Agriculture & Food Sector
Food-Diversified
Saudi Arabia
11 Dec 2012

الراجحي المالية
Al Rajhi Capital

US$14.99bn	44.9%	US$11.8mn
Market cap	Free float	Avg. daily volume

Target mkt cap	**SAR61bn**	**9% over current**
Consensus mkt cap.	**SAR59.8bn**	7% over current
Current mkt cap.	**SAR55.7bn**	as at 10/12/2012

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Underweight | **Neutral** | **Overweight**

Agriculture & Food Sector: extending coverage

We extend our Saudi food and agriculture sector coverage by adding Saudi Airline Catering (SACC), which is a promising bet considering rising airline traffic and its association with Saudi Airlines. Favorable demographics will continue to benefit companies in the food sector but near term concerns have emerged. We like Herfy and Savola for their robust growth outlook, while we are concerned for Almarai, which has been unable to pass on rising costs.

Food market to witness healthy demand: Rising income levels, changing lifestyles, and increasing population will drive the demand for diversified protein-rich and processed food in Saudi Arabia and the larger GCC region. These factors present growth opportunities for companies like Savola and Herfy.

New avenues are emerging: Juice, bakery and poultry are emerging sub-sectors. We expect Almarai to dominate the fragmented juice market, while massive investments have already been made in the bakery and poultry markets, mainly by Herfy and Almarai respectively.

Government interventions are concerning: The Saudi government recently ordered Almarai to roll back a price increase for some of its dairy products despite rising input costs. This is the second instance of such intervention, which we believe stems from the government's aim at curbing inflation. However, we believe continuing interventions will hinder the growth of food companies.

Stock conclusions: We initiate coverage on SACC with a price target of SAR91 per share, implying 17.4% upside and an Overweight rating, while we increase Herfy's target on account of healthy growth prospects to SAR110 but maintain our Neutral rating as we believe all positives have been already factored in its share price. On the other hand, we lower our target price for Almarai to SAR63.5 per share, implying 1.2% downside with Neutral rating. Finally, we upgrade our rating for Savola to Overweight with a revised target price of SAR49.1 on account of better outlook for local retail division as well as international operations.

Key themes

Rising income levels, changing lifestyles and increasing population will drive the growth for companies like Herfy and Savola in the food sector. We believe increase in crop prices globally coupled with the Saudi government cap on prices will pose a challenge for basic food suppliers like Almarai in the near-term. New sectors such as juice, bakery and poultry are emerging in the Kingdom apart from niche markets like airline catering.

Implications

We initiate coverage on SACC with an Overweight rating. We upgrade our target prices for Savola and upgrade our rating to Overweight. We also upgrade our target price for Herfy. On the other hand, we lower our target price for Almarai. However we maintain a Neutral rating on both Almarai and Herfy.

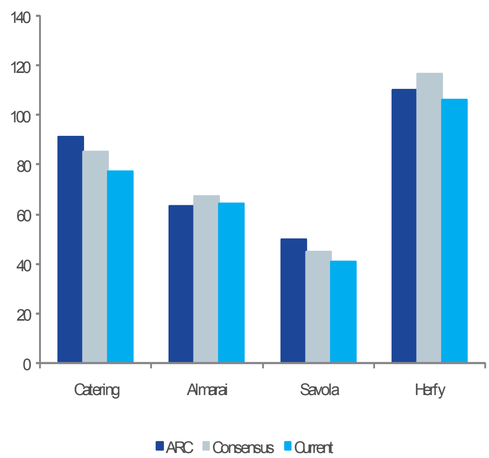
What do we think?

Stock	Rating	Price Target
Saudi Catering	Overweight	SAR91.0
Almarai	Neutral	SAR63.5
Savola	Overweight	SAR49.1
Herfy	Neutral	SAR110.0

Why do we think it?

Stock	3 year EBITDA CAGR	2013 EV/EBITDA
Saudi Catering	**15.7%**	**8.4x**
Almarai	**11.0%**	**13.1x**
Savola	**10.5%**	**6.3x**
Herfy	**13.0%**	**12.2x**

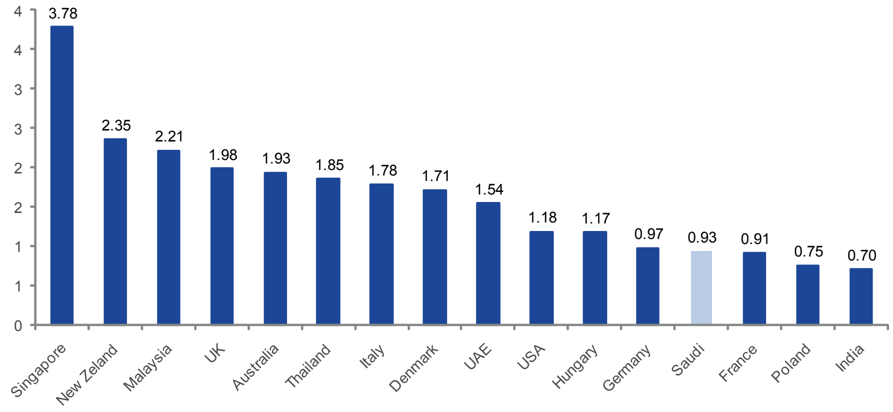
Where are we versus consensus?



Source Bloomberg, ARC Research

Milk prices in Saudi Arabia is among the lowest in the world

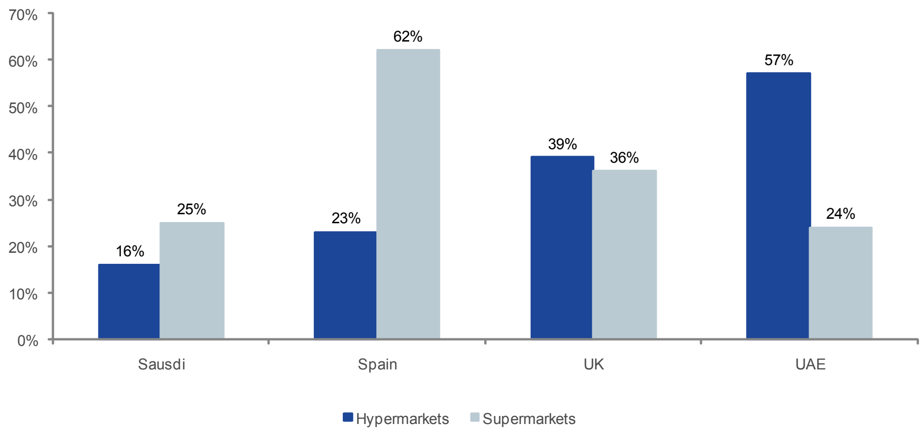
Figure 1 Comparison of milk prices in the world (US$ per liter)



Source: Almarai, Al Rajhi Capital

Saudi's supermarkets and hypermarkets penetration levels are still low

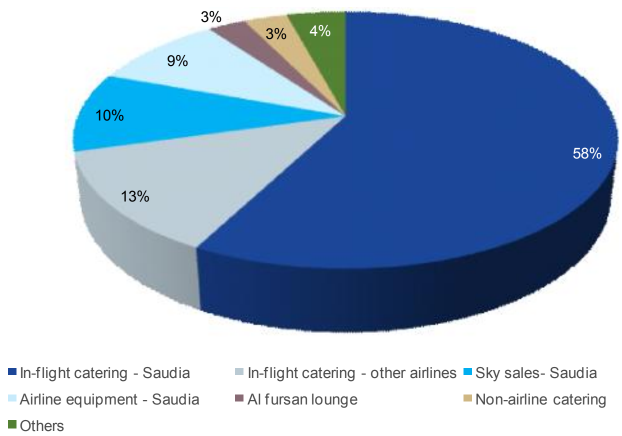
Figure 2 Supermarkets and hypermarkets penetration levels



Source: Savola, Al Rajhi Capital

SACC is gradually reducing its reliance on Saudia catering

Figure 3 Saudi Airline Catering revenue breakdown



Source: Saudi Airline Catering Company, Al Rajhi Capital

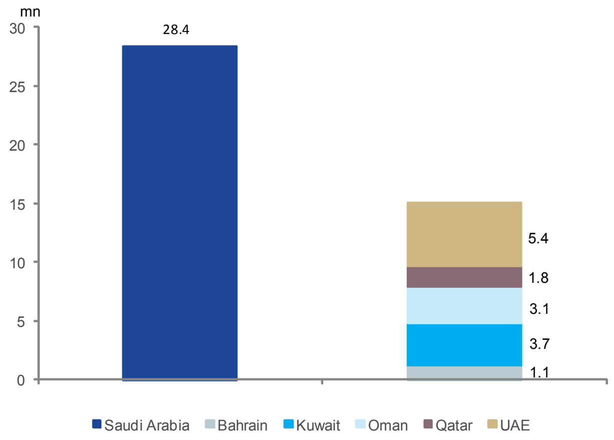
Saudi food market is growing: tempered by near-term challenges

Growing population and income levels

Saudi Arabia sustains a large and young population

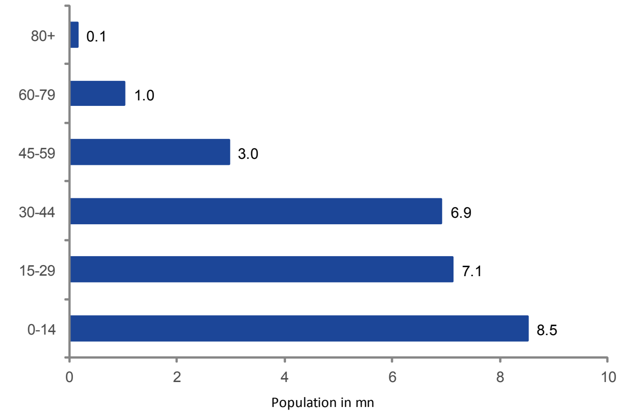
Saudi Arabia is the largest member in the GCC region in terms of population size (28.4mn in 2011, according to the Central Department of Statistics and Information). Apart from the relatively massive population size compared to other countries in the region, a significant portion of it is young making the country one of the best markets for food and beverage companies. According to UN data, 32% of the Saudi population belonged to the 0-14 age-group, while around 50% belonged to the 15-40 age-group in 2010.

Figure 4 Saudi Arabia's population vs. Rest of GCC in 2011



Source: CDSI, IMF WEO, Al Rajhi Capital

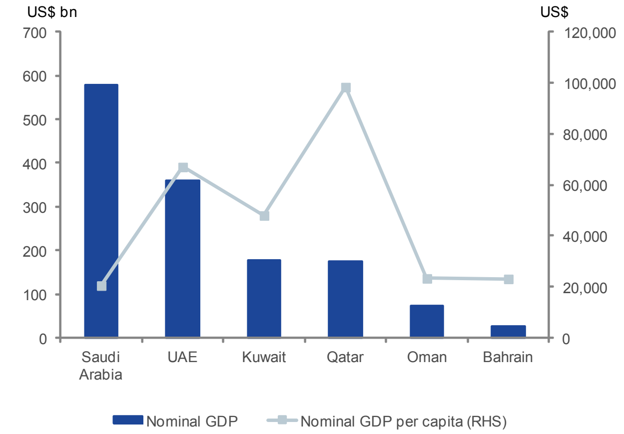
Figure 5 Saudi Arabia has a young population profile



Source: UNSD, Al Rajhi Capital; Note: Data is as of 2010

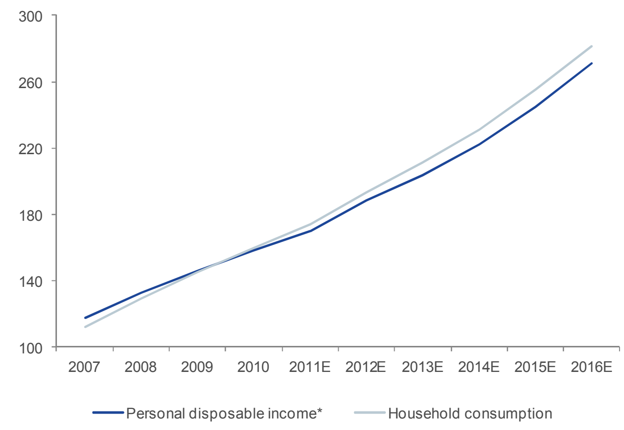
Although Saudi Arabia's GDP per capita is one of the lowest among the GCC countries, it is among the top-50 in global rankings. We believe personal disposable income levels will continue to progress northward in the Kingdom (10% CAGR over 2011-2016 according to EIU) with development across all sectors, supported by the strong foundation of its oil and petrochemical exports. Consequently, this will lead to higher and more varied spending patterns in household consumption, which augurs well for sectors like food.

Figure 6 2011 GDP and GDP per capita comparison



Source: IMF WEO, Al Rajhi Capital

Figure 7 Rising disposable income leading to higher consumption



Source: EIU, Al Rajhi Capital
*EIU estimates from 2009

Higher dependence on imports of staple foods

Wheat and rice will be increasingly sourced from imports

Saudi Arabia has been dependent on grain imports in the past due to the arid weather conditions prevailing across the country. During the seventies and eighties, Saudi Arabia commenced a subsidy and land distribution program to attain self-sufficiency (particularly for wheat). The Kingdom was producing around 4mtpa of wheat by the 1990s and became a net exporter of wheat in subsequent years. However, this production of wheat entailed high monetary costs in the form of fertilizers, farm equipments, labor as well as consumption of precious water resources (one ton of wheat production requires around 1,000 cubic meters of water). Resultantly, in 2008, the Saudi government announced that wheat production will be phased out by 2016 by reducing wheat production by 12.5% every year.

Water scarcity also led Saudi Arabia to be an importer of other key crops as well. Although rice is another kind of staple foods consumed in the Kingdom, there is absolutely no production of this grain in the country. Saudi Arabia depends entirely on imports for its rice consumption, most of which is sourced from India (59% in 2011 according to the USDA). The country is currently also the largest importer of barley, representing 40% of world imports, which is used mainly as feed for livestock. However, according to the USDA, barley imports will reduce going forward and shall be replaced with other low-cost processed feed.

Saudi government has planned various alternatives to achieve secure food supplies

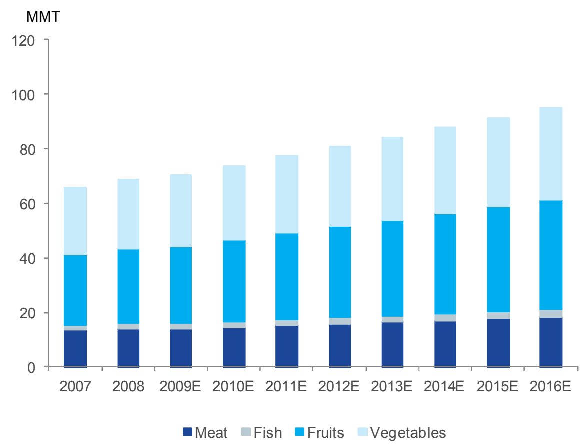
The Saudi government has planned various alternatives to achieve secure food supplies, including investing in arable land abroad. According to a statement made by the Saudi commerce and industry minister in January 2012, the government had identified 27 countries for agricultural investment. A technical team has already visited 14 of these 27 nations to explore prospects. Almarai's investment in Argentina-based Fondomonte is an example of such investment (it acquired 12,306 hectares of farmland). Striking long-term deals with reliable supplier countries like Canada and Australia is another alternative the Saudi government is mulling. Although these alternatives can be seen as long-term solutions, we believe the reduction in indigenous agricultural production will have to be substituted with higher imports and development of contingency storage facilities over the short-term.

Protein and processed food intake likely to increase

Higher income levels will lead to more protein consumption

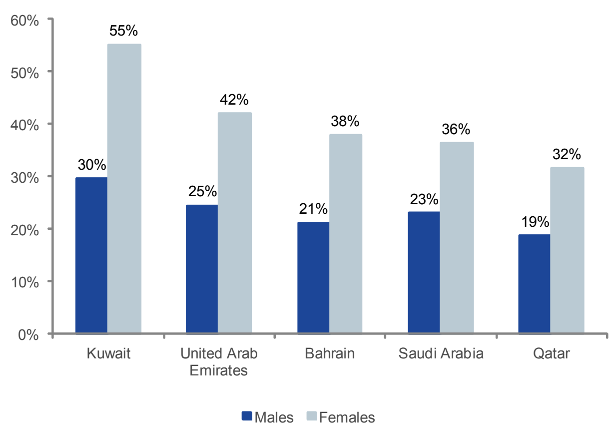
Higher income levels are also leading to a shift from a carbohydrates-based diet (grains) to a protein-based diet (meat, eggs and dairy products). Chicken is the main form of meat consumption in Saudi Arabia. In fact, the Kingdom was the second-largest importer of poultry in the world, at 788,000 tons in 2011, according to the USDA. Milk and milk products as well as fruit juices are part of the regular diet due to the dry weather conditions prevailing across the country. Moreover, we believe the share of milk and fruits will increase in future due to emphasis on a healthier lifestyle, considering the growing concerns about obesity among the local population.

Figure 8 Saudi food consumption apart from cereals



Source: EIU, Al Rajhi Capital

Figure 9 Obesity* prevalence among those above 15 years - 2010



Source: WHO, Al Rajhi Capital
* Weight more than prescribed BMI by 30kg

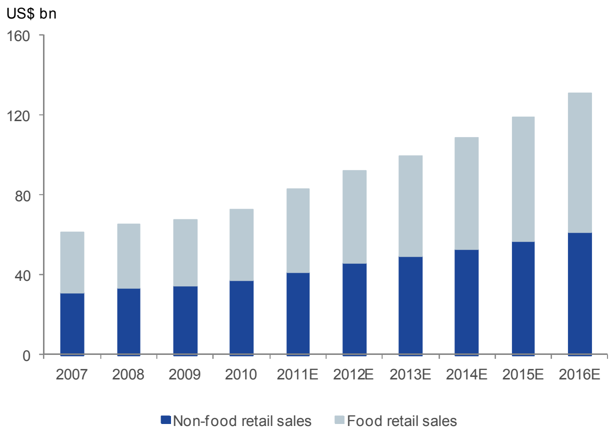
Apart from the growing trend toward healthier and protein-rich food, we think that processed (dried, frozen, canned and chilled) and ready-to-eat foods will gradually gain prominence on the back of increasing urbanization, a growing interest in western lifestyle among the youth (through television and the internet), wider variety of food items available in the ever-increasing number of supermarkets and hypermarkets, as well as women being allowed to work outside their home. Further, an expat population accounting for around a third of the overall population and religious tourism in the form of Umrah and Hajj will also create demand for greater diversity of food products.

Food to be an important part of retail sales growth

Food sales to represent more than 50% of retail sales by 2016

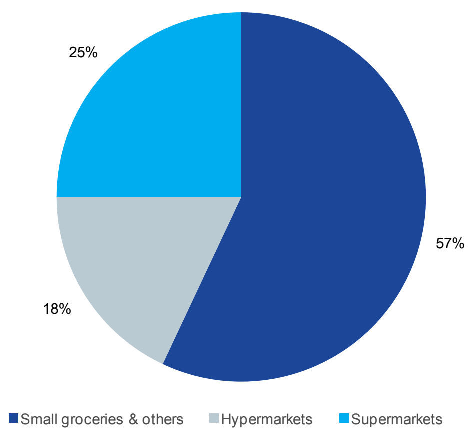
The fortunes of the Saudi Arabian food sector will be closely linked with the growth of the retail sector. According to EIU estimates, the Saudi retail sales market has touched US$83.3bn in 2011, of which contribution from food sales is estimated to be around 50% at US$41.7bn. According to the EIU, the food sales market is expected to grow by around 1.7 times to US$69.9bn by 2016, contributing around 53% of the retail sales market, which is expected to reach US$131.2bn by then.

Figure 10 Composition of food and non-food in retail sales



Source: EIU, Al Rajhi Capital

Figure 11 Saudi retail dominated by small groceries

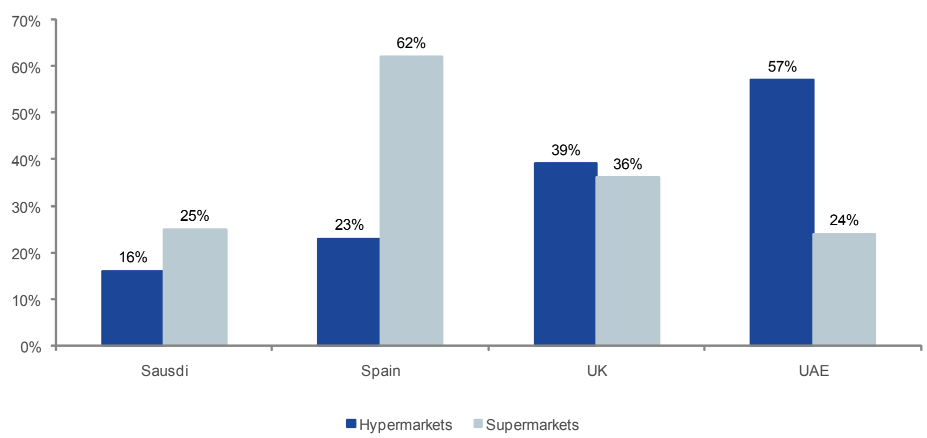


Source: Euromonitor, Al Rajhi Capital

Higher level of disposable income in the hands of a young population is creating increased demand for better quality and diversified products. This higher disposal income has led to mushrooming of supermarkets and hypermarkets in the country as well as attracting a bevy of foreign brands. Although small grocery stores currently dominate the retail scene, cornering a 57% market share, we believe future growth will emanate from supermarkets and hypermarkets (refer to our update on Savola, dated March 28, 2012).

Saudi's supermarkets and hypermarkets penetration levels are still low

Figure 12 Supermarkets and hypermarkets penetration levels in Saudi



Source: Savola, Al Rajhi Capital

Local food companies facing near-term challenges

We believe Saudi food companies will face challenges, which could result in near-term margin contraction. However, these challenges will bode well for the long-term growth of the sector by making these companies more efficient as well as providing consumers with better quality and fairly priced products.

Competition to intensify: The attractive Saudi food market has led to the entry of a number of foreign brands into the country, which we believe will intensify competition over the next few years. We believe this trend will force Saudi players to become more focused and efficient in their operations. Further, we believe local players will continue to dominate the market with active government support.

Subsidies proving to be inadequate: Over the past few years, the steady rise in crop prices (discussed in our crop price analysis on page 8) has substantially increased raw material costs for Saudi food companies, who rely on imports. This rise in costs is being partly offset by the subsidies offered by the Saudi government in the form of soft or interest-free loans, free farm land as well as subsidized production equipments and animal feed. Although these subsidies provide some relief to the food companies, they are inadequate to meet the rising crop prices.

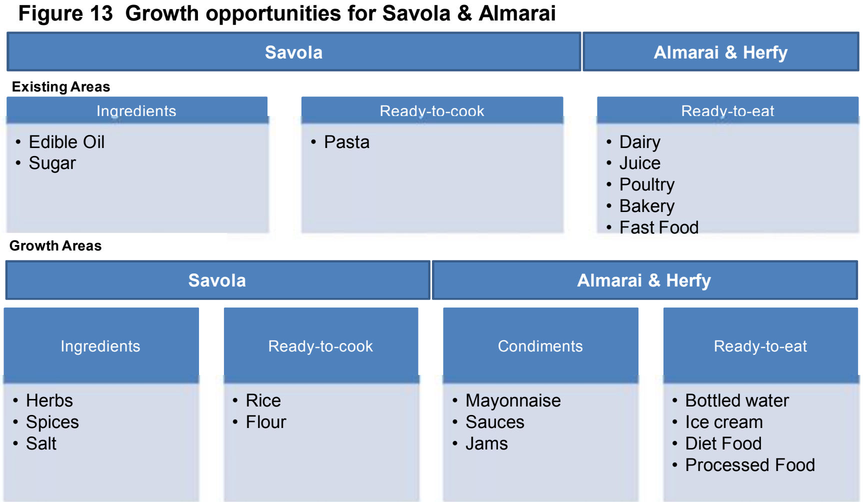
Food inflation being controlled by the government: The Saudi food companies are finding it difficult to pass on the increase in raw material costs to its consumers as they used to in the past. The interventions by the Ministry of Commerce asking Almarai to roll back prices of some of its dairy products in July 2011 and November 2012 two such specific instances. Such government intervention will directly affect the profit margins of food companies like Almarai and Savola and are not sustainable over the long-term.

Growth opportunities remain

Although challenges remain, we believe Saudi food companies have growth opportunities

Despite the existence of near-term challenges as mentioned above, the food sector will remain an important part of the Saudi economy. Savola and Almarai are the leading food companies in the Kingdom. Although they cover a wide spectrum of food commodities, there still remain opportunities which these companies can leverage to their advantage both within the country and the wider MENA region, which we list in Figure 13 below.

Figure 13 Growth opportunities for Savola & Almarai



Source: Savola, Almarai, Al Rajhi Capital

Crop prices:
to stay at elevated levels

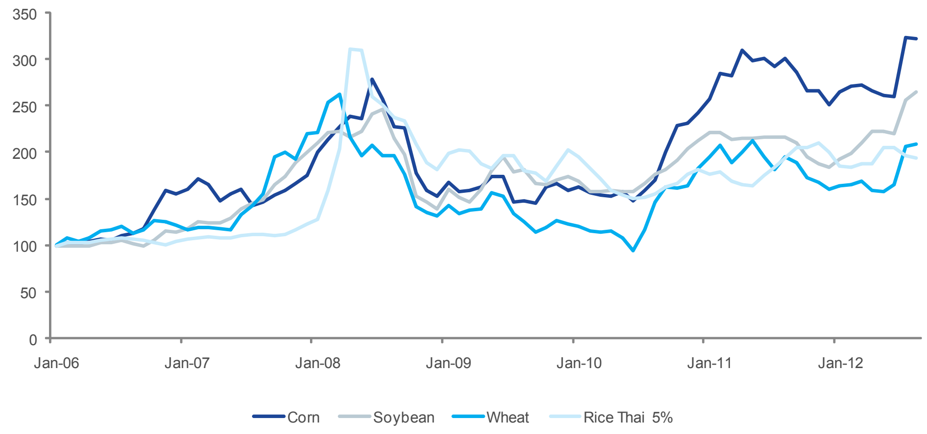
The next decade to witness high crop prices

Supply side constraints and higher demand to drive crop prices over the long-term

According to the FAO-OECD 2012-2021 outlook, crop prices are expected to remain at higher levels over the next decade, mainly due to increased demand from emerging markets and slowing growth in global production. The demand side will be fuelled by population growth, higher per capita income, urbanization, and changing diets in developing countries as well as increased need for bio-fuel feedstock. On the other hand, the supply side growth will be slower due to increasing resource constraints (water and arable land availability), higher input costs in terms of fertilizers and pesticides (driven by crude oil prices), and increased use of grains for non-food purposes (for instance, corn being used for ethanol production and wheat being used as a feed).

Further, corn prices touched record levels in August 2012 due to unprecedented drought conditions in the US (the Corn Belt in Midwest US) and Europe (Russia, Ukraine and Kazakhstan) coupled with deficit rainfall in India. Soybean prices also moved upwards, although it remained lower than 2008 all-time peaks. Rice prices remained relatively stable mainly due to plentiful supplies.

Figure 14 Price movements of key crops



Source: World Bank, Al Rajhi Capital

While the global inventory levels of corn is expected to contract to a six-year low, the existing stock levels of wheat in China and India, although large, are likely to be used for domestic consumption rather than export trade. Consequently, we expect corn and wheat prices to remain volatile over the near-term.

Softening crop prices to benefit only for the short-term

The rally in corn and soybean prices seems to have temporarily tapered off

The strong rally witnessed in corn and soybean prices since June 2012 seems to be running out of steam on a better crop outlook. The record pace at which the US harvest (corn and soybean harvest were completed 54% and 41%, respectively by the end of September 2012 according to the USDA) has been completed and moderating demand from China has resulted in the price correction. Further, the soybean market is facing pressure from a weak palm oil market.

Although prices have corrected for now, which should provide some respite to Saudi food companies, we believe prices will rise with a positive bias over the medium to long-term. Demand-supply fundamentals as discussed above clearly indicate tighter markets. Hence, we believe there is limited downside for crop prices in comparison to upward pressures. Grain importers like Saudi Arabia will face a tough situation in such a scenario. Therefore, we believe the backward integration activities carried out by Almarai and Savola are the right steps to ensure food security and lower costs in the long-run.

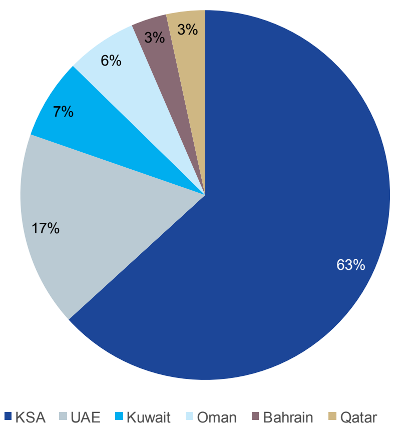
Dairy and food markets:
Healthy prospects despite challenges

Dairy sector to witness growth in volumes but at a cost

Almarai dominates the Saudi dairy sector

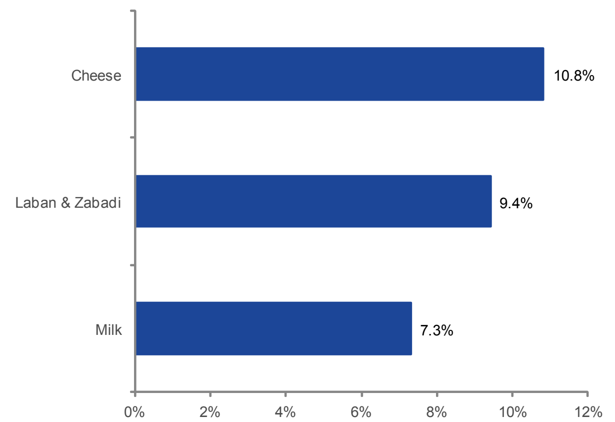
Milk consumption is one of the main factors driving the GCC dairy market, of which Saudi Arabia currently accounts for more than 60%. According to BMI, demand for milk has grown by around 6% annually over the past few years, up from approximately 4% in the early 2000s. Almarai has a dominating presence in all the milk products, including laban (an Arabic form of buttermilk) and zabadi (yoghurt) in the GCC region. We believe demand for milk products will be healthy, as the Saudi population shifts to a healthier lifestyle.

Figure 15 Dairy market for GCC countries



Source: Nielsen Company 2011, Al Rajhi Capital

Figure 16 Expected CAGR for milk based products (2012-2016)

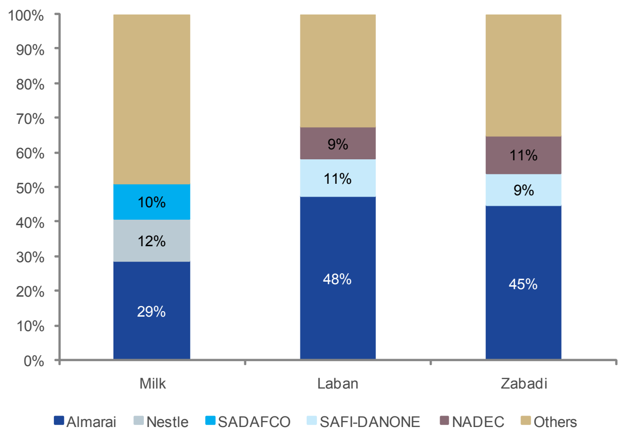


Source: Euromonitor, Al Rajhi Capital

Almarai dominates the growing milk and cheese market

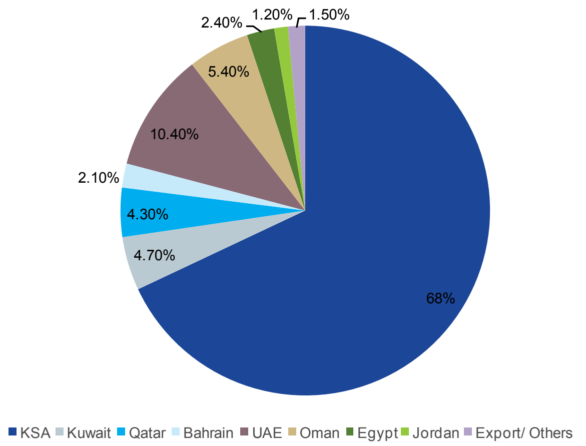
According to the Nielsen Company, the GCC dairy market was worth US$ 3.2bn in 2011 and is expected to grow at a CAGR of 9.5% over the next three years. We believe this forecast is reasonable considering the favorable demographics and income levels in the Kingdom. Almarai dominates the GCC dairy segment, capturing a 35% market share despite presence of multinationals like Nestle (second with 8% market share) and Alsafi-Danone (7%). Most of the company's strength is derived from the sales it generates in the Kingdom (71% of the company's revenue in 2011), of which milk and its derivatives constitute around two-thirds.

Figure 17 Top 3 players by milk products in GCC



Source: Almarai, Al Rajhi Capital

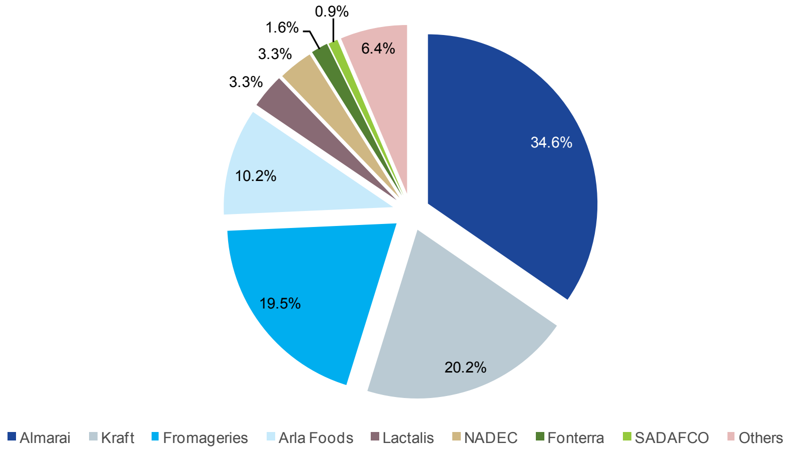
Figure 18 Almarai: Revenue breakdown by geography – H1 2012



Source: Almarai, Al Rajhi Capital

According to Euromonitor, cheese market constitutes an important part of the Saudi dairy industry and was estimated to be worth around US$1.2bn in 2011. The growth outlook for cheese consumption is expected to be robust – it is expected to post a CAGR of 10.8% during 2012-2016. We believe these estimates are justified considering the shift toward processed foods and western-style diets. The Saudi Arabian cheese market represents more than two-thirds of the entire GCC market, and by virtue of Almarai's dominance in the Kingdom, the company has the largest share in the GCC region.

Figure 19 Almarai dominates the GCC cheese market



Source: Almarai, Al Rajhi Capital

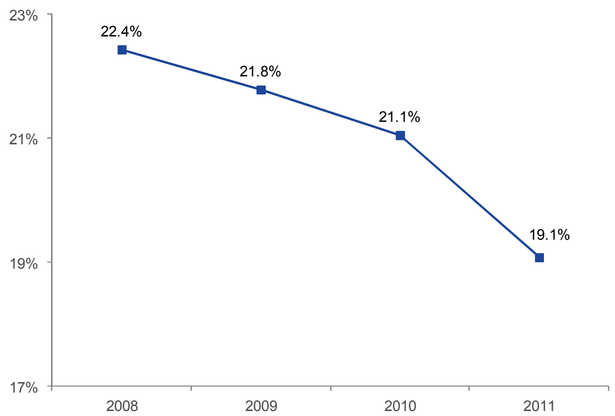
Moreover, Almarai's move to increase stake in its JV with PepsiCo — International Dairy and Juice Limited (IDJ) — from 48% to 52% in March 2012 (acquiring a majority control) confirms our view (refer our February 2012 update on Almarai) that the company will be targeting the Iraqi market for growth, a market similar in size to Saudi Arabia where Almarai had limited presence, while IDJ is already established. This will provide the first-mover advantage to Almarai in Iraq, even as other large dairy players line-up to enter the market.

Competition and pricing pressures pose near-term concerns

The attractive Saudi market is luring foreign brands into the country

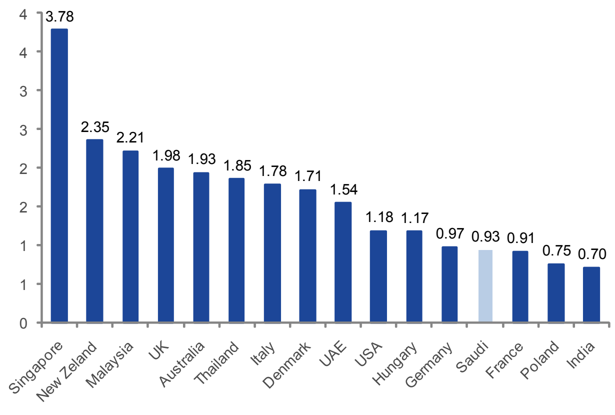
We believe Almarai will face stiff competition in the coming years, especially from foreign players such as Nestle (which commenced direct operations in the Kingdom in May 2011), Egypt's Mashreq Des Produits Laitiers (which launched its Milkana brand dairy products through Abbar Foods in April 2011) and Australian Tatura Milk Industries (which recently signed several trade agreements with Saudi food distributors). Although it will take some time before these competitors pose a serious threat to Almarai, the company will find it difficult to sustain its market share, if not increase it.

Figure 20 Almarai's operating margins have been declining



Source: Almarai, Al Rajhi Capital

Figure 21 Comparison of retail milk prices across countries (US$ per liter)



Source: Almarai, Al Rajhi Capital

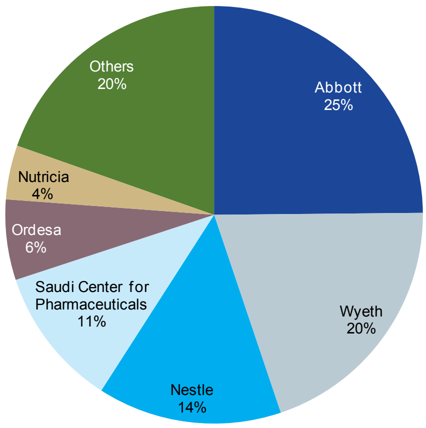
Almarai is finding it tough to pass on increase in input costs to its consumers

Further, Almarai has not been able to pass on any increase in input costs (in terms of feed and packaging costs) to its consumers. In mid-2011, the Saudi government did not allow the company to hike the prices of its dairy products in a bid to curb food inflation in the country. Although the government almost doubled the feed subsidies for the company in 2011, we believe they have only partially offset the recent surge in crop prices. Since the company is being used as a tool to serve the strategic interest of the nation, its operating margins have been gradually eroding. Given the fact that milk price is among the lowest in the world (Figure 16 above), we believe prices could increase in future, although not in the near-term.

Baby milk powder market is a growing segment

Almarai shall become the only local producer of baby milk powder in the GCC region, once it starts commercial production. Nearly 80% of the baby milk powder in the country is exported from Europe. According to BMI, the Saudi Arabia baby milk powder market is estimated to be worth US$300mn and is forecast to grow exceed the population growth. This segment is currently dominated by foreign companies such as Abbot (Similac), Wyeth (S26) and Nestle (Nido).

Figure 22 Baby milk powder market in Saudi Arabia



Source: Almarai, Al Rajhi Capital

Here again, we believe Almarai is being positioned to act as the guardian of food security of the Kingdom as there have been concerns regarding the ingredients in imported milk powders (palm oil content leading to lower calcium absorption in children) and increasing prices (prices have increased by around 15% despite subsidies being increased from SAR2 to SAR12 per kg). Consequently, we believe Almarai will be able to successfully scale up in this segment once it commences operations.

Backward integration, a move driven by strategic interest

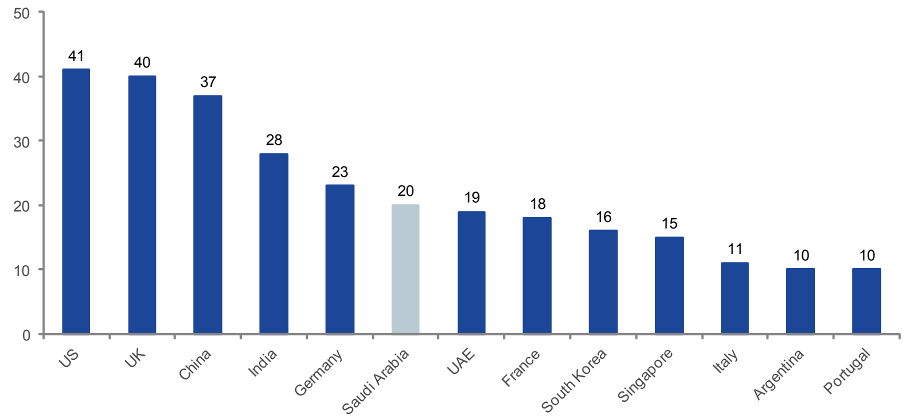
Almarai's backward integration move is in line with Saudi government's policies

Almarai owns one of the best livestock (Holstein cows) in the world for its dairy segment, with each producing around 13,300 liters of milk every year, almost double the European average. The company maintains a herd of 60,000 cows spread over seven high-tech farms, which effectively means an immense feed requirement. Given the scarcity of water in the Kingdom and the reliance on imports for crops including feed as discussed earlier, Almarai has expanded its supply chain backward by investing in Fondomonte in late 2011. The latter owns 12,306 hectares of farmland in Argentina for producing corn and soybean, which shall be used by Almarai to secure feed and keep its costs under check.

In contrast, Nestle – one of the leading companies in the food segment – does not own any farms. Instead the company focuses on providing technical support to suppliers for following sustainable agricultural practices. It continues to focus on manufacturing food products rather than farm management. A similar strategy has been adopted by Kraft foods and Groupe Danone. Arla Foods is a cooperative comprising Danish, Swedish and German farmers, which derives its strength from the synergies of the joint efforts of all its members. It does not therefore technically own the farms from which it derives its produce.

While we understand the fact that a focus on the core business of food production enables these international companies to operate efficiently, we feel Almarai's model of backward integration has evolved out of the necessity to achieve food security apart from generating profits. The company by virtue of being the major dairy supplier in Saudi Arabia has to secure its supply chain, in line with the Saudi government's policies of achieving food self-sufficiency. Moreover, Almarai also facilitates achieving another government objective of conservation of precious water resources in the Kingdom. According to data from GAIN – a non-governmental organization that supports small farmers – the phenomenon of investing in land abroad is not a new phenomenon and has been carried out by more than 50 countries across the world through multi-million dollar deals.

Figure 23 Investment deals made in agricultural land abroad by countries



Source: GAIN, Al Rajhi Capital

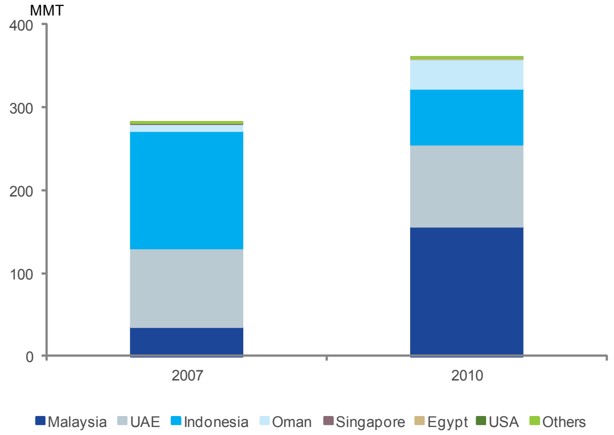
Edible oil business

Palm oil consumption is increasing in the region

Demand outlook for palm oil remains strong

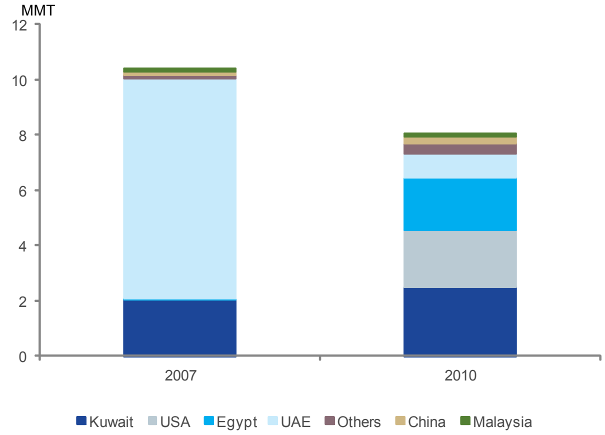
Soybean and palm oil account for almost two-thirds of the global edible oil production and hence represent a large chunk of the global vegetable oil consumption. However, in Saudi Arabia, palm oil consumption makes up for majority of the edible oil consumption (around 87% for 2011/2012, according to the USDA). Further, imports constitute more than 90% of the palm oil supply in the Kingdom. According to FAO, imports of palm oil have grown rapidly in Saudi Arabia, at a CAGR of 9% to 360mn tons during 2007-2010, while imports of soybean oil declined at a CAGR of 8% to 8mn tons over the same period.

Figure 24 Saudi Arabia's palm oil imports



Source: FAOSTAT, Al Rajhi Capital; Note: GCC suppliers are more in the role of traders

Figure 25 Saudi Arabia's soybean oil imports



Source: FAOSTAT, Al Rajhi Capital; Note: GCC suppliers are more in the role of traders

We believe Saudi Arabia has been slowly diversifying its supply base to ensure secure supplies. Looking ahead, we expect palm oil consumption to grow at a robust pace across the MENA region due to its young demographics coupled with an increasing trend toward consumption of food prepared outside (processed food and restaurant food), in which palm oil is predominantly used.

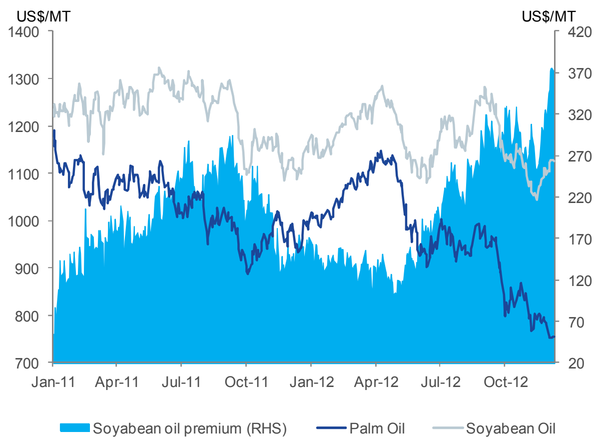
Palm oil and soybean oil prices are likely to come down over the near-term

Softening edible oil prices on favorable supply outlook

Palm oil and soybean oil prices are invariably linked to each other and move in tandem. However, this trend has been broken since the first week of April 2012. The November delivery of palm oil in Bursa Malaysia, which had reached an all-time peak of MYR3,530/MT (US$1,147/MT) in the second week of April 2012, has retreated by 35% and is currently trading around MYR2,311/MT (US$755/MT).

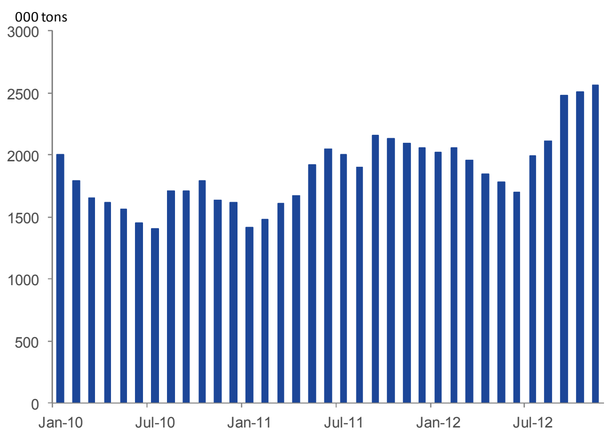
The December delivery of soybean oil in Chicago Board of Trade (CBOT) had also peaked in the second week of April 2012 to reach US¢58.28/lb (US$1,284/MT) due to concerns about drought-like conditions in the Midwest US. However, these concerns have eased following a better-than-expected harvest in the US and favorable crop weather in Brazil. The prices of soybean oil have declined slightly by 1% since April to reach US¢57.56/lb (US$1,269/MT).

Figure 26 Palm and soybean oil price trends



Source: Bloomberg, Al Rajhi Capital

Figure 27 Malaysian palm oil inventory are at two-year highs



Source: Bloomberg, Al Rajhi Capital

Consequently, the spread or premium between soybean oil and palm oil prices has widened to around US$300/MT. Considering the fact that soybean oil premium lags behind the palm oil price movement, we expect it to contract over the next few months leading to softening in soybean oil prices over the next few months. Further, according to data from the Malaysian Palm Oil Board (MPOB), palm oil inventory levels in Malaysia (the second-largest palm oil producer in the world) have touched a two-year high of more than 2mn tons, indicating abundant supply to keep palm oil prices under check. Hence, we expect palm oil and soybean oil prices to average around US$940-950/MT and US$1,150-1,175/MT for the remainder of 2012. This softening in palm and soybean oil prices will prove beneficial to the margins of companies like Savola, which had come under pressure over the past few quarters.

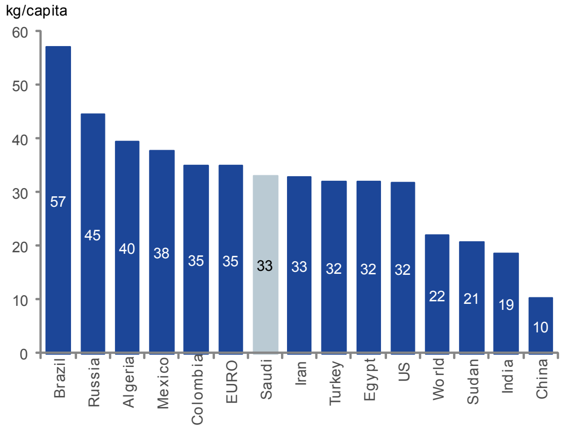
Sugar is sweeter outside the Kingdom

With a saturated domestic market, we expect growth to emanate from Egypt

Saturated domestic market implies growth from Egypt

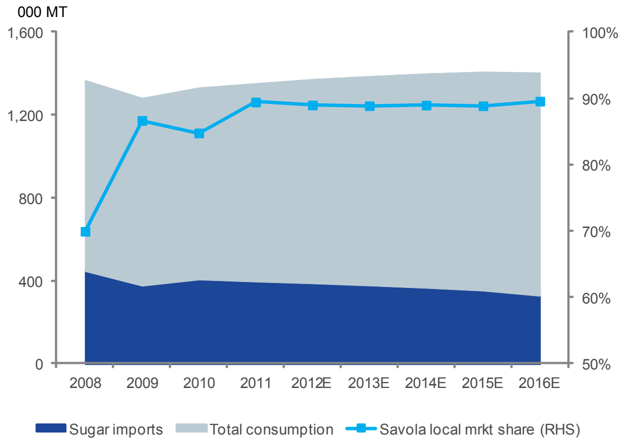
As we mentioned in our update on Savola in March 2012, the Saudi sugar market has become saturated considering that the Saudi per capita consumption is at par with regional consumption rates. The only growth that we can envisage apart from meeting the needs of a growing population is bridging the demand-supply gap of refined sugar (currently around 10% of the supply is imported). With Savola controlling almost 90% of the Saudi market by our estimates, we do not expect the company to further expand its capacity in Saudi Arabia over the near-term.

Figure 28 Global sugar consumption patterns



Source: Bloomberg, USDA, CDSI, Company data, Al Rajhi Capital

Figure 29 Local consumption and Savola's market share



Source: Bloomberg, USDA, CDSI, Company data, Al Rajhi Capital

However, we believe Savola can experience growth in Egypt, where demand will be robust with a population expanding by 1.5mn people every year, and the country reverting to normalcy post the election of Mohamed Morsi. Apart from domestic demand (nearly 3mn tons), of which imports accounts for a third, there is also demand from neighboring countries like Libya, Sudan, and Syria, where supply has been hampered due to political unrests. Traditionally, sugar has been a staple food in these countries and rising imports due to the unrests presents a window of opportunity for sugar refiners like Savola to expand their global footprint. While there could be near-term issues on realization of sales made in politically volatile countries coupled with currency fluctuations, we believe it will facilitate building new businesses, which will drive top-line growth over the long-term.

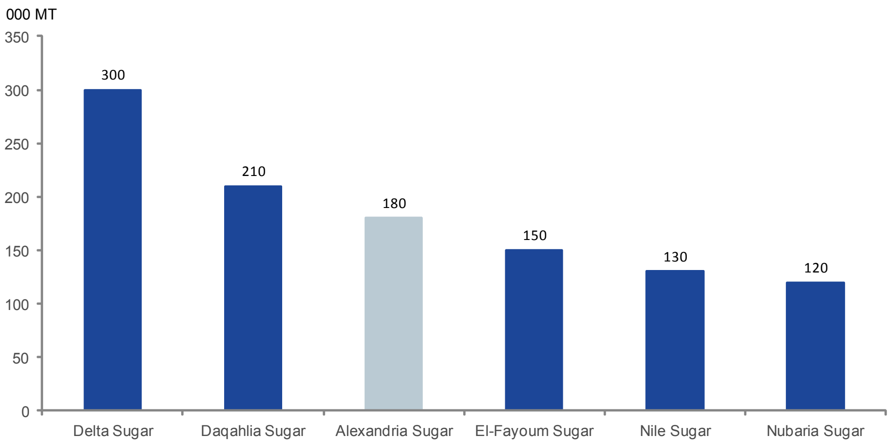
Beet sugar sub-segment likely to produce traction

Beet sugar segment in Egypt holds out promise

Savola's beet sugar refining through the Alexandria Sugar Company (ASC) have not yet commenced operations (Q1 2013 as per the management's guidance) and will be a small part (0.18mn tons of refining capacity) of the overall sugar segment (2.18mn tons) initially. However, we expect this sub-segment to rapidly scale up in future. ASC currently cultivates beet and sells it to other sugar companies and targets to produce around 1.3mtpa of beet.

The Egyptian government has been promoting the growth of beet in the country, which consumes less water than sugar cane. The government doles out additional payments to beet farmers based on the sugar content in the crop rather than just weight as in the case of sugar cane. Further, beet farmers, who sell their crops earlier in the harvest season, receive additional incentives.

Figure 30 Beet Sugar producers in Egypt



Source: USDA, Company data, Al Rajhi Capital

While beet production itself is lucrative in the country, ASC will gradually shift to production of refined sugar, once its refinery commences operations. This shift in production will enable the company to reap the benefits of vertical integration and become one among the handful of beet processors in the country.

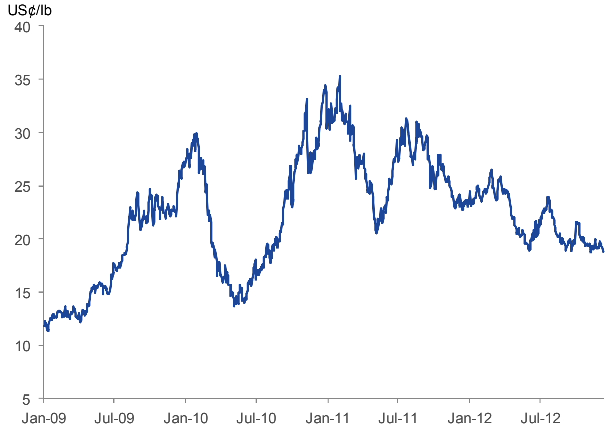
Sugar prices to soften on strong supply

A higher global surplus is likely to keep sugar prices under pressure

Raw sugar prices, which had peaked to more than US¢30/lb in the beginning of 2011, have fallen since then and are currently trading at US¢18-19/lb. The reason for this price decline has been a global sugar surplus in 2011/2012, following a balanced market in 2010/2011 and large deficits in the earlier two years.

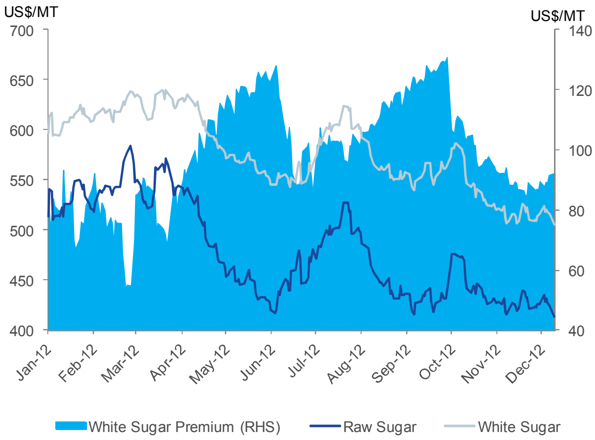
According to the International Sugar Organization, the global sugar surplus is expected to widen to 5.86mn tons during the September 2012-October 2013 season from last year's 5.19mn tons. The cause of this surplus can be attributed to pick-up in sugar production in Brazil (the top sugar exporter in the world), improved crop outlook in India following a monsoon revival and a bumper output from Russia. According to F.O. Litch, a leading soft commodity analyst, Russian beet sugar production is expected to touch 5.5mn tons in 2012/2013 from 5.48mn tons in 2011/2012. Although beet production was only slightly above last year's numbers, it was a bumper harvest for the second consecutive year following a production of only 2.96mn tons in 2010/2011. Taking all this information into perspective, we expect raw sugar prices to remain under pressure over the next few months.

Figure 31 Raw sugar price trends for past two years



Source: Bloomberg, Al Rajhi Capital

Figure 32 Sugar price movements since beginning of the year



Source: Bloomberg, Al Rajhi Capital

While the price movements of refined or white sugar has been in line with raw sugar, the white sugar spread or premium over raw sugar had been increasing since the beginning of 2012 and reached a peak at the end of September (+57.6% YTD). However, the white sugar premium has dipped, reaching US$90/ton at the end of October 2012.

We believe the correction in the price spike to be on account of the announcement by the European commission to release 1.2mn tons of additional sugar as an interim measure to alleviate the shortages caused by a flawed 2006 sugar policy. This contrasts the situation in US, where sugar is in surplus and the American Sugar Alliance – a domestic sugar producer organization – demanding the current policy of sugar tariffs to be maintained in the 2012 Farm Bill. Consequently, we expect white sugar premium to remain at these levels unless there are new developments in Europe or the US.

Softness in raw sugar prices will benefit refiners like Savola in the next few quarters

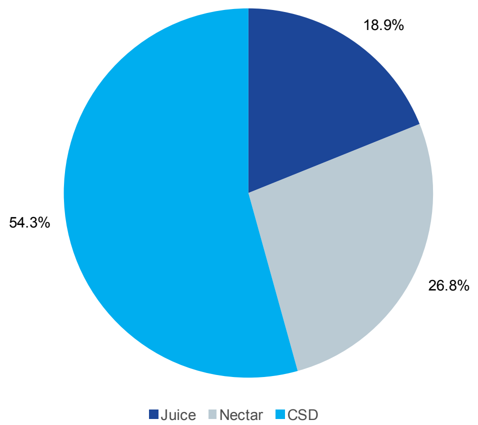
To conclude, we believe that a good sugar harvest in exporting countries of Brazil, Thailand, and Russia and self-sufficiency in consuming countries of China and India will lead to softening of raw sugar prices in the forthcoming season (till October 2013). The softening in raw sugar prices will boost the top-line and operating margins of refiners like Savola, who import raw sugar and sell it as white sugar, over the next few quarters.

Juice, bakery, and poultry are sunrise sectors

Ample room for growth and innovation in the juice market

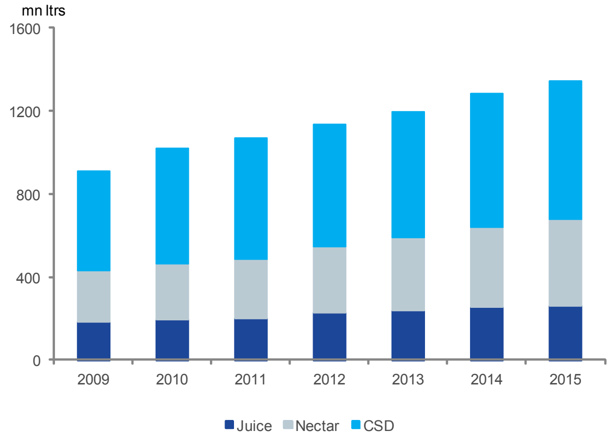
According to Al Rabie, a leading juice producer in Saudi Arabia, the juice, nectar (25-99% juice), and carbonated soft drink (CSD) market in Saudi Arabia is estimated to be worth US$1.3bn and is growing at a healthy rate (posted a CAGR of 8% during 2009-2011). The market is dominated by CSD, which corners more than 50% market share. We believe this market domination is mainly on account of the western eating lifestyle adopted by the young population in the Kingdom, driven by the increasing number of super and hyper-markets along with fast food outlets like McDonalds, Burger King, KFC, Pizza Hut, Domino's, etc.

Figure 33 Carbonated soft drinks currently dominate the market



Source: Al Rabie, Industry data, Al Rajhi Capital

Figure 34 Juice and nectars composition likely to grow faster

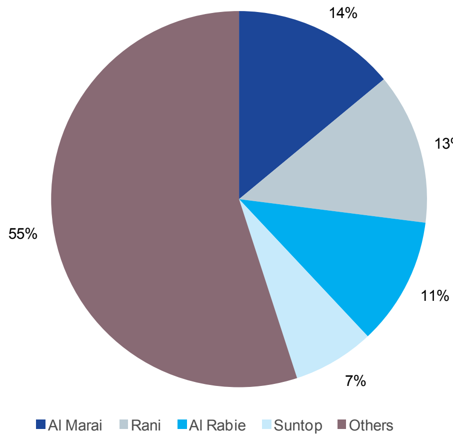


Source: Al Rabie, Industry data, Al Rajhi Capital

The fresh juice and nectar segments are likely to see better growth than CSD

Looking ahead, we believe the market will shift more toward nectars and fresh fruit juice, due to increasing health awareness. Our view is supported by the forecasts made by Al Rabie. According to data provided by the company, the juice, nectar and CSD segments grew at a CAGR of 4.3%, 8.0%, and 9.7%, respectively over 2009-2011. However, this growing trend is expected to change in the future with the juice, nectar and CSD segments growing at a CAGR of 6.6%, 10.1%, and 3.5%, respectively during 2011-2015.

Figure 35 The Saudi juice market is fragmented



Source: Nielsen Company 2011, Al Rajhi Capital

The juice market is currently fragmented with almost 100 different brands and too many players. The top four companies — Almarai, Rani, Al Rabie and Suntop — corner around 45% market share, while the remaining 55% is split among small local players.

Consequently, we believe a fast growing market will lead to a consolidation in the sector as large players buy out the smaller ones. A lot of innovation also remains to be done in terms of packaging (currently there are only four different kinds of packs), product offering (soya drinks introduced by Al Rabie in the Kingdom only in 2010) as well as development of brand awareness and loyalty (through discounts, coupons, gifts, etc.).

Competition heating up in the bakery segment

Top players in the market are gearing up for a price war

The Euromonitor has estimated Saudi Arabia's bakery market to touch US$3.7bn in 2011 and expects it to grow to US$4.7bn over the next five years. Almarai through its two brands – Lusine and 7 Days – dominates the bakery segment and we believe the company has plans to ramp up capacity as a small part of its recently announced SAR15.7bn capex plan for 2012-2017 in May 2012. Pain D'Or – a new bakery brand of the Lebanese Malco Group – has recently set up one of the largest industrial baking facilities in the Kingdom, and has gained the lion's share of the market.

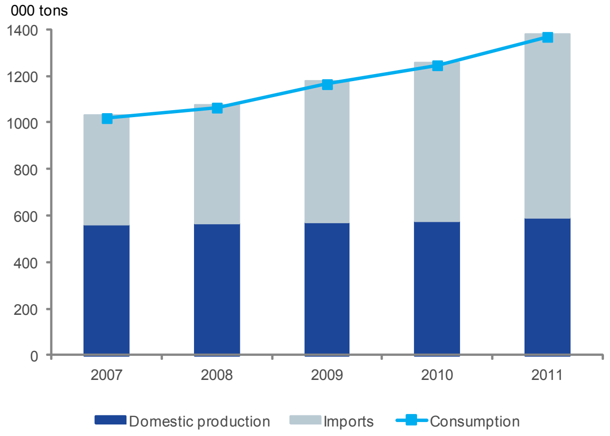
Savola has been operating its baking business through Herfy. The bakery segment is the second-largest division for Herfy in terms of revenue contribution, after its popular restaurant business. Herfy has also commenced its first production line at a new plant. The cost of the plant is SAR119mn and will have three times the current capacity. Although the intense competition is bound to impact the near-term margins of companies in the sector, it also indicates the attractiveness of the industry.

Domestic poultry production trying to catch up with rising demand

While demand outlook is robust most of it will be met by imports

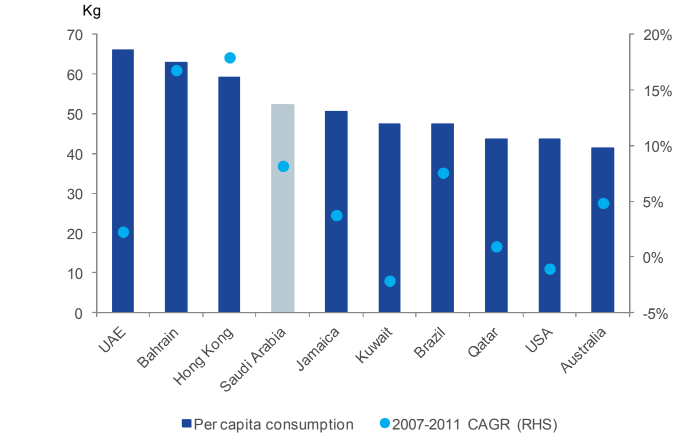
Chicken is preferred over red meat (bovine and sheep) in Saudi Arabia. According to the USDA, Saudi consumption of chicken is currently around 1.4mn tons with nearly 60% being supplied by imports. According to data from the FAO, most of the imports are from Brazil (81%) followed by France (17%). In 2011, Saudi Arabia was the second largest importer in the world at 895,000 tons after Japan, while in terms of per capita consumption, the Kingdom ranked fourth at 52.4 kg. GCC countries are among the top consumers of chicken in the world, where Bahrain, Oman and Saudi are the fastest growing (CAGR of 17%, 12% and 8%, respectively over 2007-2011), which reflects a shift to a more protein-based diet in the region.

Figure 36 Poultry consumption trend in Saudi Arabia



Source: USDA, Al Rajhi Capital

Figure 37 Top ten poultry consumers in the world



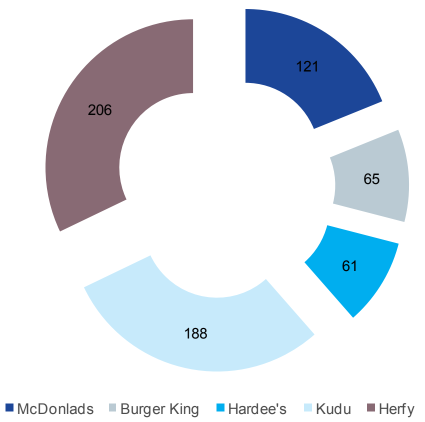
Source: USDA, Al Rajhi Capital

Almarai's poultry segment targets to achieve a capacity of 100mn birds by the 2012 end (~25-30% of the Kingdom's domestic supply, as per our calculations) from 40mn in 2011, with plans to raise it even further to 180mn over the long-term. The segment, whose products are marketed under the Alyoum brand, has witnessed robust top-line growth from SAR44.5mn in 2009 to SAR319mn in 2011. It has already clocked SAR215mn revenue for H1 2012.

Saudi Fast Food Market: growth outside big cities

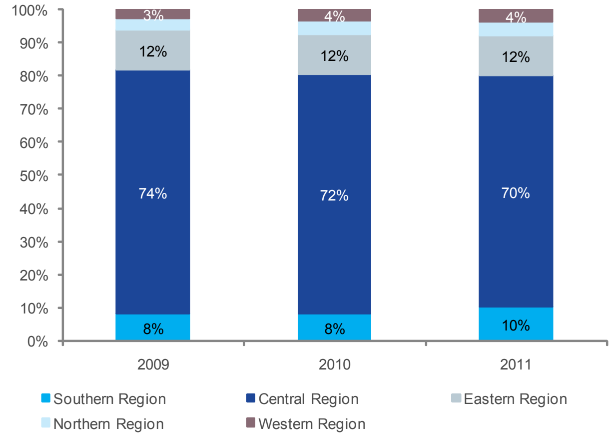
The Saudi fast food market is the biggest in the GCC region, and is one of the largest in the MENA region. While there is very little industry data available, we believe McDonald's and Herfy are the market leaders in this space. Other active players are Burger King, Kudu and Al Baik. The rest of the market comprises minor local players, who are rapidly gaining market share. Despite being the largest player in terms of number of stores, we believe Herfy comes second after McDonald's as the latter has achieved better utilization rates and higher sales per store. We estimate Herfy's market share in the fast food hamburger restaurants (FFHR) to be around 27-29%, slightly below McDonald's market share of around 33-35%.

Figure 38 No. of stores of large players in the FFHR market



Source: Company data, Al Rajhi Capital

Figure 39 Central region's sales share is dropping – Herfy



Source: Companies data, Al Rajhi Capital

We strongly believe big cities such as Riyadh and Jeddah have become saturated, and are witnessing intense competition coupled with high real estate prices. Consequently, we expect the fast food market to penetrate into other parts of the country. Our view is supported by Herfy's recent activities outside the central region as the central region's sale share is dropping. For the next 3-5 years, we believe the growth outside the main cities will be higher, as fast food companies enhance their market penetration across the Kingdom.

Saudization and high real estate prices pose challenges

The Saudi Ministry of Labor has undertaken consistent efforts to reduce the unemployment rate in the country, and the fast food market is one of the key markets under its focus. This has put increased pressure on companies like Herfy, as attrition among the young Saudis employees remains high. Further, the Ministry of Labor has proposed a penalty of SAR2,400 for each expatriate employee not permitted under the Nitaqat system.

Fast food restaurants in the Kingdom are generally categorized into three types: i) standalone outlets, ii) leased stores within buildings and iii) stores inside malls. International brands such as McDonald's and Burger King do not usually prefer to buy land to establish a store, as compared to Herfy, whose stores are mostly built on owned land. This limits Herfy to fewer choices and slows down the company's expansion plans. We believe Herfy needs to set up more stores on leased land in future, if it wants to expand rapidly and capture a larger market share.

Local airline catering market: dominated by Saudi Airlines Catering

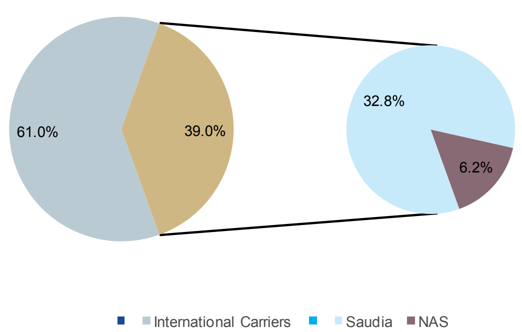
Passenger traffic in the Kingdom will grow at a GAGR of 7% over the next five years

The Saudi airline catering market is well positioned to grow by capitalizing on the growing population, ever-increasing religious visitors and high economic growth in the Kingdom. According to our estimates, airline passenger traffic in Saudi Arabia is set to grow at a CAGR of 7% over 2011-2015, higher than the global average of about 5.2%.

Saudia is the second-largest airline in the Middle East region

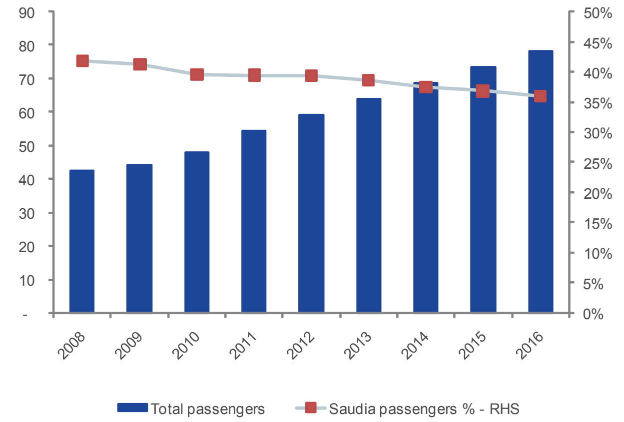
In 2011, national carriers accounted for almost 39% of international passengers passing through Saudi airports. Among them, Saudi Airlines (Saudia) represented 33%, while the remainder 6% was represented by National Air Services (NAS) – the sole domestic competitor for Saudia – after Sama Airlines suspended its operations in late 2010. On the other hand, Saudia dominates the domestic market with a 94% market share. Saudia is the second-largest airline in the Middle East region, after UAE-based Emirates. The company is planning to expand its fleet from around 99 planes to 128 planes by 2016.

Figure 40 International passengers market share in Saudi



Source: GACA, Al Rajhi Capital

Figure 41 Total passengers passing through Kingdom's airports



Source: GACA, Al Rajhi Capital

Improving and upgrading airports will act as catalyst

Saudi Arabia's General Authority of Civil Aviation (GACA) has drawn up aggressive plans for expansion and upgrading of airports in the Kingdom. Airports in Riyadh, Jeddah (the biggest airport in the Kingdom) and Madinah are ramping up capacity. Apart from these, new regional airports are also being built in Abha, Jazan and Qassim. Further, GACA has upgraded Yanbu and Najran airports from local to regional status. In total, the country now has twenty-seven airports, of which four are international and six are regional.

Non-airline catering market is also developing

The biggest segment in non-airline catering market is providing catering services to pilgrims visiting holy cities of Makkah & Madinah

The non-airline catering market is relatively new in the Kingdom. Demand for such services is expected to come from large government institutions, corporate enterprises, hospitals, and educational institutions, which traditionally had been managing through internal catering departments. However, many of these entities have begun outsourcing these services in recent times. We believe these entities have started outsourcing to prune costs and focus on their core operations, especially those operating in the remote areas of the country. The biggest segment in the non-airline catering market is offering catering services to pilgrims visiting the holy cities of Makkah and Madinah with nearly 40% share, followed by companies operating at remote sites at 22%.

Saudi Airlines Catering Co

Food Service –Industrial

CATERING AB: Saudi Arabia

11 December 2012

Al Rajhi Capital

US$1.689bn	30%	US$2.796mn
Market cap	Free float	Avg. daily volume

Target price	91.00	17.8% over current
Consensus price	85.40	10.6% over current
Current price	77.25	as at 9/12/2012

Research Department
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Underweight | Neutral | **Overweight**

Key themes

We expect SACC to continue on its growth path on the back of increasing passenger traffic and improvement in the Kingdom's airports. The company is the market leader in airline catering in the Kingdom, with around 95% market share. In addition, SACC is also diversifying its income sources by expanding its non-airline catering operations.

Implications

We rate SACC as Overweight. The company has just been listed this year, and we expect it to deliver a decent performance given the positive outlook for the Saudi airlines industry.

Performance

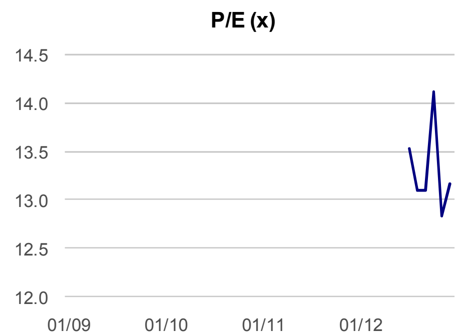
Source: Bloomberg

Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	1,465	1,737	2,040	2,323
Revenue Growth	22.8%	18.5%	17.5%	13.9%
EBITDA (mn)	435	543	637	726
EBITDA Growth	1.0%	24.8%	17.4%	14.0%
EPS	4.69	5.87	6.89	7.85
EPS Growth	-2.2%	25.2%	17.4%	13.9%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Saudi Airlines Catering Co
fasten your seatbelt

Saudi Airlines Catering Company (SACC) is the largest in-flight caterer in the Kingdom. The company benefits from its strategic relationship with Saudi Airlines (Saudia) as the latter holds a 94% market share in the domestic airline market, and accounts for 35% of the international passengers passing through the country. Additionally, SACC carries out operations in allied businesses, and is also active in expanding its non-airline catering business. We strongly believe the company is well positioned to benefit from the robust growth in airline passenger traffic across the Kingdom. We initiate coverage on SACC with an Overweight rating and a target price of SAR91.0 per share, implying an upside potential of 17.8%.

Saudi airline industry has a positive outlook: The airline industry in Saudi Arabia offers promising growth opportunities. According to our estimates, passenger traffic in Saudi airports is set to grow at a CAGR of 7% over the next five years, higher than the international average of about 5-6%. It is pertinent to mention here that many airports across Saudi Arabia are ramping up capacity. We believe these airport expansions will drive the top-line growth for companies like SACC in future. Further, the company also manages sky sales (on-board sales of retail products) besides operating the Al Fursan Lounges.

New growth opportunities are emerging: The General Authority of Civil Aviation (GACA) is in the final stages of issuing licenses to international carriers for operating flights in the domestic market, which will expand SACC's customer base. SACC is already providing services to international airlines passing through the Kingdom. Given this scenario, the issuing of licenses to international carriers would further widen the company's customer base.

Non-airline businesses to complement airline catering: SACC has been actively diversifying its income sources. The company now provides services to large companies such as STC, Ma'aden, and NCB apart from a couple of educational institutions. We believe SACC's market share in the non-airline catering market is growing at a rapid pace.

High economic profit: According to our calculations, SACC will achieve a return on invested capital (ROIC) of 42.5% for 2012. This is higher than our estimates of the company's weighted average cost of capital (WACC) of 12.3%, indicating that the company will achieve an economic profit spread (ROIC-WACC) of 30.2%

Summary: SACC has been able to make the most of its strategic relationship with Saudia Airlines – the dominant flight operator in the Kingdom. The company is well placed to reap the benefits of Saudi Arabia's growing aviation market in future. SACC has also been active in related airline businesses such as sky sales, airport lounge operations in the Kingdom apart from foraying into non-airline catering. We believe these businesses will bolster its core business over the long-term. We initiate coverage on SACC with an Overweight rating and a target price of SAR91.0 per share, implying an upside potential of 17.8%.

Corporate summary

SACC is the largest airline catering company in Saudi Arabia, with around 95% market share mainly due to its strategic relationship with Saudia. The company is also into other related businesses like sky sales and management of Saudia's lounges, apart from expanding its non-airline catering services. SACC was listed on the Saudi Stock Exchange in June 2012 in the food & agriculture sector.

Share information

Market cap (SAR/US$)	6.33bn / 1.689bn
52-week range	60.50 - 80.00
Daily avg volume (US$)	2.796mn
Shares outstanding	82.00mn
Free float (est)	30%

Performance:	1M	3M	12M
Absolute	-3.1%	8.8%	%
Relative to index	-0.8%	13.2%	%

Major Shareholder:	
SAUDIA	35.7%
Strategic Catering Company	34.3%

Source: **Bloomberg, Al Rajhi Capital**

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	1,465	1,737	2,040	2,323
EBITDA (SARmn)	435	543	637	726
Net Profit (SARmn)	384	481	565	643
EPS (SAR)	4.69	5.87	6.89	7.85
DPS (SAR)	4.15	4.00	4.82	5.49
EPS Growth	-2.2%	25.2%	17.4%	13.9%
EV/EBITDA (x)	13.1	10.2	8.3	7.0
P/E (x)	16.5	13.2	11.2	9.8
P/B (x)	6.5	5.6	4.8	4.2
Dividend Yield	5.4%	5.2%	6.2%	7.1%

Source: **Company data, Al Rajhi Capital**

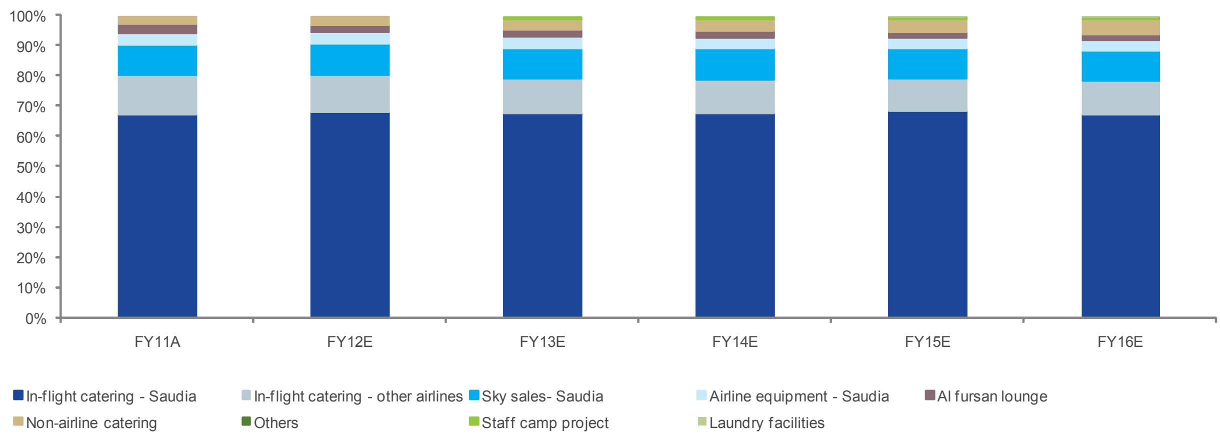
Saudi Airlines Catering Co looking strong

Leading airline catering player in the Kingdom

SACC dominates the airline catering segment due to its strategic relationship with Saudia

SACC is the biggest player in the Saudi airline catering market with a 95% market share. Abu Al Jadayel Flight Catering Company is the closest competitor for SACC, with a daily capacity of about 8,000 meals per day as compared to SACC's design capacity of 124,000 meals per day. The company's dominating market presence is not surprising given the fact that it is the exclusive provider of catering services to Saudia, which enjoys a 94% market share in the domestic airline market, and accounts for 33% of the international passengers passing through the Kingdom. The long-term nature of SACC's strategic agreement with Saudia (renewal due-date on January 29, 2015) ensures stable revenue in future. During the 2008 - 2011 period, the company's revenue, EBITDA and net profit grew at a CAGR of 12-14%. Looking ahead, we believe SACC will continue to chart a growth path and post a top-line and bottom-line growth of 15% CAGR over the next five years. SACC's core catering business with Saudia is its largest segment, which represented 67% of its revenue in 2011. We expect this segment to remain the biggest contributor for the company in future.

Figure 42 Saudi Airline Catering Company revenue forecasts



Source: Company data, Al Rajhi Capital

We estimate the number of passengers travelling through Saudi airports to grow at a CAGR of 7% over the next five years

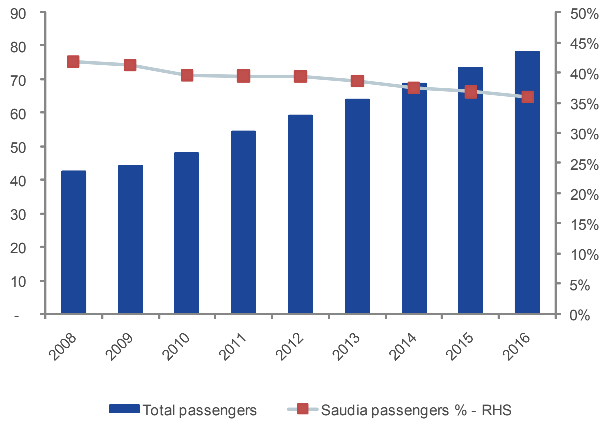
Saudi airlines industry has a positive outlook

The Saudi airline market has much to offer as the country benefits from the inelastic demand for religious flights (Hajj and Umrah), expanding economy, ever-increasing population and high GDP per capita. All these factors have contributed substantially in ensuring the continued growth of the Saudi airline industry. According to GACA, the number of passengers travelling through Saudi airports grew at a CAGR of 10.5% during the 2004-2011 period. We believe this high passenger growth trend will continue and we estimate a CAGR of 7% for the 2011-2016 period. This is higher than the international average of 5.5-6%.

GACA has drawn up major airport expansion plans

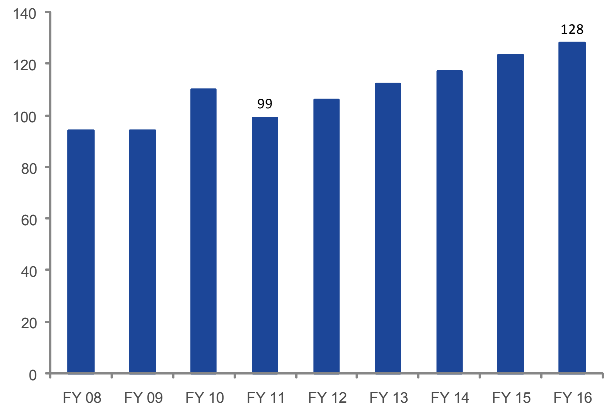
Further, Saudia Airlines has lined up plans to expand its fleet size from 99 planes in 2011 to 128 planes in 2016. In addition, GACA has drawn up aggressive plans for expansion and upgrading of airports in the Kingdom. The King Khalid International Airport in Riyadh is scaling up capacity with an aim to reach 25 mn passengers per annum within the next three years from its current capacity of 12 mn passengers per annum. Additionally, the first phase of the new King Abdulaziz International Airport, being built in Jeddah (the biggest airport in the Kingdom), will handle 30 mn passengers per annum, once it is up and running by 2014. The Jeddah airport, which is being constructed in three phases, is expected to handle 80 mn passengers per annum once it is fully completed. Besides the above, the Prince Muhammad Bin Abdul Aziz International Airport in Madinah will ramp up its capacity to 12 mn passengers per annum by 2015 from its current capacity of 8 mn passengers. Apart from these, several new regional airports are also being built in Abha, Jazan and Qassim. Further, GACA has upgraded the Yanbu and Najran airports from local to regional status. In total, the country now has twenty-seven airports, of which four are international and six are regional.

Figure 43 Total passengers passing through Kingdom's airports



Source: GACA, Al Rajhi Capital

Figure 44 Saudia Airlines fleet size



Source: Saudia Airlines, Al Rajhi Capital

SACC operates sky sales (on-board sales of retail items like cosmetics, watches, electronics, toys, etc.) on both Saudia and NAS flights. SACC also operates the Al Fursan Lounges in all the international airports in the Kingdom on behalf of Saudia and charges a fee. While the agreement tenure for sky sales is limited till January 29, 2015 like the airline catering agreement, the tenure for Al Fursan Lounges is unlimited. These segments accounted for 13% of SACC's revenue in 2011 and we believe they will offer healthy growth prospects, given the expected rise in passenger traffic in the Kingdom.

New growth opportunities are emerging

The GACA is in the final stages of issuing licenses to international carriers to operate flights in the domestic market. Despite the possible adverse affect that this could have on Saudia (SACC's key customer), we believe it will provide new opportunities to SACC to expand its customer base. It is only recently that SACC began providing services to other airlines such as NAS, Garuda Indonesia, Turkish and Middle East Airlines (in-flight catering of airlines other than Saudia accounted for 13% of the company's total revenue in 2011). Thus, the issuing of licenses to international carriers would further widen its customer base.

Non-airline businesses to complement airline catering

SACC has been diversifying its revenue streams by expanding its non-airline catering services. The business is relatively new in the Kingdom, and demand for non-airline catering services comes from large corporate, companies operating at remote sites, government institutions, hospitals, and educational institutions, which were earlier depending on internal departments. These institutions are now outsourcing their catering needs, providing a new income avenue for companies like SACC.

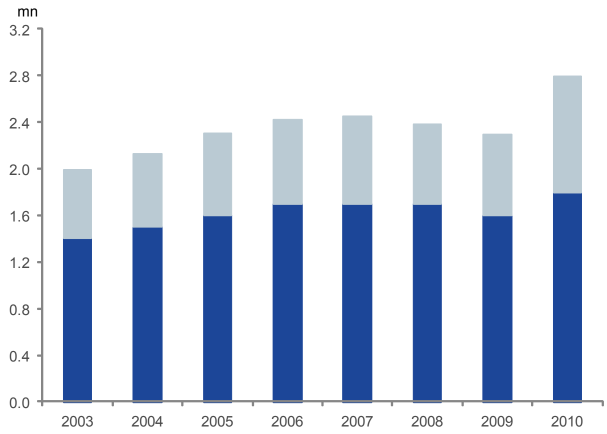
Religious visitors are the biggest segment in non-airline catering across the Kingdom

Apart from these institutions, in-flight catering for religious visitors performing Hajj and Umrah, especially those coming from abroad, provides another opportunity. Over the years the number of Hajj and Umrah visitors has been increasing.. The Saudi government is currently expanding the two holy mosques and developing supporting infrastructure such as transportation networks and accommodation for more pilgrims by pumping in multi-billion dollar investments, which is a fair indication of an increase in religious visitors in future.

As the non-airline catering market is fragmented, there is intense competition in this segment. Some of the key players are Tamimi Global Company, National Company for Management Services (managed by Sodexo group), Gulf Catering Company and Arabian Food Supplies. Even small restaurants are also active in this market space.

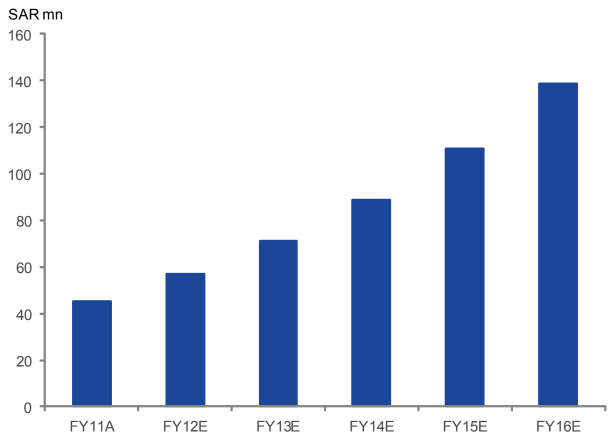
SACC has managed to bag catering contracts with a few big companies in Saudi Arabia, namely Saudi Telecom Company (STC), National Commercial Bank, and Saudi Arabian Mining Company (Ma'aden). The company has also signed contracts with a few educational institutions. SACC is now focusing on serving the health care industry in future, and has separately launched a B2B laundry service for the hospitality and healthcare sector.

Figure 45 Number of Hajj pilgrims are steadily increasing



Source: CDSI, Al Rajhi Capital

Figure 46 Non-airline catering segment to grow rapidly



Source: Company data, Al Rajhi Capital

We believe SACC's non-airline catering revenues will grow at a CAGR of 25% to reach SAR137mn by 2016. This revenue increase will result in the segment's contribution to the company's overall revenue growing from 3% currently to 5% by 2016.

Attractive dividend payment

We believe the company will pay attractive dividends in future

SACC distributed SAR340mn as dividend to its shareholders (SAR4.1 per share) in 2011, which implies a payout ratio of 88.5%. For 2012, the company announced a dividend of SAR3 per share for the first nine months of 2012. We expect another payment of SAR1 per share in Q4 to match last year's dividend. This implies a dividend yield of 5.2%. Looking ahead, we expect SACC to increase its dividend to SAR4.8 in 2013 and maintain a dividend payout ratio of not less than 66%.

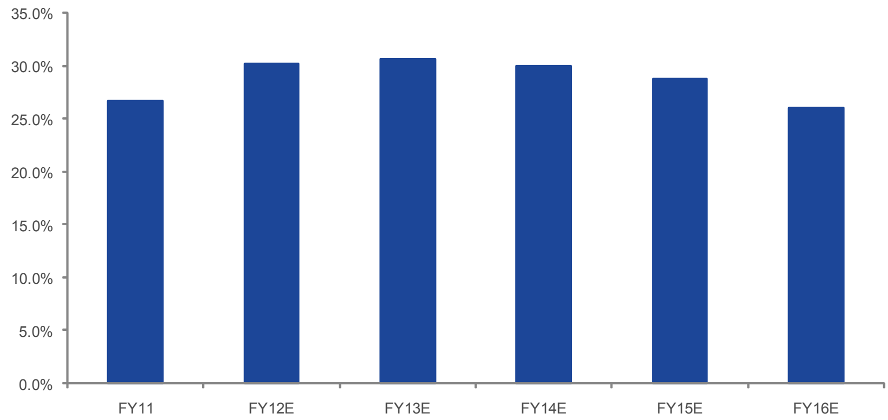
Valuation
SACC offers good long-term value

High economic profit; growth in dividend

High economic profit of 30%

As per our estimates, SACC will achieve a ROIC of 42.5% for 2012. This is more than our estimates of the company's WACC of 12.3%, indicating that the company will achieve an economic profit spread (ROIC –WACC) of 30.2%.

Figure 47 SACC: Economic profit spread (ROIC-WACC)



Source: Company data, Al Rajhi Capital

Summary of our approach and conclusions

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

Our key valuation method for SACC is the long-run discounted economic profit (DEP), also called the discounted long-run EVA ("economic value added"). This is a simple variation on discounted cash flow, and is mathematically equivalent. In our models, we make explicit forecasts for income statement, balance sheet and cash flow through to 2023. We then assume a steady fading of ROIC, i.e. excess return, down to the cost of capital over a period of up to 40 years from end of our explicit forecasting period. This approach avoids a common problem in long-run modeling; 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, regulation 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 competitive advantage period, 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. We have assumed 30 years for SACC on the grounds that it is the market leader and that it will take several years for its rivals to pose a challenge.

However, as with any DCF-based approach, DEP valuation is most sensitive to WACC; we have assumed a WACC of 12.3% for SACC. The company has an adjusted beta of around 0.9, according to Bloomberg.

Nearly 95% of our estimated fair enterprise value for SACC comes from future economic returns

One of the advantages of discounted economic profit forecasting is that it splits the analyst's appraised fair enterprise value for a company between discounted economic profit, i.e. the present value of the company's future returns in excess of the cost of capital, and invested capital, i.e. (in simple terms) the debt and equity funding already invested in the business. With regards to SACC, as the table below shows, we calculate the discounted economic profit at SAR6,324, i.e. roughly 19x the opening invested capital of SAR325mn. In other words, about 95% of our estimated fair enterprise value for SACC comes from discounted economic profit. This means that a large part of the company's value lies in its high economic returns, which it will generate in the future.

We estimate the fair value per share at SAR91.1

As noted, the appraised fair enterprise value is the sum of discounted economic profit and invested capital. From the appraised fair enterprise value, we subtract the net debt to estimate the fair value of equity. We divided the fair value of equity by the number of shares to arrive at the intrinsic fair value per share. Based on the long-run DEP analysis, and using our core assumption of a competitive advantage period of 40 years, we thus estimate the fair value per share for SACC at SAR91.1.

Figure 48 SACC valuation - discounted economic profit

Total value created/ (detroyed)	**6,324,317**
Opening invested Capital	325,950
Total Enterprise Value	**6,650,266**
Less:	
Value of debt (2012E)	823,056
Equity value	**7,473,323**
Number of shares	82,000
Fair value per share	**91.1**

Source: Company data, Al Rajhi Capital

Al Rajhi Capital الراجحي المالية

We expect strong revenue growth for SACC

Income Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue	**1,193**	**1,465**	**1,737**	**2,040**	**2,323**
Cost of Goods Sold	(648)	(907)	(1,073)	(1,259)	(1,433)
Gross Profit	**545**	**558**	**663**	**781**	**890**
Government Charges	-	-	-	-	-
S.G. & A. Costs	(131)	(140)	(137)	(163)	(186)
Operating EBIT	**414**	**419**	**526**	**618**	**704**
Cash Operating Costs	(763)	(1,031)	(1,194)	(1,403)	(1,597)
EBITDA	431	435	543	637	726
Depreciation and Amortisation	(17)	(16)	(16)	(19)	(22)
Operating Profit	**414**	**419**	**526**	**618**	**704**
Net financing income/(costs)	-	-	-	-	-
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income	3	2	-	-	-
Other Expenses					
Net Profit Before Taxes	**417**	**421**	**526**	**618**	**704**
Taxes	(24)	(36)	(45)	(53)	(61)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	**393**	**384**	**481**	**565**	**643**
Dividends	-	(340)	(328)	(395)	(450)
Transfer to Capital Reserve					

We expect DPS to increase as we expect the payout ratio to be above 66%

	12/10A	12/11A	12/12E	12/13E	12/14E
Adjusted Shares Out (mn)	82.00	82.00	82.00	82.00	82.00
CFPS (SAR)	5.00	4.88	6.07	7.12	8.12
EPS (SAR)	4.79	4.69	5.87	6.89	7.85
DPS (SAR)	0.00	4.15	4.00	4.82	5.49

Growth	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue Growth	15.6%	22.8%	18.5%	17.5%	13.9%
Gross Profit Growth	19.9%	2.4%	18.8%	17.8%	13.9%
EBITDA Growth	25.2%	1.0%	24.8%	17.4%	14.0%
Operating Profit Growth	27.4%	1.1%	25.7%	17.4%	13.9%
Net Profit Growth	32.8%	-2.2%	25.2%	17.4%	13.9%
EPS Growth	32.8%	-2.2%	25.2%	17.4%	13.9%

We expect the gross margin for the company to improve

Margins	12/10A	12/11A	12/12E	12/13E	12/14E
Gross profit margin	45.7%	38.1%	38.2%	38.3%	38.3%
EBITDA margin	36.1%	29.7%	31.3%	31.2%	31.3%
Operating Margin	34.7%	28.6%	30.3%	30.3%	30.3%
Pretax profit margin	35.0%	28.7%	30.3%	30.3%	30.3%
Net profit margin	32.9%	26.2%	27.7%	27.7%	27.7%

Other Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
ROCE	50.3%	42.7%	46.5%	46.9%	46.2%
ROIC	119.8%	608.7%	147.6%	183.4%	224.2%
ROE	62.2%	42.6%	45.5%	46.1%	45.3%
Effective Tax Rate	5.8%	8.6%	8.6%	8.6%	8.6%
Capex/Sales	1.1%	4.0%	2.0%	2.0%	2.5%
Dividend Payout Ratio	0.0%	88.5%	68.2%	70.0%	70.0%

The company has the lowest foreword PE multiple in our food sector coverage

Valuation Measures	12/10A	12/11A	12/12E	12/13E	12/14E
P/E (x)	16.1	16.5	13.2	11.2	9.8
P/CF (x)	15.5	15.8	12.7	10.8	9.5
P/B (x)	7.7	6.5	5.6	4.8	4.2
EV/Sales (x)	4.7	3.9	3.2	2.6	2.2
EV/EBITDA (x)	12.9	13.1	10.2	8.3	7.0
EV/EBIT (x)	13.5	13.6	10.5	8.6	7.2
EV/IC (x)	88.7	17.4	17.9	18.5	18.2
Dividend Yield	0.0%	5.4%	5.2%	6.2%	7.1%

Source: **Company data, Al Rajhi Capital**

SACC's balance sheet is expanding

Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	761	655	823	1,030	1,245
Current Receivables	303	564	581	597	609
Inventories	53	66	78	92	105
Other current assets	24	30	30	30	30
Total Current Assets	**1,141**	**1,315**	**1,513**	**1,750**	**1,989**
Fixed Assets	67	110	128	150	185
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**67**	**110**	**128**	**150**	**185**
Total Assets	**1,208**	**1,424**	**1,641**	**1,899**	**2,174**
Short Term Debt	-	-	-	-	-
Accounts Payable	89	116	137	161	184
Accrued Expenses	210	233	278	326	372
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	**300**	**349**	**415**	**488**	**555**
Long-Term Debt	-	-	-	-	-
Other LT Payables	-	-	-	-	-
Provisions	85	95	95	95	95
Total Non-current Liabilities	**85**	**95**	**95**	**95**	**95**
Minority interests	-	-	-	-	-
Paid-up share capital	101	820	820	820	820
Total Reserves	723	161	311	497	704
Total Shareholders' Equity	**824**	**981**	**1,131**	**1,317**	**1,524**
Total Equity	**824**	**981**	**1,131**	**1,317**	**1,524**
Total Liabilities & Shareholders' Equity	**1,208**	**1,424**	**1,641**	**1,899**	**2,174**

The company is debt free

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	(761)	(655)	(823)	(1,030)	(1,245)
Net Debt/EBITDA (x)	1.77-	1.51-	1.52-	1.62-	1.71-
Net Debt to Equity	-92.4%	-66.8%	-72.8%	-78.2%	-81.7%
EBITDA Interest Cover (x)					
BVPS (SAR)	10.04	11.96	13.79	16.07	18.59

We expect strong operating cash flows

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Net Income before Tax & Minority Interest	**417**	**421**	**526**	**618**	**704**
Depreciation & Amortisation	17	16	16	19	22
Decrease in Working Capital	222	(258)	36	43	43
Other Operating Cashflow	3	(1)	(45)	(53)	(61)
Cashflow from Operations	**658**	**178**	**534**	**627**	**709**
Capital Expenditure	(13)	(59)	(35)	(41)	(58)
New Investments	-	-	-	-	-
Others	-	-	-	-	-
Cashflow from investing activities	**(13)**	**(59)**	**(35)**	**(41)**	**(58)**
Net Operating Cashflow	**645**	**119**	**499**	**586**	**651**
Dividends paid to ordinary shareholders	-	(225)	(331)	(379)	(437)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	-	-	-
Cashflow from financing activities	**-**	**(225)**	**(331)**	**(379)**	**(437)**
Total cash generated	645	(106)	168	207	214
Cash at beginning of period	116	761	655	823	1,030
Implied cash at end of year	**761**	**655**	**823**	**1,030**	**1,245**

The company operates in a very low CAPEX model

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	1.1%	4.0%	2.0%	2.0%	2.5%

Source: **Company data, Al Rajhi Capital**

Almarai Company
Food-Diversified –Industrial
ALMARAI AB: Saudi Arabia
11 December 2012

الراجحي المالية
Al Rajhi Capital

US$6.99bn	36%	US$13.00mn
Market cap	Free float	Avg. daily volume

Target price	63.50	-1.2% over current
Consensus price	67.12	10.6% over current
Current price	64.25	as at 10/12/2012

Research Department
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Underweight | **Neutral** | Overweight

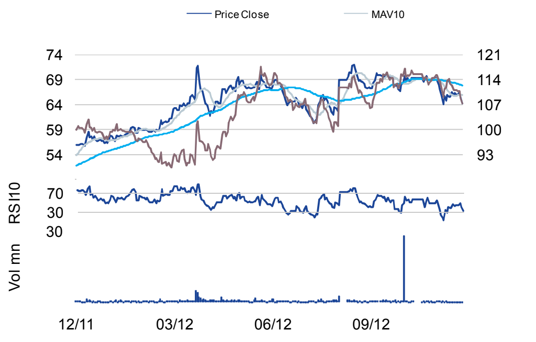
Key themes

We believe rising crop prices coupled with government's cap on prices will pose challenges for Almarai next year. The government intervention is second such instance for Almarai and though we believe the move is to curb inflation, they do not bode well for companies in the sector.

Implications

Almarai has the largest market cap in the Saudi food & agriculture sector. Since 2011, the company has been facing difficulties in increasing the prices of its dairy products. We, therefore, lower our target price but maintain our Neutral rating on the company.

Performance



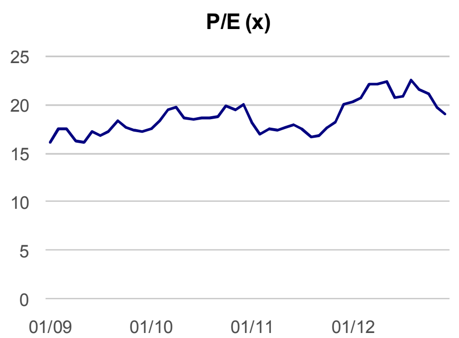
Source: Bloomberg

Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	7,951	9,620	10,883	11,670
Revenue Growth	14.7%	21.0%	13.1%	7.2%
EBITDA (mn)	2,250	2,534	2,841	3,100
EBITDA Growth	7.4%	12.6%	12.1%	9.1%
EPS	2.85	3.38	3.63	4.53
EPS Growth	-11.3%	18.5%	7.6%	24.8%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Almarai
strangled by government interventions

We maintain our Neutral rating on Almarai, as we expect the margin pressures to continue over the next year due to: 1) the slow restructuring process of IDJ's operations, 2) challenges in the poultry segment (expected to breakeven in 2014), and 3) rising crop prices, which will be fully felt next year. Further, in our previous forecasts, we had assumed a price hike for some of Almarai's products to offset its declining margins. However, the government recently intervened on Almarai's price increase of its non-core products such as chocolate milk. Since we believe any price hike will be next to impossible, at least for the next year, we have cut our forecasts and accordingly lowered our target price for Almarai to SAR63.5, which implies a 1.2 % downside to the current market price.

Tough year ahead: We strongly believe 2013 will be one of the toughest years for Almarai, as the sharp increase in feedstock prices witnessed during this year will begin to affect the company's cost of sales next year. The company was cushioned from the impact of rising input costs in 2012, with its existing supply of inventories. Consequently, we have trimmed our margins forecasts for Almarai in 2013, and now expect gross margins to decrease by 70 bps y-o-y. We expect a gradual recovery from 2014 onward.

Ministry of Commerce and Industry intervened to roll back prices: Almarai tried to raise milk and laban prices in July 2011, but the Ministry of Commerce and Industry intervened and forced it to roll back prices. Later in November 2012, the company increased the prices of non-core products such as chocolate milk in an attempt to offset the increasing feedstock prices. However, the Ministry intervened again and forced Almarai to roll back the prices. Such government interventions are literally throwing a spanner in the works for Almarai's profitable operations.

Margin forecasts slashed: Following IDJ's consolidation, Almarai's margins have contracted as it struggles to operate as planned. Further, we expect the poultry segment to struggle next year and breakeven only by 2014. These factors coupled with the government cap on product prices have prompted us to cut our forecasts, as we had included price improvements earlier. We now expect gross margins to decline from 36.2% in 2012 to 35.5% in 2013.

Summary: We believe Almarai is one of the best managed companies in the MENA region. However, rising crop prices and the inability to pass on this increase in costs to customers due to regulatory interventions make the company's near-term outlook negative. Hence, we have lowered our target price for Almarai. Our new target price of SAR63.5 implies a 1.2% downside from the current market price. We further note that the company trades at a forward PE of 17.7 and an EV/EBITDA multiple of 13.1x.

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Corporate summary

Almarai is the largest integrated dairy foods company in the world, with a reputation for quality in the Gulf states in which it operates. Almarai began in 1976. The company is based in Riyadh, the capital of Saudi Arabia. Almarai's network extends throughout the Arabian Peninsula, leading and influencing the agricultural, dairy processing and food distribution industries. Almarai started as a pure dairy company but it has greatly expanded to include cheese, bakery, juice, and poultry.

Share information

Market cap (SAR/US$)	25.70bn / 6.85bn
52-week range	55.64 - 72.00
Daily avg volume (US$)	12.51mn
Shares outstanding	400.0mn
Free float (est)	36%

Performance:	1M	3M	12M
Absolute	-6.9%	-4.8%	16.4%
Relative to index	-4.3%	-0.1%	9.4%

Major Shareholder:	
Savola Al-Azizia United Co	36.5%
Al-Saud Sultan Mohamed	28.6%

Source: **Bloomberg, Al Rajhi Capital**

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	7,951	9,620	10,883	11,670
EBITDA (SARmn)	2,250	2,534	2,841	3,100
Net Profit (SARmn)	1,140	1,350	1,453	1,814
EPS (SAR)	2.85	3.38	3.63	4.53
DPS (SAR)	1.29	1.29	1.29	1.45
EPS Growth	-11.3%	18.5%	7.6%	24.8%
EV/EBITDA (x)	14.5	14.4	13.1	12.2
P/E (x)	22.6	19.0	17.7	14.2
P/B (x)	3.8	3.4	3.0	2.6
Dividend Yield	2.0%	2.0%	2.0%	2.3%

Source: **Company data, Al Rajhi Capital**

Valuation

We use two valuation methods – long-run EVA and relative multiples analysis for our valuation of Almarai.

We use the long-run EVA method to calculate Almarai's fair value. Using a WACC of around 8.1% and our core assumption of a competitive advantage period of 30 years, we estimate the fair value per share for Almarai at SAR63.5.

DANONE and Nestle have been chosen as benchmarks

For the multiples analysis, we use the average EV/EBITDA and PE multiples of international peers. We have selected two strong multinational companies – DANONE and Nestle – as benchmarks. Despite their high market capitalization as compared to Almarai, they are almost perfect peers considering their similar business profile. We consider Almarai in the MENA region to be as strong as these companies are in their respective regions. We arrive at a fair value of SAR54.6 per share, using the average PE and EV/EBITDA ratios of these international peers.

Figure 49 Almarai: comparative multiples analysis

Coompany	Market	Sector	MKT Cap	P/E	EV/EBITDA	EPS	Bloomberg Code
Danone	EN Paris	Food-Misc/Diversified	$40,787.0	16.2	10.6	$3.9	BN FP
Nestle	SIX Swiss Ex	Food-Misc/Diversified	$207,923.7	17.5	12.0	$3.7	NESN VX
Almarai	Tadawul	Food & Agriculture	$6,989.6	19.0	14.0	$0.9	ALMARAI AB

Source: Bloomberg, Al Rajhi Capital

We arrive at a target price of SAR63.5 per share for Almarai

We arrive at a target price of SAR63.5 per share for Almarai by assigning a weight of 80% to the long-run EVA method (SAR65.7 per share), and 20% weight to the multiples method (SAR54.6 per share).

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Al Rajhi Capital

We expect revenues for Almarai to grow by 13% for 2013 to reach SAR10.8bn

We expect gross profit growth to lag revenue growth in 2013 but recover in 2014

Almarai is not cheap; the company trades on a forward PE of 17.7

Income Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue	**6,931**	**7,951**	**9,620**	**10,883**	**11,670**
Cost of Goods Sold	(4,195)	(4,954)	(6,140)	(7,016)	(7,352)
Gross Profit	**2,736**	**2,997**	**3,480**	**3,866**	**4,318**
Government Charges					
S.G. & A. Costs	(1,276)	(1,479)	(1,877)	(2,122)	(2,171)
Operating EBIT	**1,460**	**1,518**	**1,602**	**1,745**	**2,147**
Cash Operating Costs	(4,836)	(5,701)	(7,086)	(8,041)	(8,571)
EBITDA	2,095	2,250	2,534	2,841	3,100
Depreciation and Amortisation	(635)	(733)	(931)	(1,097)	(952)
Operating Profit	**1,460**	**1,518**	**1,602**	**1,745**	**2,147**
Net financing income/(costs)	(127)	(177)	(212)	(246)	(292)
Forex and Related Gains	-	-	-	-	-
Provisions	-	(160)	-	-	-
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	**1,333**	**1,180**	**1,391**	**1,499**	**1,855**
Taxes	(26)	(33)	(45)	(50)	(47)
Minority Interests	(22)	(7)	5	4	5
Net profit available to shareholders	**1,285**	**1,140**	**1,350**	**1,453**	**1,814**
Dividends	(518)	(518)	(518)	(518)	(580)
Transfer to Capital Reserve	-	-	-	-	-

	12/10A	12/11A	12/12E	12/13E	12/14E
Adjusted Shares Out (mn)	400.0	400.0	400.0	400.0	400.0
CFPS (SAR)	4.86	4.70	5.69	6.36	6.90
EPS (SAR)	3.214	2.849	3.376	3.632	4.534
DPS (SAR)	1.294	1.294	1.294	1.294	1.451

Growth	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue Growth	18.1%	14.7%	21.0%	13.1%	7.2%
Gross Profit Growth	15.6%	9.5%	16.1%	11.1%	11.7%
EBITDA Growth	17.4%	7.4%	12.6%	12.1%	9.1%
Operating Profit Growth	14.1%	4.0%	5.6%	8.9%	23.1%
Net Profit Growth	17.2%	-11.3%	18.5%	7.6%	24.8%
EPS Growth	17.2%	-11.3%	18.5%	7.6%	24.8%

Margins	12/10A	12/11A	12/12E	12/13E	12/14E
Gross profit margin	39.5%	37.7%	36.2%	35.5%	37.0%
EBITDA margin	30.2%	28.3%	26.3%	26.1%	26.6%
Operating Margin	21.1%	19.1%	16.7%	16.0%	18.4%
Pretax profit margin	19.2%	14.8%	14.5%	13.8%	15.9%
Net profit margin	18.5%	14.3%	14.0%	13.4%	15.5%

Other Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
ROCE	13.9%	12.1%	10.5%	10.1%	10.8%
ROIC	17.2%	15.0%	12.3%	10.4%	11.5%
ROE	22.3%	17.7%	18.9%	18.1%	19.9%
Effective Tax Rate	2.0%	2.8%	3.2%	3.3%	2.5%
Capex/Sales	30.4%	40.8%	30.2%	25.0%	25.0%
Dividend Payout Ratio	40.3%	45.4%	38.3%	35.6%	32.0%

Valuation Measures	12/10A	12/11A	12/12E	12/13E	12/14E
P/E (x)	20.0	22.6	19.0	17.7	14.2
P/CF (x)	13.2	13.7	11.3	10.1	9.3
P/B (x)	4.2	3.8	3.4	3.0	2.6
EV/Sales (x)	4.4	4.1	3.8	3.4	3.2
EV/EBITDA (x)	14.6	14.5	14.4	13.1	12.2
EV/EBIT (x)	20.9	21.5	22.7	21.4	17.6
EV/IC (x)	3.1	2.6	2.3	2.0	1.9
Dividend Yield	2.0%	2.0%	2.0%	2.0%	2.3%

Source: **Company data, Al Rajhi Capital**

The company's balance sheet is expanding

Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	247	272	404	308	800
Current Receivables	614	617	905	1,034	1,167
Inventories	1,299	1,697	1,668	1,863	2,031
Other current assets	-	-	-	-	-
Total Current Assets	**2,160**	**2,586**	**2,977**	**3,205**	**3,998**
Fixed Assets	8,636	11,326	14,181	15,805	17,770
Investments	958	853	319	319	319
Goodwill	793	827	1,383	1,383	1,383
Other Intangible Assets	-	-	-	-	-
Total Other Assets	24	62	72	72	72
Total Non-current Assets	**10,411**	**13,068**	**15,955**	**17,579**	**19,545**
Total Assets	**12,571**	**15,654**	**18,932**	**20,785**	**23,542**
Short Term Debt	546	1,209	1,542	1,542	1,542
Accounts Payable	1,253	1,513	1,525	1,346	1,494
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	79	96	114	114	114
Total Current Liabilities	**1,878**	**2,818**	**3,181**	**3,003**	**3,150**
Long-Term Debt	4,301	5,717	7,080	8,179	9,498
Other LT Payables	-	-	-	-	-
Provisions	206	341	425	425	425
Total Non-current Liabilities	**4,507**	**6,058**	**7,505**	**8,604**	**9,923**
Minority interests	52	59	706	702	698
Paid-up share capital	2,300	2,300	4,000	4,000	4,000
Total Reserves	3,834	4,418	3,539	4,475	5,771
Total Shareholders' Equity	**6,134**	**6,718**	**7,539**	**8,475**	**9,771**
Total Equity	**6,185**	**6,778**	**8,246**	**9,177**	**10,469**
Total Liabilities & Shareholders' Equity	**12,571**	**15,654**	**18,932**	**20,785**	**23,542**

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	4,600	6,653	8,218	9,414	10,240
Net Debt/EBITDA (x)	2.20	2.96	3.24	3.31	3.30
Net Debt to Equity	74.4%	98.2%	99.7%	102.6%	97.8%
EBITDA Interest Cover (x)	16.6	12.7	12.0	11.6	10.6
BVPS (SAR)	15.33	16.80	18.85	21.19	24.43

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Net Income before Tax & Minority Interest	**1,333**	**1,180**	**1,391**	**1,499**	**1,855**
Depreciation & Amortisation	635	733	931	1,097	952
Decrease in Working Capital	49	(172)	(41)	(503)	(153)
Other Operating Cashflow	38	63	18	(50)	(47)
Cashflow from Operations	**2,055**	**1,804**	**2,299**	**2,043**	**2,608**
Capital Expenditure	(2,104)	(3,241)	(2,905)	(2,721)	(2,918)
New Investments	-	-	5	-	-
Others	(84)	3	-	-	-
Cashflow from investing activities	**(2,189)**	**(3,237)**	**(2,899)**	**(2,721)**	**(2,918)**
Net Operating Cashflow	**(134)**	**(1,433)**	**(600)**	**(678)**	**(309)**
Dividends paid to ordinary shareholders	(456)	(516)	(518)	(518)	(518)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(98)	(217)	(1)	-	-
Cashflow from financing activities	**(84)**	**1,345**	**743**	**582**	**801**
Total cash generated	(217)	(88)	142	(96)	492
Cash at beginning of period	508	247	272	404	308
Implied cash at end of year	**290**	**159**	**414**	**308**	**800**

We expect Capex to sales ration to remain high

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	30.4%	40.8%	30.2%	25.0%	25.0%

Source: **Company data, Al Rajhi Capital**

Savola Group Company

Food-Diversified –Industrial
SAVOLA AB: Saudi Arabia
11 December 2012

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US$5.47bn	60%	US$2.295mn
Market cap	Free float	Avg. daily volume

Target price	**49.10**	19.7% over current
Consensus price	45.00	10.6% over current
Current price	41.00	as at 10/12/2012

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Underweight | Neutral | **Overweight**

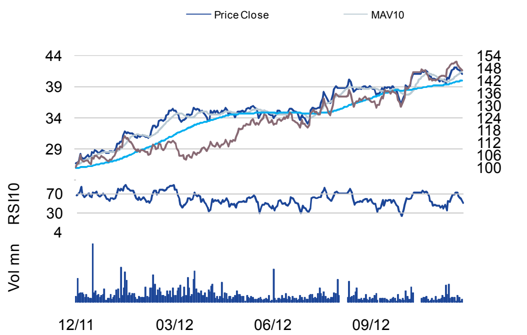
Key themes

We believe rising income levels, changing lifestyles and ever-increasing population in the Kingdom will continue to be the main drivers for companies like Savola. Although the company operates in unstable markets, such as Iran and Egypt, its performance has been better than expected.

Implications

Savola is a leader in nearly all the regions it operates in. The company has performed well despite rising commodity prices, raw material supply and the Arab spring. Further, the local retail segment's profitability has improved indicating better efficiency. Therefore, we upgrade our rating to Overweight.

Performance



Source: Bloomberg

Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	25,196	27,833	30,726	33,587
Revenue Growth	20.1%	10.5%	10.4%	9.3%
EBITDA (mn)	1,822	2,327	2,651	2,842
EBITDA Growth	7.2%	27.7%	13.9%	7.2%
EPS	2.40	3.40	3.39	3.81
EPS Growth	35.6%	41.2%	-0.3%	12.6%

Source: Company data, Al Rajhi Capital

Valuation

Source: Company data, Al Rajhi Capital

Savola Group
exceeds forecasts, increase TP

Savola posted impressive results this year despite rising commodity prices, raw material supply difficulties (especially in Iran), and the Arab spring. The company's performance in Iran and Egypt has been better than our expectations at the beginning of 2012. Further, the retail segment's profitability has improved indicating that Savola's super and hypermarket efficiency is well on the road to recovery. Further, Savola has upped its stake in Almarai, which we believe is a good asset. We have raised our revenue and profit forecasts from Iran and Egypt and increased the margins of Savola's retail segment. Accordingly, we have raised our target price to SAR49.1 per share for Savola. Our new target price offers more than 19% upside potential from the current market price. Hence, upgrade our rating to Overweight.

Higher stake in Almarai, good but could have been cheaper: Savola raised its stake in Almarai from 29.95% to 36.52% on October 16, 2012 for a total cash consideration of SAR2bn. Despite lowering our target price for Almarai (SAR63.5), we strongly believe that having Almarai as an asset in Savola's portfolio is a good move. Having said that, we question the timing of this deal, as we believe the coming year will be extremely difficult for Almarai. Savola could have easily raised its stake in Almarai for a lower price, had it waited a bit longer.

Substantial improvements in retail division: Savola's retail division's revenue for the first nine months of 2012 was SAR7.4bn, 6% lower than our forecasts. However, the net margin almost doubled as net profit rose remarkably for the first nine months by 76% to SAR137mn. This reflects significant improvements in operational efficiency. Considering that supermarkets and hypermarkets are still underpenetrated in the Kingdom, we believe Savola will continue to expand its stores. We further note that the company has lined up plans to operate 140 supermarkets and 50 hypermarkets by 2015, from the current levels of around 101 and 45 respectively.

Sales of non-core assets to boost profits in Q4: Following Savola's announcement to sell its stake in a land in Al-Madina for SAR631mn, the group has reported a gain on disposable investments of SAR47mn for the nine months ended 2012. If the company does not make any new announcements on the deal, the deal should be completed by the end of 2012, i.e. SAR184mn will be gained in Q4. Usually, Savola raises its dividend whenever such income occurs. Based on that, we expect Savola to increase its dividend in Q4 to SAR0.55 per share, making the total dividend for the year at SAR1.5 per share (implying a dividend yield of 3.5%).

Summary: Savola posted impressive results this year despite the challenges of rising commodity prices, difficulties in raw supplies and the Arab spring. Further, Savola increased its stake in Almarai from 29.95% to 36.52%. We believe the acquisition will boost Savola's profits over the long-term. We like the growing demand from the domestic market and believe it will drive the company's future growth. Following the retail division's strong performance and the increase in Almarai's stake, we raise our target price to SAR49.1, implying a upside potential of 19%. Hence, we upgrade our rating for Savola to Overweight.

Corporate summary

Savola – one of the leading companies in food and retail industries – is a conglomerate. The group operates its businesses through three broad sectors – 'Savola Foods Sector' comprising edible oil, sugar and pasta, 'Savola Retail Sector' comprising retail (Panda - and Hyper Panda), and 'Savola Plastics Sector'. Furthermore, Savola has made substantial investments in Almarai (the leading dairy company in the GCC region) and Herfy (a successful fast food chain) with 36.5% and 47.6% stakes respectively.

Share information

Market cap (SAR/US$)	20.50bn / 5.47bn
52-week range	26.60 - 42.00
Daily avg volume (US$)	2.295mn
Shares outstanding	500.0mn
Free float (est)	60%

Performance:	1M	3M	12M
Absolute	1%	5.1%	55.3%
Relative to index	3.6%	9.8%	48.3%

Major Shareholder:	
Mohammed Ibrahim Alisa	11.9%
General Oraganistion for Social Insurance	10.9%

Source: **Bloomberg, Al Rajhi Capital**

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	25,196	27,833	30,726	33,587
EBITDA (SARmn)	1,822	2,327	2,651	2,842
Net Profit (SARmn)	1,202	1,698	1,693	1,906
EPS (SAR)	2.40	3.40	3.39	3.81
DPS (SAR)	1.30	1.45	1.20	1.33
EPS Growth	35.6%	41.2%	-0.3%	12.6%
EV/EBITDA (x)	11.5	8.9	7.5	6.9
P/E (x)	17.0	12.1	12.1	10.8
P/B (x)	2.7	2.4	2.1	1.9
Dividend Yield	3.2%	3.5%	2.9%	3.3%

Source: **Company data, Al Rajhi Capital**

Valuation

We use two valuation methods – Sum of the Parts (SoTP) approach using the EV/EBITDA multiple and long run EVA for Savola.

We have used the average EV/EBITDA multiples of international peers for the SoTP valuation

We believe valuing each division of the group separately will be more appropriate for Savola, given its diverse operations. The SoTP approach attempts to value the constituent segments of Savola separately. In an ideal case, we would use the long-run DCF or DEP analysis for each segment of the business. However, the financial information on these companies as well as overseas operations is limited, since many of Savola's companies are unlisted. We have therefore decided to value Savola's various operations – including its domestic business – on a comparative basis, using the aggregate EV/EBITDA multiples for peer companies to estimate a fair enterprise value for Savola's constituent parts. We believe this method provides a practical and speedy way of valuing Savola's constituent parts. We have always preferred EV/EBITDA to PE as a valuation measure, since it is not affected by differences in financial structure or tax rate.

Figure 50 Savola: SoTP valuation

		EBITDA		2011	2012		Enterprise Value	
(SAR mn)	**Method**	**2011**	**2012E**	(x)	(x)	**Interest in EV**	**2011**	**2012E**
Retail business	Comparables	483.0	553.4	8.4	8.0	74.4%	3,008.4	3,275.0
Oil business	Comparables	809.0	823.5	9.5	10.2	86.7%	6,685.3	7,290.9
Sugar business	Comparables	417.0	462.2	9.6	5.3	72.9%	2,912.8	1,796.2
Plastics business	Comparables	153.0	182.9	9.8	9.1	100%	1,505.8	1,668.3
Pasta business	Comparables (started Q4 2011)	8.0	31.2	10.8	10.3	100%	86.3	322.5
Total Enterprise Value							**14,198.5**	**14,352.9**

Associates	**Method**	Ownership	Value
Almarai	ARC target price (SAR64)	36.5%	9,271.0
Herfy	Market price (SAR106.25)	47.6%	1,517.3
Kinan Real Estate Devalopment	Book value at 1.0x	30.0%	525.3
Other	Book value at 1.0x	value at YE 2011	1,068.0

Enterprise Value YE 2011	**14,198.5**	**14,352.9**
Net debt	5,019	4,514
Equity value at YE 2011	9,179.6	9,838.6
Associates and other investments	12,381.6	12,381.6
Total Equity Value	**21,561.2**	**22,220.2**
Shares outstanding (mn)	500	500
Price per Share	**43.1**	**44.4**

Source: Company data, Al Rajhi Capital

On a comparative SoTP basis, we estimate the fair value per share for Savola at SAR44.4. For Almarai, we use our target price (SAR63.5), which is lower than the market price. On the other hand, despite being also Neutral on Herfy; we use the market price as it is lower than our target price. We believe our calculations represent a conservative fair value of Savola's share price.

Then again, we utilize the long-run EVA to calculate Savola's fair value using a WACC of about 10%. Using our core assumption of a competitive advantage period of 30 years, we estimate the fair value per share for Savola at SAR53.7.

We arrive at a target price of SAR49.1 per share for Savola

To summarize, we estimate the fair value per share for Savola using the SoTP method to be SAR44.4 and using the long-run DEP basis to be SAR53.7. We assign an equal weight to both methods and arrive at our target price of SAR49.1 per share for Savola, which offers more than 19% upside potential from the current market price.

We expect revenues to grow by 10.4% next year to reach SAR30.7bn

We expect DPS to go back to SAR1.2 per share in 2013 due to the lack of any capital gains

We expect revenue growth to remain strong

Savola trades on a forward PE of 12.1x

Income Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue	**20,985**	**25,196**	**27,833**	**30,726**	**33,587**
Cost of Goods Sold	(17,614)	(21,225)	(23,227)	(25,621)	(28,006)
Gross Profit	**3,370**	**3,971**	**4,606**	**5,105**	**5,580**
Government Charges					
S.G. & A. Costs	(2,485)	(2,707)	(2,914)	(3,174)	(3,527)
Operating EBIT	**886**	**1,263**	**1,692**	**1,931**	**2,054**
Cash Operating Costs	(19,286)	(23,374)	(25,506)	(28,075)	(30,745)
EBITDA	1,699	1,822	2,327	2,651	2,842
Depreciation and Amortisation	(813)	(558)	(635)	(720)	(788)
Operating Profit	**886**	**1,263**	**1,692**	**1,931**	**2,054**
Net financing income/(costs)	(218)	(317)	(414)	(382)	(382)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	782	690	1,094	811	971
Other Expenses	(284)	(35)	-	-	-
Net Profit Before Taxes	**1,166**	**1,601**	**2,372**	**2,360**	**2,642**
Taxes	(140)	(132)	(245)	(231)	(248)
Minority Interests	(139)	(266)	(429)	(437)	(489)
Net profit available to shareholders	**887**	**1,202**	**1,698**	**1,693**	**1,906**
Dividends	(625)	(650)	(725)	(600)	(667)
Transfer to Capital Reserve	-	-	-	-	-

	12/10A	12/11A	12/12E	12/13E	12/14E
Adjusted Shares Out (mn)	500.0	500.0	500.0	500.0	500.0
CFPS (SAR)	3.68	4.05	5.52	5.70	6.37
EPS (SAR)	1.773	2.405	3.395	3.385	3.812
DPS (SAR)	1.250	1.300	1.450	1.200	1.334

Growth	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue Growth	17.1%	20.1%	10.5%	10.4%	9.3%
Gross Profit Growth	8.5%	17.8%	16.0%	10.8%	9.3%
EBITDA Growth	19.6%	7.2%	27.7%	13.9%	7.2%
Operating Profit Growth	-6.3%	42.6%	33.9%	14.2%	6.3%
Net Profit Growth	-6.8%	35.6%	41.2%	-0.3%	12.6%
EPS Growth	-6.8%	35.6%	41.2%	-0.3%	12.6%

Margins	12/10A	12/11A	12/12E	12/13E	12/14E
Gross profit margin	16.1%	15.8%	16.5%	16.6%	16.6%
EBITDA margin	8.1%	7.2%	8.4%	8.6%	8.5%
Operating Margin	4.2%	5.0%	6.1%	6.3%	6.1%
Pretax profit margin	5.6%	6.4%	8.5%	7.7%	7.9%
Net profit margin	4.2%	4.8%	6.1%	5.5%	5.7%

Other Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
ROCE	8.1%	10.6%	13.3%	13.7%	12.9%
ROIC	10.5%	17.2%	17.3%	18.5%	19.2%
ROE	12.7%	16.3%	20.7%	18.4%	18.5%
Effective Tax Rate	12.0%	8.2%	10.3%	9.8%	9.4%
Capex/Sales	2.3%	4.1%	3.5%	4.7%	4.8%
Dividend Payout Ratio	70.5%	54.1%	42.7%	35.4%	35.0%

Valuation Measures	12/10A	12/11A	12/12E	12/13E	12/14E
P/E (x)	23.1	17.0	12.1	12.1	10.8
P/CF (x)	11.1	10.1	7.4	7.2	6.4
P/B (x)	2.9	2.7	2.4	2.1	1.9
EV/Sales (x)	0.9	0.8	0.7	0.7	0.6
EV/EBITDA (x)	11.6	11.5	8.9	7.5	6.9
EV/EBIT (x)	22.2	16.6	12.2	10.4	9.6
EV/IC (x)	2.9	2.4	2.2	2.1	1.8
Dividend Yield	3.0%	3.2%	3.5%	2.9%	3.3%

Source: **Company data, Al Rajhi Capital**

Savola's balance sheet is expanding

Balance Sheet (SARmn)	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Cash and Cash Equivalents	533	1,214	1,855	2,980	3,771
Current Receivables	1,503	1,816	1,920	2,128	2,351
Inventories	2,527	3,152	3,249	3,078	3,359
Other current assets	1,348	1,592	2,319	2,319	2,319
Total Current Assets	**5,911**	**7,774**	**9,343**	**10,504**	**11,799**
Fixed Assets	4,739	5,384	5,709	6,435	7,259
Investments	6,107	5,332	5,466	5,466	5,466
Goodwill	1,025	1,302	1,305	1,305	1,305
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	309	327	327	327
Total Non-current Assets	**11,871**	**12,328**	**12,808**	**13,533**	**14,357**
Total Assets	**17,782**	**20,101**	**22,150**	**24,038**	**26,157**
Short Term Debt	2,779	3,412	4,158	4,158	4,158
Accounts Payable	2,076	2,719	2,836	3,241	3,493
Accrued Expenses	1,550	1,429	1,891	2,161	2,284
Dividends Payable	-	-	-	-	-
Other Current Liabilities	200	181	193	-	-
Total Current Liabilities	**6,605**	**7,740**	**9,077**	**9,560**	**9,935**
Long-Term Debt	2,395	2,821	2,211	2,211	2,211
Other LT Payables	292	58	163	163	163
Provisions	276	410	340	340	340
Total Non-current Liabilities	**2,962**	**3,290**	**2,715**	**2,715**	**2,715**
Minority interests	1,195	1,348	1,655	2,091	2,580
Paid-up share capital	5,000	5,000	5,000	5,000	5,000
Total Reserves	2,020	2,722	3,704	4,671	5,927
Total Shareholders' Equity	**7,020**	**7,722**	**8,704**	**9,671**	**10,927**
Total Equity	**8,215**	**9,071**	**10,358**	**11,763**	**13,507**
Total Liabilities & Shareholders' Equity	**17,782**	**20,101**	**22,150**	**24,038**	**26,157**

The company has healthy gearing ratios

Ratios	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Net Debt (SARmn)	4,641	5,019	4,514	3,389	2,598
Net Debt/EBITDA (x)	2.73	2.76	1.94	1.28	0.91
Net Debt to Equity	56.5%	55.3%	43.6%	28.8%	19.2%
EBITDA Interest Cover (x)	7.8	5.7	5.6	6.9	7.4
BVPS (SAR)	14.04	15.44	17.41	19.34	21.85

Cashflow Statement (SARmn)	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Net Income before Tax & Minority Interest	**1,166**	**1,601**	**2,372**	**2,360**	**2,642**
Depreciation & Amortisation	813	558	635	720	788
Decrease in Working Capital	(137)	(187)	(310)	447	(129)
Other Operating Cashflow	12	(398)	21	(231)	(248)
Cashflow from Operations	**1,853**	**1,573**	**2,718**	**3,296**	**3,054**
Capital Expenditure	(478)	(1,025)	(970)	(1,446)	(1,612)
New Investments	(497)	152	361	-	-
Others	(164)	104	37	-	-
Cashflow from investing activities	**(1,139)**	**(768)**	**(572)**	**(1,446)**	**(1,612)**
Net Operating Cashflow	**714**	**805**	**2,146**	**1,850**	**1,442**
Dividends paid to ordinary shareholders	(623)	(498)	(743)	(725)	(650)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(689)	(385)	(428)	-	-
Cashflow from financing activities	**(1,138)**	**(124)**	**(1,035)**	**(725)**	**(650)**
Total cash generated	(424)	682	1,110	1,125	791
Cash at beginning of period	1,001	533	1,214	1,855	2,980
Implied cash at end of year	**577**	**1,215**	**2,325**	**2,980**	**3,771**

Ratios	**12/10A**	**12/11A**	**12/12E**	**12/13E**	**12/14E**
Capex/Sales	2.3%	4.1%	3.5%	4.7%	4.8%

Source: **Company data, Al Rajhi Capital**

Herfy Food Services

Food/Dairy Products –Industrial
HERFY AB: Saudi Arabia
11 December 2012

الراجحي المالية
Al Rajhi Capital

US$0.850bn	51%	US$0.625mn
Market cap	Free float	Avg. daily volume

Target price	110.0	4.1% over current
Consensus price	116.7	10.6% over current
Current price	106.3	as at 9/12/2012

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Underweight | **Neutral** | Overweight

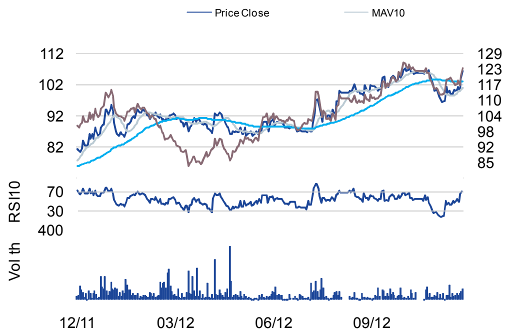
Key themes

We believe the fast food market will continue to grow strongly in the Kingdom. Herfy currently occupies the second position, just behind McDonald's. We believe Herfy's strategy to open new restaurants, especially outside big cities, coupled with expansion in the bakery and meat divisions will enable it to grow strongly.

Implications

Herfy has been performing well operationally, and offers near-term growth at a reasonable valuation. We believe the company's handsome dividends coupled with decent transparency will continue to support Herfy's share price.

Performance



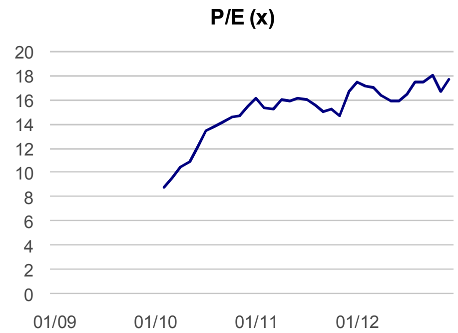
Source: Bloomberg

Earnings

Period End (SAR)	12/11A	12/12E	12/13E	12/14E
Revenue (mn)	709	835	958	1,074
Revenue Growth	22.2%	17.8%	14.8%	12.1%
EBITDA (mn)	188	225	255	287
EBITDA Growth	19.6%	19.7%	13.3%	12.6%
EPS	5.15	6.00	6.76	7.81
EPS Growth	11.8%	16.5%	12.8%	15.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Herfy
impressive track record

Herfy has performed exceedingly well during the first nine months of 2012. Backed by its vertically integrated model, the company has managed to survive input price swings as compared to its industry peers and avoid margin deterioration. We have raised our estimates for store yields for the coming years. Additionally, we have increased our sales forecasts for the bakery and meat divisions. Accordingly, we have upped our target price to SAR110.0, That said, our new target price offers a limited upside potential (4%) from the current market price. Therefore, we maintain our Neutral rating. We further note that we expect Herfy to raise its dividend from SAR3.0 for 2011 to SAR3.5 for the full year 2012, implying a dividend yield of 3.3%.

Strong revenue growth: During the first nine months of 2012, Herfy's revenues grew by 19% y-o-y to SAR620mn. This was mainly due to the strong performance in the restaurant's division as the sales per store grew remarkably by around 14% over the same period. We believe revenue will grow by 17.8% y-o-y for the full year of 2012. Division-wise, we believe bakery will be the highest growth driver for 2013, thanks to the capacity ramp-up, followed by the restaurant and meat divisions.

Q4 should witness new store openings: Herfy has opened only 7 new restaurants so far as compared to its earlier growth plan (20 new restaurants annually). The main reason for this delay is that the company's construction division had focused more on building and ramping up the new bakery plant. With the new bakery plant having commenced production, we believe Herfy will be able to roll out 7 new stores in Q4 2012, taking the total number to 14 for 2012. Further, we believe Herfy will lower its yearly additions of stores from 20 to 16 per year for 2013 and 2014, due to rising real estate prices on account of scarce land availability in the Kingdom.

Vertical integration makes it easy to maintain margins: Herfy has managed to relatively maintain its gross margins, thanks to its integrated business model. This is a much better performance given the fact that many companies in the food sector have been witnessing declining margins. For the past four years, the company's gross and EBITDA margins have remained relatively stable at around 67.7% and 27% respectively. Given that Herfy has not increased its product prices over the last few quarters, it has enough room for a moderate price rise, considering many of its competitors have raised their prices. That said, we have not factored in any price hike in our forecasts for 2013.

Valuation and summary: We like Herfy's performance for the first nine months of 2012, as it has managed to relatively stabilize its margins despite volatile raw material prices. Further, we expect the company to raise its dividend distribution for the full year to SAR3.5 (up from SAR3), resulting in a dividend yield of 3.3%. We have raised our revenue per store forecasts based on the performance of the first 9 months of 2012, and accordingly we have raised our target price to SAR110.0 but maintained our Neutral rating for the company as the stock recently rallied (7% MTD). Our new target price implies limited upside potential of 4% from current market prices.

Corporate summary

Herfy is a food services company that was founded in 1981 by Ahmed Alsaeed and Hamod Albrahim. The company's business includes four divisions – fast food chain, bakery, rusk (Shaborah), and meats. The fast food chain is its biggest division, comprising about 80% of its total revenues. Herfy has international business in the GCC and MENA regions through franchise and exports. The company was listed on the Tadawul in February 2010.

Share information

Market cap (SAR/US$)	3.188bn / 0.850bn
52-week range	80.25 - 107.8
Daily avg volume (US$)	0.625mn
Shares outstanding	27.00mn
Free float (est)	51%

Performance:	1M	3M	12M
Absolute	1.2%	6%	32%
Relative to index	3.5%	10.4%	23.5%

Major Shareholder:	
Savola group	47.6%
Ahmed Hamad Mohammed Alsaeed	20.3%

Source: **Bloomberg, Al Rajhi Capital**

Valuation

Period End	12/11A	12/12E	12/13E	12/14E
Revenue (SARmn)	709	835	958	1,074
EBITDA (SARmn)	188	225	255	287
Net Profit (SARmn)	147	180	203	234
EPS (SAR)	5.15	6.00	6.76	7.81
DPS (SAR)	3.00	3.50	3.50	4.00
EPS Growth	11.8%	16.5%	12.8%	15.4%
EV/EBITDA (x)	16.1	14.2	12.5	11.1
P/E (x)	20.6	17.7	15.7	13.6
P/B (x)	7.3	6.1	5.2	4.3
Dividend Yield	2.8%	3.3%	3.3%	3.8%

Source: **Company data, Al Rajhi Capital**

Valuation

We use two valuation methods – long-run EVA and relative multiples analysis for our valuation of Herfy.

We use the long-run EVA method to calculate the Herfy's fair value. Using WACC of around 9% and our core assumption of a competitive advantage period of 25 years, we estimate the fair value per share for Herfy at SAR110.6.

McDonald's and Wendy's have been chosen as benchmarks

For the multiples analysis, we use the average EV/EBITDA and PE multiples of international peers. We have selected two strong multinational companies in the food sector, McDonald's and Wendy's, as benchmarks. Despite their high market capitalization as compared to Herfy's, we believe they are almost perfect peers considering their similar business profiles. We arrive at a fair value of SAR98 per share for Herfy, using the average PE and EV/EBITDA ratios of these international peers.

Figure 51 Herfy: comparative multiples analysis

Coompany	Market	Sector	MKT Cap	P/E	EV/EBITDA	Bloomberg Code
Mcdonald's	US - NY	Retail-Restaurants	$ 87,396	16.39	9.9	MCD US
Wendy's	US - NY	Retail-Restaurants	$ 1,833	36.64	8.95	WED US
Herfy	KSA - Tadawul	Food & Agriculture	$ 850	21.7	16.7	Herfy AB

Source: Company data, Al Rajhi Capital

We arrive at a target price of SAR110.0 per share for Herfy

We arrive at a target price per share of SAR110.0 for Herfy by assigning a weight of 80% to the long-run EVA method (SAR113.8 per share), and 20% weight to the multiples method (SAR98 per share).

We expect Herfy's revenues to exceed SAR1bn by 2014

Income Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue	**580**	**709**	**835**	**958**	**1,074**
Cost of Goods Sold	(387)	(482)	(570)	(652)	(723)
Gross Profit	**193**	**226**	**264**	**306**	**351**
Government Charges					
S.G. & A. Costs	(69)	(78)	(87)	(108)	(121)
Operating EBIT	**124**	**148**	**178**	**199**	**230**
Cash Operating Costs	(423)	(520)	(609)	(703)	(787)
EBITDA	157	188	225	255	287
Depreciation and Amortisation	(34)	(40)	(47)	(56)	(57)
Operating Profit	**124**	**148**	**178**	**199**	**230**
Net financing income/(costs)	(0)	(1)	(1)	2	3
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	4	3	7	7	7
Other Expenses					
Net Profit Before Taxes	**128**	**150**	**184**	**208**	**240**
Taxes	(3)	(4)	(5)	(5)	(6)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	**124**	**147**	**180**	**203**	**234**
Dividends	(81)	(90)	(105)	(105)	(120)
Transfer to Capital Reserve					

We expect Herfy to increase its DPS for this year to SAR3.5

	12/10A	12/11A	12/12E	12/13E	12/14E
Adjusted Shares Out (mn)	27.00	30.00	30.00	30.00	30.00
CFPS (SAR)	5.85	6.55	7.57	8.64	9.72
EPS (SAR)	4.60	5.15	6.00	6.76	7.81
DPS (SAR)	2.981	3.000	3.500	3.500	4.000

Revenue growth to remain strong

Growth	12/10A	12/11A	12/12E	12/13E	12/14E
Revenue Growth	12.0%	22.2%	17.8%	14.8%	12.1%
Gross Profit Growth	13.9%	17.3%	16.9%	15.9%	14.6%
EBITDA Growth	8.3%	19.6%	19.7%	13.3%	12.6%
Operating Profit Growth	9.1%	19.8%	19.9%	11.8%	15.6%
Net Profit Growth	8.4%	18.0%	22.6%	12.8%	15.4%
EPS Growth	-25.7%	11.8%	16.5%	12.8%	15.4%

Looking ahead, we expect improvements in margins

Margins	12/10A	12/11A	12/12E	12/13E	12/14E
Gross profit margin	33.3%	31.9%	31.7%	32.0%	32.7%
EBITDA margin	27.1%	26.6%	27.0%	26.6%	26.7%
Operating Margin	21.3%	20.9%	21.3%	20.7%	21.4%
Pretax profit margin	22.0%	21.2%	22.1%	21.7%	22.4%
Net profit margin	21.4%	20.7%	21.5%	21.2%	21.8%

Other Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
ROCE	30.8%	31.8%	32.4%	30.7%	30.1%
ROIC	38.7%	40.2%	41.4%	38.8%	39.8%
ROE	35.7%	35.8%	37.5%	35.6%	34.6%
Effective Tax Rate	2.7%	2.4%	2.5%	2.5%	2.5%
Capex/Sales	14.3%	14.5%	15.6%	12.0%	12.5%
Dividend Payout Ratio	64.8%	61.4%	58.4%	51.8%	51.2%

Herfy is not cheap, trades on a forward PE of 15.7x

Valuation Measures	12/10A	12/11A	12/12E	12/13E	12/14E
P/E (x)	23.1	20.6	17.7	15.7	13.6
P/CF (x)	18.2	16.2	14.0	12.3	10.9
P/B (x)	7.5	7.3	6.1	5.2	4.3
EV/Sales (x)	4.9	4.3	3.8	3.3	3.0
EV/EBITDA (x)	18.2	16.1	14.2	12.5	11.1
EV/EBIT (x)	23.2	20.4	17.9	16.0	13.9
EV/IC (x)	8.0	7.6	6.4	5.7	4.5
Dividend Yield	2.8%	2.8%	3.3%	3.3%	3.8%

Source: **Company data, Al Rajhi Capital**

Balance Sheet (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Cash and Cash Equivalents	50	58	61	96	68
Current Receivables	24	20	23	27	38
Inventories	48	65	73	84	86
Other current assets	51	57	63	63	63
Total Current Assets	**173**	**201**	**220**	**268**	**254**
Fixed Assets	321	382	466	524	601
Investments	4	4	4	4	4
Goodwill	-	-	-	-	-
Other Intangible Assets	-	-	-	-	-
Total Other Assets	1	1	0	0	0
Total Non-current Assets	**326**	**386**	**470**	**529**	**605**
Total Assets	**499**	**587**	**690**	**797**	**859**
Short Term Debt	13	15	16	16	16
Accounts Payable	25	36	43	49	43
Accrued Expenses	30	37	43	49	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	**71**	**92**	**105**	**114**	**59**
Long-Term Debt	21	26	29	29	29
Other LT Payables	-	-	-	-	-
Provisions	26	30	36	36	36
Total Non-current Liabilities	**47**	**56**	**65**	**65**	**65**
Minority interests	-	-	-	-	-
Paid-up share capital	270	300	300	300	300
Total Reserves	110	140	220	318	436
Total Shareholders' Equity	**380**	**440**	**520**	**618**	**736**
Total Equity	**380**	**440**	**520**	**618**	**736**
Total Liabilities & Shareholders' Equity	**499**	**587**	**690**	**797**	**859**

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Net Debt (SARmn)	(16)	(16)	(16)	(51)	(23)
Net Debt/EBITDA (x)	0.10-	0.09-	0.07-	0.20-	0.08-
Net Debt to Equity	-4.2%	-3.7%	-3.1%	-8.3%	-3.2%
EBITDA Interest Cover (x)	340.5	353.7	255.3	(107.4)	(83.5)
BVPS (SAR)	14.08	14.65	17.34	20.60	24.53

We expect cash from operating activities to remain strong

Cashflow Statement (SARmn)	12/10A	12/11A	12/12E	12/13E	12/14E
Net Income before Tax & Minority Interest	**128**	**150**	**184**	**208**	**240**
Depreciation & Amortisation	34	40	47	56	57
Decrease in Working Capital	(3)	0	3	(5)	(69)
Other Operating Cashflow	1	1	(2)	(5)	(6)
Cashflow from Operations	**159**	**192**	**233**	**254**	**223**
Capital Expenditure	(83)	(103)	(130)	(115)	(134)
New Investments	-	-	-	-	-
Others	1	2	-	-	-
Cashflow from investing activities	**(82)**	**(101)**	**(130)**	**(115)**	**(134)**
Net Operating Cashflow	**78**	**91**	**103**	**140**	**89**
Dividends paid to ordinary shareholders	(61)	(87)	(99)	(105)	(116)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(8)	-	-	-	-
Cashflow from financing activities	**(45)**	**(80)**	**(96)**	**(105)**	**(116)**
Total cash generated	33	11	7	35	(28)
Cash at beginning of period	20	50	58	61	96
Implied cash at end of year	**53**	**61**	**65**	**96**	**68**

Looking ahead, we expect Capex to slightly decline

Ratios	12/10A	12/11A	12/12E	12/13E	12/14E
Capex/Sales	14.3%	14.5%	15.6%	12.0%	12.5%

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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