Results Update Report

Saudia Dairy and Foodstuff Co (SADAFCO)

During Q3 2020*, SADAFCO maintained its strong growth during the year delivering 5.6% and 27.0% top-line and bottom-line growth, respectively. The company continues to report a stellar cash flow position providing it with immense potential for growth.

16 February 2020

Recommendation	Overweight
Current Price (16-02-2020)	SAR135.0
Target Price (52 Weeks)	SAR158.2
Upside/ (Downside)	17.2%
Shariah Compliance	Pass

Key Points

We have adjusted our 52 weeks target price for SADAFCO to SAR158.2 and changed our recommendation to Overweight. This represents an upside potential of around 17.2%.

- SADAFCO maintained its recovery momentum during Q3 2020, reporting 5.6% and 27.0% Y-o-Y revenue and net income growth, respectively. Revenue growth was mainly volume-led-growth from the ice-cream segment, coupled with easing of price discounting in the milk market. Net income during Q3 2020 reached a two- year high of SAR68mn, reflecting net margin expansion by 230bps compared to Q3 2019.
- Despite the concerns regarding the global rise in Skimmed Milk Powder (SMP), one of SADAFCO's key raw materials, Mlekoma acquisition and SADAFCO's SMP purchases from Mlekoma supported partial offsetting of cost pressures.
- During the quarter, SADAFCO confirmed its intention to repurchase 2.7mn shares, to be used as treasury shares, within a maximum period of 12 months. The board also approved an increase in the interim dividend to SAR2.5/share, which was paid last December (from SAR2.0/share).
- SADAFCO maintained its robust cash flow position in Q3 2020; as a result of strong cash flow from operations, leaving room for future expansions, share repurchase, and increased dividends payout without the need for leverage, providing a high growth potential.

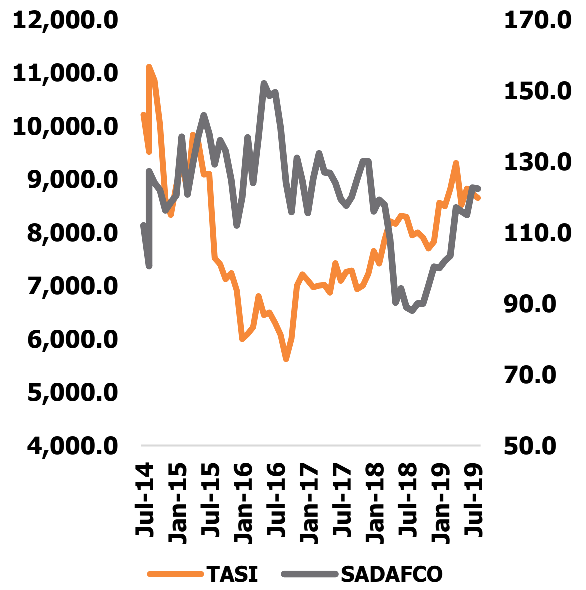
Key Growth Catalysts

- Sustainable management and ability to adapt to market conditions.
- Improvement in the supply chain, new Jeddah Central Warehouse.
- SADAFCO's constant effort to establish its physical presence.
- SADAFCO's strong cash position.

Key Risk Factors

- Market challenges and its impact on SADAFCO.
- SADAFCO's heavy dependence on UHT milk sales.

Reuters Code	2270.SE
Bloomberg Code	SADAFCO: AB
52 Weeks High	SAR148.0
52 Weeks Low	SAR100.2
Market Cap	SAR4.4bn
P/E	17.6
EPS (TTM)	7.7
Dividends (TTM)	SAR4.5
AVG Value Traded	SAR148.2mn

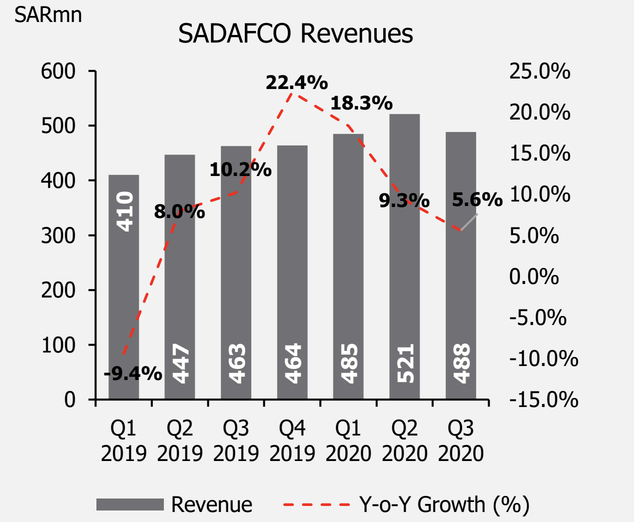


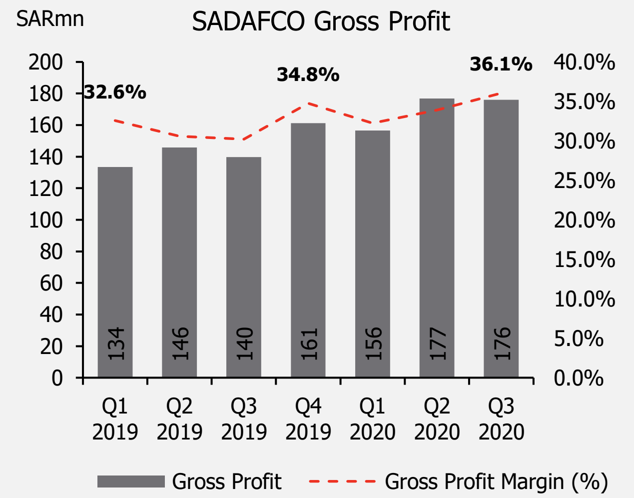
*SADAFCO's fiscal year begins on the 1st of April, this result update is for Q3 2020 (the three months ended December 31st ,2019).

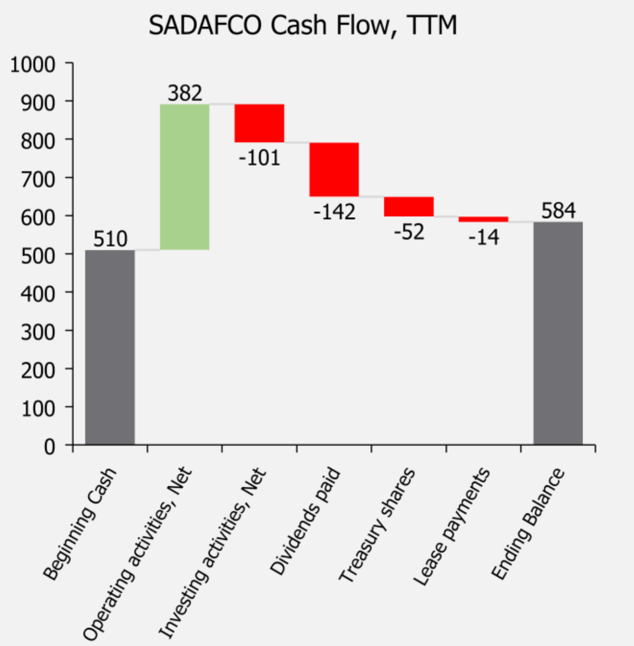
Company Analysis

Financial Results

- SADAFCO's revenue grew 5.6% Y-o-Y compared to Q3 2019, mainly due to volume led the growth from ice cream sales, where the company expanded its distribution during the year. Growth was also spurred by the milk segment on the back of lower price discounting in UHT milk and consumer focused advertising. Revenues slid by 6.3% Q-o-Q, mainly as a result of ice cream seasonality given that Q3 in SADAFCO's fiscal year represents a winter season.
- SADAFCO posted revenues of SAR488mn during Q3 2020 compared to SAR463mn during Q3 2019. Year to date, SADAFCO reported 10.8% top-line growth. The company maintained its strong market share position across UHT milk, tomato paste, and ice cream during the quarter.
- Milk and ice cream segments reported 16.2% and 16.7% Y-o-Y revenue growth, respectively. Meanwhile, tomato paste sales remained stagnant. Powdered milk and cheese sales fell by 4.4% and 11.7%, respectively, while snack sales grew by 12.4% Y-o-Y.
- Despite the revenue growth of 5.6% Y-o-Y and a global rise in Skimmed Milk Powder prices, SADAFCO managed to decrease its cost of sales by 3.3% Y-o-Y, which reflected in gross profit expansion of 26.0% Y-o-Y; recording SAR176mn compared to SAR140mn during Q3 2019. Gross profit margin reached a two-year high, expanding by 580 basis points compared to Q3 2019, driven by less intense milk discounting, higher ice-cream sales, and production efficiencies. Moreover, Q3 2019 reflected a low base of gross margin (with respect to Q3 2020) due to a weak quarter margin for Mlekoma. SADAFCO's purchases of SMP from Mlekoma also partially offset the impact of higher SMP prices.
- SG&A expenses increased by 25.2% Y-o-Y during the quarter given higher advertising and promotion costs, higher expat levies, and higher Saudization rates.
- On the back of improved gross margins, EBIT margins reached a two-year high as well of 14.4% (Q3 2019: 11.9%). EBIT recorded SAR70m during Q3 2020 compared to SAR55mn during the same quarter last year. Year to date, EBIT increased by 22.2%, recording SAR196mn compared to SAR160mn in 9m 2019.
- SADAFCO maintained its earnings growth momentum in Q3 2020, reporting bottom line growth of 27.0% Y-o-Y during the quarter, reaching SAR68mn compared to SAR54mn. Year to date, net income expanded by 21.4% recording SAR191mn compared to SAR157mn during 9m 2019. Net margins recorded 13.9% in Q3 2020 (Q3 2019: 11.6%). Despite Q-o-Q decline in revenue, net income grew by 4.5% Q-o-Q on the back of lower SG&A compared to Q2 2020.
- SADAFCO remains to be debt-free with a strong cash flow position, leaving the potential for future expansions, share repurchase and increased dividends payout without the need for leverage.







Valuation Rationale

DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F	2025 F
EBITDA	363	371	389	408	427	448
Operating CF	301	331	346	362	379	405
Capex	(90)	(105)	(110)	(115)	(121)	(127)
FCFF	211	226	236	247	259	278
Stub Period (FCF to be discounted)	53	226	236	247	259	278
PV (FCFF)	52	205	197	191	185	184

WACC	8.2%
Perpetuity Growth	3.0%
PV-FCFF	1,013
PV-TV	3,551
Net Debt	584
Less: End of services benefits	(111)
Less: Minority Interest	(19)
Intrinsic Value	5,018
Shares Outstanding (million shares)	32.5
Equity value per share	154.4
CMP (16-02-2020)	135.0
Upside / (Downside%)	14.4%

We have valued SADAFCO using DCF and multiples approaches, considering a WACC is equal to 8.2% (based on a risk-free rate of 4.4%, market risk premium 6.5%, Beta of 0.32).

Based on the DCF valuation, the fair price of SADAFCO share price is SAR154.4, which is higher than the traded value by 14.4%.

Comparable Valuation – Local Peers

Name	Country	P/E
SADAFCO	KSA	17.6
Almarai	KSA	25.9
Savola Group	KSA	30.4
Aghtia Group	UAE	11.6
Juhyana Food Industries	Egypt	22.7
Obourland Food Industries	Egypt	7.6
Median		**20.1**
Value Per Share		**163.9**

** We excluded Halwani Bros and Nadec as their P/E ratios are outliers.*

Weighted Valuation

Based on a weighted valuation approach, where the DCF is weighed 60%, and multiple valuation is weighed 40%, we value SADAFCO share price at SAR158.2.

Valuation Approach	Weight	Value
DCF	60%	154.4
P/E	40%	163.9
Valuation	**100%**	**158.2**

Financial Projection

Local Peers	Country	Code	Market Price (SR)	Market Cap (SRBN)	P/E	Sales (SRMN)	Net Income (SRMN)
SADAFCO	KSA	2270	135.0	4.4	17.6	1,958	250
Almarai	KSA	2280	46.7	46.7	25.9	14,352	1,802
Savola Group	KSA	2050	34.7	18.5	30.4	22,243	609
Halwani Bros	KSA	6001	34.7	1.1	NA	880	(3)
Nadec	KSA	6010	26.8	2.3	468.5	2,201	5
Agthia Group	UAE	AGTHIA	3.3	2.0	11.6	2,106	170
Juhyana Food Industries	Egypt	JUFO.CA	2.0	1.9	22.7	1,801	82
Obourland Food Industries	Egypt	OLFI.CA	1.3	0.5	7.6	621	71

Quarterly Income Statement	Q3 2019	Q2 2020	Q3 2020	Q-o-Q	Y-o-Y
Sales	463	521	488	-6.3%	5.6%
Cost of sales	(323)	(344)	(312)	-9.3%	-3.3%
Gross profit	140	177	176	-0.4%	26.0%
SG&A	(85)	(110)	(106)	-4.1%	25.2%
EBIT	55	66	70	5.8%	27.2%
Net Income					

Interim Balance Sheet	Q3 2019	Q2 2020	Q3 2020	Q-o-Q	Y-o-Y
Total assets	1,836	2,054	2,097	2.1%	14.2%
Total liabilities	494	637	692	8.6%	39.9%
Total equity	1,342	1,417	1,405	-0.8%	4.7%
Total liabilities & equity	1,836	2,054	2,097	2.1%	14.2%

Financial Ratios	2019A	2020E	2021F	2022F	2023F	2024F	2025F
Return on Average Assets (%)	11.7%	12.9%	12.3%	12.6%	12.9%	13.0%	13.0%
Return on Average Equity (%)	16.1%	18.4%	17.8%	18.0%	18.2%	18.5%	18.6%
Earnings Before Zakat Margin (%)	12.9%	14.0%	13.6%	13.8%	13.9%	14.0%	14.0%
Net Income Margin (%)	11.9%	13.0%	12.6%	12.7%	12.9%	13.0%	13.0%
Revenue Growth (%)	7.1%	10.2%	5.0%	4.8%	4.8%	4.8%	4.8%
EPS	6.6	8.0	8.1	8.6	9.1	9.6	9.8

Income Statement	2019A	2020E	2021F	2022F	2023F	2024F	2025F
Revenues	1,813	1,997	2,097	2,198	2,303	2,414	2,531
Cost of Revenues	(1,233)	(1,307)	(1,373)	(1,437)	(1,505)	(1,577)	(1,652)
Gross Profit	580	690	724	760	798	837	878
SG&A	(358)	(423)	(449)	(470)	(491)	(514)	(538)
Zakat	(17)	(21)	(21)	(22)	(24)	(25)	(26)
Net Income	**216**	**259**	**264**	**280**	**296**	**313**	**328**

Balance Sheet	2019A	2020E	2021F	2022F	2023F	2024F	2025F
Current Assets	1,095	1,218	1,286	1,348	1,408	1,467	1,529
Non-Current Assets	821	898	906	917	931	1,013	1,032
Total Assets	**1,916**	**2,115**	**2,192**	**2,266**	**2,340**	**2,480**	**2,561**
Current Liabilities	420	466	490	513	536	554	580
Non-Current Liabilities	138	194	178	160	142	195	182
Total Equity	1,358	1,455	1,524	1,593	1,661	1,731	1,799
Total Liabilities and Equity	**1,916**	**2,115**	**2,192**	**2,266**	**2,340**	**2,480**	**2,561**

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

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