (SAR)	29.05
Target Price (SAR)	34.20
Upside / (Downside)	17.7%

*prices as of 20th of June 2017

Olive's oil and green fodder boosted sales revenue growth in 2016; gross margin increased to 35.9% from 33.2% in 2015 supported by lower COGS of olives oil sales. However, higher OPEX due to fuel cost hike: Al-Jouf Agricultural Development Co. reported a 7.3%YoY increase in revenue for FY2016 to SAR 380.2mn (Adjusted report). In FY2016, the company's gross margin rose 270 bps YoY to 35.9%, owing to a 5.1%YoY decline in cost of sales due to lower production cost per ton of agricultural green fodder and olives oil. The company reported 11.9%YoY increase in gross profit for FY2016 to SAR 136.54mn. Selling and distribution expenses witnessed a 21.3%YoY increase in FY2016, which can be attributed to the fuel cost hike and higher transport cost. The company registered a 6.7%YoY increase in operating profit for FY2016 to SAR 78.08mn, with operating profit margin rose by 82 bps YoY to 20.44%. During the period, other income increased to SAR 8.4mn (46.6%) and net income rose by 7.3%YoY to SAR 77.7mn.

We believe the successful expansions and growth in olive cultivation (38%YoY to SAR 103.6) will help the company to lower the impact of wheat cultivation & green fodder production decline in the future. Although the energy price are expected to increase, operating cost is expected to increase at a lower rate than the increase in revenues in 2017/2018. Furthermore, We expect that the company's ability to sell a large part of the crops before harvest would decrease the future input cost and lower the transport cost. Overall, we estimate 0.7% and 4.0% YoY increase in revenue in FY2017 and FY2018 respectively.

Highly exposed to wheat production decline, expansion in Olive oil and green fodder to act as counter balance: In 2016, Al-Jouf Agricultural Development Co.'s revenue increased by 3.1% YoY to SAR 380.2.0mn. Revenue from wheat segment decline by 72% YoY to SAR 15.0mn. The crop segment, Yellow and Sudani Corn revenue fell by 36.0% YoY to SAR 30.1mn, and Potatoes revenue declined by 28% YoY to SAR 54.6mn. However, highest growth was observed in olive oil segment where revenue rose by 38%YoY to SAR 103.6mn from SAR 74.9mn in 2015. While green fodder production rose by 58% to SAR 126.7mn from SAR 80mn in 2015. We believe that 2016 operating profit was also skewed towards olive oil which accounted for 63.0% of the total operating profit compared to 33.4% in 2015.

Key Segments	% of sales FY2015	% of sales FY2016	
Olives Oil	20.4%	27.3%	The company becomes the largest olives oil producer in the middle east and pushing hard to increase its exposure in olive business. The capacity to produce olive oil reached 400 tons/day of olive in 2016; where, the capacity is expected to reach 450 tons/day in the coming years. Additionally, revenue and contribution from Olive oil segment is expected to rise from 2017 onwards to stand at 35% of revenues in 2019, as compared to 27.3% in 2016.
Wheat	14.5%	3.9%	Wheat production will be almost completely phased out in the ongoing seasons 2016/2017 and Saudi Arabia will become entirely dependent on imports for its grain needs. The government stated it was to end its programme of purchasing local wheat in 2015/16. Revenue from wheat segment is expected stabilize at the same level in the coming year, where the company switched its farming to classic & durum wheat that consume lower water.
Potatoes	20.5%	14.4%	Due to the government export ban on potatoes, the sales of potatoes in 2016 declined by 28%YoY. However, the company's initiatives to farming the crop during summer is expected to raise the productivity per hectare to almost 42ton in 2017.
Green Fodder	21.7%	33.4%	We believe that government initiative to stop domestic production of green fodder would impact Al-Jouf's total revenue from green fodder by end of 2019 and onwards, to stand at 23.9% in FY2019 and 0.0% in FY2020, as compared to 33.4% in FY2016.

Source: the company reports, Governmental multiple sources, AlJazira Capital

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	369.0	380.2	382.9
Growth %	5.3%	3.1%	0.7%
Net Income	72.40	77.71	92.36
Growth %	-32.3%	7.3%	18.8%
EPS	2.41	2.59	3.08

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	33.1%	35.9%	36.5%
EBITDA Margin	32.4%	33.5%	36.5%
Net Margin	19.6%	20.4%	24.1%
P/E	13.82x	13.39x	9.44x
P/B	1.30x	1.27x	0.99x
EV/EBITDA (x)	8.56x	8.27x	5.64x
ROE	9.3%	9.8%	12.3%
ROA	8.0%	8.3%	10.6%
Dividend Yield	2.4%	3.0%	3.5%

Source: Company reports, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Fitaihi Holding Group Company	14.26%
Riyad M. A. Al Humaidan	14.01%
Public	71.73%

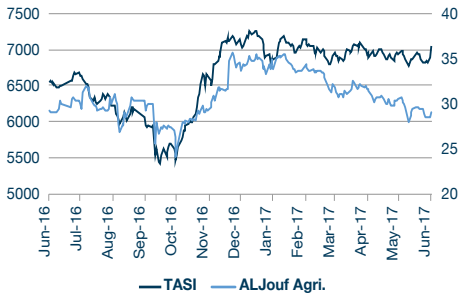
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	871.50
YTD %	-16.5%
52 Week (High)	37.0
52 Week (Low)	23.45
Shares Outstanding (mn)	30.0

Source: Company reports, Aljazira Capital

Figure1: Tasi & AlJouf Agri price performance



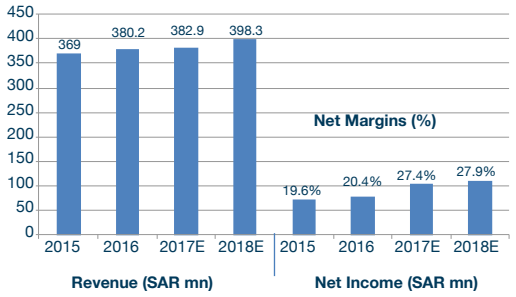
Source: Company reports, Aljazira Capital

Key Catalyst:

1. **Olive oil - a crucial project;** According to the given information, the number of olive trees was recorded at 5.0mn in 2016 as compared to 0.5mn trees recorded in 2008 and expected to reach 6.0mn in 2018 with production capacity of 400 tons/day of olive in 2016. The company is on track to complete the pickled olives production line with capacity of 1000 ton/day, which is expected to commercially start by the end of 2017, and exports to Spain and Switzerland to start in the same time period.

2. **Low risk story with strong balance sheet to support expansion:** we expect the company to maintain its dividend payment at SAR 1.0 DPS (3.5% D/Y) in FY2017. At the end of 2016, Aljouf's debt-to-equity ratio stood at 4.0%, with gross debt at around SAR 32.7mn. Going forward, we believe a strong balance sheet and sustainable cash flows would be sufficient for the company to repay existing debt and having the flexibility for dividend payment. In FY2016, the company generated operating cash flow of SAR 157.1 (down 7.1%YoY) due to the impact of inventories and account payable increase; however, operating cash flow is expected to exceed SAR 160mn in FY2017. The company has consistently operated at net cash and cash equivalent level of SAR 63mn, indicating a solid balance sheet with low leverage (Net debt/Equity stood at 4.0%)

Figure2: Key Financials (in SAR mn, unless specified)



Source: Company reports, Aljazira Capital

The company becomes the largest olives oil producer in the Middle East and pushing hard to increase its exposure in olive business. The capacity to produce olive oil reached 400 tons/day of olive in 2016; where, the capacity is expected to reach 450 tons/day of olive in the coming years.

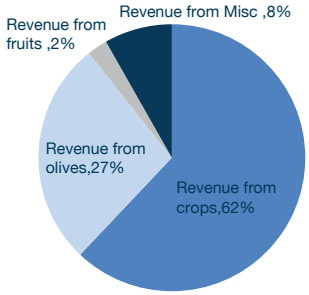
Key concerns:

1. **Climatic factors:** Agriculture crops are sensitive to climatic factors, rain fall and water supply. Therefore, any extraordinary event in these factors would reflect accordingly on the cultivation & yield of a particular crop and lead us to make subsequent adjustments in our estimates.

2. **Fuel price hikes:** Saudi Arabia is under pressure to cut agricultural and consumer subsidies among low oil prices and rising economic distresses, which would have a major negative impact on production and consumption growth. The government plans to gradually reduce subsidies on fuel for the coming years until the full liberalization of fuel prices by 2019.

3. **Labor cost:** labor is considered as a key risk for such a company which is based mainly on expat population for its core operations. A growing Saudization program and labor related cost (Labor license and Iqama) are estimated to pressure margins and pushing-up cost, where the government plans to impose additional fees on expatriates.

Figure3: Revenues breakdown by product

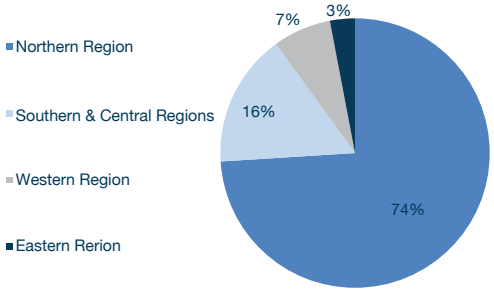


Source: Company reports, Aljazira Capital

Financial growth: We expect the successful expansions in olive cultivation; will help the company to lower the impact of wheat cultivation & green fodder production decline, leading overall sales revenue to increase at a CAGR of 3.1%, during FY2016-19. However, the company's net profitability is expected to increase at a CAGR of 9.6% during FY2016-19. Operating costs are expected to increase at a lower rate than the increase in revenues along with increase in energy prices. We expect that the company's tendency to sell a large part of the crops before harvest would decrease the future input cost. Al-Jouf maintains a strong shareholder remuneration policy (2016 dividend yield at 3.0%), supported by comfortable liquidity. The company is trading at a forward P/E multiples of 9.4x compared to the current sector PE of 93.6x.

The company is on track to complete the pickled olives production line with capacity of 1000 ton/day, which is expected to commercially start by the end of 2017, and start exporting to Spain and Switzerland

Figure4: Revenues breakdown by Regions



Source: Company reports, Aljazira Capital

Our estimates and valuation summary: We value AlJouf using a 5-year DCF model. We discount AlJouf's cash flows using a WACC of 11.9% and a terminal growth rate of 2.5%. We arrive at our WACC using a risk free rate of 3.29%. We use an equity risk premium of 7.77% in order to arrive at our Cost of Equity of 11.8%. AlJouf Agriculture Co. is expected to post SAR 104.8mn in net income (3.49 EPS) for FY2017, recording an increase of 34.9%YoY supported by the growth of olive oil, other crops, beside the stability of green fodder production. Thus, we maintain our '**Overweight**' on the stock with target price at **SAR 34.20**/share; indicating a potential upside of 17.7% over current market price of SAR 29.05/share (as of 21th June 2017). The company is trading at a forward PE and PB of 9.4x and 0.99x respectively based on our 2017 earnings forecast.

Halwani Bros: sales witnessed a fall of 8.1% due to decrease in local and export sales in Saudi Arabia, in addition to the FOREX impact. Strong presence in Egypt reduced the company's net income by almost 58% in FY2016 due to 132% devaluation in the Egyptian pound against US dollar. However, capacity expansions at core business to increase revenues, from local operation at 2016-19CAGR of 4.6%, boosting net income to SAR 85.6mn in 2017. We remain "Neutral" on the stock with PT of SAR 55.10/share.

Recommendation	'Neutral'
Current Price* (SAR)	50.40
Target Price (SAR)	55.10
Upside / (Downside)	9.3%

*prices as of 21st of June 2017

Decline in sales value, higher depreciation and FOREX loss of SAR 74.8mn led to disappointing performance in FY2016, while benefiting from lower raw material costs, lower tax rate for Egyptian subsidiary, and higher investment income from subsidiary mitigated the impacts on the company's result: Halwani Bros. Co. (Halwani) reported 8.1%YoY fall in revenue for FY2016 to SAR 987.6mn. The fall was due to a 6.7%YoY decrease in local and export sales in Saudi Arabia, in addition to the foreign exchange impact of subsidiary company in Egypt. In 2016, the company's gross margin rose 260 bps YoY to 33.7% from 31.7% in FY2015, primarily due to a fall in key raw materials' costs and the selling price increase in Egypt. Halwani reported a 0.5% YoY decline in gross profit to SAR 332.7mn that mainly contributed to sales decline and higher depreciation. It's selling, general, and administrative expenses rose 9.4%YoY to SAR 195.2mn due to new business expansion (new poultry Plant built in the Egyptian market). Halwani registered a 4.4% YoY fall in operating profit to SAR 142.2mn, with operating profit margin gaining 60 bps YoY to 14.4%. During FY2016, net income fell 53.2% YoY to SAR 53.9mn, mainly impacted by the devaluation of Egyptian Pound against US dollar in subsidiary company that leading to Forex losses of SAR 74.8mn during 2016. We believe that the main impact is owing to unfavorable economic conditions in Egypt that resulted in SAR 74.8mn losses after Egyptian pound devaluation. However, the reversal of income tax in subsidiary company as a result of the realized Forex losses reduced the company's effects and partially absorbed the impact of the devaluation of the Egyptian pound against the US dollar. In addition, its subsidiary's income from Islamic Murabaha supported the bottom line, where the return on deposits increased to SAR 3.07mn from SAR 1.3mn in FY2015.

Strong presence in Egypt reduced the company's net income by almost 58% in 2016FY due to 132% devaluation in the Egyptian pound against US dollar: Halwani is a market share leader in meat products in Egypt with 7 plants and a new production line for poultry. Almost 51% of the total revenue and almost 65% of the net income came from Egypt in 2016. Thus, the absence of currency hedging and the worsening of Egyptian economic conditions would definitely impact the company's sales revenue. In 2016, the Egyptian pound depreciated 132% against USD after the Central bank (CBE) decided to free float the Egyptian Pound on the 3rd of November. In 2016, the Egyptian pound devaluated by almost 132% against USD due to the deteriorating of economic conditions, which directly impacted the company's net income, in 2016, by SAR 74.8mn. Furthermore, the cost of raw material is expected to be slightly pushed up in 2017 due to the strong presence in Egypt. Consequently, we expect the company's sales, in 2017, would decline by 15.5% to stand at SAR 834.8mn, the impact of FOREX on bottom line is expected to be negligible this year due to stability in Egyptian economy. We revised our FY2017 EPS estimates to SAR 2.99 per share (revised up from SAR 2.47 per share, a 24.1% revision).

Capacity Expansions at core business to increase revenues from local operation at 2016-19CAGR of 4.6% ,boosting net income to SAR 85.6mn in 2017 (58.7% growth): On July-2016 Halwani Bros started commercial operations at its dairy plant in industrial complex in the Industrial City in Jeddah, after completion of the second phase of complex. The company will be able to expand its capacity of the main products (Halawa, Tahina, meat and dairy). Moreover, the company started introducing new line of products in Saudi Market such as Burger (Meat/chicken) and sausages.We believe this will lead the revenues from local operation to increase at 2016-19CAGR of 4.6%. Furthermore, In order to cater high increase in demand, the company completed its first 50% capacity expansion at its meat plant in 2012, while the remaining 50% expansion is assumed to be completed soon. Moreover, Egypt-based poultry plant has already started commercial operations in early 2016, with the company's intention of further expansion in meat based products manufacturing (almost 44.2% of the total revenue). In addition, we believe high demand in Egyptian market will lead the company to run its post expansion meat facilities on higher capacity utilization rate, which is expected to recover some loss due to weak value of Egyptian pound. Consequently, we expect the company's net income in 2017 would increase by 58.7% to stand at SAR 85.6mn from 2016 net income of SAR 53.9mn.

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	1,075.3	987.6	834.8
Growth %	0.97%	-8.15%	-15.47%
Net Income	115.1	53.9	85.6
Growth %	26.8%	-53.2%	58.7%
EPS	4.03	1.89	2.99

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	31.1%	33.7%	36.2%
EBITDA Margin	16.1%	18.4%	20.0%
Net Margin	10.7%	5.5%	10.2%
P/E	17.47x	33.11x	16.83x
P/B	3.06x	3.36x	2.69x
EV/EBITDA (x)	12.09x	10.31x	9.37x
ROE	18.2%	9.1%	16.1%
ROA	11.1%	5.2%	8.6%
Dividend Yield	2.8%	4.0%	5.0%

Source: Company reports, Aljazira Capital

Shareholders Pattern

Shareholders Pattern	Holding
Aseer Arabian for Industrial Investment co.	55.50%
Mohamed Abdelhamid Halwani	6.99%
Public	37.51%

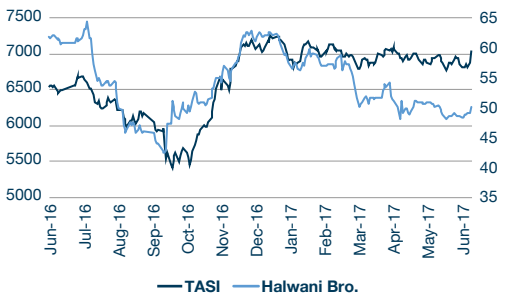
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	1,442.8
YTD %	-19.2%
52 Week (High)	66.75
52 Week (Low)	40.80
Shares Outstanding (mn)	28.57

Source: Company reports, Aljazira Capital

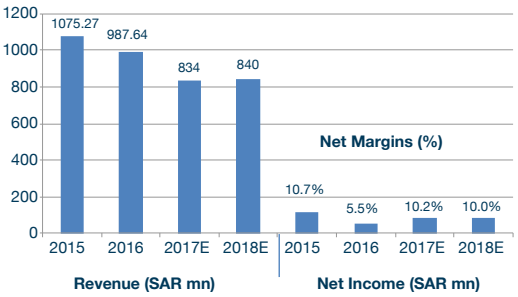
Figure1: Tasi & Halwani price performance



Source: Company reports, Aljazira Capital

Highly leveraged balance sheet due to CAPEX, financing cost to hurt the company's net income by SAR 17.5mn in FY2017: Halwani Bros. increased their debt financing during 2016 and 1Q-2017 as it acquired SAR 322mn in debt, increasing its D/E from 31.2% in 2015 to 58.8% in 2016. The expansion is being financed through almost 41.3% debt and 58.7% equity with short-term obligation of SAR 187mn. Hence, the financing cost is expected to stand at SAR 17.5mn in 2017 compared to SAR 12.8mn in 2016, on the back of higher leveraging and interest rates. We expect the company to maintain its dividend payment at SAR 2.5/share for FY2017.

Figure2: Key Financials (in SAR mn, unless specified)



Source: Company reports, Aljazira Capital

The Key catalyst:

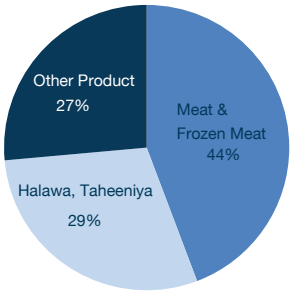
1. **A key to sustain sales revenues growth:** With the obvious population growth where the company operates (mainly Saudi Arabia & Egypt), along with the consumption per family rate for foodstuff, and the rise of demand for the company's current products, especially among the Arab families, we believe the company has ample opportunities to grow.

2. **Familiar products:** It is widely known that among the middle & higher-middle class Arab families, some food items are ever present on their dinner table, and among such highly consumed food products are: "Halawa Taheeniya" - Jam - Maamoul which are also some of Halwani Brothers' most popular products. This provides the company with much needed stability in terms of demand of their major products, as consumer taste is not as easy to change overtime.

3. **Focusing strategic locations:** An industrial land in King Abdullah Economic City worth SAR44.7mn is owned by the company for its long term investment which goes beyond the scope of 5 years; where the location advantages being close to the King Abdullah seaport along with the potential future expansions.

In 2016, the Egyptian pound devaluated by almost 132% against USD due to the deteriorating of economic conditions, which directly impacted the company's net income in 2016 by SAR 74.8mn

Figure3: Revenues breakdown by product



Source: Company reports, Aljazira Capital

The key concern:

1. **Labor reform:** The current labor reform steps in the Kingdom could play a factor in terms of lack of resources to distribute "Saudization programme" and also in terms of consumption. In addition to the expected higher cost/labor that could weigh on margins.

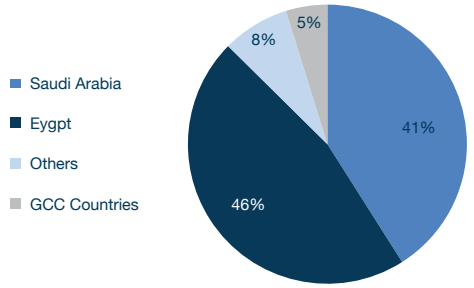
2. **Consumer spending:** We believe continuing low oil prices could negatively affect government spending thus depressing business and consumer confidence. Based on IMF forecast, the GDP growth of Saudi Arabian economy will fall into 0.4%YoY in 2017, as fiscal consolidation and oil production cuts hit economic activity. The Saudi consumer will be hit hard as a result, with private consumption.

3. **An Additional devaluation of Egyptian currency:** the absence of currency hedges could adversely impact the company's sales revenue, where almost 51% of the total revenue comes from Egypt.

With the obvious population growth where the company operates (mainly Saudi Arabia & Egypt), along with the consumption per family rate for foodstuff, and the rise of demand for the company's current products especially among the Arab families, we believe the company has ample opportunities to grow.

Our estimates and valuation: We value Halwani Bros. using a 5-year DCF model. We discount Halwani's cash flows using a WACC of 7.9% and a terminal growth rate of 2.5%. We arrive at our WACC using a risk free rate of 3.29%. We use an equity risk premium of 7.77% in order to arrive at our Cost of Equity of 9.6%. HB Co. is expected to post SAR 85.6mn in net income (2.99 EPS) for 2017, recording an increase of 58.7%YoY due to higher operating rate and new expansions. However, we maintain our '**Neutral**' recommendation and target price of **SAR 55.10/share**; indicating a potential upside of 9.3% over current market price of SAR 50.40/share (as of 21st June 2017). The company is trading at a forward PE and PB of 16.8x and 2.70x respectively based on our 2017 earnings forecast. We anticipate the company to maintain its dividend payment at SAR 2.50 DPS (4.9% D/Y) in 2017.

Figure4: Revenues breakdown by Country



Source: Company reports, Aljazira Capital

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AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer