الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

March 2024

المطاحن الحديثة
MODERN MILLS

Modern Mills for Food Products Co.
Initiation Coverage Report

Seeding their expansions ahead of the growing food demand; paving the way towards market leadership in KSA

Senior Equity Analyst
Fahad Qureshi, CFA
+966 11 225 6315
f.irfan@aljaziracapital.com.sa

Table of contents

Initiate with "Overweight" rating, backed by 40% addition in flour milling capacity and increasing animal feed utilization rate

Modern Mills is well positioned to benefit from the robust industry growth which is poised in the flour/animal feed/animal bran space due to growing consumption from bakeries and food manufacturers, population expansion, increased tourism and government's investments to expand poultry and livestock production. The animal feed/flour/animal bran industry is expected to grow at 4.6/4.4/2.9% CAGR over FY22-30E. MMC has delivered a revenue CAGR of 29.6% over FY19-22, company's planned capacity expansion is likely to be the backbone of MMC's growth story, which could drive revenues at 7.1% CAGR over FY22-28E to reach SAR 1,474mn. We highlight planned de-subsidization of the industry in July 2025 as a key event for MMC. We expect the company to pass on price increase in the flour segment and don't expect a price war in case of subsidy withdrawal. However, animal feed business has little room to pass on prices, and can see margin contraction – 30% reduction in subsidy would result in a 16% reduction in 2028E earnings. That said, we see high chances of subsidy being continued as total subsidy of SAR 3.5bn is insignificant in the context of national budget. We initiate coverage on Modern Mills with an "Overweight" rating and a TP of SAR 71.1/share

Planned 1500MT capacity expansions to drive revenue growth and enable Modern mills to further enhance market share: MMC has plans to increase the production capacity of wheat flour and animal feed, to arrest the growing demand patterns and the investment plans by the Saudi government. By Q1-25, it plans to double its daily wheat flour production capacity of Al-Jumum facility, from 1,200 MT to 2,450 MT, thereby making it the largest production line in KSA. Further it also has plans to increase the daily animal feed production capacity of Khamis Mushait from 1,650 MT to 1,800 MT. We believe these expansion plans will drive a 7.1% revenue CAGR over FY22-28E to reach SAR 1,474mn by FY28E. We expect the flour business to grow the fastest at 7.4% CAGR over FY22-28E, followed by animal bran at 7.0% CAGR and animal feed at 6.8% CAGR.

MMC to benefit from growth in the industry, driven by growing population, tourism & localization of livestock production: The market size of the animal feed/ wheat flour/ animal bran industry in which MMC operates, is expected to grow at 4.6%/ 4.4%/ 2.9% CAGR over FY22-30, driven by i) population expansion, increased tourism activities; ii) growing demand pattern from bakeries and food manufacturers; and iii) increasing KSA's food self-sufficiency through investments to expand poultry and livestock production. We believe MMC will be at forefront to reap this industry growth, as it derives 98% of its revenues from B2B customers, which includes bakeries. Further the planned capacity expansion will make its production facilities the largest in Saudi Arabia, thereby enabling it to close the market share gap with its peer (First Milling).

Well-diversified geographically, customer wise and product wise: MMC's three production facilities located at South, West and Northern regions of KSA are strategically located and enable MMC to distribute its products across the entire KSA. Further they can also aid MMC to reap the benefits of exports when it embarks on its journey of expansion into other geographies. Moreover, the company has a wide variety of customers including bakeries, HoReCa sector and industrial sector, hence it does not rely on few customers or sectors. We also highlight that Increasing overall mix of unregulated flour (convenient sizes, where pricing is unrestricted), value added products (superior flour, brown flour gluten free) and animal feed business has created a well-diversified product portfolio for the company which has materially reduced operational risk and would also limit the impact of any potential cut in subsidy.

Recommendation	Overweight
Target Price (SAR)	71.1
Upside / (Downside)*	48.0%

Source: Tadawul *upside from the IPO price

Key Financials

SARmn (unless specified)	FY22	FY23E	FY24E	FY25E
Revenue	978	968	997	1,125
Growth %	76.2%	-1.0%	3.0%	12.9%
Gross Profit	366	357	365	407
Net Income	233	207	222	258
Growth %	193.0%	-11.0%	6.8%	16.4%
EPS	2.85	2.54	2.71	3.15
DPS	2.17	0.8	1.1	1.6

Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23E	FY24E	FY25E
Gross Margin	37.4%	36.9%	36.6%	36.2%
Net Margin	23.8%	21.4%	22.2%	22.9%
ROE	168.7%	94.3%	65.3%	50.9%
ROA	20.0%	17.8%	17.2%	18.0%
P/E (x)	16.9	18.9	17.7	15.3
P/B (x)	22.0	15.0	9.4	6.6
EV/EBITDA (x)	13.5	14.2	12.1	10.2

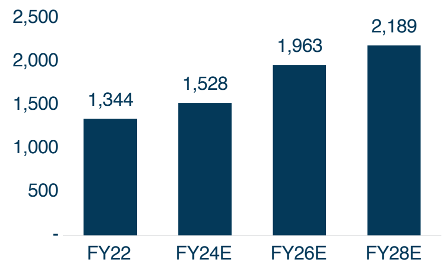
Source: Company reports, Aljazira Capital

Key Market Data

IPO price (SAR per share)	48.0
Market Cap at IPO price (SAR bn)	3.9
Share Outstanding (mn)	81.8

Source: Company reports, Aljazira Capital

Production (000's tons)



Source: Company reports, Aljazira Capital

Balanced business mix enabled MMC to outpace First Milling on multiple fronts: in the recent past, MMC has not only outperformed First Milling on overall revenue growth, but also in each business segment. Overall MMC's revenues grew at 29.6% CAGR over FY19-22 versus 12.4% for First Milling. This outperformance was largely due to MMC's intuitive strategy of having a balanced revenue mix between flour and animal feed/bran, unlike First Milling, whose business is skewed towards flour business. This strategy enabled MMC to leverage the increased government focus on boosting animal feed production. Moreover, MMC has delivered 2022 ROE of 169% vs 31% for FMC, MMC has better leverage level 1.9x Net debt/EBITDA in 9M-23 vs 4.0x for FMC, and MMC has gained market share by 400bps over 2021-22 while FMC has lost share by 500bps.

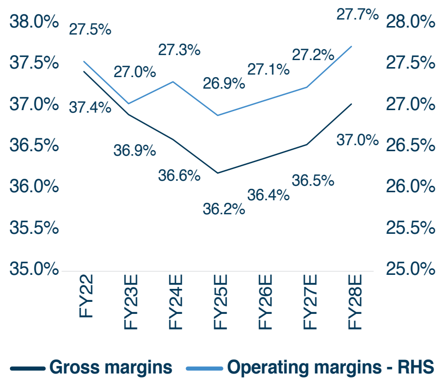
Net profit margins to remain resilient despite capacity expansions: MMC's net profit margins have expanded from 8.9% in FY19 to 23.8% in FY22 at the back of commanding pricing power in the animal feed business by aligning its prices with the market prices and improved market share in the wheat flour business. We believe these levels are sustainable in the long run, due to i) revenue growth by capacity expansion; ii) focus on the unregulated animal feed business; iii) operating leverage at play. However, we expect the net profit margins to be impacted in the near term due to the capacity expansion, but over FY22-28E we expect them to expand from 23.8% levels in FY22 to 26.1% in FY28E.

Efficient working capital and cash flow considerations to aid in debt level reduction: Efficient control can be seen in MMC's cash conversion cycle which reduced from 72 days in FY19 to 18 days in FY22, at the back of better inventory management, thereby enabling it to have the industry leading inventory days at 35 days (versus 83 days at First Milling). Better working capital management has enabled MMC to have strong cash flow metrics with its CFO/Operating income metric consistently staying beyond 100%. These financial efficiencies can aid MMC to reduce its debt levels, fund future expansion plans or increase its shareholder payouts.

The impact of likely withdrawal of subsidies is expected to be passed through to customers in flour business, however margins in feed business can be affected: MMC procures wheat from GFSA at a subsidized rate, which currently is SAR 180 per ton, regardless of international price. Following the Company's privatization, the GFSA committed to maintaining a SAR 320 per ton price difference between the unified purchase cost of wheat from all member countries and the selling price of flour products to end-users (~SAR 500 per ton depending on bulk packaging or 45 kg packs) until the end of the period of price stability in July 2025. The subsidy which MMC receives from GFSA for the purchase of raw materials to produce wheat, is likely to get lifted partially or completely from July 2025. If the subsidy is lifted then the cost increases are likely to be passed through to customers in flour segment, as had been in the case of dairy products. That said margins in feed business can come under pressure, as bran is being sold at international parity prices, hence there is little room for price increase once wheat is de-subsidized. There is high likelihood that subsidy would not be removed in one shot, and rather it would be reduced in a gradual manner over a few years. In addition, it is also highly probable that subsidy is reduced and not fully removed, a 30% reduction in total subsidy will negatively impact our 2028 earnings estimates by ~16%. There is also a possibility of subsidy being extended, given that the cumulative impact of subsidy of SAR 3.5bn is immaterial in the context of national budget. Whereas the impact of subsidy removal can sizably increase domestic flour prices.

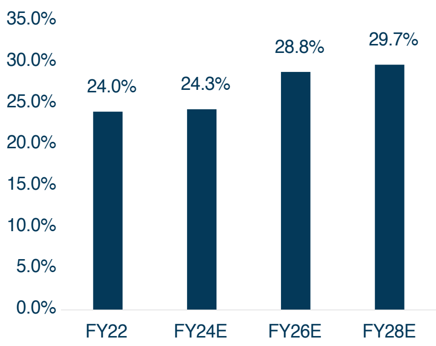
Valuation: MMC's capacity expansion plan is the backbone of the company's growth story. The expansion plan is supported by the i) growing wheat flour demand patterns from bakeries and food manufacturers; and ii) government's plans to expand the poultry and livestock production by increasing investments. These capacity expansions will enable MMC to close its gap with First Milling in the wheat flour business and enhance its market position in the animal feed industry. Overall, we expect the company to deliver revenue CAGR of 7.1% over FY22-28E to reach SAR 1,474mn by FY28E. this would translate to net income CAGR of 8.7% over the same period. We expect gross margins to see slight attrition in the near term, however margins would recoup to ~37% over the medium term. We value the stock with 50% weightage to DCF (WACC=8.7%, terminal growth rate=2.75%) and 50% weight to PE to arrive at a TP of **SAR 71.1/share**, implying 48.0% upside.

Gross and operating margins



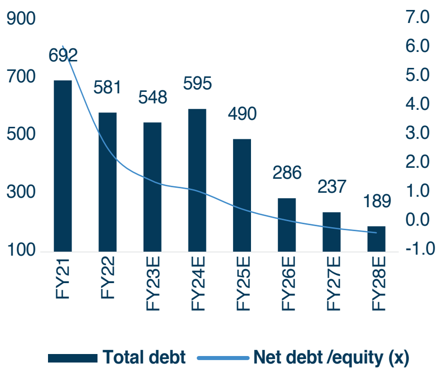
Source: Company Prospectus, AlJazira Capital research

Market share by volume



Source: Company Prospectus, AlJazira Capital research

Leverage level



Source: Company Prospectus, AlJazira Capital research

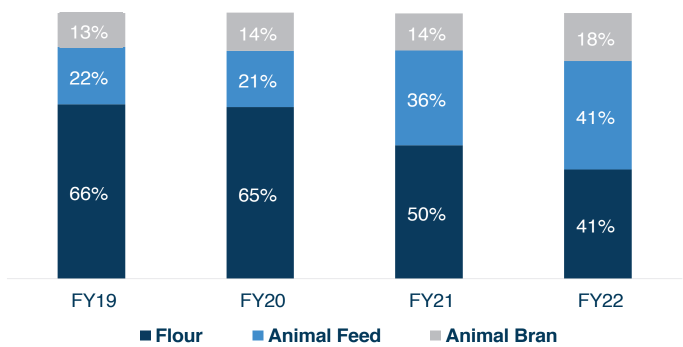
Company Overview

Having incorporated as a company in 1972, pursuant to Ministerial Resolution, Modern Mills (MMC) has undergone various business transitions as an outcome of regulatory changes. After commencing its operations as a separate entity in 2017, Modern Mills invested its complete focus in producing flour, animal feed and animal bran, and embarking its recent foray into value added items like gluten-free products. It is one of the key milling companies in the Kingdom with a revenue base of SAR 691.1mn as on 9MFY23 and capturing a whopping 24% market share (by volume) in the flour business as on FY22. Its 3 manufacturing facilities are strategically located in the Southern, Western and the Northern regions of the Kingdom with a daily wheat production capacity of 3,450 tons and 1,400 tons of daily animal feed production.

Brief overview of business segments

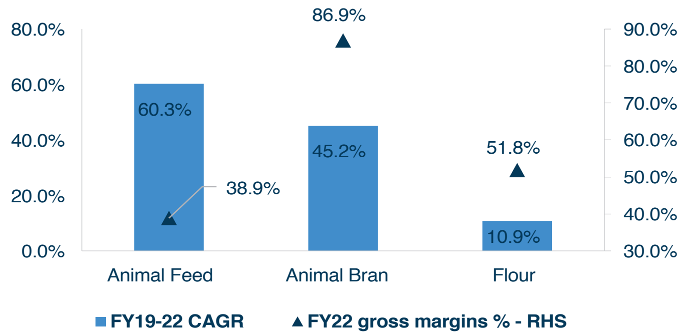
MMC manufactures products for both human and animal consumption and its main business activities revolve around producing flour, animal feed and animal bran. Historically its business was skewed towards the production of flour, however in recent years it has increased its focus on expanding the animal feed business.

Fig 1: Revenue mix changed from flour focused to animal feed and bran focused, where it has leadership position among other milling companies



Source: Company Prospectus, AlJazira Capital research

Fig 2: MMC has the biggest feed milling capacity, enabling it to capture 7% of national animal feed market in FY22, and achieve highest growth rate over FY19-22



Source: Company Prospectus, AlJazira Capital research

1. Flour business

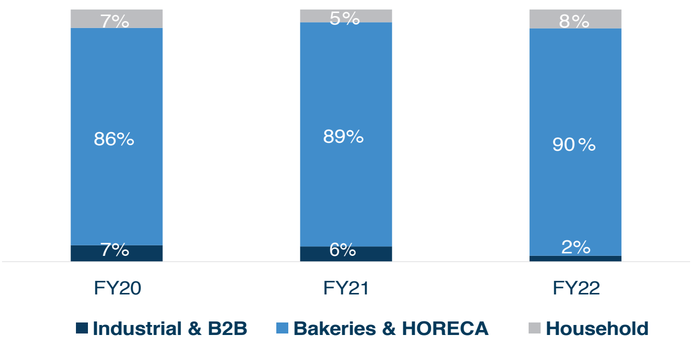
The company produces flour products and caters to large bakeries, food manufacturers, HORECA and retail consumers. To establish a market leading position, MMC manufactures products in various quantities, ranging from 1kg to 45kg which enables it to cover various types of customers in the retail market. It recently launched retail brands for low tier to premium tier customer classes indicating its strategy of categorization.

Fig 3: MMC covers almost the majority of consumer of the retail industry, indicating a diversified presence in the consumption value chain. MMC's top-10 flour customers account for 31% of flour revenues as on FY22

Customer category	Use-case
Industrial & B2B	• Commercial use by large businesses • Bulk purchases, usually 45kg packets • Comprises of industrial manufactures, large bakeries
Bakeries and HORECA	• Commercial use • Purchase 10kg to 45kg packets • Comprises of hospitality chains, restaurants, cafes and small bakeries
Household	• Private consumption • Purchase 1kg to 10kg packets • Comprises of individual consumers

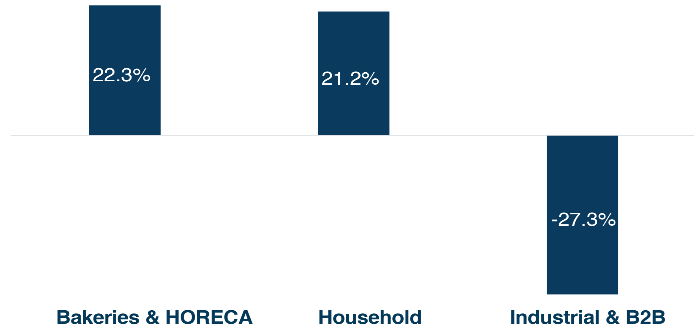
Source: Company Prospectus, AlJazira Capital research

Fig 4: Company's focus has always been on bakeries and HORECA type of customers for its flour business



Source: Company Prospectus, AlJazira Capital research

Fig 5: Bakeries and HORECA have also been the fastest growing customer type over FY20-22

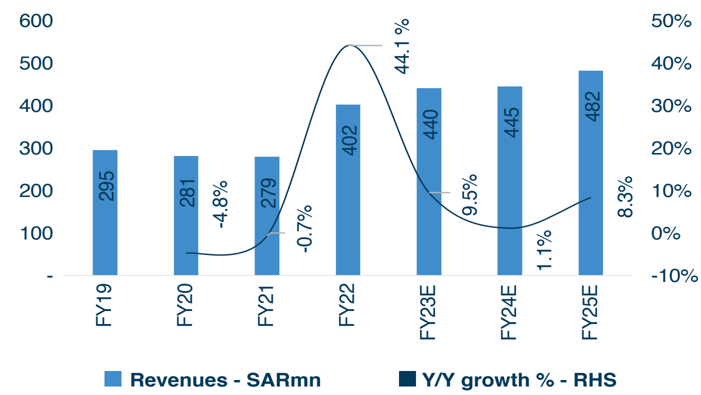


Source: Company Prospectus, AlJazira Capital research

Over the years the revenue contribution from this business segment has reduced from 66% in FY19 to 41% in FY22, however since FY21 the company has experienced significant growth in its market share which increased from 20% in FY21 to 24% in FY22, on volume basis. This market share increase was at the back of proactive marketing, improved quality consistency and improved customer engagement, which enabled it to narrow the gap with the industry leader.

The primary raw material required for producing flour is wheat, which MMC procures from the General Food Security Authority (GFSA) at subsidized rates under the terms of its Wheat Supply Agreement. The wheat purchases from GFSA comprised 42% of the company's total raw material costs in FY22. Despite procuring the raw material at a subsidized rate, gross margins of this business segment hover around 52% as per our calculations due to government regulating the sale price of flour packets exceeding 10kg, which is where MMC focuses the most. The company plans on 1250MT per day expansion in flour mill in Al Jummum in 2025, total flour milling capacity is expected to be increased by ~40% over the medium term.

Fig 6: Internal turnaround strategies devised led to a sharp 44% Y/Y increase in flour business revenue



Source: Company Prospectus, AlJazira Capital research

Fig 7: Turnaround increased production & sales quantity, thereby aiding it to increase its market share to 24% in FY22

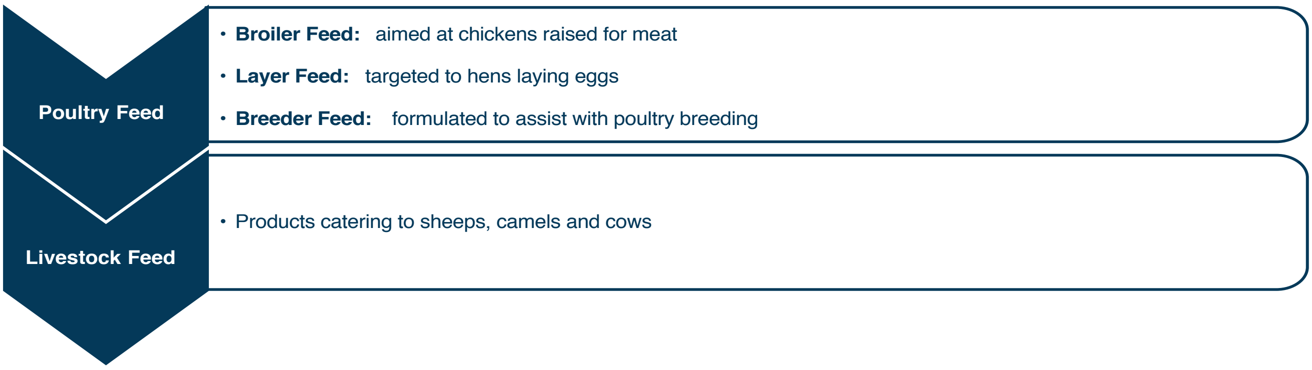
Particulars	FY20	FY21	FY22	FY23E	FY24E	FY25E
Revenues - SARmn	281	279	402	440	445	482
Y/Y growth %	-4.8%	-0.7%	44.1%	9.5%	1.1%	8.3%
Production qty – 000's tons	526	538	818	782	889	1008
Sales qty – 000's tons	531	547	802	784	844	907

Source: Company Prospectus, AlJazira Capital research

2. Animal Feed business

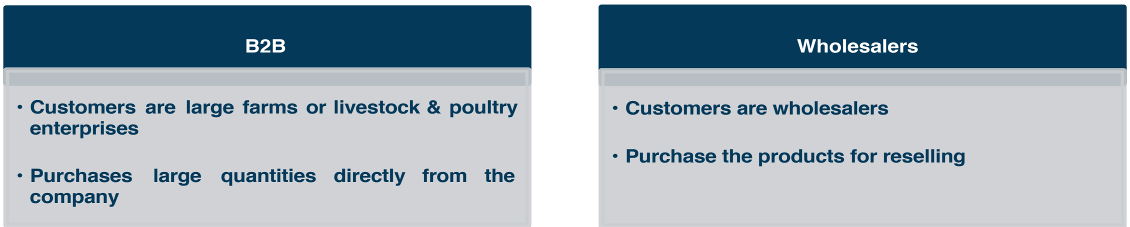
The company produces animal feed products under the brand name 'Premier' with prime focus on animal productivity and health. The products are typically sold in large packs of 40kg and 50kg to wholesalers and poultry farms. The company has developed a market leadership position both in terms of quality and production capacity, which is the largest among other milling companies.

Fig 8: Animal feed products offer synergistic value in other product offerings of MMC due to utilization of identical capabilities through a similar manufacturing process and utilizing by-products of flour business as a feedstock



Source: Company Prospectus, AlJazira Capital research

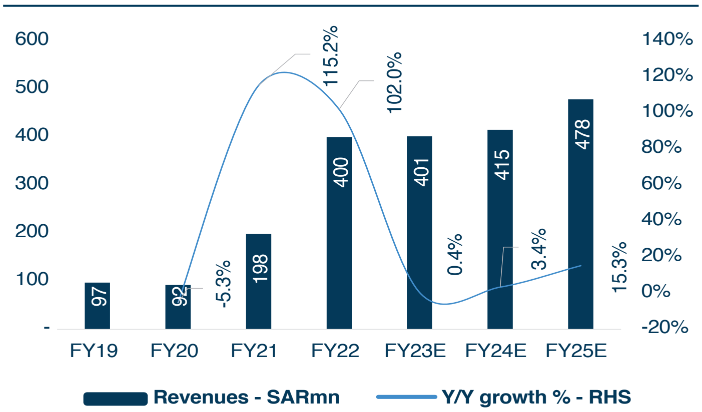
Fig 9: Animal feed business focuses largely on B2B customers, with top-10 customers accounting for 54% of animal feed and bran revenues in FY22



Source: Company Prospectus, AlJazira Capital research

The revenue contribution from this business segment has increased from 22% in FY19 to 41% in FY22, largely due to the increased government incentives for agricultural producers to scale up poultry and livestock production to improve self-sufficiency in the Kingdom. The raw material required for producing animal feed is the by-product of flour production (eg wheat bran) which is used as a feedstock for producing animal feed. The other raw materials required for producing animal feed, such as yellow corn, barley and the likes, are procured from the local and international markets. In FY22 the imports accounted for 58% of total raw material costs and the balance was sourced locally. Based on our calculations, this business segment operates at around 39% gross margin levels. Since the pricing of animal feed products is not regulated by the government, the company can demand higher prices for the higher quality of products offered. We expect growth in feed business to be driven by increased utilization, which is likely to reach 100% in 2026.

Fig 10: Increasing utilization rate aided MMC to drive 60.3% revenue CAGR over FY19-22



Source: Company Prospectus, AlJazira Capital research

Fig 11: Unregulated pricing of animal feed products and superior product quality aided MMC to command pricing power and enhance its unit economics

Particulars	FY20	FY21	FY22	FY23E	FY24E	FY25E
Revenues - SARmn	92	198	400	401	415	478
Y/Y growth %	-5.3%	115.2%	102.0%	0.4%	3.4%	15.3%
Production qty – 000's tons	108	168	244	342	377	416
Sales qty – 000's tons	109	161	246	228	251	284

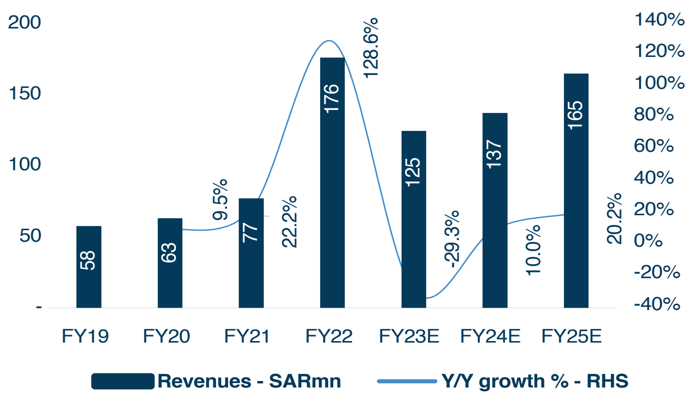
Source: Company Prospectus, AlJazira Capital research

3. Animal Bran business

The animal bran is produced as a by-product of the flour milling process. The company produces wheat bran which is used captively for animal feed production and sells the remaining portion to appointed distributors, primarily in large packs of 40kgs and beyond.

The revenue contribution from this business segment increased from 13% in FY19 to 18% in FY22 at a 45.2% CAGR, largely on account of adjusting the prices to align with the market prices, along with the increased government incentives for agricultural producers to scale up poultry and livestock production to improve self-sufficiency in the Kingdom. Based on our calculations, this business segment operates at around 87% gross margin levels. Since the pricing of animal feed products is not regulated by the government, the company can demand higher prices for the higher quality of products offered.

Fig 12: Support from government and aligning product prices with market prices enabled MMC to drive 45.2% revenue CAGR over FY19-22



Source: Company Prospectus, AlJazira Capital research

Fig 13: Unregulated pricing of animal bran products aided MMC to command pricing power and enhance its unit economics

Particulars	FY20	FY21	FY22	FY23E	FY24E	FY25E
Revenues - SARmn	63	77	176	125	137	165
Y/Y growth %	9.5%	22.2%	128.6%	-29.3%	10.0%	20.2%
Production qty – 000's tons	171	191	282	228	263	302
Sales qty – 000's tons	107	109	178	142	164	193

Source: Company Prospectus, AlJazira Capital research

Group Structure

The company is led by Chairman Dr. Ibrahim Al Rajhi and CEO Mr. Osama Ashi. The management team has extensive experience in the FMCG sector with a proven track-record of commercial success and value creation. The company also has one subsidiary called Hasad Al-Arabia, which is actually the distribution arm of MMC.

Fig 14: MMC incorporated subsidiary in FY22 to facilitate the distribution of company's branded products and serve as its distribution arm

Subsidiary	Revenues	Business
Hasad Al-Arabia	SAR 6.6mn* amounting to 0.7% of group revenues	™ Wholesaler of food grains and livestock feed additives ™ Storage of agricultural products

Source: Company Prospectus, AlJazira Capital research. *SAR 6.6mn is annualized revenues for FY23

IPO Offering Summary

MMC is floating 24.5mn shares, representing 30.0% of the company's share capital, with a fully paid nominal value of SAR 1 per share. The IPO is divided into two tranches: one for institutional investors and the other for retail investors. The institutional investors will be allocated 100% of the offered shares. If retail investors fully subscribe to their allocated shares, the financial advisor will have the right to reduce the number of their allocated shares to 90% of the total offered shares. The subscription period for institutional investors and the book building process was open from February 15, 2024 to February 21, 2024 and was oversubscribed 127x. The final offer price is set at SAR 48 per share.

Ownership (Pre and Post IPO)

Fig 15: Mada International, Al Ghurair and Masafi, the existing shareholders selling their stake to public investors and towards treasure shares

Shareholder name	Pre-IPO ownership		Post-IPO ownership	
	No. of shares (in mn)	% ownership	No. of shares (in mn)	% ownership
Mada International	40.9	50.0%	28.2	34.5%
Al Ghurair Foods	36.8	45.0%	25.4	31.0%
Masafi Company	4.1	5.0%	2.8	3.4%
Treasury shares	0.0	0.0%	0.8	1.0%
Public investors	0.0	0.0%	24.5	30.0%
Total	**81.8**	**100%**	**81.8**	**100%**

Source: Company Prospectus, AlJazira Capital research

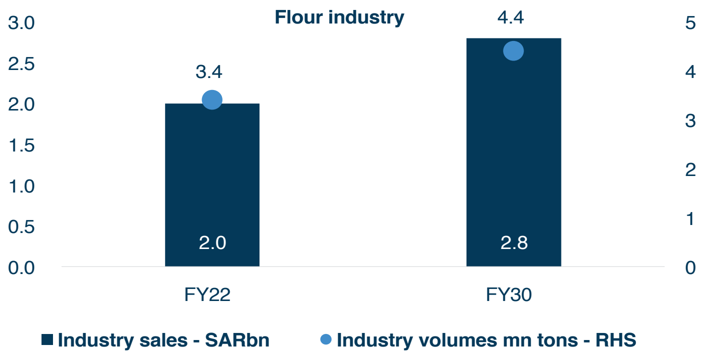
Competitive Advantages

1. Attractive industry fundamentals with resilient and protected growth

Flour consumption in KSA stands at 3.4mn tons in FY22 and is expected to grow at 3.2% CAGR over FY22-30E to 4.4mn tons, driven by i) population expansion especially in Riyadh; ii) increased tourism in the southern and western regions; iii) increased government investments in form of infrastructure expansion. KSA is not only going to benefit from volume growth, but the sales value of the flour industry too is expected to increase from SAR 2.0bn in FY22 to SAR 2.8bn in FY30, at a 4.4% CAGR. The growth will be reflected due to i) upward price impact on unregulated products driven by inflation; and ii) diversification of use-case across multiple customer channels.

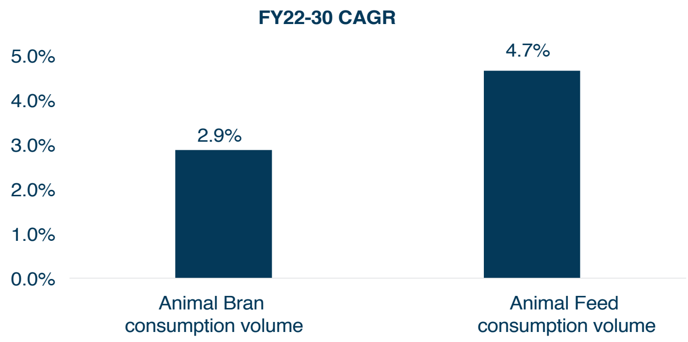
Animal feed consumption in KSA currently stands at 3.5mn tons in FY22 and is likely to grow at 4.7% CAGR over FY22-30E to 5.1mn tons. Whereas the sales value of the industry is expected to increase at 3.5% CAGR over the said period to SAR 7.7bn. The growth driver for animal feed industry is primarily the Vision 2030 objective of increasing food self-sufficiency through the continued expansion of poultry and livestock production.

Fig 16: Flour industry sales / volume to grow at 4.4 / 3.2% CAGR respectively over FY22-30 driven by population expansion and increased tourism activities



Source: Company Prospectus, Aljazira Capital Research

Fig 17: Animal feed and bran consumption volumes to be driven by increasing food self-sufficiency through expansion of poultry and livestock production



Source: Company Prospectus, Aljazira Capital Research

2. Leading local market position

MMC is among the market leaders, with a flour market share of 24% by volume in FY22. The company's leadership position is secured way of an exclusive 10-year regional flour milling contracts granted by GFSA. Further the wheat flour market in KSA is dominated by only four milling companies, capturing around 98% of the market share. This highly concentrated market acts as an entry barrier for any new entrant. MMC also holds a leadership position in the animal feed segment, with the biggest feed milling capacity among the other milling companies, with a 7% market share of the national animal feed market as on FY22.

MMC was able to achieve this leadership position through a variety of initiatives that had been undertaken over the past two years. Initiatives such as i) capital investments to enhance capacity utilization; ii) improved customer engagement; iii) product improvement through increased R&D.

3. Well-diversified operations

Although the company has 3 production facilities in the Northern, Southern and Western regions of KSA, the sales are not limited to these facilities, as the company's products are sold in other regions through the warehouses of third-party distributors. Further the locations of the production units are of strategic importance to MMC as it can aid it to reap the benefits of export driven sales when it embarks on its journey of expansion in other geographies.

Risk Factors

- **Government subsidies:** Higher dependency on procurement of raw material (wheat) from GFSA at a subsidized rate could impact company's profitability metrics and business operations once the subsidy will be withdrawn by FY25E. MMC's animal bran business is more vulnerable to the withdrawal of wheat subsidy as wheat is one of the crucial inputs for producing animal bran.
- **Imported raw materials:** Imports account for nearly 58% of the total raw material cost consumed in FY22. Most of the raw materials imported are used to produce animal feed. The company's operations are vulnerable to increases in the sourcing costs due to changes in demand and supply patterns, interest rates and other external factors.
- **Delays in capacity addition:** Any delays in capacity addition would slow down the expected business growth and might lead to a loss in market share. Additionally, as per the prospectus, the company's success and earnings growth depends on its ability to increase the sales volumes in competitive markets and find additional efficiencies in the production and extraction of flour.

Industry Overview

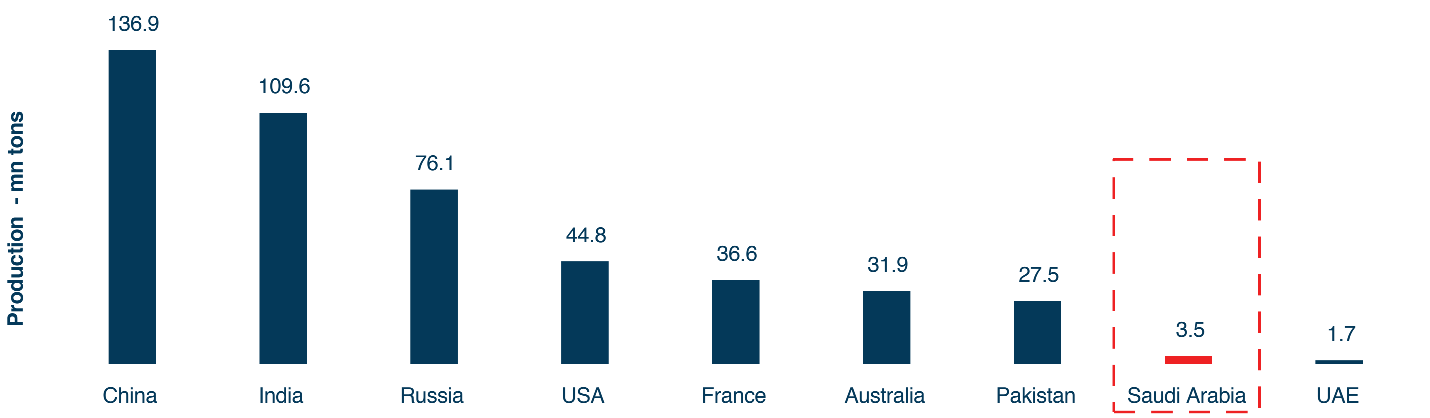
Growing demand patterns to aid Saudi's wheat and animal bran market's growth narrative till FY30E

The most cultivated food plant, wheat, supplies more nutrients for human nutrition than any other source of food, and hence is the main reason why it makes up the majority portion of diet in Saudi Arabia. Historically around 95% of the wheat consumed was imported, but in the late 1970s the government changed the agricultural policy to encourage farmers to grow new varieties of wheat along with the old varieties, thus reducing the imports.

Saudi Arabia's wheat flour market has historically grown at 6.1% CAGR over FY18-22 and is currently pegged at SAR 2.0bn in FY22. This robust growth is expected to continue till FY30E, with the wheat flour market size reaching SAR 2.8bn by FY30E, at 4.4% CAGR over FY22-30E, driven by growing demand in bakeries and consumer food service.

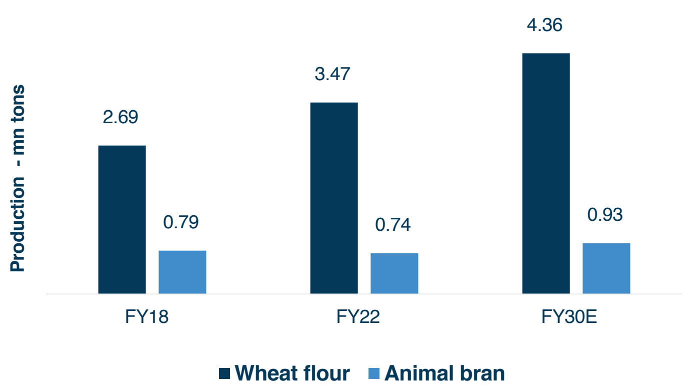
The animal bran which is produced as a by-product of the wheat milling and serves as a nutrient-rich dietary fibre is expected to be aided by growing demand for poultry meat and consistent demand for livestock animal feed. The animal bran production is likely to grow at 2.9% CAGR over FY22-30E to 0.9mn tons. However, since the animal bran prices are influenced by global wheat costs which are significantly impacted by the geopolitical concerns in Central and Eastern Europe, KSA's animal bran market could grow at 0.7% CAGR to SAR 0.7bn by FY30E. However, as global wheat production stabilizes, prices are expected to reset.

Fig 18: Saudi Arabia accounts for 0.4% of global wheat production indicating a long growth runway, which will be driven by demographic expansion, infrastructure developments supporting capacity expansion and tapping into high-potential remote and underserved regions in KSA



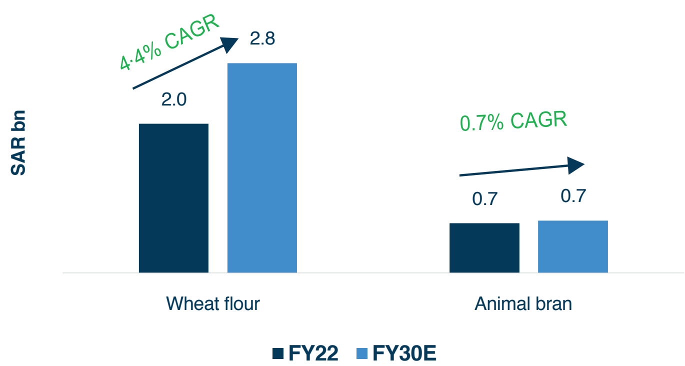
Source: GFG, AlJazira Capital research

Fig 19: Wheat production to grow from 3.5mn tons to 4.4mn tons by FY30E, whereas animal bran production to grow from 0.7mn tons to 0.9mn tons



Source: Company Prospectus, AlJazira Capital research

Fig 20: Sales value to reach SAR 2.8bn for wheat and SAR 0.7bn for animal bran. Bakeries, consumer food service and poultry meat to be the core demand drivers



Source: Company Prospectus, AlJazira Capital research

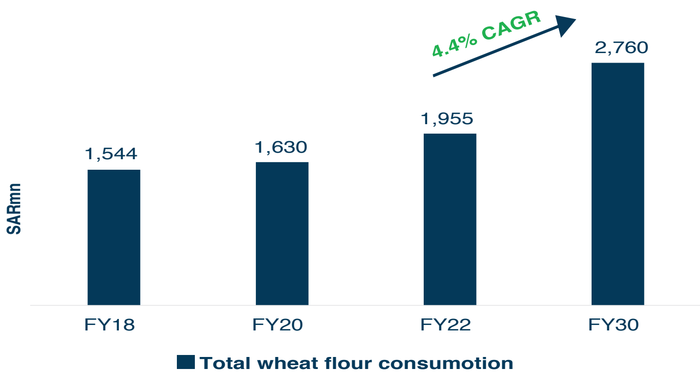
Regulated wheat flour industry growth to be driven by higher growing consumption patterns from large bakeries and food manufacturers

The wheat flour production in Saudi Arabia is heavily regulated. Traditionally GFSA has played a pre-dominant role in sourcing, storing, and distributing wheat. It has been the dominant wheat supplier to most of the milling companies, with MMC purchasing around 42% of its FY22 raw material costs from GFSA. Wheat supplied by GFSA is generally in accordance with the Wheat Supply Agreement, which is entered into for a long duration. The purchase price of the wheat from GFSA is pegged to the final sale price, effectively providing a subsidy on the wheat purchase price compared to the open market price of wheat.

In FY22, Saudi Arabia consumed 3.4mn tons of wheat, with bakeries and food manufacturers being the largest consumers who accounted for 81.5% of wheat consumption, by volume terms. These consumers generally make bulk purchases (45kgs and above) and hence 45kgs wheat packets dominate the wheat consumption in Saudi Arabia. This consumption trend has been consistent since FY18 and is also projected to continue till FY30E, thereby aiding MMC as 98% of MMC's revenues is driven by B2B customers.

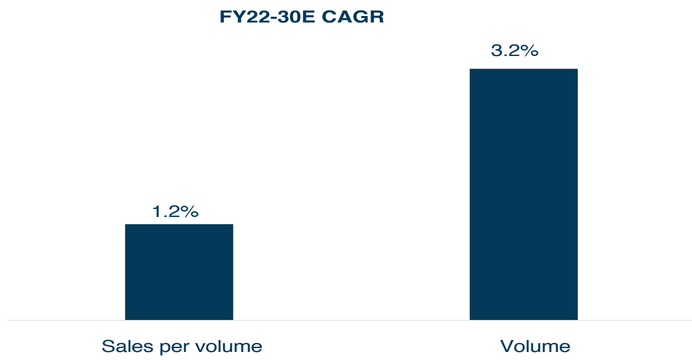
Bakeries are expected to continue being the largest wheat consumers as they are expecting a robust growth in baked products, which would be driven by i) population growth; ii) increase in consumer foodservice outlets; and iii) strong uptick in tourism. The value of baked goods is expected to rise from SAR 21.4bn in FY22 to SAR 28.0bn by FY30E, at a 5.6% CAGR over the said period.

Fig 21: Sales value of wheat flour consumption likely to increase at 4.4% CAGR from SAR 1.9bn in FY22 to SAR 2.8bn in FY30E



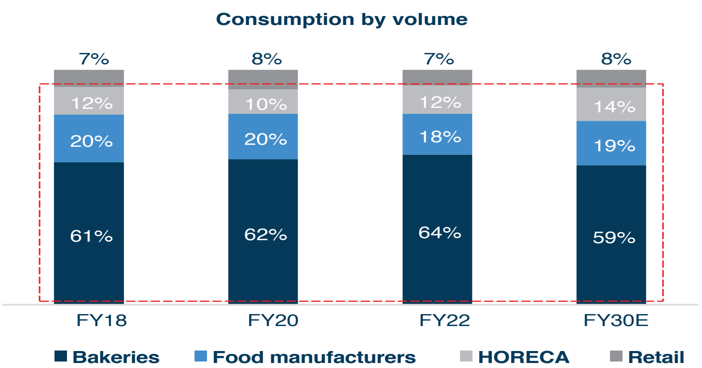
Source: Company Prospectus, Aljazira Capital Research

Fig 22: Growth to be driven largely by volumes rather than pricing power. Stronger penetration of smaller SKUs across channel to drive the volume growth



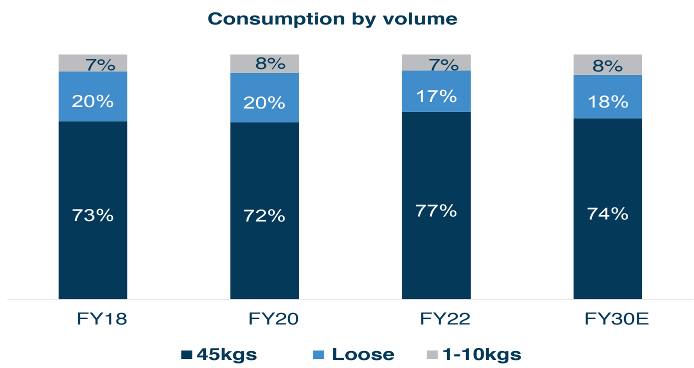
Source: Company Prospectus, Aljazira Capital Research

Fig 23: Continued dominance by bakeries, food manufacturers and HORECA to aid MMC due to higher business dependency on these categories



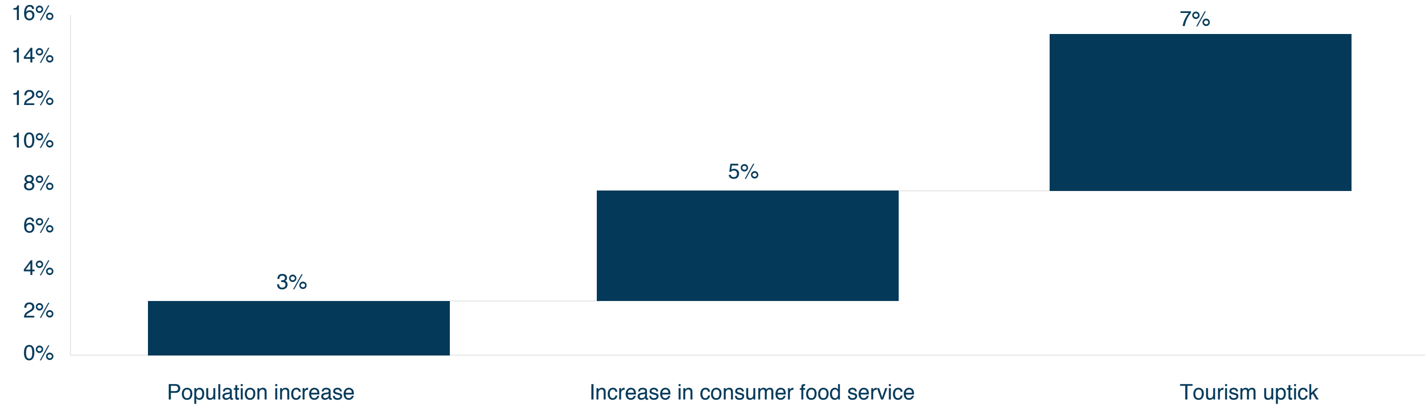
Source: Company Prospectus, AlJazira Capital research

Fig 24: With bakeries and food manufacturers constituting the majority of customer base, 45kgs of packet account for most of the consumption types



Source: Company Prospectus, AlJazira Capital research

Fig 25: Bakeries likely to witness robust demand over FY22-30 driven by high demand for baked goods. Increase in population, consumer food service outlets and surge in tourism to drive the demand for baked goods

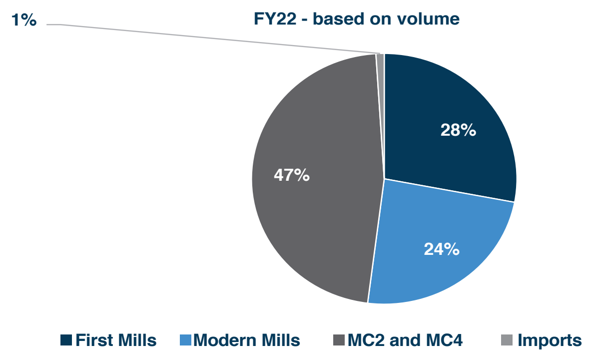


Source: Company Prospectus, AlJazira Capital research

High entry barriers in the wheat industry

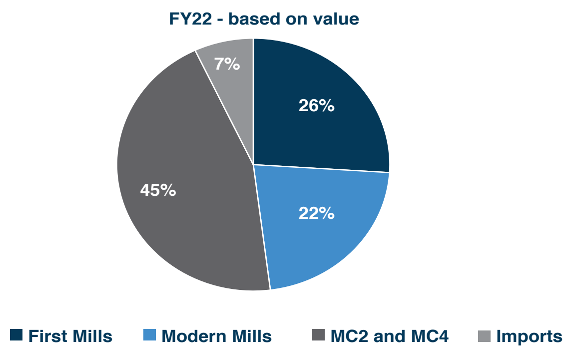
The wheat flour market is concentrated among four milling companies, which account for the majority of KSA's wheat flour production. This dominant position held by the incumbents acts as an entry barrier for any new entrants in the Kingdom's highly controlled wheat flour market.

Fig 26: Top-4 players account for 99% of the wheat industry. First Mills dominates, followed by Modern Mills



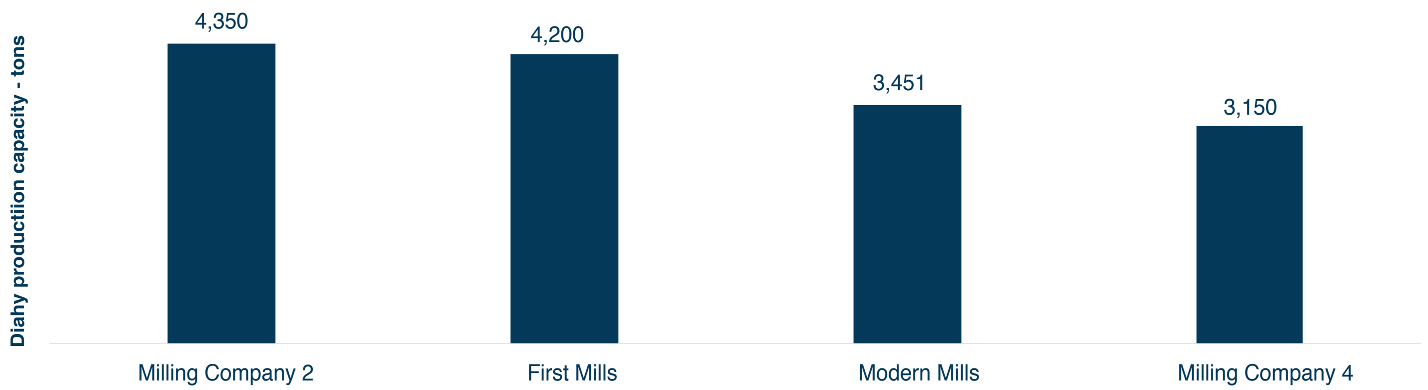
Source: Company Prospectus, AlJazira Capital research

Fig 27: Top-4 players market share dominance trend can be seen based on industry sales



Source: Company Prospectus, AlJazira Capital research

Fig 28: Milling company 2 is the largest wheat producer in KSA, followed by First Mills and Modern Mills



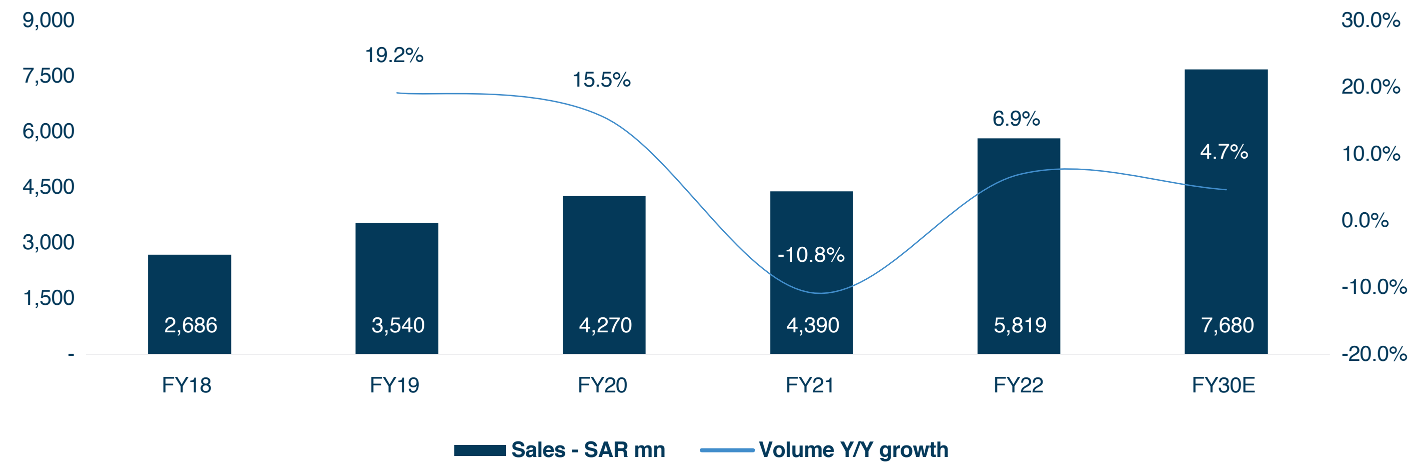
Source: Company Prospectus, AlJazira Capital research

Animal feed industry

Over the last 3-4 years the animal feed industry of KSA has undergone a rollercoaster ride with periods of highs and lows, due to the lingering effects of pandemic and rising procurement costs globally. However, in FY22 the animal feed industry rebounded because of the robust support received from government initiatives in the form of multiple import bans, which aided the local production.

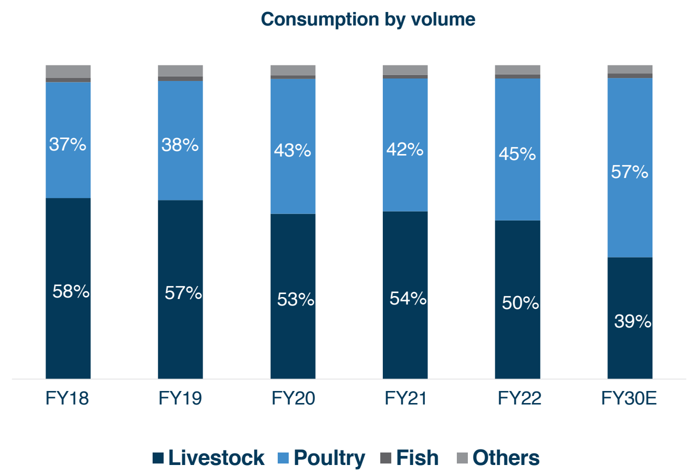
The animal feed industry of Saudi Arabia which is currently pegged at SAR 5.8bn is expected to increase at 3.5% CAGR to SAR 7.7bn by FY30E, at the back of increased focus from government on increasing the food self-sufficiency. The government aims for continued expansion of poultry and livestock production to enable KSA to achieve 80% food self-sufficiency by FY25E, from 68% in FY22E.

Fig 29: Lingering effects of the pandemic in form of rising procurement costs impacted the animal feed industry in FY21, however going forward the industry is expected to grow at 3.5% CAGR



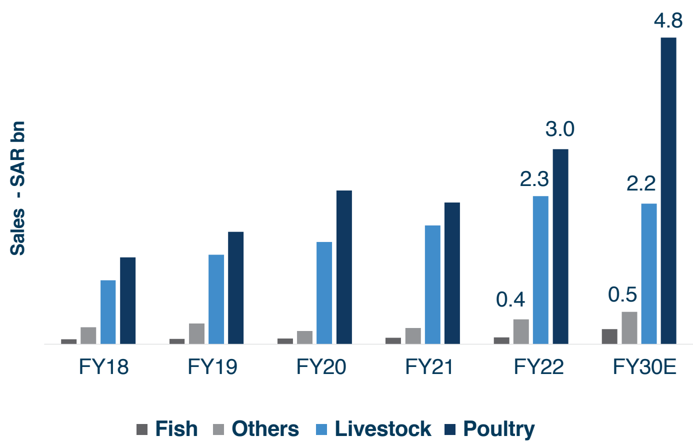
Source: Company Prospectus, AlJazira Capital research

Fig 30: Consumption from poultry and fish categories which are likely to grow at 7.7% and 7.2% CAGR over FY22-30E, respectively



Source: Company Prospectus, AlJazira Capital research

Fig 31: Fish and poultry categories are likely to grow the fastest at 10.2% and 5.8% CAGR over FY22-30E at the back of continued government investment to increase production

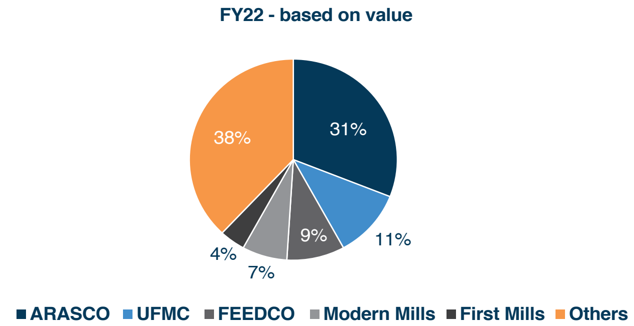


Source: Company Prospectus, AlJazira Capital research

Fragmented animal feed industry provides space for all to survive

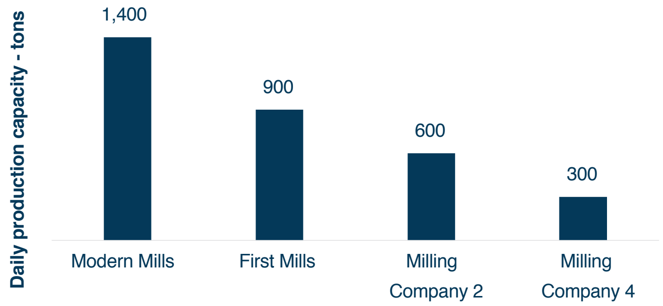
Unlike wheat industry, the animal feed industry is fragmented in nature, with space for small players to survive. The top-3 players account for just 41% of the industry sales as on FY22 and are renowned for providing tailored products to their customers. Among the milling companies, Modern Mills has the highest daily capacity of 1,400 tons, thereby enabling it to capture 7% share of national animal feed market in FY22.

Fig 32: Fragmented animal feed industry has less entry barriers compared to the wheat industry



Source: Company Prospectus, AlJazira Capital research

Fig 33: Modern Mills has leadership position in terms of production capacity among other milling companies



Source: Company Prospectus, AlJazira Capital research

Competitive analysis with First Mills

Fig 34: Intuitive business strategy in terms of working capital management and business mix focus has enabled Modern Mills outpace its closest peer, First Millings on revenue growth, however it lags First Millings in terms of margin and debt profile

SARmn	First Milling	Modern Mills	Remarks
Revenues			
Overall revenue size - FY22	914	978	Higher business skew to animal feed than First Milling, aids Modern Mills in having better revenue size and growth. MMC leveraged the increased government focus on boosting animal feed production.
Revenue CAGR (FY19-22)	12.4%	29.6%	
Business segments			
Flour	56%	41%	Balanced business skew enables MMC to reduce dependency on one business segment and increase revenue visibility.
Animal Feed	30%	41%	
Animal Bran	15%	18%	
Business segment growth - FY19-22 CAGR			
Flour	5.0%	10.9%	MMC's focus diversion to animal feed from flour business has aided it outpacing the business segments of First Milling.
Animal Feed	29.5%	60.3%	
Animal Bran	18.5%	45.2%	
Profitability			
Gross margins	43.5%	37.4%	Higher business skew to flour business enables First Milling to enjoy higher margins as the sourcing is done at subsidized rate from GFSA, which increases the chances of levying a higher mark-up.
Gross margin expansion - FY19-22	1,210bps	1,000 bps	
Operating margins	28.4%	27.5%	
Operating margin expansion	750bps	1,740bps	
Debt profile and cash conversion			
Net debt/equity	1.3	2.6	First Milling outpaces Modern Mills in terms of debt profile, however Modern Mills efficient management of debtor and inventory days offsets it.
Debtor days	2	0	
Inventory days	83	35	

Source: Company Prospectus, AlJazira Capital research

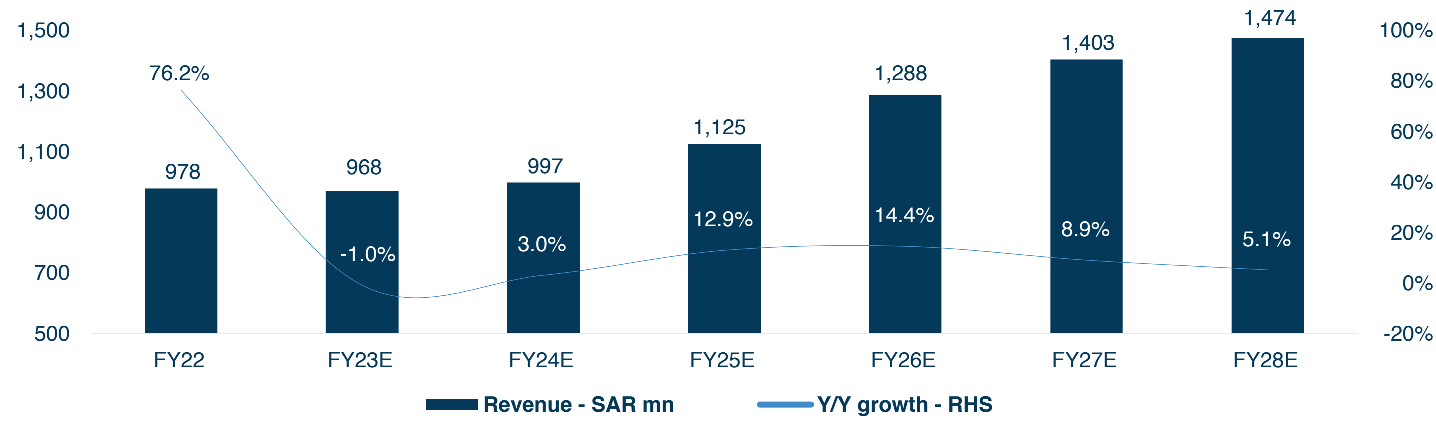
Financial Analysis

Flour business to drive revenues on planned capacity expansion and continue business mix dominance

Over the years MMC has derived most of its revenues from the flour business due to its diversified products being addressed to all types of customer classes. Going forward we expect the same trend to continue as the flour business is likely to outpace the other business segments by growing at 7.4% CAGR over FY22-28E. Company's plans to double the Al-Jumum's daily production capacity from 1,200 MT to 2,450 MT by Q1-FY25, thereby making it's the largest production lines in Saudi Arabia. We believe MMC's flour business will be at the forefront to be the key beneficiary from Saudi Government's plans to increase its investment in food security and tourism growth in MMC's key regions (Western and Southern KSA) to USD 810bn.

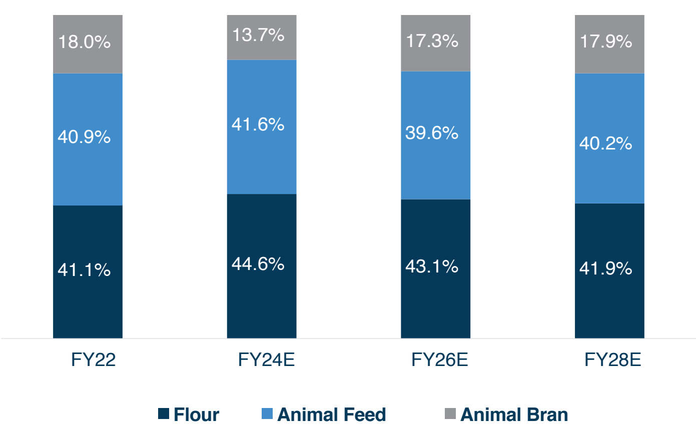
We forecast a 7.0% and 6.8% revenue CAGR for MMC's animal bran and animal feed business, respectively. These businesses will be driven by increased government intervention in the form of enhanced investments to increase poultry and livestock production. With MMC having leadership position amongst other milling companies in terms of production capacity of animal feed, it will be the key beneficiary of these increased investments at the macro level. Further it is also likely to benefit from the capacity expansion of its Khamis Mushait facility from a daily production capacity of 1,650 MT to 1,800 MT. Overall, we expect MMC's revenues to grow at 7.1% CAGR over FY22-28E, largely driven by its flour business.

Fig 35: Historical revenue growth of 29.6% CAGR over FY19-22 driven by premium pricing policy adopted by its animal feed business. However, going forward we expect the revenues to grow at 7.1% CAGR over FY22-28E, driven by capacity expansion of its flour business



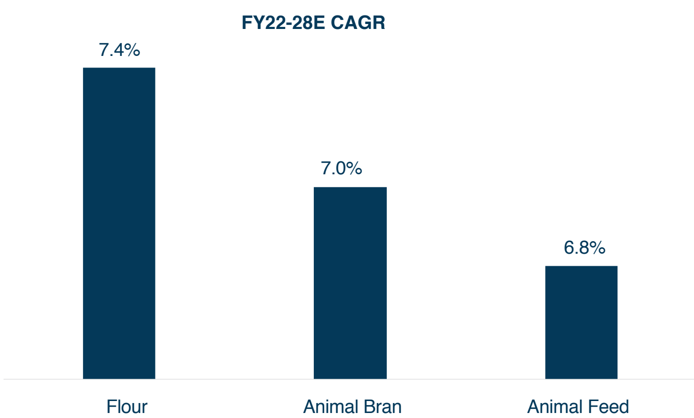
Source: Company Prospectus, AlJazira Capital research

Fig 36: Historical business mix trend to continue in future with flour business being dominant



Source: Company Prospectus, AlJazira Capital research

Fig 37: Flour business to deliver fastest revenue growth of 7.4% CAGR due to capacity enhancement



Source: Company Prospectus, AlJazira Capital research

Planned capacity expansion to drive production capabilities and close gap with closest peer in flour business

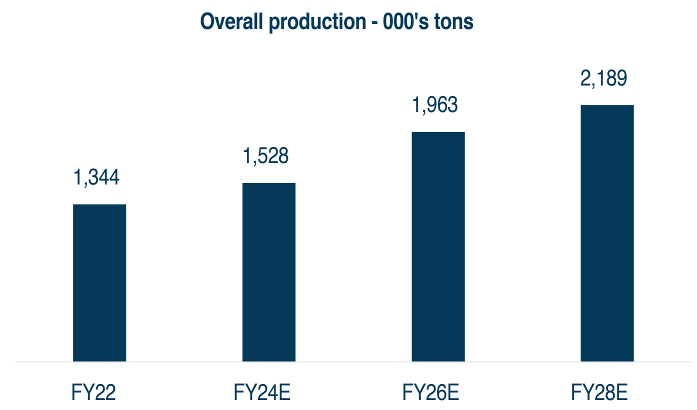
The company has planned to expand its Al-Jumum facility's daily flour production capacity from 1,200 mt to 2,450 mt by Q1-25, thereby making it the largest production lines in Saudi Arabia. Furthermore, in order to leverage the government's initiatives of supporting local companies to increase the production capacity of poultry and livestock, MMC has planned to expand its Khamis Mushait facility's daily animal feed production capacity from 1,650 MT to 1,800 MT. We believe not only will these planned capacity expansions drive the overall production of the company, but also aid MMC to close the gap with the market leader First Mills in the flour business.

Fig 38: Upcoming expansions

Facility name	Product category	Current daily capacity (tons)	Future daily capacity (tons)	Details
Al-Jumum	Flour	1,200	2,450	By Q1-25
Khamis Mushait	Animal feed	1,650	1,800	--

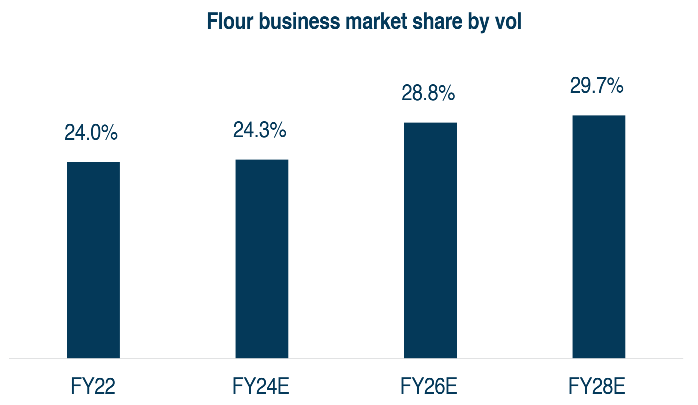
Source: Company Prospectus, AlJazira Capital research

Fig 39: Company's production capabilities outlook



Source: Company Prospectus, AlJazira Capital research

Fig 40: Expansions to close the gap with the closest peer in the flour business

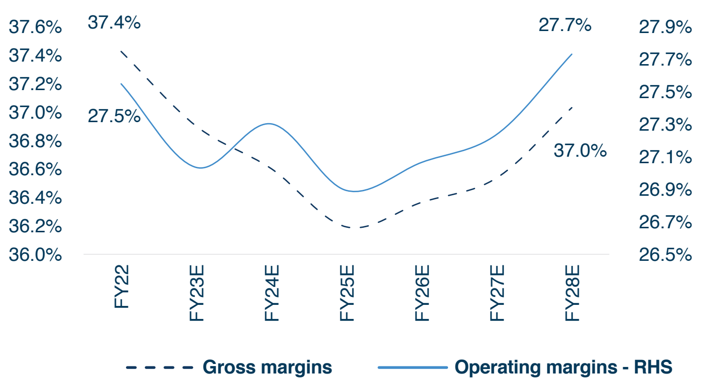


Source: Company Prospectus, AlJazira Capital research

Production capacity less likely to deter the company's robust margin profiles

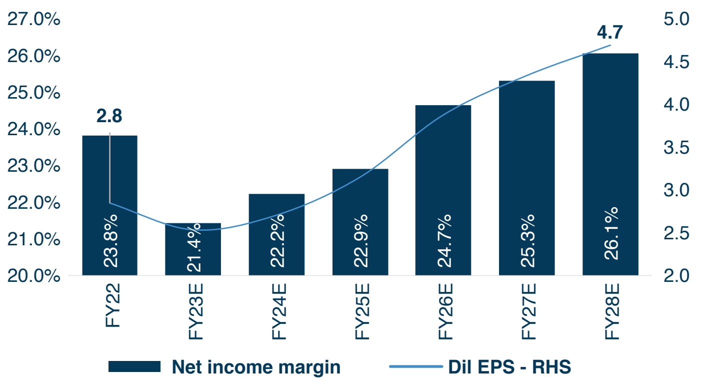
MMC's operating margins have expanded from 10.1% in FY19 to 27.5% in FY22 at the back of i) improved market share in flour business; ii) aligning animal feed prices with market prices; and iii) commanding pricing power aiding the gross margin expansion. Low levels of financing cost enabled the majority part of the operating profit to flow to the net profit and enabled its net profit margins to expand from 8.9% levels in FY19 to 23.8% levels in FY22. We believe these levels are sustainable as the company is likely to benefit from i) revenue growth driven by capacity expansion; ii) robust demand driven by Vision 2030 initiatives; iii) company's focus on the unregulated animal feed business; and iv) operating leverage at play. We forecast the net profit margin to expand from 23.8% in FY22 to 26.1% in FY28E.

Fig 41: Capacity expansion to put pressure on the gross margins and operating margins in the near term



Source: Company Prospectus, Aljazira Capital Research

Fig 42: Brownfield capacity expansion to enable net profit margins to expand faster on lower financing cost



Source: Company Prospectus, Aljazira Capital Research

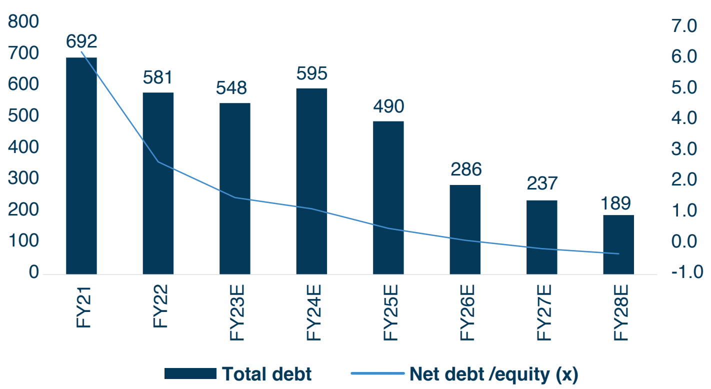
Efficient working capital requirement and reduction in debt levels to aid in funding future expansions and elevate shareholder payouts

The company has efficiently controlled its cash conversion cycle which reduced from 72 days in FY19 to 18 days in FY22. This was largely due to better inventory management which almost halved from 82 days in FY19 to 35 days in FY22. Further the company operates as a cash generative business model with reliance on cash sales as basic sales revenue, thereby ensuring minimal working capital requirement for future cash flows in the medium to long term.

Historically the company operated with high debt levels, thereby impacting the margin profile by way of higher financing costs. However, going forward we believe the company will start repaying the majority portion of the debt, leading to an improvement in the net debt/equity ratio from 2.6x in FY22 to -0.3x in FY28E. The improvements in the capacity utilization levels post the planned expansions will aid in improving the profitability metrics and enable the company to repay the existing debts.

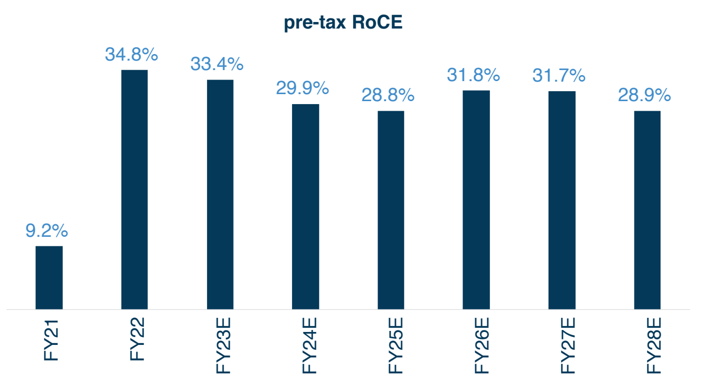
Efficient working capital requirement and reduction in debt levels ensures consistency in cash generation and profitability, which can aid the company in funding its future expansions plan or elevating its shareholder payouts. We currently expect the return on capital employed to increase from 9.2% levels in FY21 to 28.9% in FY28E.

Fig 43: Efficient working capital control and reduction in debt levels



Source: Company Prospectus, Aljazira Capital Research

Fig 44: Return on capital employed to improve from 9.2% in FY21 to 28.9% in FY28E



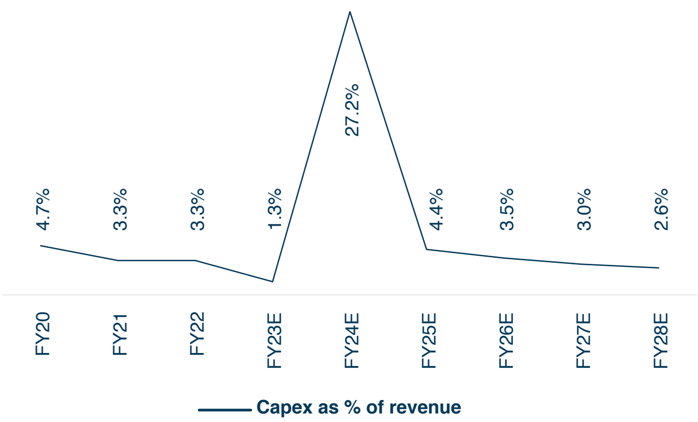
Source: Company Prospectus, Aljazira Capital Research

Cash flow consideration

Historically the company's capex intensity has been within 3-5% of revenues, however we expect a sharp increase in the capex intensity in FY24E on account of the planned expansion of Al-Jumum facility, which will commence production from Q1-25E. Post this expansion we believe the capex intensity will revert to its normal levels of 3-5% of revenues.

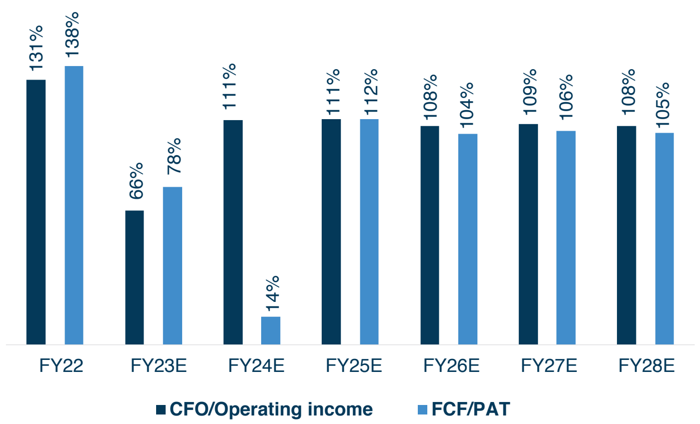
Due to the company's ability to manage its working capital requirement efficiently, we believe the CFO/Operating income metric will stay beyond 100%, indicating CFO growth always exceeding the operating income growth. Further lower capex intensity, except in FY24E, shall keep the FCF/PAT conversion beyond 100% levels, thereby leaving avenues for the company to plough back the cash generated either into business or return it back to the shareholders.

Fig 45: Capex intensity to revert to historical levels post a sharp increase in FY24E on account of the planned expansions



Source: Company Prospectus, AlJazira Capital research

Fig 46: Efficient working capital management to drive CFO and FCF conversion, enabling MMC to plough back the cash, either into business or as shareholder payouts



Source: Company Prospectus, AlJazira Capital research

Valuation Methodologies

We have performed 50% DCF and 50% PE based valuation based on our forecasts for the next five years. We assumed risk free rate of 3.5%, market risk premium of 6.2% and beta of 0.9 to arrive at WACC of 8.7%. Terminal growth rate is assumed at 2.75%. Our valuation of Modern Mills based on DCF yielded an enterprise value of SAR 6.09bn and fair value to equity shareholders of SAR 5.64bn, which translated into a value of SAR 68.9 per share. We also have valued MMC using a relative valuation method based on 12-month forward P/E multiple for domestic peers (First Milling) (applied 10% premium to FMC's 12-month forward PE, due to 40% capacity addition for MMC) and applied it to our average earnings for FY24-25E estimates. Based on the P/E based valuation our value is SAR 73.2 per share. Further assigning 50% weightage to DCF and 50% to P/E based valuation methodology, we have arrived at a weighted target price of SAR 71.1 per share.

Fig 47: Discounted Cash Flow model

SAR mn	FY22	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
Revenue	978.0	968.2	997.0	1,125.1	1,287.5	1,402.7	1,473.8
Y/Y growth %		-1.0%	3.0%	12.9%	14.4%	8.9%	5.1%
NOPLAT	266.4	251.8	263.9	292.4	337.5	368.9	395.0
NOPLAT margin	27.2%	26.0%	26.5%	26.0%	26.2%	26.3%	26.8%
Depreciation	53.5	42.8	38.0	45.4	45.5	45.4	45.2
Change in working cap	13.8	-60.4	-3.6	-3.9	-10.0	0.5	-1.3
CFO	**333.8**	**234.2**	**298.3**	**333.9**	**373.0**	**414.8**	**439.0**
Capex	-32.2	-12.3	-271.0	-49.3	-45.6	-42.0	-38.6
FCFF	**301.6**	**221.9**	**27.3**	**284.5**	**327.4**	**372.8**	**400.4**
Discounting factor	1.0	1.0	1.0	0.9	0.9	0.8	0.7
Present value of FCFF	**301.6**	**221.9**	**27.3**	**263.1**	**279.2**	**291.7**	**286.8**
Sum of present value							1,148.0
Terminal Value							6,911.1
PV of terminal value							4,949.7
Enterprise value							**6,097.7**
Net debt							(461.5)
Fair value - shareholders							5,636.2
No of shares (mn)							81.8
Fair value							**68.9**

Source: Company Prospectus, AlJazira Capital research

Fig 48: DCF key assumptions

Terminal growth rate \ Risk premium	5.20%	5.70%	6.20%	6.70%	7.20%
2.25%	73.75	68.51	63.92	59.85	56.23
2.50%	76.93	71.25	66.30	61.94	58.07
2.75%	80.41	74.23	68.88	64.19	60.05
3.00%	84.24	77.49	71.68	66.62	62.18
3.25%	88.49	81.08	74.74	69.27	64.48

Source: AlJazira Capital research

Above is an illustration of sensitivity of our DCF based target price to the changes in terminal growth rate (range: 2.25%-3.25%) and risk premium (range: 5.2%-7.2%). The sensitivity analysis indicates valuation in the range between a minimum of SAR 56.23 (at terminal growth rate of 2.25% and risk premium of 7.2%) and a maximum of SAR 88.49 per share (at terminal growth rate of 3.25% and risk premium of 5.20%).

Fig 49: Relative valuation using P/E multiple

P/E ratio (x)	25.0
2024/25 EPS	2.93
TP	73.2

Source: AlJazira Capital research

Fig 50: Weighted valuation summary

	TP (SAR)	Weight	Weighted TP
DCF	68.9	50%	34.4
P/E	73.2	50%	36.6
Total			71.1

Source: AlJazira Capital research

Key Financial Data

Amount in SAR mn, unless otherwise specified	FY20	FY21	FY22	FY23E	FY24E	FY25E	FY26E
Income statement							
Revenues	435	555	978	968	997	1,125	1,288
Y/Y	**-3.20%**	**27.50%**	**76.20%**	**-1.00%**	**3.00%**	**12.90%**	**14.40%**
Cost	-297	-393	-612	-611	-632	-718	-819
Gross profit	**138**	**162**	**366**	**357**	**365**	**407**	**468**
Selling & distribution expense	-5	-11	-28	-28	-28	-32	-36
General & administration expense	-62	-63	-69	-68	-65	-73	-84
Operating profit	**71**	**89**	**269**	**262**	**272**	**303**	**348**
Y/Y	**55.20%**	**25.50%**	**204.30%**	**-2.80%**	**4.00%**	**11.20%**	**15.20%**
Financial charges	-9	-7	-36	-48	-46	-38	-24
Income before zakat	**65**	**82**	**236**	**216**	**228**	**266**	**327**
Zakat	0	-2	-3	-8	-7	-9	-10
Net income	**65**	**80**	**233**	**207**	**221**	**257**	**317**
Y/Y	**62.80%**	**22.50%**	**192.90%**	**-10.90%**	**6.70%**	**16.30%**	**23.10%**
EPS (SAR)	0.8	1	2.8	2.5	2.7	3.1	3.9
DPS (SAR)	0	4.9	2.2	0.8	1.1	1.6	2.3
Balance sheet							
Assets							
Cash & equivalent	345	94	118	168	134	208	217
Other current assets	119	130	108	111	120	130	149
Total current assets	**464**	**224**	**226**	**279**	**256**	**339**	**367**
Property plant & equipment	903	707	695	673	906	906	906
Right of use assets	-	237	228	224	224	224	224
Total assets	**1,371**	**1,172**	**1,152**	**1,179**	**1,388**	**1,472**	**1,500**
Liabilities & owners' equity							
Short term loans	-	12	45	52	52	52	52
Trade payables	13	46	45	30	33	36	43
Other current liabilities	33	78	94	88	88	88	88
Total current liabilities	**51**	**150**	**197**	**186**	**189**	**192**	**199**
Lease liabilities – non-current	181	243	237	230	230	230	230
Long term loans	-	681	536	495	547	447	247
Total non-current liabilities	**182**	**924**	**776**	**731**	**783**	**683**	**483**
Share capital	900	900	82	82	82	82	82
Reserves	239	-802	97	180	335	515	737
Total owners' equity	**1,138**	**98**	**178**	**262**	**417**	**597**	**819**
Total equity & liabilities	**1,371**	**1,172**	**1,152**	**1,179**	**1,388**	**1,472**	**1,500**
Cashflow statement							
Operating activities	104	154	353	174	299	334	373
Investing activities	-20	-18	-32	-12	-271	-45	-45
Financing activities	-14	-412	-297	-112	-61	-216	-319
Change in cash	71	-276	24	49	-33	73	9
Ending cash balance	**345**	**94**	**118**	**168**	**134**	**208**	**217**
Liquidity ratios							
Current ratio (x)	9.2	1.5	1.1	1.5	1.4	1.8	1.8
Quick ratio (x)	2.3	0.9	0.5	0.6	0.6	0.7	0.8
Profitability ratios							
Gross profit margin	31.70%	29.30%	37.40%	36.90%	36.60%	36.20%	36.40%
Operating margin	16.20%	15.90%	27.50%	27.00%	27.30%	26.90%	27.10%
Net profit margin	14.90%	14.30%	23.80%	21.40%	22.20%	22.90%	24.60%
Return on assets	4.80%	6.30%	20.00%	17.80%	17.20%	18.00%	21.30%
Return on equity	5.90%	12.90%	168.70%	94.30%	65.30%	50.80%	44.80%
Leverage ratio							
Debt / equity (x)	-0.3	6.1	2.6	1.5	1.1	0.5	0.1
Market/valuation ratios							
EV/sales (x)	-	-	-	4.4	4.4	3.7	3.1
EV/EBITDA (x)	-	-	-	14.1	14.2	12.1	10.2
Market-Cap	-	-	-	3,928	3,928	3,928	3,928
P/E ratio (x)	-	-	-	18.9	17.7	15.3	12.4
P/BV ratio (x)	-	-	-	15	9.4	6.6	4.8
DY (%)				1.60%	2.30%	3.30%	4.80%

Source: Company Prospectus, Aljazira Capital Research

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

RESEARCH DIVISION

Head of Sell-Side Research - AGM
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

RESEARCH DIVISION

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

RATING TERMINOLOGY

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

Disclaimer