NCB CAPITAL

Almarai Company

Neutral

Target price (SR) 200.1

Current price (SR) 192.8

Stock details

52-week range H/L (SR)	201/151
Market cap ($mn)	5,919
Shares outstanding (mn)	115
Listed on exchanges	TADAWUL

Price perf. (%)	**1M**	**3M**	**12M**
Absolute	1.4	(0.5)	26.4
Rel. to market	4.8	10.0	18.4
Avg daily turn.(mn)		**SR**	**US$**
3M		17.4	4.6
12M		21.8	5.8

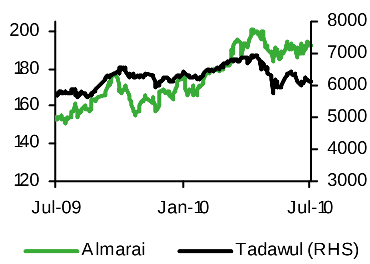
Reuters code	2280.SE
Bloomberg code	ALMARAI AB
Website	www.almarai.com

Valuation multiples

	09	**10E**	**11E**
Reported P/E (x)	19.5	16.8	14.2
Adjusted P/E* (x)	19.2	16.5	14.0
Reported P/B (x)	4.0	3.6	3.1
Adjusted P/B* (x)	3.9	3.5	3.0
EV/EBITDA (x)	15.2	13.2	11.6
Div yield (%)	2.1	2.3	2.8

Source: NCBC Research estimates
*MCap adj for dividends as well as MV of listed investments divided by net incomes

Share price performance



Source: Bloomberg

Farouk Miah
f.miah@ncbc.com
Tel. +966 2 690 7717

Please refer to the last page for important disclaimer

Impressive growth, but in-line

We maintain our Neutral rating on Almarai with our PT increasing marginally. Almarai announced impressive top and bottom line YoY growth of around 20% in 2Q10, although these numbers were in-line with our estimates. Given the high levels of investment going into new business lines, and the associated extra risk, we continue to believe the stock is fairly valued at around the current share price.

- **Financial performance remained strong in 2Q10, although margins a concern:** Sales increased 20% YoY to SR1,739mn in 2Q10, attributable to robust performances across all business lines. Margins fell slightly in 2Q10; the net margin declined by 11bps YoY to 19.7% during the quarter due to increased feedstock costs. We believe there could be further margin pressure going forward due to one-off expenses being taken as Almarai expands into new business-lines, as well as integrating the acquired HADCO business.
- **Infant Milk and Poultry the next big catalysts, but need to wait:** The SR700mn new infant milk venture and the poultry business which will see up to SR2bn of investment in the coming three years are the key catalysts for Almarai going forward. However, much of the coming 12 months are seen as laying the foundations for these two businesses, with results coming beyond this time frame. With both ventures seeing Almarai enter new businesses, we view the associated risk as higher than previous organic expansions.
- **Robust performance from existing businesses a pleasant surprise:** With much of the focus on the expansion into new businesses we believe the core dairy business has been overlooked by investors. Fresh Dairy, Long-Life and Cheese & Butter all continued to grow sales in double-digits YoY in 2Q10.
- **Coming 12 months focused on consolidation, remain Neutral:** Although our PT increases marginally to SR200, we maintain our Neutral rating. With the coming 12 months focused on laying the foundations for the new businesses, alongside the risks which these investments pose, we believe the stock lacks the catalysts required to expand beyond the current range.

Summary financials

		2009A	**2010E**	**2011E**	**2012E**	**2013E**
Sales	SR mn	5,869	6,935	7,893	8,876	9,855
Gross income	SR mn	2,366	2,784	3,182	3,540	3,906
Gross margin	%	40.3	40.2	40.3	39.9	39.6
Operating income	SR mn	1,279	1,514	1,739	1,947	2,168
Operating margin	%	21.8	21.8	22.0	21.9	22.0
Net income	SR mn	1,097	1,330	1,569	1,782	1,998
Net margin	%	18.7	19.2	19.9	20.1	20.3
EPS	SR	9.95	11.57	13.64	15.50	17.37

Source: Company, NCBC Research estimates

Summary of 2Q10

Continued double-digit sales growth in 2Q10 encouraging: All business lines continued to see solid double-digit YoY sales growth in 2Q10 with Bakery recording the highest growth for the second quarter in a row at 35%. In our view, what is even more impressive is that for the second quarter running, Almarai was able to continue recording double-digit growth in its more "mature" business lines such as Fresh Dairy (up 13% YoY in 2Q10) and Long-Life (up 24% YoY in 2Q10). Management highlighted in its analyst conference call that the gains are largely due to increased efficiencies in distribution, as well as better management of wastage.

Concerns on margins, although largely to do with new business-line expansion: Gross margins declined by 60bps to 40.3% in 2Q10, although the net margin was able to reduce this deficit and fell only by 11bps to 19.7% due to lower bank charges and lower General and Administration costs. As was the case in 1Q10, we believe that margins suffered at the gross level due to non revenue generating costs from various expansions in its business operations. We believe the coming two quarter may continue to see expenses associated with the expansion taking place in bakery and fruit juice, as well as the new business lines leading to some margin pressure.

High level of investments continue with SR1bn spent in 1H10: Almarai's aggressive expansion plans continued as it spent a total of SR1bn in investments in order to expand the business in both its core products as well as the new business lines. Management stated in the analyst call that they are looking to spend SR2bn in 2010 on capex (up from the previously announced SR1.8bn) and SR8bn in total to 2014, inclusive. Although investment for the future is a positive, the high sums involved and the fact that this investment is largely in new businesses where Almarai does not have previous experience, means the execution risk is higher than with previous capex.

We have particular concern on the poultry business where SR2bn is expected to be invested in the coming 2-3 years, in addition to the SR1bn or so spent to acquire the HADCO business. The KSA poultry market seems relatively saturated with poultry consumption in Saudi amongst the highest in the world. Thus, it seems Almarai's strategy is one of focusing on taking market share from others, against growing due to the market itself growing strongly. Additionally, it will take up to three years for the company to reach its target of increasing poultry capacity five fold to 100mn, meaning the risk is present for a longer period of time.

Exhibit 1: 2Q10 Results summary

		2Q10A	2Q10E	2Q09A	YoY chg (%)	Variance(%)*
Sales	SR mn	1,739	1,689	1,447	20.2	2.9
Operating income	SR mn	388	377	335	15.6	3.0
Net income	SR mn	343	333	287	19.5	2.9
EPS	SR	2.98	2.90	2.63	13.3	2.9

Source: Company, NCBC Research estimates
* Variance of actual numbers against NCBC estimates

Key highlights from the analysts call

On 12 July, Almarai continued with its market leading levels of transparency by hosting its third post results conference call. We highlight below the key findings from the call

Core business

- Bakery not expected to be strong in Ramadan but 2Q10 growth expected to be repeated in 3Q10
- Both net income/revenue growth from 1H10 expected to be repeated in 2H10
- EBIT margin should grow in 2H; 2010 figure expected to be in-line with 2009
- Long-Life and Fresh dairy businesses recorded good growth in 2Q10 due to continued focus on distribution as there still remains some areas of KSA where Almarai doesn't have exposure. Also better management of wastage helped with growth.
- Fruit juice growth should be higher in 2H10 than in 2Q10
- Target is for Net debt/Ebitda multiple of 3x and/or debt : equity ratio of 1:1
- 2010/11 in consolidation mode; ie not looking for new acquisitions
- All 2Q10 growth from volume

New businesses

- Poultry capacity at the end of 2010 should be around 20mn, increasing to 25mn by the end of 2011, then to around 55mn by mid 2012 and reaching 100mn by end of 2013.
- Target ROI for the HADCO business is 15%
- Infant milk; target remains to start selling products in mid 2011.
- The competition is relatively concentrated with the largest four infant milk players holding around 65% market share
- PepsiCo JV – will introduce 4 Almarai branded items in Egypt this year; looking to build a farm from H210 onwards in Egypt

Capex investments

- Capex to increase to SR2bn from SR1.8bn previously announced in 2010 due to timing of some spending
- Expected to spend SR8bn in total capex during 2010-2014 inclusive

Changes to our model

Limited changes to numbers

Based on the numbers reported in 2Q10 there are minimal changes to our model. Our top-line estimate increases by 1% in 2010 and 0.3% in 2011 due to better than expected performance in 2Q10. We have trimmed margins slightly due to our concerns on ongoing expenses in Almarai's expansion plans which will remain non-revenue generating for a portion of 2H10. We have again increased our capex number marginally to bring these in line with the management outlook leading to downward pressure on the PT. However, the higher peer P/E of 15x 2010 earnings compensates by increasing the PT.

Exhibit 2: Changes to estimates

		Old 2010E	New 2010E	% Chg	% Gr	Old 2011E	New 2011E	% Chg	% Gr
Revenue	SR mn	6,867	6,935	1.0	18.2	7,873	7,893	0.3	13.8
Gross profit	SR mn	2,755	2,784	1.1	17.7	3,174	3,182	0.3	14.3
EBIT	SR mn	1,509	1,514	0.4	18.4	1,748	1,739	(0.5)	14.8
Net profit	SR mn	1,330	1,330	0.0	21.3	1,580	1,569	(0.7)	17.9
Target price	SR					193.5	200.1	3.4	N/A

Source: Company, NCBC Research estimates

Price Target

Due to the higher top-line figures and peer multiples, our PT increases marginally to SR200 from SR193/share. Almarai currently trades at an adjusted 16.5x 2010e P/E, falling to 14.0x in 2011e.

Financials

Exhibit 3: Income statement

In SAR millions

	2009A	2010E	2011E	2012E	2013E	2014E
Net sales	5,869	6,935	7,893	8,876	9,855	10,784
% change	16.7	18.2	13.8	12.4	11.0	9.4
Gross income	2,366	2,784	3,182	3,540	3,906	4,241
Gross margin (%)	40.3	40.2	40.3	39.9	39.6	39.3
Operating expenses	4,590	5,421	6,155	6,929	7,687	8,436
Operating profit	1,279	1,514	1,739	1,947	2,168	2,347
Operating margin (%)	21.8	21.8	22.0	21.9	22.0	21.8
EBITDA	1,642	1,948	2,244	2,534	2,779	2,993
% change	23.4	18.6	15.2	12.9	9.7	7.7
Dep. & Amortization	363	433	505	587	611	646
Interest Income, net	(148)	(127)	(133)	(131)	(139)	(116)
Pre-tax profit	1,129	1,391	1,632	1,854	2,078	2,287
Tax (Zakat)	29	36	42	48	54	59
Net income	1,097	1,330	1,569	1,782	1,998	2,199
% change	20.5	21.3	17.9	13.6	12.1	10.0
EPS (SR)	9.95	11.57	13.64	15.50	17.37	19.12

Exhibit 4: Balance sheet

In SAR millions

	2009A	2010E	2011E	2012E	2013E	2014E
Cash & bank balances	508	351	321	279	263	216
Other current assets	1,706	1,865	2,049	2,232	2,400	2,566
Total current assets	2,213	2,217	2,370	2,510	2,662	2,782
Investments	963	964	989	1,025	1,071	1,124
Net fixed assets	6,282	7,661	8,880	9,621	10,139	10,629
Other assets	1,528	1,628	1,703	1,761	1,807	1,835
Total assets	10,987	12,469	13,941	14,917	15,679	16,371
Short-term loans	396	441	468	441	386	314
Other current liab.	1,045	1,142	1,241	1,342	1,428	1,497
Current liabilities	1,440	1,583	1,709	1,783	1,815	1,811
Long-term loans	3,981	4,436	4,709	4,436	3,890	3,163
Other liabilities	166	155	168	183	197	214
Total liabilities	4,147	4,591	4,877	4,619	4,087	3,376
Share capital	1,150	1,150	1,150	1,150	1,150	1,150
Reserves & surplus	4,233	5,103	6,154	7,304	8,554	9,948
Shareholders' funds	5,383	6,253	7,304	8,454	9,704	11,098
Total equity & liab	10,987	12,469	13,941	14,917	15,679	16,371

Source: Company, NCBC Research estimates

Exhibit 5: Cash flow statement

In SAR millions

	2009A	2010E	2011E	2012E	2013E	2014E
Cash flow from op. (a)	1,802	1,839	2,131	2,421	2,660	2,856
Cash flow from inv.(b)	(1,711)	(1,908)	(1,799)	(1,386)	(1,175)	(1,165)
NOPLAT	1,246	1,475	1,694	1,897	2,112	2,286
WC	163	(62)	(85)	(82)	(82)	(98)
Capex	(1,335)	(2,000)	(1,900)	(1,500)	(1,300)	(1,300)
Depreciation	363	433	505	587	611	646
Free cash flow	437	(153)	214	902	1,341	1,534
Cash flow from fin.(c)	170	(87)	(362)	(1,077)	(1,501)	(1,738)
Debt	690	500	300	(300)	(600)	(800)
Net chg. in cash (a+b+c)	261	(156)	(30)	(43)	(16)	(46)
Cash at start of the year	247	508	351	321	279	263
Cash at end of the year	508	351	321	279	263	216

Source: Company, NCBC Research estimates

Key ratios

Exhibit 6: Key ratios

	2009A	2010E	2011E	2012E	2013E	2014E
Per share ratios (SR)						
EPS	9.9	11.6	13.6	15.5	17.4	19.1
FCF per share	4.0	(1.3)	1.9	7.8	11.7	13.3
Div per share	4.0	4.5	5.5	6.5	7.0	7.5
Book value per share	48.8	54.4	63.5	73.5	84.4	96.5
Valuation ratios (x)						
P/E	19.5	16.8	14.2	12.5	11.2	10.2
Adjusted P/E^	19.2	16.5	14.0	12.3	11.0	10.0
P/FCF	49.0	(145.9)	104.4	24.8	16.7	14.6
P/BV	3.9	3.5	3.0	2.6	2.3	2.0
EV/sales	4.3	3.7	3.3	2.9	2.6	2.3
EV/EBITDA	15.2	13.2	11.6	10.2	9.1	8.2
Div yield (%)	2.1	2.3	2.8	3.3	3.6	3.9
Profitability ratios (%)						
Gross margins	40.3	40.2	40.3	39.9	39.6	39.3
Operating margin	21.8	21.8	22.0	21.9	22.0	21.8
EBITDA margins	28.0	28.1	28.4	28.5	28.2	27.8
Net profit margins	18.7	19.2	19.9	20.1	20.3	20.4
ROE	24.4	22.9	23.1	22.6	22.0	21.1
ROA	11.4	11.3	11.9	12.4	13.1	13.7
Liquidity ratios						
Current ratio	1.8	1.8	1.8	1.8	1.8	1.8
Quick Ratio	0.5	0.5	0.5	0.5	0.5	0.5
Operating ratios (days)						
Inventory	127	119	116	112	108	106
Receivables outstanding	23	23	22	21	20	19
Payables outstanding	49	44	40	36	33	29
Operating cycle	150	142	138	133	128	125
Cash cycle	101	98	98	97	95	96

Source: Company, NCBC Research estimates
^ excluding Zain

Kindly send all mailing list requests to research@ncbc.com

Head of Research	Eiji Aono	e.aono@ncbc.com	+966 2 690 7786
Brokerage website	www.alahlitadawul.com / www.alahlibrokerage.com		
Corporate website	www.ncbc.com		

NCBC INVESTMENT RATINGS

Overweight:	Target price represents expected returns in excess of 15% in the next 12 months
Neutral:	Target price represents expected returns between -10% and +15% in the next 12 months
Underweight:	Target price represents a fall in share price exceeding 10% in the next 12 months
Price Target:	Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

OTHER DEFINITIONS

NR:	Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations
CS:	Coverage Suspended. NCBC has suspended coverage of this company
NC:	Not Covered. NCBC does not cover this company

IMPORTANT INFORMATION