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Event Update

SADAFCO - Possible Impact Of SNZMP Divestment

SADAFCO – Event Update

Saudia Dairy & Foodstuff Company (SADAFCO) has recently entered in a process to make decision regarding the liquidation or remain invested in Saudi New Zealand Milk Product Company (SNZMP). The company has 51.0% stakes in SNZMP and the decision to divest or maintain the investment is schedule to be finalized by the end of Dec 2009. We believe a positive impact of non-recurring gain on the company's 3Q2009-10 (as per SADAFCO fiscal year end) profitability in case of successful divestment of SNZMP holding. In addition, the value of investment in SNZMP by SADAFCO was recorded at SR7.7mn by the end of last fiscal year end (Mar 2009).

Based on our understanding, SNZMP has limited contribution in the company's bottom line. Thus, even in the case of divestment we are not considering any major impact on the profitability and valuation of SADAFCO.

SNZMP is a private limited company and deals in the production of powder milk, processed cheese and cream with the production capacity of 15,000 tons of milk powder and 5,000 tons of cheese per year. Main brands of SNZMP are (i) Anchor, (ii) Anlene, (iii) Chesdale, (iv) Fernlead, (v) Fonterra and (vi) Mainland. Furthermore, SADAFCO has also signed a Memorandum of Understanding (MoU) with Milk Product Holdings and New Zealand Milk International to study the plan. It is worth to mention that Milk Product Holdings (MPH) already has 49.0% stakes in SNZMP. This indicates that we cannot rule out the possibility of MPH to become the major stakeholder of SNZMP. It is worth to mention that under SADAFCO consolidated accounts SNZMP it is not treated as the subsidiary. Hence, there will be no impact on the sales revenue of SADAFCO in case of divestment but there will be lower income from investments going forward. The company has recorded investment income of SR1.5mn by the end of 2Q2009 (as per SADAFCO fiscal year).

Considering the divestment of SNZMP and rise in other income, the company's profitability is expected to show an upward movement during FY2009-10. If this will be the case, the company will not be able to get investment income from SNZMP in future thus there will be a minimal downward impact in the profitability.

Table 1: Impact On EPS

EPS (SR)	FY2009-10E	FY2010-11E	FY2011-12E	FY2012-13E
Divestment - 30.0% Gain	3.7	3.8	4.1	4.2
Divestment - 10.0% Gain	3.6	3.8	4.1	4.2
Base	**3.4**	**3.9**	**4.2**	**4.3**
Divestment - 10.0% Loss	3.6	3.8	4.1	4.2
Divestment - 30.0% Loss	3.5	3.8	4.1	4.2

*Source: Company Press Release, Zawya & **Global** Research*

As the company has not given exact date of liquidation of investment from SNZMP so we are unsure to take the impact effectively. However, it is also uncertain whether the company will divest or not. So in order to facilitate investors, we have done analysis and determined the possible impact of divestment of SNZMP investments on the company's expected profitability.

Table 2: Scenaria Analysis

SR mn	If Divestment in 3Q2009-10E	If Divestment in 4Q2009-10E	Fair Value
Divestment - 30.0% Gain	39.3	39.5	41.9
Divestment - 10.0% Gain	37.9	38.1	41.9
Base Profitability	**30.5**	**31.2**	**41.6**
Divestment - 10.0% Loss	36.1	36.7	41.8
Divestment - 30.0% Loss	34.7	35.6	41.8

*Source: Company Press Release, Zawya & **Global** Research*

However, based on the expected divestment the rise in other income during FY2009-10, will not have impact on the free cash free cash flows but there will be an increase in the company's cash reserves, which will make minimal positive impact on the company's valuation. At present the stock is trading at a market price of SR44.2 (as on 07th Dec 2009) and shows a premium of 5.8% to our base fair value of SR41.6. We, therefore, recommend **HOLD** for the stock.

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