Astra Industrial Group

Diversified Operations –Industrial

ASTRA AB: Saudi Arabia

02 June 2012

الراجحي المالية
Al Rajhi Capital

US$0.800bn	33.9%	US$2.797mn
Market cap	Free float	Avg. daily volume

Target price	47.90	18.3% over current
Consensus price	43.00	6.2% over current
Current price	40.50	as at 30/5/2012

Research Department
ARC Research Team,
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Underweight | Neutral | **Overweight**

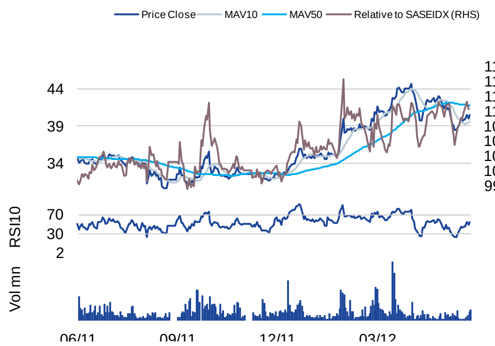
Key themes

Industrial companies like Astra are focused on the domestic market as well as the MENA region. Consequently, we believe Astra's performance will be closely linked with the macroeconomic developments and growth in the MENA region.

Implications

Astra is a holding company, whose operations are focused mainly in the MENA region. The company earlier used to be heavily dependent on its pharma and chemicals businesses. However, following a major expansion in the steel segment via its investment in Iraq, the company plans to tread a new growth path.

Performance

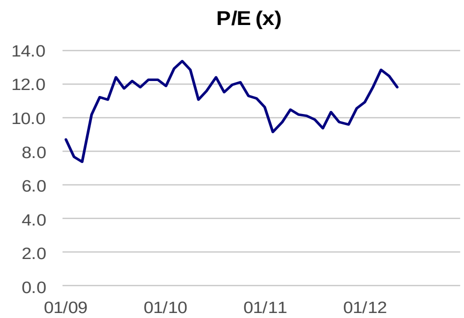


Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	1,382	1,621	2,232	2,498
Revenue Growth	23.3%	17.3%	37.7%	11.9%
EBITDA (mn)	215	246	378	490
EBITDA Growth	4.3%	14.4%	53.7%	29.5%
EPS	3.35	3.53	4.73	5.63
EPS Growth	-4.2%	5.5%	33.9%	19.0%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Astra Industrial Group
Reinforced by steel business

Astra Industrial Group (Astra), with investments in pharmaceuticals, chemicals and steel, caters to the growing economies in the MENA region. Deriving full advantage of the favorable market environment, the company occupies the market-leading position in the pharma and chemicals businesses in Saudi Arabia, which ensures healthy cash flows and stable growth. That said, Astra's future growth will be significantly driven by its investment in Al Anmaa (the Iraqi steel business), which will not only boost up its top-line but also result in healthy margins due to availability of cheap feedstock in Iraq. We initiate coverage on the stock with an Overweight rating and a target price of SAR47.9.

Iraqi steel business to provide growth stimulus: Astra's investments in Al Anmaa, which is expected to commence production in Q3 2012, will boost the group's revenue over the near-term (70% of the revenue growth in 2013, as per our estimates). Further, Al Anmaa by virtue of the availability of cheap steel scrap (70-80% discount to international prices) coupled with the early-mover advantage will serve as the key growth catalyst for Astra. That said, Al Anmaa has added to the company's geopolitical risk profile and any delay in launch of operations will act as a major dampener to the stock price in the near term.

Pharma business to benefit from macro factors: Astra's pharma business enjoys a leading presence in Saudi Arabia - the largest health care market in the MENA region - contributing substantially to the group's net profit (58% in 2011). Astra benefits from favorable demographic factors and regulatory support in the Kingdom. We expect pharma business to grow at an 8.4% CAGR over the next 5 years owing to its strong pipeline and extensive sales network.

Chemicals business lends stability to the business model: Astra's polymer business corners more than 70% market share in Saudi Arabia and the UAE. We believe this dominating market share has enabled Astra to forge long-term associations with leading petrochemical producers like SABIC and Borouge. With these long term associations and presence across the MENA region, Chemical business is likely to generate stable revenue and cash flows in the medium term.

Dividends to improve going forward: We believe Astra has strong business prospects backed by the launch of Al Anmaa and consolidation of its recent acquisitions – Alsaudia Advanced Pharmaceutical Company, Constab Middle East Poimer, and Astra Nova. Since majority of the capex program is over, the company will start generating strong free cash flows in the coming years, which will help the company increase its dividend payouts. We expect Astra's dividend per share to increase from SAR1.75 in 2011 to SAR2.25 in 2014, translating to dividend yield of 5.6% dividend yield (versus 4.3% in 2011).

Valuation and Conclusion: We like Astra's emphasis on growth across all of its operating segments and believe the investment made in Al Anmaa will put the company on a new growth trajectory. We value Astra using a blend of long-run DEP forecasting (80% weight) and comparative multiple analysis (20%) to arrive at a target price of SAR47.9, which implies an upside of 18.3% from the current market price. We initiate coverage on Astra with an Overweight rating.

Corporate summary

Astra is a holding company - backed by its parent Astra Group - the second largest private conglomerate in Saudi Arabia. Astra draws its strength from diverse business base encompassing pharma, polymers, agrochemicals and steel. Astra was established in 1988 as a limited liability company and later converted into a closed joint stock company in 2008. This was followed by an increase in share capital after which Astra was listed on the TASI.

Share information

Market cap (SAR/US$)	3.002bn / 0.800bn
52-week range	30.60 - 44.60
Daily avg volume (US$)	2.797mn
Shares outstanding	74.12mn
Free float (est)	33.9%

Performance:	1M	3M	12M
Absolute	-4.7%	1.3%	15.4%
Relative to index	2.3%	4%	10.9%

Major Shareholder:	
Arab Supply & Trading Co.	43.8%
Mohammad N. S. Al Otaibi	8%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	1,382	1,621	2,232	2,498
EBITDA (SARmn)	215	246	378	490
Net Profit (SARmn)	248	262	351	417
EPS (SAR)	3.35	3.53	4.73	5.63
DPS (SAR)	1.75	1.75	1.75	2.25
EPS Growth	-4.2%	5.5%	33.9%	19.0%
EV/EBITDA (x)	14.1	13.2	8.6	6.3
P/E (x)	12.1	11.5	8.6	7.2
P/B (x)	1.7	1.6	1.4	1.2
Dividend Yield	4.3%	4.3%	4.3%	5.6%

Source: Company data, Al Rajhi Capital

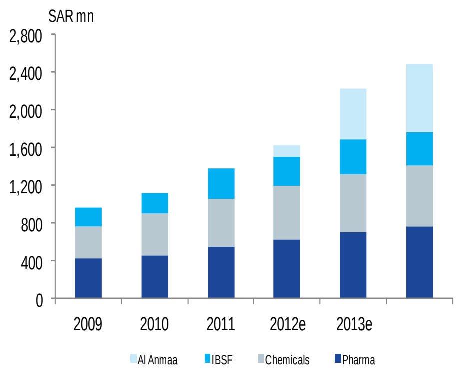
Steel segment:
Al Anmaa's launch to be crucial

Al Anmaa will be the catalyst, driven by strong demand in Iraq

Al Anmaa has strong prospects owing to growing steel demand in Iraq, besides other operational advantages

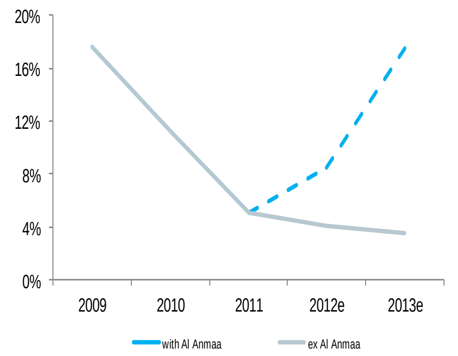
In 2009, Astra acquired Al Anmaa - a steel melting factory located in Basra, South Iraq through its acquisition of a 51% stake in Al Tanmiya - a Jordanian based offshore holding company. The plant with a production capacity of 435,000 tons per annum (tpa) of steel billets (scalable up to 560,000tpa) and 350,000tpa of steel reinforcing bars (rebars) is expected to commence trial operations by June 2012 and commercial production by Q3 2012. As per the company press release, it has received approvals for the technical specifications and the connectivity route to connect the power plant with the National electricity grid. Further the company is on track to launch trial production in June 2012. The launch of Al Anmaa will provide a significant boost to Astra's overall revenue as it will account for 70% of the company's revenue growth in 2013 as per our estimates.

Figure 1. Astra's revenue forecasts



Source: Company data, Al Rajhi Capital

Figure 2. Steel segment's operating margins



Source: Company data, Al Rajhi Capital

Iraq has embarked on a major reconstruction plans following decades of war and international sanctions, which provides a bright demand outlook for Al Anmaa's steel business. The country's construction boom will largely emanate from housing and infrastructure projects, which will in turn drive up the steel demand. According to industry reports, more than US$30bn will be invested over the next ten years in Baghdad alone. Additionally, 85% of the housing projects will be carried out by the private sector, while the Iraqi government plans to build 3.5mn houses over the next ten years. Taking these factors into consideration, we estimate that around 23mn houses will be built in the coming decade, which would trigger a massive demand for building materials like steel rebars.

Early-mover advantage will boost its margins

According to the company management, net margins for Al Anmaa will be healthy for the next 2-3 years due to early-mover advantage

Setting up a steel plant in Iraq is an extremely difficult proposition owing to the geopolitical risks and a lack of infrastructure and power. Against this backdrop, Astra has built a steel plant, which is adequately backed by support facilities required for production, especially a power plant for its own use, which took the company 2-3 years to build. Hence, we expect Astra to have an early-mover advantage , which will help the company achieve healthy margins over the next 2-3 years, as well as facilitate improvement in operating rates (60% in the first twelve months, 70% in the next and 80% subsequently). Further, the abundant availability of steel scrap in Iraq at a 70-80% discount to international prices will boost its profit margins (25-30% net margin, as per management guidance).

Currently, the production from the steel plant will be sold only in the domestic market as required by the Iraqi government. However, the company can have the option to export to other countries in the GCC region in the medium term, due to its proximity with the Basra sea port. This reflects the long-term vision of the management, which has planned meticulously for Al Anmaa to become a valuable asset over the long-term.

Al Anmaa assumes significance as Saudi operations are struggling

Existing steel business in Saudi Arabia has been facing difficult business conditions

Saudi Arabia-based IBSF, the company's steel business, manufactures pre-engineered steel for buildings, structural steel frames and sandwich panels and caters mainly to the energy, petrochemical, water desalination and other heavy industries in the GCC region. IBSF's three factories are currently equipped with a production capacity of 30,000 tpa in Riyadh Industrial City and its sales are majorly focused on the local markets (93% of total sales in 2011)

Though IBSF contributes to nearly a quarter of its overall top-line, profitability has been lower as compared to the other segments (2011 net margin of 6% vs. 25% and 15% of pharma and chemicals segments respectively). IBSF had well established relationships with the engineering, procurement and construction (EPC) contractors of companies like SABIC and Saudi Aramco. However, the growing presence of Korean EPC contractors in Saudi Arabia is a cause for concern, as IBSF has yet to build a strong relationship with them. Further, the investments made in Al Anmaa have not been capitalized, rather these are charged to profit and loss account, resulting in lower margins for the steel business. We believe these factors have resulted in a decline in operating margin for the segment from 17.6% in 2009 to 5.1% in 2011. As per the discussion with the company management, IBSF has acquired a site in Jubail to produce high-margin specialized steel structures by mid-2013. Being a steel plant producing specialized products, the company expects it to achieve better margins from Jubail facility as compared to its existing operations.

Geopolitical risks increased and a delay in Al Anmaa's launch could prove costly

Though Al Anmaa is a potential growth driver for the company, it has increased the risk profile of the company

Though the Al Anmaa plant in Iraq has very good prospects considering demand scenario and cheaper scrap steel in Iraq, the risk profile of Astra have increased considerably after this investment. We believe that the geopolitical and security concerns can weigh on the stock price if the company fails to achieve production commencement on time. The start of commercial production of Al Anmaa has been already delayed by around six months and currently trial operations are expected by June 2012. Looking ahead, we believe that the timely commencement of Al Anmaa will be crucial for the company as it is a major revenue driver for the company over the next few years. We will closely monitor the developments at Al Anmaa as any major delay in commencement of operations would affect the valuation and our rating of the company.

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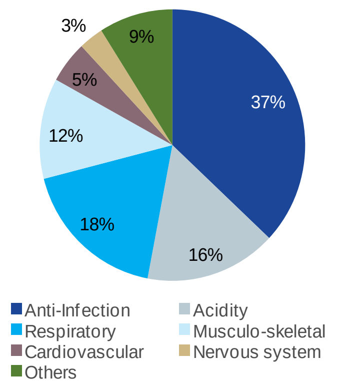
Pharma segment:
To benefit from the macro factors

One of the leading players in Saudi Arabia

TPMC is one of the largest vendors of generic drugs in Saudi Arabia

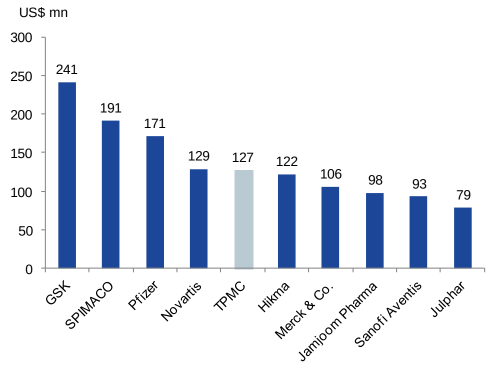
Astra's pharma business – Tabuk Pharmaceutical Manufacturing Company (TPMC) - is the dominant contributor to the company's overall revenues and net profit in 2011 (39.4% and 57.7% respectively). Established in 1994, TPMC has a diverse portfolio of generic drugs consisting of 101 registered brands with 217 strengths. The company emerged as the fifth-largest vendor of generic drugs in Saudi Arabia's private market space at the end of 2011, despite intense competition from large multinational companies like Pfizer, GlaxoSmithKline and Novartis. Amongst the local players, TPMC ranked second behind SPIMACO in 2011, while Jamjoom occupied the third place. We expect pharma business to continue deliver decent margins owing to its strong product pipeline and extensive sales network.

Figure 3. Sales by therapeutic categories



Source: Company data, Al Rajhi Capital

Figure 4. 2011 Saudi private market sales



Source: IMS, Al Rajhi Capital

Healthy growth ahead on favorable fundamentals

Saudi Arabia's pharmaceutical market (worth ~US$3.5bn as per industry sources), especially that of generic drugs, continues to grow rapidly due to a number of demographic and regulatory factors. The demand for generic drugs is being boosted by higher prevalence of non-communicable or lifestyle-related diseases like obesity, hypertension and diabetes in Saudi Arabia as compared to the rest of the GCC region, on account of a number of favorable demographic factors which include:

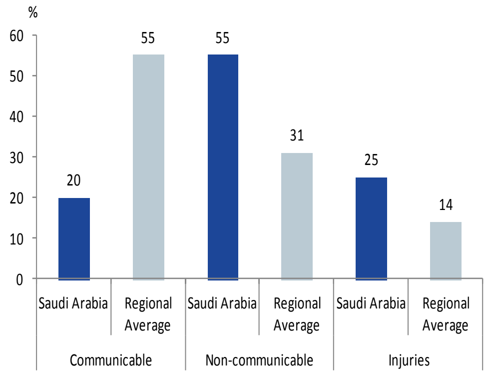
Ever-growing population – Saudi Arabia has the largest and fastest growing population in the GCC region. According to the Central Department of Statistics and Information, the total population of the Kingdom is estimated to grow to 31.6mn by 2016 (of which 22.8mn will comprise Saudi nationals), at a CAGR of 3.1% between 2011 and 2016.

Higher life expectancy – According to the World Health Organization, life expectancy in Saudi Arabia was 69 years for males and 75 for females in 2009, higher than the regional average of 64 and 67 years respectively.

Increasing over-the-counter (OTC) consumption – The health care sector is poised to witness increased private sector participation, as the Saudi government shifts its focus from being a service provider to a regulator, which will pave the way for a rise in OTC drug consumption in the coming years.

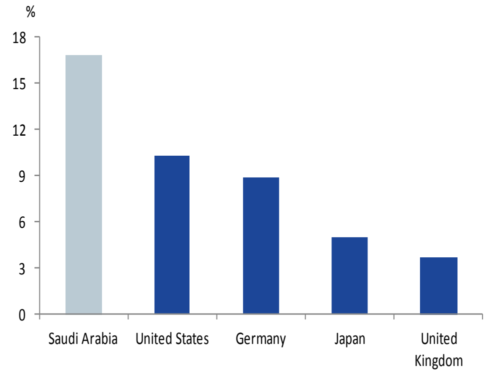
Penetration of generic drugs to increase –According to a study on the healthcare market, in 2009, the market share of generic drugs stood at only 5.7% in Saudi Arabia as compared to 50% in many European countries. The affluence of the Saudi people had led to higher demand for imported patented drugs. However, with the regulatory system (discussed below) undergoing changes, we believe patented drugs will lose their sheen, setting the stage for increased consumption of generic drugs.

Figure 5. Distribution of life, in years, by type of ailment suffered – 2008



Source: WHO, Al Rajhi Capital

Figure 6. Diabetes prevalence (% of population aged 20-79) – 2010



Source: World Bank, Al Rajhi Capital

Regulatory factors are also conducive

According to the World Health Organization, the Saudi government's spending on healthcare remains the prime contributor (62.9% in 2010), while budgetary allocations reached an all-time high in absolute terms (SAR68.7bn in 2011, up 12.3% y-o-y). As a result, the government is undertaking a number of steps like shifting its focus from being a healthcare provider to a regulator, allowing active private sector participation, making health insurance mandatory for expatriates and promoting the use of generic products, mainly in the public sector.

Local producers enjoy a competitive edge over multinational companies in introducing drugs in the Kingdom owing to a complicated drug licensing process and restrictions placed on foreign ownership. Moreover, the pricing system is regulated in such a manner that a drug producer who registers a medicine first secures the best price. Interestingly, those who obtain the permission to market the same drug later have to price it at a discount to the one before them. For instance, if a drug is introduced in the market for SAR10 for the first time, then the next supplier of the same drug will have to price it at a certain discount to SAR10. The subsequent supplier will have to price it at even further discount, thus resulting in lower margins for the late entrants. Since local producers are offered a preference during drug registration and pricing review, they are able to generate better margins than their foreign competitors.

Growing through the organic as well as the inorganic route

Astra is expanding its business organically as well as inorganically

As part of its inorganic expansion program, TPMC acquired an 80% stake Sudan-based Alsaudia Advanced Pharmaceutical Industries in 2010 with an option to purchase the remaining 20% after three years at a pre-agreed price. This is seen as a step by TPMC to extend its geographic reach to Africa, specifically the pharmaceutical markets in northern region of the country.

Further, the subsidiary is establishing a new research and development facility in Dammam with an investment of US$30-40mn by mid-2013. This is essential considering that TPMC has to consistently keep building a pipeline of drugs for registration, in order to retain its early-mover advantage and secure the best pricing, as discussed earlier, in a heavily regulated Saudi market.

Chemicals segment:
Lends stability to business model

Astra's chemicals business comprises polymers (masterbatches) and agrochemicals

Chemicals segment is based on two niche areas

Astra's chemicals segment contributes nearly equal to that of the pharma business, in terms of revenue, though its contribution is less in terms of margins (34% of the overall profit in 2011 with a net margin of 15%). The segment comprises mainly two divisions – a) Astra Polymers Compounding Company (APCC), which is into polymer business and b) Astra Industrial Complex Company (Astra Chem), which produces and markets agrochemicals and fertilizers.

APCC specializes in producing masterbatches (an additive used for coloring as well as imparting properties like night glow, anti-static, flame retardant, etc. to petrochemical products) and customized thermoplastic compounds. APCC enjoys stable margins due to its "toll manufacturing contracts" (where, the customer provides the raw materials for production), ensuring secure feedstock supply. It also benefits of its proximity to customers which act as a barrier to other international producers. Currently, APCC contributes 60% of the revenue from the chemicals segment.

Founded in 1996, Astra Chem caters to the agriculture sector in MENA and contributes the remaining 40% of the revenue from the chemicals segment. We believe the agrochemical and fertilizer business has stable operating models on the back of its diverse product offering including agrochemicals (insecticides, pesticides, and herbicides), fertilizers and vegetable seeds. Agrochemicals dominate the revenue mix (56% of the total segment sales as of 2011), followed by fertilizers and seeds (33% and 10% respectively).

Astra's polymer business has a dominating presence in Saudi Arabia and the UAE

Leading presence across the MENA region

APCC enjoys a market share of more than 70% in Saudi Arabia and the UAE - the two major petrochemical producing countries in the region. We believe this market dominance enables APCC to enter into long-term associations with petrochemical producers like SABIC and Boruoge, resulting in revenue visibility. In 2010, APCC acquired 100% stake in Turkey-based Constab Middle East Polimer A.S. for US$7mn as part of its expansion program, further consolidating its position as a masterbatch supplier in the region.

On the other hand, Astra Chem markets its products through a wide marketing network across the MENA region (through its subsidiaries in Algeria, Morocco, Turkey, Jordan, Uzbekistan, Ukraine, Syria, and Egypt, in addition to agents in the rest of the region), which lends stability to its business.

Polymer business is growing organically

APCC is building a polymer plant in Rabigh. While the first production line with a capacity of 9,000 tpa, commenced operations at the end of 2011, the second production line, with a capacity of 15,000tpa, is expected to come on stream in 2012.

Figure 7. APCC - Sales by products, 2011

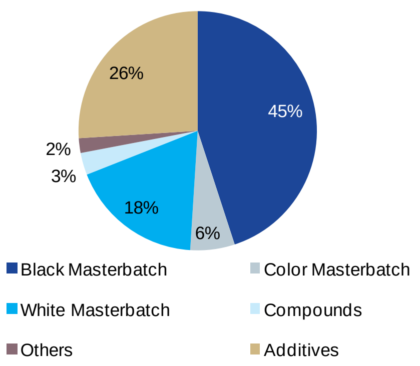
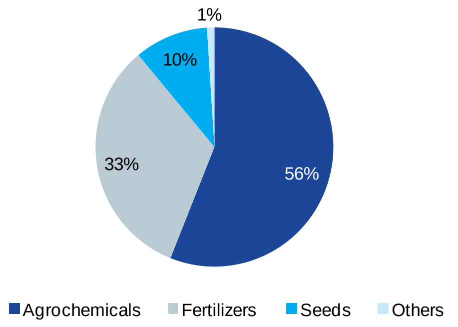


Figure 8. Astra Chem - Sales by products, 2011



Source: IMS Reports, Company data

Astra's financial performance:
Steel segment to spur growth

Steel segment to drive top-line growth

We estimate total revenue to grow at a CAGR of 14.4% during 2011-2016

In 2011, Astra's total revenue increased significantly by 23.3% y-o-y to SAR1.4bn due to revenue growth witnessed across segments. Revenue from the pharma segment grew by 20.8% to SAR545mn mainly on account of rising exports sales (+39.5% y-o-y), while revenue from the chemicals segment registered a y-o-y growth of 16.4% to SAR520mn owing to a full year consolidation of Constab (acquired in Q2 2010) coupled with high capacity utilization rates as well as an increase in product prices. The steel segment witnessed revenue growth of 42.3% y-o-y (to SAR317mn) on the back of strong domestic demand.

Total revenue grew at a CAGR of 12.9% during 2007-2011 on the back of acquisitions as well as organic expansions. Currently, we do not expect the company to carry out large expansion over the next couple of years (excluding the ongoing capacity expansions in the steel and pharma segments). We expect revenue to grow at a CAGR of 14.4% during 2011-2016, to reach SAR2.7bn, aided by the launch of Al Anmaa as well as a marginal improvement in product prices from 2012 onward.

We expect to see a shift in revenue mix, with the steel segment dominating in the future

In 2009, the pharma segment contributed 40.6% of the total revenue, while chemicals and steel segments contributed 33% and 19.7% respectively, the remaining 6.7% of the revenue was derived from the Head office and other segment. The sale of Arabian Company for Comforts and Pillows (Head office and other segment) and the acquisition of Constab in 2010 led to higher revenue contribution from the chemicals segment (~40% in 2010), almost at par with the revenue contribution from the pharma segment. In 2011, revenue mix remained similar to 2010 with the pharma and chemicals segment contributing 39.4% and 37.6% respectively.

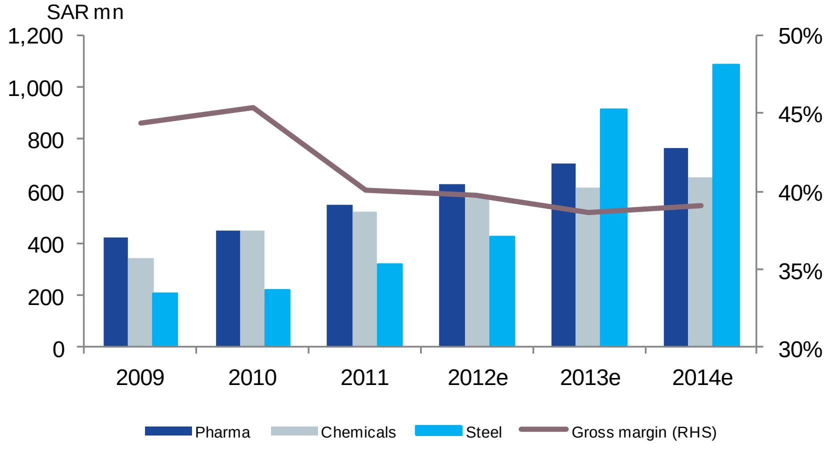
We expect the revenue mix to undergo a change in 2013, with the steel segment dominating due to Al Anmaa's launch (41% of total revenue, as per our estimates), followed by the pharma and the chemicals segments (32% and 27% respectively). We estimate Al Anmaa's contribution to the steel segment to be around 60% and to Astra's top line to be 24% in 2013. We expect the steel segment's contribution to overall revenue to reach 45% by 2015, as Al Anmaa reaches its peak capacity.

Figure 9: Segment forecast

Sales	2009	2010	2011	2012e	2013e	2014e
Pharma segment	422,783	450,928	544,944	623,512	706,069	762,762
Chemical segment	343,482	446,955	520,229	572,525	615,158	650,659
Steel segment - IBSF	205,261	222,577	316,816	315,232	372,467	352,863
Steel segment - Al Anmaa	-	-	-	109,922	538,178	731,921
Head office and other	70,033	-	-	-	-	-
Total	**1,041,560**	**1,120,460**	**1,381,989**	**1,621,191**	**2,231,871**	**2,498,206**
Gross income						
Pharma segment	272,323	303,759	331,618	378,630	427,163	462,234
Chemical segment	114,649	143,319	161,122	171,659	190,459	208,211
Steel segment - IBSF	55,072	60,878	61,573	60,247	67,044	63,515
Steel segment - Al Anmaa	-	-	-	32,977	176,749	241,534
Head office and other	19,375	-	-	-	-	-
Total	**461,420**	**507,955**	**554,314**	**643,512**	**861,415**	**975,494**
Gross margin						
Pharma segment	64.4%	67.4%	60.9%	60.7%	60.5%	60.6%
Chemical segment	33.4%	32.1%	31.0%	30.0%	31.0%	32.0%
Steel segment - IBSF	26.8%	27.4%	19.4%	19.1%	18.0%	18.0%
Steel segment - Al Anmaa	-	-	-	30.0%	32.8%	33.0%
Head office and other	27.7%	-	-	-	-	-
Total	**44.3%**	**45.3%**	**40.1%**	**39.7%**	**38.6%**	**39.0%**

Source: Company data, Al Rajhi Capital

Figure 10: Segmental revenue



Source: Company data, Al Rajhi Capital

Overall margins to remain stable and then improve

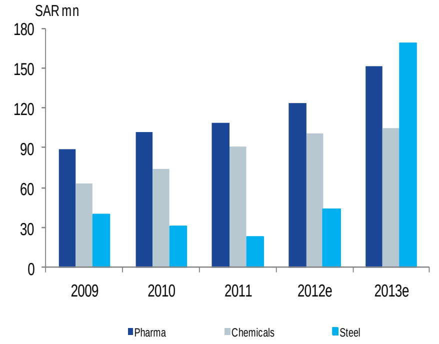
Gross margin to remain at 39-40% levels in the medium-term

The company reported gross margin in the range of 43-45% in 2009 and 2010. However in 2011, the gross margin fell to 40.1%, primarily due to reclassification of some cost items (from SG&A expenses to COS) in 2011 and an increase in operating costs. We expect the gross margin to be slightly lower in 2012 as a result of the commencement of operations at Al Anmaa and APCC's second production line at Rabigh. Due to a gradual increase in marketing and administrative expenses, EBITDA margin declined to 15.6% in 2011 as compared to 18.4% reported in 2010. We expect the EBITDA margin to remain in the range of 15-19% over the next three years based on a healthy outlook for the pharma segment, which is the major contributor to the company's growth and an improvement in profitability of the steel segment. Accordingly, we expect the operating margin to remain in the range of 13-16% during the same period as compared to 13.5% reported in 2011.

We expect to see an improvement in steel segment's margins due to the launch of Al Anmaa

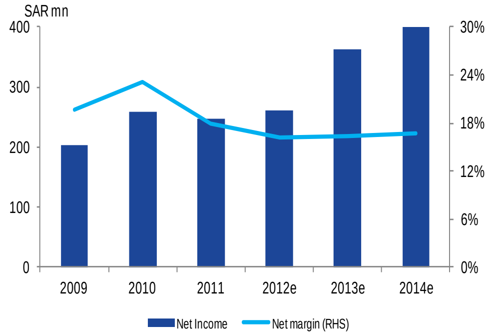
The pharma as well as the chemicals segment reported operating margins in the range 17-19% during 2009-2011, while the steel segment witnessed a significant decline in operating margin (from 17.6% in 2009 to 5.1% in 2011) due to increasing costs and pricing pressure from higher competition. Looking ahead, we estimate the operating margins to remain at current levels in the pharma and chemicals segments, while it will improve significantly in the steel segment due to the launch of Al Anmaa.

Figure 11: EBITDA



Source: Company data, Al Rajhi Capital

Figure 12: Net income & Net margin



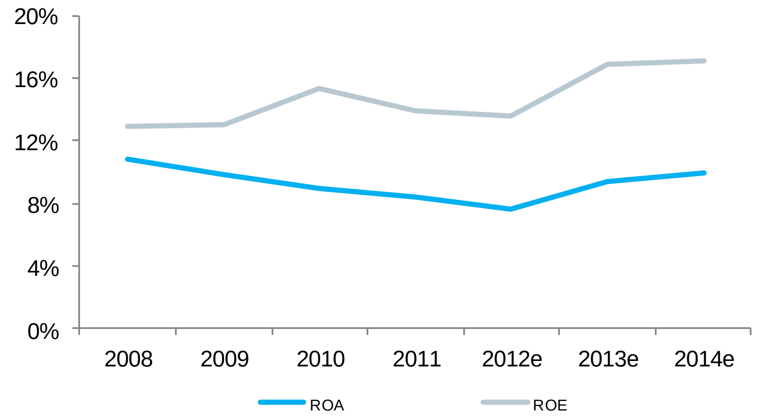
Source: Company data, Al Rajhi Capital

In 2011, Astra posted a net profit of SAR248mn (net margin of 18%) as compared to SAR259mn (including a non-recurring gain of SAR28.8mn from the sale of Arabian Company for Comforts and Pillows) in 2010. We expect the company to report net margin in the range of 16-17% over the next three years as the relatively lower margin steel segment starts to dominate the revenue mix. However, we expect the net margin to grow over the medium-term with increasing profitability in the pharma and chemicals segment owing to improvement in prices, which will partially offset the low margin from the steel segment.

We expect the company's ROE to improve to 17.2% by 2014 from 13.9% in 2011

The company's ROA fell from 10.9% in 2008 to 8.4% in 2011 following substantial investments (organic as well as inorganic) made by the company during 2009-2011. We expect ROA to decline marginally in 2012, due to the launch of Al Anmaa and ongoing organic investments across the group. However, ROA is expected to pick up from 2013 onward following the completion of expansion programs and Al Anmaa operating at full capacity. Similarly, we estimate ROE to grow gradually from 13.9% reported in 2011 to 17.2% by 2014.

Figure 13: ROA & ROE ratios



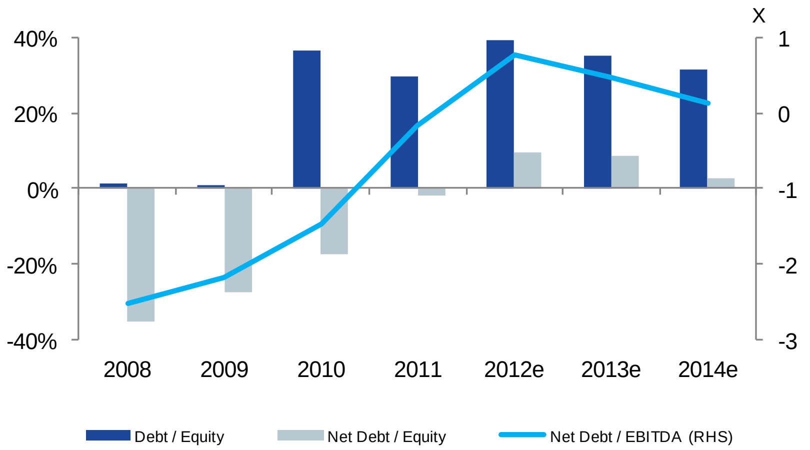
Source: Company data, Al Rajhi Capital

Financial health to improve post completion of expansion programs

We expect the net debt/EBITDA ratio to reach 0.5x by 2013, before declining significantly

Astra's net cash (cash minus total debt) decreased from SAR509mn at the end of 2008 to SAR33.4mn at the end of 2011, due to healthy increase in operating cash flow. The company's major acquisitions during this period include a 51% stake in Al Tanmiya Company for Steel Manufacturing – the holding company of Al Anmaa (acquisition cost SAR228mn in 2009), 100% stake in Constab Middle East Polimer (SAR27mn in 2010) and 51% stake in AG Nova (2010). The acquisitions were partly funded by the sale of Astra's subsidiary - Arabian Company for Comforts and Pillows - in 2010 for SAR95mn. We expect the net debt/EBITDA ratio to reach 0.5x by 2013, mainly to fund capex for its organic growth plans in the pharma and steel segments. We expect the company to maintain dividend payments at same levels as of 2011, before cash generation from the new additions kick in.

Figure 14: Astra's debt position

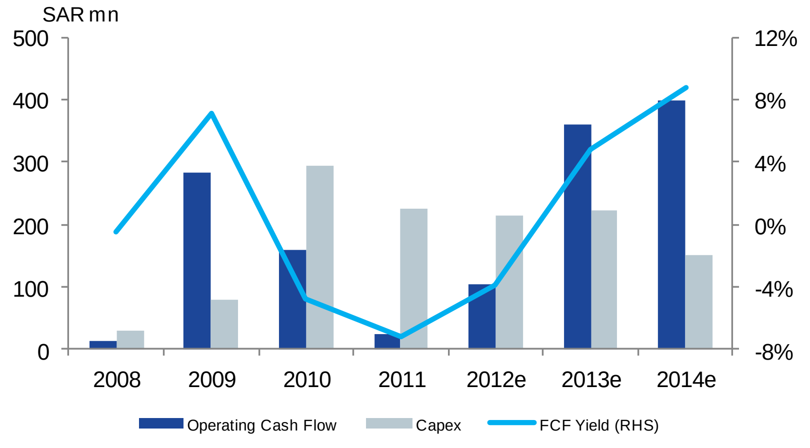


Source: Company data, Al Rajhi Capital

Capex to decline by 2014 with completion of expansion programs

In 2011, Astra reported cash outflow of SAR203mn, mainly due to an increase in working capital as well as high capex. We expect the capex-to-sales ratio to decline gradually from 16.4% reported in 2011 to 6% by 2014, following the completion of most of the expansion programs by 2014 and unlikely prospects of undertaking any acquisitions in the near future. Currently, we estimate a cash outflow of SAR109mn in 2012, which will translate into free cash flow generation of around SAR136mn by 2013, resulting in FCF yield improving from -3.8% to 4.8%. Higher FCF yield will enable the company to pay additional dividends, remain debt-free and explore more growth opportunities.

Figure 15: Capex, operating cash flow & FCF yield – 2008 to 2014e



Source: Company data, Al Rajhi Capital
Note: FCF yield is calculated at current market capitalization

Revenue growth witnessed in Q1, though margins declined

Decent performance in the pharma segment dragged down by weak results in the steel and chemicals segments

Astra posted revenue of SAR392mn in Q1 2012, reflecting a strong recovery on a quarterly basis (up by 23% q-o-q). On a yearly basis, revenue growth stood at 10%. This was mainly attributable to strong performance in the pharma segment, where local sales grew by 40% q-o-q to SAR173mn and 28% on a yearly basis, with most of the growth (67.7%) coming from local sales. The steel segment's revenue was up by 22% q-o-q at SAR83mn, though on a yearly basis there was almost no growth. Revenue from the chemicals segment saw a moderate growth of 7% q-o-q to SAR136mn; however, they declined by 2% y-o-y due to a decline in exports.

The company reported an operating profit of SAR60mn (margin of 15.2%) in Q1 2012 as compared to SAR45mn (14.1%) in Q4 2011. Comparing on a yearly basis, the operating margin was 100bps lower. This can be attributed to a significant decline in margins in the chemicals and steel segments (lower by 397 and 425bps respectively), which was offset to some extent by a rise in margins in the pharma segment (up by 211bps), which dominated the revenue mix with a contribution of 44.1%.

Dividends to improve going forward

We believe Astra has strong business prospects with the launch of Al Anmaa and consolidation of its recent acquisitions. According to our estimates, Al Anmaa will add significant value (17% of Astra's 2013 enterprise value), once it reaches full operations by 2013. Coupled with an improvement in margins in the pharma and chemicals segments, we expect Astra to generate strong operating cash flows.

We expect Astra to provide attractive dividend yield in the medium-term

Astra has been declaring increasing amount of dividends since 2008. The company announced a dividend of SAR1.75 per share (dividend payout ratio of 52.3%) for 2011, which translates into a dividend yield of 4.3% at current market price. We expect Astra's dividend per share to increase to SAR2.25 in 2014 (dividend yield of 5.6%) as it attains stability in its new operations and improves profitability of its existing operations. Besides, strong operating cash flows will allow the company to expand further through organic and inorganic growth opportunities.

Valuation
Astra offers value over the long-run

Summary of our approach

Our key long-run method of forecasting is discounted economic profit (DEP) forecasting

Our key valuation method is the long-run discounted economic profit (DEP), also called discounted long-run EVA (economic value added). This is a simple variation of discounted cash flow and is mathematically equivalent. In our models, we make explicit forecasts for income statement, balance sheet and cash flow through 2023. We then assume a steady fading of return on invested capital, i.e. excess return, down to the cost of capital over a period of up to 25 years from the end of our period of explicit forecasting. This approach avoids a common problem in long-run modeling: namely, that the analyst stops forecasting at some arbitrary point when the company in question is still generating high returns. In terms of financial theory, this is implausible, and excess returns will eventually disappear through competition, regulations or some other means.

Our DEP valuation is sensitive to many factors, including assumed revenue growth, EBITDA margin and capex/sales ratio in 2023, i.e. the last year of explicit forecasting. Another important variable is the assumed duration of the period of competitive advantage remaining at the current levels, i.e. the period during which the company generates returns above the weighted average cost of capital (WACC). Deciding on the length of the competitive advantage period is naturally a subjective exercise involving many variables and scenarios. We have assumed 25 years for Astra on the ground that Astra's diversified revenue streams, healthy financials, and potential for pharmaceutical business as well as sound fundamentals of the chemicals business, which will enable the company to achieve positive cash flows for the next 25 years.

We estimate Astra's WACC at 12%

However, as with any DCF-based approach, the factor to which the DEP valuation is most sensitive is WACC. We have assumed a WACC of 12% for Astra on the back of higher market risk premium; however, low interest rate on debt has slightly offset the high cost of equity. We attribute this low rate to the fact that as of 2011, all the outstanding loans are short-term in nature, which carries commission charges at prevailing market rates. On the other hand, beta i.e. the company's systematic risk is 1.2x based on Bloomberg data. Higher beta indicates that the stock is more volatile and therefore risky. WACC is, in turn, highly sensitive to assumed terminal capital structure. Estimating terminal capital structure is again a rather subjective exercise. We estimate a terminal debt/total capital ratio of 25% for Astra in the medium-term.

We have also valued Astra based on relative valuation method

In addition to long-run DEP, we use comparative multiple analysis to value Astra in relation to global peers. We have used multiple analysis valuation method particularly for Astra as the company has different business segments (pharma, chemicals and steel), which have entirely different characteristics. Under this approach, we use EV/EBITDA multiples of companies with similar business models to estimate the fair value of Astra. As the company has a well-diversified portfolio, we have evaluated each business segment separately.

We have taken a weighted average of the two methods as our target price by giving a weight of 80% to the long-run DEP method and weight of 20% to the comparative multiples analysis method as we believe that the long-run DEP method is a better indicator of performance and pricing in the real world, given that the peers are international players who do not operate in the same kind of environment and also are large, in terms of market capitalization, as compared to Astra.

We assume a competitive advantage period of 25 years for Astra

Long-run DEP approach

In the long-run DEP method of estimating Astra's fair value, we use a WACC of 12%. We calculate WACC as shown in the table (figure 16) below.

Figure 16: Astra - weighted average cost of capital (WACC)

Particulars	
Risk-free rate	2.0%
Expected Mkt Return - Risk-free Rate	11.0%
Adjusted Beta	1.15
Cost of Equity	14.7%
Pre-tax Cost of Debt	4.0%
Effective Tax rate	0.0%
After-tax Cost of Debt	4.0%
Target D/(D+E)	25.0%
WACC	**12.0%**

Source: Bloomberg, Al Rajhi Capital

Astra's value lies both in invested capital as well as in its future economic returns

In DEP forecasting, the appraised fair enterprise value may be broken down into two elements: opening invested capital, i.e. the debt and equity capital that have already been deployed in the business, and discounted economic profit, i.e. present value of future economic returns (returns above the cost of capital). While the company has made huge investments during 2009-2010 to grow inorganically, currently the company is focusing on organic growth across its segments. Consequently, we believe the value of the company lies in invested capital as well as in its future economic returns. Discounted economic profit, i.e. the present value of future economic returns or returns above the cost of capital, represents about 53% of our fair enterprise value of SAR3.8bn. Discounted economic profit is shown in the table below (figure 17) as "total value created/destroyed". From the appraised fair enterprise value, we add non-core investments made by the company and subtract net debt & minority estimates to arrive at the estimated fair equity value of SAR3.6bn. On this basis, we estimate Astra's fair value per share at SAR48.6.

Figure 17: Astra valuation - discounted economic profit

Total value created / (destroyed)	**2,037**
Opening Invested capital	1,798
Total Enterprise Value	**3,835**
Add:	
Associates and non-core assets	2
Less:	
Value of Debt (2012E)	(192)
Minority Interests	(42)
Equity Value	**3,602**
No. of Shares (mn)	74
Fair Value per share	**SAR 48.6**

Source: Al Rajhi Capital

We have used the comparative multiples approach as Astra enjoys a presence in different business segments

Comparative multiples approach

We have valued Astra's pharma, chemicals and steel segments separately by applying trading multiples for 2013 of comparable global peers. The tables below show market values and valuation multiples for these companies compared to Astra.

Figure 18: Astra's pharma segment: comparative multiple analysis

Companies	Region	Enterprise Value ($mn)	EV/EBITDA (X) 2012	2013
Saudi Pharmaceutical Indust.& Med Appliances Corp	Saudi Arabia	3,381	15.5	16.0
Hikma Pharmaceuticals PLC	Global	9,091	10.9	9.2
GSK India	Global	9,936	17.1	15.0
Median Market Multiple			**15.5**	**15.0**

Source: Bloomberg, Al Rajhi Capital

Figure 19: Astra's chemicals segment: comparative multiple analysis

Companies	Region	Enterprise Value ($mn)	EV/EBITDA (X) 2012	2013
Clarinat AG	Global	18,659	5.1	4.5
PolyOne Corp	Global	6,319	6.0	5.4
Cabot Corp	Global	10,770	6.0	5.5
Median Market Multiple			**6.0**	**5.4**

Source: Bloomberg, Al Rajhi Capital

Figure 20: Astra's steel segment: comparative multiple analysis

Companies	Region	Enterprise Value ($mn)	EV/EBITDA (X) 2012	2013
Steel Authority of India Ltd	Global	27,234	5.0	4.0
JSW Steel Ltd	Global	16,740	3.9	3.5
ThyssenKrupp AG	Global	66,851	6.6	4.5
Nucor Corp	Global	50,650	6.8	4.9
United States Steel Corp	Global	24,770	4.6	3.7
Median Market Multiple			**5.0**	**4.0**

Source: Bloomberg, Al Rajhi Capital

Based on the median EV/EBITDA multiples for the comparable companies, we estimate a fair value per share for Astra at SAR45.3. We have assigned only 20% weight to this valuation method as these peers are not exactly comparable with Astra in terms of size (market cap), geographical presence and product profile. Book value of assets for "Holding and Other" segment is considered separately to arrive at a valuation under this method.

Figure 21: Astra - comparative valuation

	EBITDA (2013e) SAR mn	Multiple (x)	Enterprise value
Pharma segment	151	15.0	2,262
Chemicals segment	119	5.4	641
Steel segment - IBSF	22	4.0	88
Steel segment - Al Anmaa	147	4.0	581
Total EV			**3,572**
Associates and non-core assets			2
Book value of assets for "Holding and other" segment			17
Debt (2012e)			(192)
Minorities			(42)
Value of the equity (SAR mn)			**3,356**
Number of shares (mn)			74
Share price (SAR)			**45.3**

Source: Al Rajhi Capital

Astra's fair value

As mentioned above, we use two valuation methods - long-run EVA and comparative multiples analysis. For the comparative multiples analysis, we have used EV/EBITDA multiples for the pharma, chemicals and steel segments. We have ruled out 'Head office and other' segment from the comparative valuation as it does not generate any revenues.

We arrive at a target price of SAR47.9 per share based on 80:20 weightage for our two different valuation approaches

We have arrived at a target price of SAR47.9 per share by giving an 80% weight to the long-run EVA method (fair value of SAR48.6 per share), and 20% to the comparative multiples method (fair value of SAR45.3 per share). Our target price implies an 18.3% upside to the current share price of Astra.

Figure 22: Astra - Valuation summary

Valuation method	Value (SAR)	Weight	Fair Value (SAR)
Long-run DEP valuation	48.6	80%	38.9
Comparative valuation	45.3	20%	9.1
Target price for Astra			**47.9**
Potential Upside/Downside			**18.3%**

Source: Al Rajhi Capital

Risks associated with our assumptions

It is important to highlight that our valuation relies heavily on future forecasts which are uncertain. We have come up with several assumptions including growth, cost of capital, and market trend to predict the future performance. We have arrived at the most accurate assumptions; however, reality may deviate from our forecasts depending on new macroeconomic factors, slowing demand for the company's products and negative regulatory changes such as a hefty rise in feedstock costs. Competition is another factor that can influence our assumptions. New entrants or transformation of current rivals' business models might add to competitive pressures, and hence influence our overall assumptions and forecasts.

Revenue is expected to grow once Al Anmaa starts its operations

We estimate dividend pay-out ratio is to increase gradually in the long-term

Income Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue	**1,120**	**1,382**	**1,621**	**2,232**	**2,498**
Cost of Goods Sold	(613)	(828)	(978)	(1,370)	(1,523)
Gross Profit	**508**	**554**	**644**	**861**	**975**
Government Charges					
S.G. & A. Costs	(333)	(368)	(429)	(529)	(575)
Operating EBIT	**175**	**187**	**214**	**332**	**401**
Cash Operating Costs	(914)	(1,167)	(1,375)	(1,854)	(2,008)
EBITDA	206	215	246	378	490
Depreciation and Amortisation	(31)	(28)	(32)	(46)	(89)
Operating Profit	**175**	**187**	**214**	**332**	**401**
Net financing income/(costs)	16	(1)	(4)	(9)	(8)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses					
Net Profit Before Taxes	**250**	**232**	**243**	**325**	**395**
Taxes	-	-	-	-	(8)
Minority Interests	9	16	19	25	30
Net profit available to shareholders	**259**	**248**	**262**	**351**	**417**
Dividends	(111)	(130)	(130)	(130)	(167)
Transfer to Capital Reserve					

	12/10A	12/11A	12/12E	12/13E	12/14E
Adjusted Shares Out (mn)	74.12	74.12	74.12	74.12	74.12
CFPS (SAR)	3.80	3.51	3.71	5.01	6.43
EPS (SAR)	3.49	3.35	3.53	4.73	5.63
DPS (SAR)	1.500	1.750	1.750	1.750	2.252

Growth	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue Growth	7.6%	23.3%	17.3%	37.7%	11.9%
Gross Profit Growth	10.1%	9.1%	16.1%	33.9%	13.2%
EBITDA Growth	1.0%	4.3%	14.4%	53.7%	29.5%
Operating Profit Growth	-2.5%	6.5%	14.7%	55.1%	20.7%
Net Profit Growth	26.9%	-4.2%	5.5%	33.9%	19.0%
EPS Growth	21.0%	-4.2%	5.5%	33.9%	19.0%

Margins	12/10A	12/11A	12/12E	12/13E	12/14E
Gross profit margin	45.3%	40.1%	39.7%	38.6%	39.0%
EBITDA margin	18.4%	15.6%	15.2%	17.0%	19.6%
Operating Margin	15.6%	13.5%	13.2%	14.9%	16.0%
Pretax profit margin	22.4%	16.8%	15.0%	14.6%	15.8%
Net profit margin	23.1%	18.0%	16.2%	15.7%	16.7%

Other Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
ROCE	8.7%	9.1%	9.1%	13.0%	14.2%
ROIC	14.9%	13.0%	11.9%	15.4%	16.5%
ROE	16.0%	14.3%	14.1%	17.3%	18.2%
Effective Tax Rate	0.0%	0.0%	0.0%	0.0%	2.0%
Capex/Sales	26.2%	16.4%	13.1%	10.0%	6.0%
Dividend Payout Ratio	42.9%	52.3%	49.5%	37.0%	40.0%

Valuation Measures	12/10A	12/11A	12/12E	12/13E	12/14E
P/E (x)	11.6	12.1	11.5	8.6	7.2
P/CF (x)	10.7	11.5	10.9	8.1	6.3
P/B (x)	1.8	1.7	1.6	1.4	1.2
EV/Sales (x)	2.5	2.2	2.0	1.5	1.2
EV/EBITDA (x)	13.5	14.1	13.2	8.6	6.3
EV/EBIT (x)	15.9	16.3	15.2	9.8	7.7
EV/IC (x)	1.9	1.7	1.5	1.4	1.2
Dividend Yield	3.7%	4.3%	4.3%	4.3%	5.6%

Source: Company data, Al Rajhi Capital

Astra's balance sheet is growing due to its ongoing expansion plans

Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	940	578	583	577	697
Current Receivables	504	579	719	906	999
Inventories	416	552	682	739	799
Other current assets	111	132	160	160	160
Total Current Assets	**1,971**	**1,841**	**2,144**	**2,381**	**2,656**
Fixed Assets	873	1,072	1,254	1,431	1,492
Investments	9	2	2	2	2
Goodwill	35	44	44	44	44
Other Intangible Assets	1	3	4	3	3
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**918**	**1,121**	**1,303**	**1,481**	**1,541**
Total Assets	**2,889**	**2,962**	**3,447**	**3,862**	**4,197**
Short Term Debt	534	545	625	625	625
Accounts Payable	97	104	189	286	325
Accrued Expenses	138	151	189	286	325
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	**819**	**845**	**1,043**	**1,237**	**1,314**
Long-Term Debt	103	-	150	150	150
Other LT Payables	171	225	231	231	231
Provisions	51	59	62	62	62
Total Non-current Liabilities	**325**	**284**	**443**	**443**	**443**
Minority interests	61	42	39	39	9
Paid-up share capital	741	741	741	741	741
Total Reserves	943	1,050	1,181	1,402	1,690
Total Shareholders' Equity	**1,684**	**1,791**	**1,922**	**2,143**	**2,431**
Total Equity	**1,745**	**1,833**	**1,961**	**2,182**	**2,440**
Total Liabilities & Shareholders' Equity	**2,889**	**2,962**	**3,447**	**3,862**	**4,197**

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	(303)	(33)	192	198	78
Net Debt/EBITDA (x)	(1.47)	(0.16)	0.78	0.52	0.16
Net Debt to Equity	-17.3%	-1.8%	9.8%	9.1%	3.2%
EBITDA Interest Cover (x)	(12.7)	214.1	69.1	43.3	63.4
BVPS (SAR)	22.73	24.16	25.94	28.92	32.80

Investments plans and dividends are expected to financed from healthy operating cash flow

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Net Income before Tax & Minority Interest	**250**	**232**	**243**	**325**	**395**
Depreciation & Amortisation	31	28	32	46	89
Decrease in Working Capital	(70)	(213)	(187)	(50)	(77)
Other Operating Cashflow	325	(316)	28	25	(8)
Cashflow from Operations	**537**	**(269)**	**115**	**347**	**400**
Capital Expenditure	(294)	(227)	(213)	(223)	(150)
New Investments	(329)	286	3	-	-
Others	2	(3)	(1)	-	-
Cashflow from investing activities	**(621)**	**57**	**(212)**	**(223)**	**(150)**
Net Operating Cashflow	**(84)**	**(213)**	**(96)**	**124**	**250**
Dividends paid to ordinary shareholders	(93)	(111)	(130)	(130)	(130)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	35	55	-	-	-
Cashflow from financing activities	**562**	**(150)**	**101**	**(130)**	**(130)**
Total cash generated	478	(362)	5	(6)	120
Cash at beginning of period	462	940	578	583	577
Implied cash at end of year	**940**	**578**	**583**	**577**	**697**

We estimate capex to decline once the company completes its expansion plans

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	26.2%	16.4%	13.1%	10.0%	6.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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