BELTONE FINANCIAL

Fundamentals intact,
but Hold on short-term exogenous factors

Saudi Arabian Food and Dairy | December 2020

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Almarai Company

Rating:	**Hold**
Fair value:	**SAR61.00**
Market price:	**SAR54.20**
Upside:	**13%**

NADEC

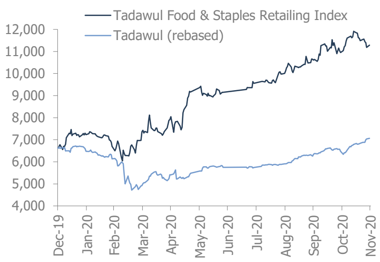
Rating:	**Hold**
Fair value:	**SAR33.90**
Market price:	**SAR30.00**
Upside:	**13%**

SADAFCO

Rating:	**Hold**
Fair value:	**SAR194.40**
Market price:	**SAR175.2**
Upside:	**11%**

Savola Group

Rating:	**Hold**
Fair value:	**SAR49.3**
Market price:	**SAR45.8**
Upside:	**8%**



*Closing as of 29 November 2020
**Rebased at 100

Saudi Arabian Food and Dairy

Fundamentals intact, but Hold on short-term exogenous factors

Food and Dairy | Saudi Arabia

Initiation of Coverage 1 December 2020

Initiate coverage on 4 Saudi food producers; favor Almarai on growth sustainability and Savola on recovering retail growth path

Though remaining resilient throughout most of 2020, food consumption in Saudi Arabia, which has for long been supported by strong demographics, is likely to bear the brunt of the implemented austerity measures in the short term. In this regard, food producers under our coverage have absorbed some of the impact of a higher value-added tax (VAT) as well as cost inflation, leading to overall pressured margins. However, we believe these companies will weather the short-term hurdles and resume their growth paths as the impact of the COVID-19 pandemic subsides, supported by intact fundamentals and the region's solid demand base. We initiate coverage on 4 Saudi food producers with Hold ratings given their limited upside, but we believe in the sustainable growth story of Almarai Company (Almarai) with its EBITDA and core earnings to grow at 6-year CAGRs of 5.1% and 9.9%, respectively, justifying the demanding P/E multiples, in our view. We also have a positive view on the Savola Group (Savola), owing to its strong 6-year EPS CAGR of 28%, capitalizing on growing investment income in Almarai (Savola owns a 34.5% stake in Almarai), its continuous deleveraging, and 5.3% EBITDA growth of core operations as its transformation plan has started to bear fruit. Despite Saudia Dairy and Foodstuff Company's (SADAFCO) expected short-term earnings decline, the stock trades broadly in line with its peers' average (2021 P/E multiple of 21x) on a high dividend yield and strong returns. Meanwhile, with low returns recorded, the National Agricultural Development Company (NADEC) new management is considering strategic growth and cost-saving initiatives, which we expect will drive core earnings to grow at a 6-year CAGR of 7%.

Dairy margins under pressure in 2020a and 2021e on lifting subsidies on imported feed amid milk oversupply

Saudi dairy producers have been exposed to a higher cost of imported forage following the government's decision to remove direct subsidies on imported forage effective December 2019 (except alfalfa, which is one third of animal feed). This has pressured NADEC's profitability margin in 9M20 and will pressure Almarai's margins in 2021, in our view, given the companies inability to fully pass on the higher cost amid the current weak purchasing power. Moreover, the current fresh milk oversupply on the expat exodus and interrupted tourism is likely to lead to increasing conversion of excess fresh milk to skim milk powder (SMP), resuming the long-life milk price discount wave. This, together with projected 11% higher SMP prices in 2021 based on future contracts, will likely pressure long-shelf-life milk producer SADAFCO's operating margins, in our view, given its 3–6 months average stocking period of SMP. Going forward, we estimate the prices of fresh milk and long-life milk will grow at 2019–25e CAGRs of 3% and 2%, respectively.

Savola's retail recovery to enhance EBITDA growth; stake in Almarai overshadows core operations

While 77% of Savola's value is generated from the stake owned in Almarai, we believe core operations will grow at 6-year EBITDA CAGR of 5.3%, generated mostly from the transformational plan of its retail business, which included the closure of inefficient stores, in addition to increased production of higher margin products, namely edible oils. Starting 2020, the company managed to recover its retail business through increased current store yields as well as increasing its fresh food offerings, and lately introducing its e-commerce platform. Meanwhile, its edible oil and sugar segments were hit on declining global prices and volumes due to increased competition and macro distress.

All 4 companies exploring new growth opportunities to create more value

While demand for dairy products has been relatively stable, dairy producers are currently exploring further growth opportunities. Almarai, according to its 2025 strategy, is seeking to enter new segments or explore new markets (further details are undisclosed) with CAPEX requirements to be centered on maintenance of its existing facilities. Also, NADEC's new management turnaround strategy focuses on reactivation of unutilized land plots as well as implementing cost-saving initiatives. Recently, shareholders at SADAFCO's EGM approved an up to 9% share buyback, utilizing 79% of its strong cash balance on hand, given the highest returns provided (ROAE of 19% and ROIC of 23%). Meanwhile, Savola is capitalizing on consumer preference towards small-scale grocery stores, while a recovery in global prices should lift performance of the struggling edible oil segment.

Table of Content

I. Investment thesis

We initiate coverage on 3 Saudi dairy producers, Almarai, NADEC, and SADAFCO, as well as Saudi food producer Savola. We have Hold ratings on all 4 stocks given their limited upside potential following a share price rally as well as short-term hurdles.

With limited inflation in food prices in Saudi Arabia over the last decade, we believe dairy companies under our coverage will continue to absorb some of the cost inflation arising from the higher VAT and the feed subsidy removal in the short term given weak consumer spending and changes in consumption patterns. Going forward, as domestic consumption returns to normal (expected post 2021e), we believe the companies could freely pass on expected increases in imported feed prices, which move in tandem with global oil prices. It is worth mentioning that the US Joe Biden presidency could transform the oil price movement, leading to higher positively correlated global food commodity prices on sugar, corn, and soybean, which are the main ingredients for biofuel.

Out of the dairy producers under our coverage, we favor the industry flagship Almarai, despite the company trading at a 2021e P/E multiple of 24.9x, a 36% premium compared to its peers, which is justified in our view. Capitalizing on diversified segment exposure, we expect Almarai to maintain its sustainable growth, with its EPS to grow at a 6-year CAGR of 9.9%, retaining its strong EBITDA margins. SADAFCO provides a high dividend yield, despite short-term pressure in profitability margins on higher forward SMP prices and increasing price discounts.

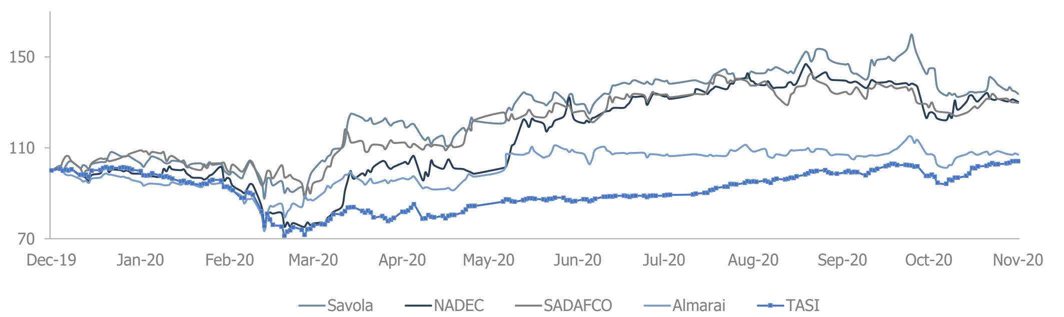
We anticipate Savola Group will capitalize on the retail transformational plan, which has started to reflect on enhancing its stores' efficiency, driving consolidated EBITDA to grow at a 2020–25e CAGR of 5.3%, on our numbers. This in addition to its continuous deleveraging, and growing income from investments in Almarai, should lead to double-digit CAGR growth in EPS over 2019–25e. This is besides the projected partial improvement global edible oil prices within 2–3 years while second-tier competitors continuing to pressure market share, therefore maintaining a policy of increased production of high-margin products. We expect Savola to generate a high FCFF yield over our forecast period, attributed mainly to the lack of significant CAPEX as management awaits an improvement in its oil and sugar segments. That said, we believe management will maintain its FY19 dividend payout of 24% going forward on continuous debt settlement. We believe this all has already been priced in Savola's share price, which currently trades at a 2021e P/E multiple of 20x, at par with the global composite peer median of 20.0x.

Figure 1: Companies' main highlights

Company	Almarai	NADEC	SADAFCO*	Savola
Main products	Dairy products Juice Poultry Bakery	Dairy products Juice Olive oil	Dairy products Juice Ice cream	Food retail Oil Sugar Pasta Frozen foods Fast food
2019–25e revenue CAGR	5.2%	5.2%	6.8%	2%
FY21e EBITDA margin	26.9%	17.6%	17.0%	10.1%
2019–25e EBTIDA CAGR	5.1%	3.4%	4.3%	5.3%
2019–25e core earnings CAGR	9.9%	7.0%	3.0%	27.8%

**FY ends on 31 March*

Figure 2: Y-T-D performance versus Tadawul Index



Y-T-D share performance	
Savola	34%
NADEC	30%
SADAFCO	30%
Almarai	7%
Tadawul	4%

Source: Bloomberg
**Rebased at 100*

II. Comparative analysis

Dairy companies comparable valuation

Company	Country	MC (USDmn)	P/E			P/BV		EV/EBITDA			EBITDA margin			Earnings CAGR	Dividend yield	
			2019	2020e	2021e	2020e	2021e	2019	2020e	2021e	2019	2020e	2021e	19/22	2020e	2021e
1. Dairy peers																
Inner Mongolia YILI	China	35,285	33.6	32.5	27.9	7.9	8.2	7.4	21.2	18.2	10.7%	11.1%	11.4%	11.7%	2.0%	2.3%
Vietnam Dairy Products	Vietnam	9,688	23.0	21.9	20.2	8.0	7.7	7.1	13.9	13.0	25.2%	25.4%	25.2%	5.9%	3.8%	3.9%
Bright Dairy & Food	China	2,877	40.6	36.9	30.8	3.4	3.2	2.9	10.6	9.3	8.9%	8.3%	8.6%	17.6%	0.8%	1.0%
Grupo Lala Sab De CV	Mexico	1,680	15.5	20.3	16.3	1.4	1.6	1.6	7.7	7.1	11.3%	10.2%	10.5%	10.4%	4.2%	4.4%
Dutch Lady Milk Inds	Malaysia	565	22.8	23.1	20.6	21.4	13.0	10.4	14.9	13.5	N/M	14.4%	15.3%	7.2%	2.3%	2.6%
Juhayna	Egypt	429	16.9	14.7	12.5	2.3	2.2	2.1	6.2	5.7	15.3%	16.4%	16.5%	17.0%	3.9%	5.1%
Nestle Lanka Plc	Sri Lanka	320	18.6	21.0	19.5	10.3	N/A	N/A	10.7	10.4	N/M	14.9%	14.7%	1.6%	3.8%	4.2%
Median		**0**	**20.7**	**21.5**	**19.9**	**3.2**	**2.9**	**9.1**	**10.7**	**9.8**	**13.3%**	**14.7%**	**15.0%**	**8.3%**	**3.8%**	**4.1%**
SADAFCO	Saudi Arabia	1,506	20.0	19.8	21.0	3.5	3.4	13.7	13.1	13.5	18.8%	18.4%	17.0%	-0.3%	3.0%	3.0%
NADEC	Saudi Arabia	816	29.3	82.9	44.7	2.1	2.0	10.0	12.0	10.9	21.0%	17.4%	17.4%	-10%	0.0%	0.0%
Weight of dairy in Almarai's earnings			74%	74%	73%	74%	73%	74%	74%	73%	74%	74%	73%	74%	74%	73%
2. Bakery peers	**Weights**															
EDITA	Egypt	433	16.1	26.4	18.1	3.9	3.2	10.1	12.5	9.4	17.7%	15.1%	17.2%	2.9%	2.0%	270.6%
Mondelez Int'l	United States	83,035	23.4	22.3	20.6	3.1	3.0	19.1	18.4	17.4	20.3%	20.6%	21.1%	7.2%	2.1%	2.2%
Hershey	United States	32,054	26.8	24.9	23.5	17.6	15.6	18.0	17.1	16.5	24.9%	25.9%	26.2%	6.4%	2.1%	2.1%
Nestle SA-REG	Switzerland	334,529	24.1	25.1	23.6	6.2	6.4	17.0	18.2	17.7	21.5%	22.0%	22.2%	3.1%	2.6%	2.7%
Tiger Brands LTD	South Africa	2,561	14.3	21.1	15.9	2.2	2.1	11.0	14.4	11.5	12.1%	9.1%	11.1%	0.5%	2.5%	3.7%
Cadbury Nigeria	Nigeria	50	21.6	22.9	11.8	N/A	N/A	4.1	4.8	2.9	7.0%	6.6%	10.0%	27.6%	NA	NA
Grupo Bimbo SAB-	Mexico	9,891	31.7	21.0	20.0	2.0	1.8	9.7	7.4	7.3	11.2%	13.1%	13.0%	19.3%	1.3%	1.5%
Median			**23.4**	**22.9**	**20.0**	**3.5**	**3.1**	**11.0**	**14.4**	**11.5**	**17.7%**	**15.1%**	**17.2%**	**7.2%**	**2.1%**	**2.4%**
Weight of bakery in Almarai's earnings			13%	12%	11%	12%	11%	13%	12%	11%	13%	12%	11%	13%	12%	11%
3. Poultry																
Tyson Foods	United States	22,712	11.3	12.4	10.7	1.5	1.4	8.2	8.3	7.7	9.6%	9.4%	9.8%	6.5%	2.7%	2.9%
MHP SE	Ukraine	642	3.4	N/A	11.4	N/A	N/A	4.7	5.1	4.7	22.0%	21.2%	22.2%	-18.5%	4.7%	4.7%
Astral Foods	South Africa	359	8.4	8.5	6.6	N/A	N/A	6.1	4.5	4.0	7.1%	9.3%	9.9%	13.1%	4.4%	8.6%
Cairo Poultry	Egypt	99	8.3	N/A	N/A	N/A	N/A	3.4	N/A	N/A	13.8%	N/M	N/M	NA	NA	NA
Median			**8.3**	**10.5**	**10.7**	**1.5**	**1.4**	**5.4**	**5.1**	**4.7**	**11.7%**	**9.4%**	**9.9%**	**22.3%**	**4.4%**	**4.7%**
Weight of poultry in Almarai’s earnings			14%	14%	15%	14%	15%	14%	14%	15%	14%	14%	15%	14%	14%	15%
Almarai composite peer average			19.3	20.0	18.4	3.0	2.7	8.8	10.3	9.2	13.6%	14.0%	14.5%	10.1%	3.7%	4.0%
Almarai Company			**28.3**	**25.9**	**24.9**	**3.7**	**3.5**	**16.2**	**15.5**	**14.7**	**29%**	**28%**	**28%**	**9.0%**	**1.7%**	**1.8%**

Source: Bloomberg
** Based on Beltone estimates*
*** SADAFCO FY ends on 31 March*
****Composite peer average is derived from the weighted average of the comparative multiples of the 3 main segments of Almarai, weighted by their annual contribution to total earnings*

Savola comparable valuation

Company	Country	Mrkt cap (USDmn)	P/E (x)			P/BV		EV/EBITDA (x)			EBITDA margin			Earnings CAGR	Dividend yield (%)		
			2019a	2020e	2021e	2020e	2021e	2019a	2020e	2021e	2019a	2020e	2021e	19/22	2019a	2020e	2021e
Food peers																	
Archer Daniels Midland	US	27,046	18.8	14.3	13.5	1.4	1.3	11.6	10.7	9.4	5%	5%	6%	14%	2.9	3.0	3.1
Bunge	US	8,204	20.4	8.9	10.8	1.4	1.3	10.6	8.2	8.9	3%	5%	4%	26%	3.4	3.3	3.5
Cosumar	Morocco	2,177	20.2	22.0	20.4	N/A	N/A	N/A	11.7	11.0	N/A	22%	23%	4%	N/A	3.3	4.8
Kernel Holding	Ukraine	978	10.4	6.8	4.7	0.6	0.5	4.9	4.5	3.8	10%	9%	10%	N/A	2.4	2.4	5.2
Graincorp Ltd	Australia	749	N/A	N/A	17.8	0.9	0.9	19.2	11.4	6.8	2%	4%	5%	-190%	0.4	0.0	3.1
Median			**19.5**	**11.6**	**13.5**	**1.1**	**1.1**	**11.1**	**10.7**	**8.9**	**4%**	**5%**	**6%**	**9%**	**2.6**	**3.0**	**3.5**
Weight of food in Savola earnings			51%	51%	43%	51%	43%	51%	51%	43%	51%	51%	43%	45%	51%	51%	43%
Composite multiple			**9.9**	**5.9**	**5.8**	**0.6**	**0.5**	**5.6**	**5.4**	**3.8**	**2%**	**3%**	**2%**	**4%**	**1.3**	**1.5**	**1.5**
Food services peers																	
McDonald's	US	159,521	27.3	34.5	25.6	N/A	N/A	18.1	21.6	17.3	51%	47%	51%	5%	2.2	2.4	2.5
Yum Brands	US	31,672	28.3	30.8	26.4	N/A	N/A	20.2	22.7	19.6	37%	33%	34%	6%	1.6	1.8	2.0
Restaurant Brands	Canada	27,678	21.9	27.2	21.3	10.0	9.8	16.8	20.3	16.9	41%	38%	41%	4%	3.4	3.5	3.6
Yum China Holdings	China	25,207	33.9	41.0	29.7	4.9	4.5	15.9	17.0	13.3	15%	15%	16%	9%	0.8	0.5	0.9
Dunkin' Brands Group	US	8,749	33.9	38.1	33.3	N/A	N/A	22.8	24.3	22.4	36%	35%	36%	3%	1.4	0.8	1.6
Texas Roadhouse	US	5,135	31.2	101.2	28.2	5.3	4.6	16.0	29.9	14.6	12%	7%	12%	11%	1.6	0.6	1.8
Wendy's Co	US	5,045	37.9	39.3	31.7	8.9	9.4	18.1	17.9	16.6	24%	24%	25%	12%	1.8	1.3	1.6
Jollibee Foods	Philippines	4,478	35.4	N/A	53.6	3.7	3.5	21.8	92.6	14.6	7%	2%	10%	1%	1.1	0.4	0.7
Cracker Barrel Old	US	3,297	15.3	53.2	28.3	N/A	N/A	9.8	20.3	11.9	13%	7%	11%	-4%	4.7	3.0	3.8
Median			31.2	38.7	28.3	5.3	4.6	18.1	21.6	16.6	24%	24%	25%	5%	1.6	1.3	1.8
Weight of food services in Savola earnings			20%	20%	32%	20%	32%	20%	20%	32%	20%	20%	32%	25%	20%	20%	32%
Composite multiple			**6.1**	**7.6**	**8.9**	**1.1**	**1.5**	**3.6**	**4.3**	**5.3**	**5%**	**5%**	**8%**	**1%**	**0.3**	**0.2**	**0.6**
Retail peers																	
Tesco	Britain	30,260	13.6	16.6	13.3	1.3	1.3	7.1	8.6	7.9	8%	7%	7%	4%	3.6	3.6	4.0
Yonghui Superstores	China	11,411	34.5	31.0	24.4	3.5	3.3	21.4	18.5	15.4	4%	4%	4%	20%	1.8	2.2	2.7
Dino Polska	Poland	7,088	65.6	45.1	35.3	12.2	9.2	38.6	28.2	22.1	9%	10%	10%	33%	0.0	0.0	0.0
Bim Birlesik Magazalar	Turkey	5,545	34.6	19.6	18.6	7.2	6.7	14.0	9.9	8.6	8%	8%	8%	32%	1.8	3.6	4.1
Axfood	Sweden	4,915	25.3	22.8	22.4	9.7	9.2	10.7	10.2	10.0	9%	9%	9%	5%	3.5	3.6	3.6
Bindawood Holding	Saudi Arabia	3,730	N/A	26.8	26.8	9.2	7.7	N/A	15.6	14.6	N/A	18%	19%	N/A	N/A	2.9	3.2
Casino Guichard	France	3,069	10.1	14.2	10.7	0.5	0.4	9.7	7.5	7.3	5%	7%	7%	8%	13.1	2.0	8.2
Abdullah Al Othaim	Saudi Arabia	2,990	33.9	24.0	24.9	6.6	6.0	20.5	15.2	15.3	7%	9%	9%	16%	2.2	3.3	2.9
Chongqing	China	1,937	12.7	12.7	10.1	1.8	1.6	6.0	7.2	5.6	4%	4%	4%	16%	2.6	2.5	2.7
Smu	Chile	900	15.5	15.1	11.8	0.9	0.9	8.9	8.1	7.6	8%	8%	8%	17%	1.4	3.8	3.3
Eurocash	Poland	532	32.7	25.5	18.9	2.0	2.0	6.1	5.7	5.4	3%	3%	3%	25%	5.6	4.0	4.9
Saudi Marketing	Saudi Arabia	345	75.7	29.3	26.6	2.1	2.0	13.6	9.3	9.2	12%	14%	14%	40%	N/A	2.6	2.7
Median			**32.7**	**23.4**	**20.7**	**2.8**	**2.6**	**10.7**	**9.6**	**8.9**	**8%**	**8%**	**8%**	**17%**	**2.4**	**3.1**	**3.2**
Weight of retail in Savola earnings			**30%**	**30%**	**26%**	**30%**	**26%**	**30%**	**30%**	**26%**	**30%**	**30%**	**26%**	**30%**	**30%**	**30%**	**26%**
Composite Multiple			**9.7**	**6.9**	**5.3**	**0.8**	**0.7**	**3.2**	**2.8**	**2.3**	**2%**	**2%**	**2%**	**5%**	**0.7**	**0.9**	**0.8**
Total composite multiple			**25.7**	**20.4**	**20.0**	**2.5**	**2.6**	**12.4**	**12.5**	**11.4**	**9.0%**	**9.7%**	**12%**	**10%**	**2.4**	**2.7**	**2.9**
Savola	**Saudi Arabia**		**50.2**	**24.1**	**20.0**	**2.6**	**2.3**	**13.5**	**11.7**	**10.4**	**8.9%**	**9.7%**	**10.1%**	**45%**	**0.7**	**1.1**	**1.3**

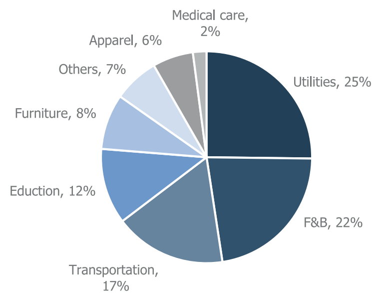
Source: Bloomberg
** Based on Beltone estimates*
***Composite peer average is derived from the weighted average of the comparative multiples of the 3 main segments of Savola Group, weighted by their annual contribution to total earnings*

III. Market overview

Moderate growth post 2021e as impact of the pandemic subsides

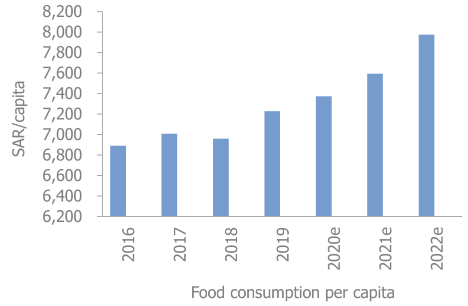
Our in-house macro team expects limited 1.3% y-o-y growth in Saudi private spending during 2021e, with private demand to return to pre-COVID levels by 2H22e. This supports our view of stalled growth in food consumption during late 2020e and 2021e, followed by moderate growth as the economy returns to normal in the year after. Consumption of food and beverages in Saudi Arabia (22% of monthly consumer expenditures) grew at a 4–year CAGR of 5% to SAR247mn in 2019. Going forward, we expect Saudi food to grow at a 4–year CAGR of 4.7%, supported by demand revival as the impact of the pandemic subsides.

Figure 5: Breakdown of average family food consumption in Saudi Arabia



Source: General Authority for Statistics, Beltone estimates

Figure 6: Expected limited growth in per capita food consumption in 2021e; demand to pick up in 2022e



Source: General Authority for Statistics, Beltone estimates

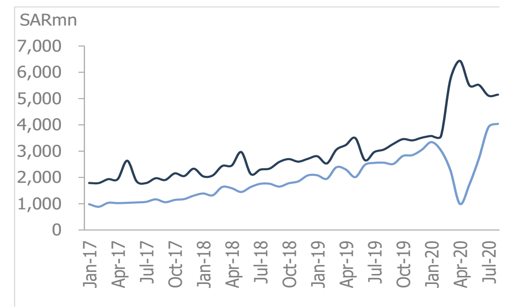
Similarly, the economies of other Gulf Cooperation Council (GCC) states have encountered hard-hitting challenges due to the fallout of the pandemic, which was further exacerbated by plunging global oil prices.

Changes in consumption patterns and risk of second wave could derail pace of recovery

The resumption of the Hajj pilgrimage starting 1 November 2020, the upcoming reversal of a ban on international flights on 1 January 2021, and our expectations of 12% growth in oil prices (oil revenue represents 64% of annual receipt) are likely to drive a mild economic recovery in Saudi Arabia in 2021e. Moreover, the recently announced 33% increase in minimum salaries for Saudi citizens to SAR4k/Saudi employee under the Nitaqat program (slated for 2Q21), should provide support to income levels and cater for a recovery in private demand given Saudi nationals account for 24% of total employment in the kingdom. However, tighter restrictions and precautionary measures with a second wave could ultimately derail the pace of economic recovery, in our view.

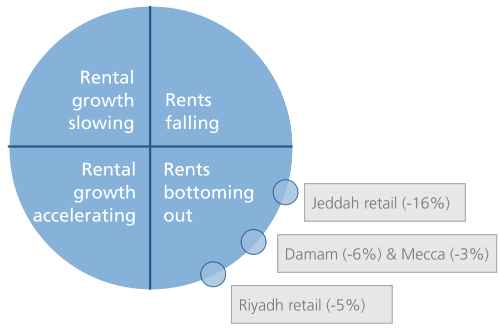
So far Consumer spending has been under pressure, particularly on dining out and entertainment, given a rise in unemployment, the expiry of stimulus programs, and the tripling of the VAT rate. We also believe consumption patterns have shifted from premium to inexpensive merchandise, which has obligated retailers to overhaul their offerings to accommodate market needs as consumers continue to focus their spending on essential goods rather than leisure items, in our view. As a result, smaller retailers who suffer from shortages in liquidity have been forced to downsize or terminate operations either temporarily or permanently. To sustain businesses, retailers are engaging with landlords in restructuring deals and demanding additional rent-free periods, with landlords adapting to the changing market on a survival basis.

Figure 7: Retail sales in Saudi Arabia by POS (SARbn)



Source: SAMA

Figure 8: Retail rentals in Saudi Arabia are bottoming out



Source: JLL Mena -Saudi real estate market 2Q20

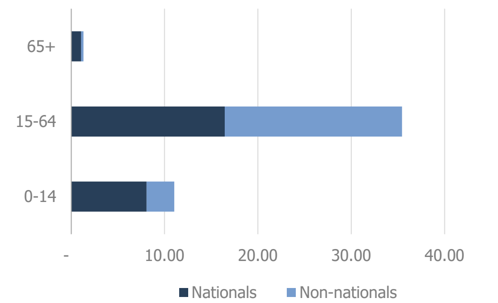
Despite ongoing challenges, we believe the GCC region has solid fundamentals in place to support resilient food consumption.

1. Solid populous base with sizeable adolescent tranche

Home to close to 50mn inhabitants, the GCC region is well regarded for its young population with around 70% of the Saudi population below the age of 30. The population is slated to remain very young over the forecast period, in contrast to the aging populations of the US and Europe. This should continue to support demand for fresh dairy products, juice, and confectionery items in the region, in our view. The International Monetary Fund (IMF) expects the Saudi population, which is close to 34mn inhabitants currently, to grow 3% annually.

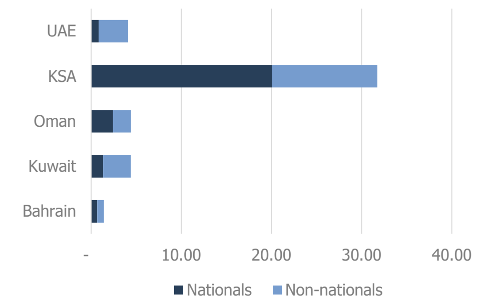
Moreover, as more women continue to enter the labor force, demand for ready-made products is likely to continue. Despite rising unemployment levels and the expat exodus as economic activity worsens, we expect the private sector will remain heavily dependent on expatriate labor (currently 45% of the GCC population).

Figure 9: About a quarter of the population is below the age of 15



Source: Gulf labour markets and migration

Figure 10: Expatriate labor represents 45% of the GCC population

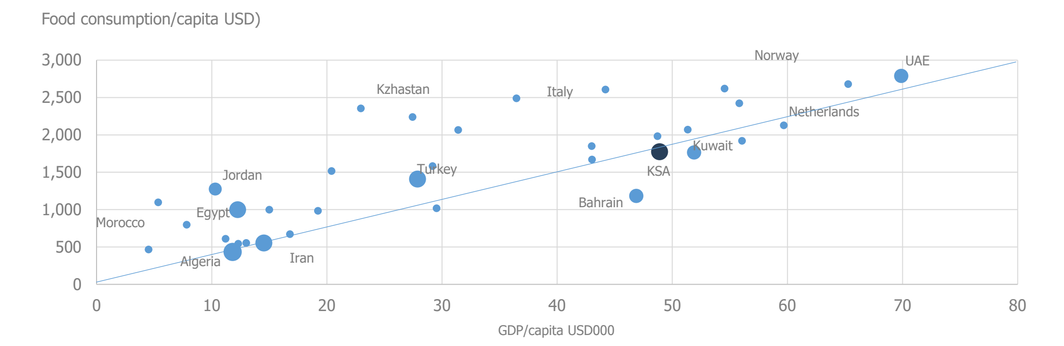


Source: Gulf labour markets and migration

2. A sustained high per capita food consumption

The per capita consumption of dairy products in the GCC is growing strongly, but remains relatively low by international standards, particularly compared to countries with similar income levels. We believe economic recovery, a sizeable young population, and higher tourism inflows should fuel food consumption per capita in the region. Additionally, as consumers grow more health conscious, this should drive robust demand for fresh products, in our view.

Figure 11: Sustained growth potential in MENA per capita food consumption

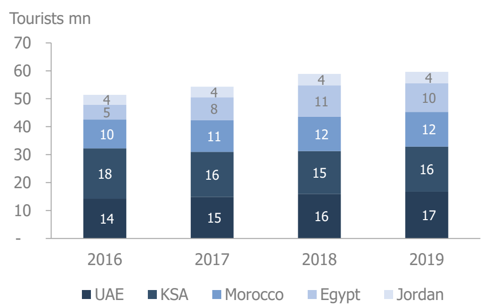


Source: NationMaster, IMF

3. Tourism activity

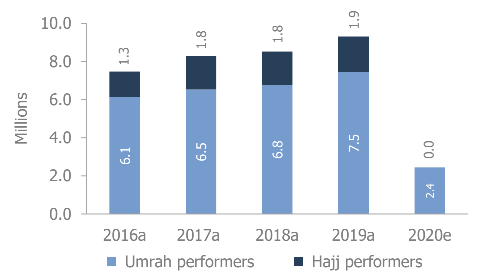
International tourism is one of the main economic pillars of most countries within the MENA region. International tourist arrivals to the top 5 destination markets in the region have grown at a 2016–20 CAGR of 5%, with the top 2 destinations in the region being the UAE followed by Saudi Arabia. We expect this trend to continue in the coming period as the pandemic subsides. While most inbound tourists in Saudi Arabia are mainly religious pilgrimages, the kingdom is currently developing its tourism infrastructure to expand its tourism base to include leisure tourists as well.

Figure 12: Growing tourism destinations



Source: World Bank

Figure 13: Foreign pilgrims

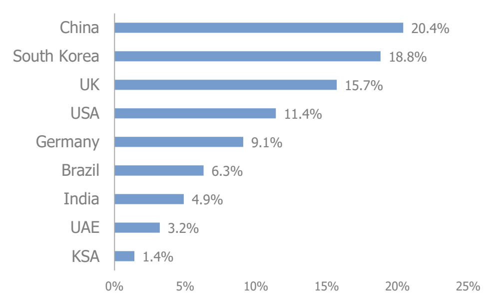


Source: General Authority for Statistics

4. Rising modern trade business and online retailing

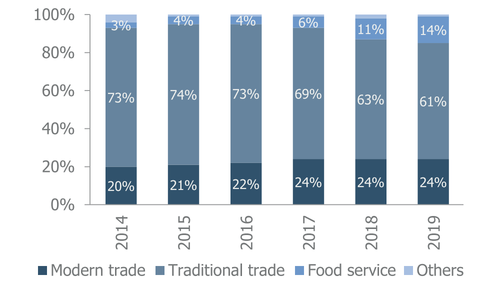
The food market is diverging with a shift toward online retail and expanding hotels, restaurants, and cafés (HORECA) on growing business-to-business supply, ready-to-eat, and the health and wellness market segments. Dominated for long by traditional retail channels (baqalas), the retail market in Saudi Arabia witnessed growing modern retail channels (hypermarkets and supermarkets) over the last few years, driven by lack of amusement destinations and growing preferences for promotional items and value-for-money products. We expect baqalas' market share to continue to be pressured after the Saudi government recently announced plans to accelerate the Saudization of expat-operated baqalas.

Figure 14: Global online retail penetration (2017)



Source: Delta Perspective

Figure 15: Saudi retail market format



Source: Almarai investor presentation, June 2020

Online groceries, though still a new concept in the MENA region, has been the fastest-growing e-commerce category over the past 3 years, representing 3% of total e-commerce sales versus 20% for electronics in 2019. The imposed lockdown measures across the kingdom as a result of COVID-19 has given rise to online delivery applications, leading retailers to launch their e-commerce platform and delivery fleets, such as Pandaclick. As a result, online purchases surged 917% y-o-y during 1H20 in Saudi Arabia. This was supported by high levels of smartphone penetration at an average rate of 80% in Saudi Arabia and the UAE compared to 42% in Egypt and the global average of 41%.

Government initiatives to support sizeable e-commerce contribution

Market specialists estimate online groceries, 1.9% of grocery consumption, will grow almost 90% annually, reaching USD4.1bn in the GCC and Egypt by 2022. This figure is still below the developed market average given low credit card penetration, as over 67% of transactions completed have used cash-on-delivery as the preferred payment method. Given the logistical challenges in Saudi Arabia, there is a significant opportunity to integrate local baqalas through marketplaces.

The Saudi government targets 80% contribution of e-commerce by 2030 under Saudi Vision 2030, supported by the launch of a new e-commerce law introduced in late 2019, and the planned USD100bn in financing to expand the country's logistics infrastructure, grants to stimulate more locals to operate in the e-commerce industry, as well as proposing interest-free financing to acquire and manage carriage trucks.

M&As in regional online groceries

There have been growing M&A transactions lately in the online grocery marketplace, with Germany's Delivery Hero (DHER.DE) acquiring online grocery marketplace InstaShop for an initial USD270mn, as it branches out of online takeaway meals into new services. InstaShop, launched in 2015, operates in the UAE, Qatar, Bahrain, Egypt, and Lebanon and has an annualized gross merchandise volume of USD300mn. Meanwhile, Saudi Arabia-based Foodics entered the Egyptian retail market aiming to provide point of sale (POS) operating systems to enhance local businesses' operations.

Biden presidency could transform oil price movement, impacting global food prices

Mixed effect on oil prices

Although US President-elect Joe Biden's win could benefit short-term oil demand on passing an additional USD1tn economic relief package (expected to be in the range of 0.5mn bpd), his approach to foreign relations could bring more supply to the market as he could ease relations with Iran and Venezuela, which in turn could unleash over 2mn bpd of oil to the market. This would likely lead to an oil supply glut, in our view, driving the OPEC+ supply cut agreement to remain intact for a longer-than-anticipated period given that the group's earlier plans discussed easing supply cuts by the beginning of 2021. This would keep the oil price elevated above USD50/bbl. We believe the Biden administration would look to re-enter the Paris Agreement to combat global climate change, and, in this regard, we believe there will be more restrictions on the issuance of new drilling permits on federal lands and waters. Accordingly, oil prices are likely to be high enough to make clean energy alternatives to fossil fuels competitive in support of the ambitious climate plan, in our view. Moreover, a return to globalized trade policies and reinstating trade relations with China could be positive for oil demand.

What does it mean for GCC economy?

As GCC economies move in correlation with oil prices given the heavy contribution of hydrocarbon revenue to the state budget, we expect a slow economic recovery in the GCC region in 2021e as we expect oil prices to remain below historical highs in the medium term. Our in-house macro team expects oil prices to reach USD55.0/bbl in 2021e, up from USD40.0/bbl in 2020e, due to a slow recovery in global energy demand. With a high break-even level for oil, we believe any positive oil price movement would positively impact the Saudi economy, with the ramping up of major projects positively reflecting on household consumption and business activity.

What's in it for global commodities?

Given the high positive correlation between crude oil and food commodities, such as sugar, soybean, and corn, we believe any upward movement in oil prices will likely reflect on higher prices of sugar, corn, and other crops. Corn is the ingredient in biofuel in the US, sugar is the primary ingredient in the biofuel ethanol in Brazil, and palm oil is a feedstock for bio-diesel. This makes these commodities positively correlated with crude oil prices as they are used as a main ingredient for the production of biofuel.

Sugar is positively correlated with oil as high crude oil prices incentivize farmers in Brazil, a large exporter of sugar, to divert sugarcane for the production of ethanol, which is used as fuel. Conversely, a decline in oil prices reduces the appeal of ethanol, and farmers accordingly divert more sugarcane for sugar production, which in turn weighs on sugar prices in global markets.

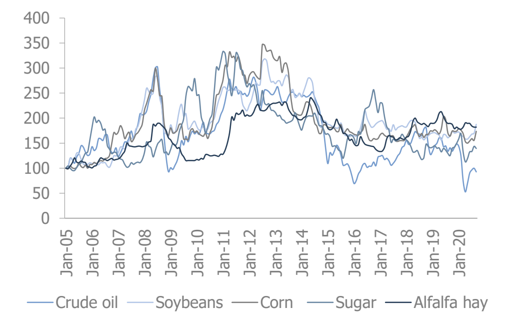
Alfalfa has considerable potential as a feedstock for the production of ethanol and other industrial materials because of its high biomass production, and, importantly, alfalfa does not require nitrogen fertilizer, which is a major and increasing cost in corn production. However, refining of alfalfa remains underdeveloped, and it is primarily processed and used as livestock feed.

What's in it for food companies and dairy producers?

The companies under our coverage in this note, namely Savola, Almarai, NADEC, and SADAFCO, are impacted by global changes in commodity prices. However, looking at the prices of edible oil, fresh milk, and sugar in Saudi Arabia, we have seen limited price inflation over the last 10 years in the Saudi market, despite global fluctuations in oil prices and positively correlated commodities. The kingdom banned forage cultivation in 2018, allocating direct subsidies to feed importers instead to overcome the high cost and preserve general price levels. However, with the latest phase out of feed subsidies and after tripling the VAT to 15%, we do not expect dairy producers to fully pass on the high cost of imported feed in 2021e, which will likely pressure margins during the year in light of weakening purchasing power. Going forward, we expect to see further price increases to accommodate for higher cost inflation as economic conditions return to normal.

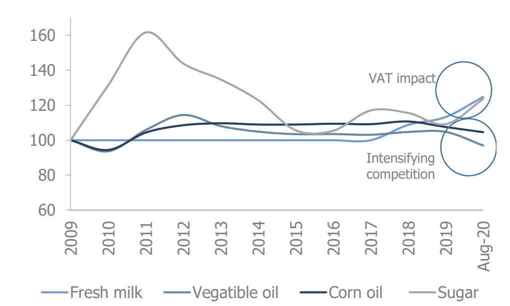
On historical grounds, the VAT enactment typically results in temporary inflationary pressure, with adjustments in consumer's expenditure behavior later steadying within a year.

Figure 16: Positive correlation of oil prices with food commodities



Source: Delta Perspective

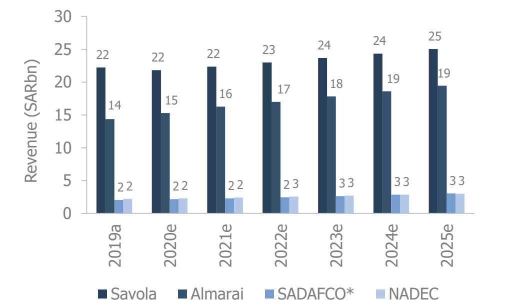
Figure 17: Stable food prices in Saudi Arabia over the last 10 years; latest food inflation reflects higher VAT



Source: General Authority for Statistics

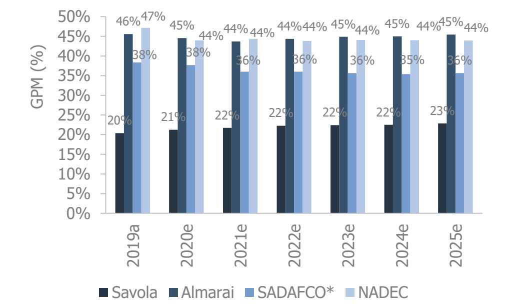
IV. Operational analysis

Figure 18: Product diversification supports revenue growth at 6-year CAGR of 5%



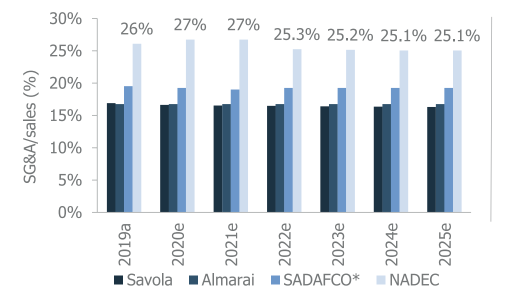
**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 19: Inflated costs to pressure dairy producers' gross margins during 2021e



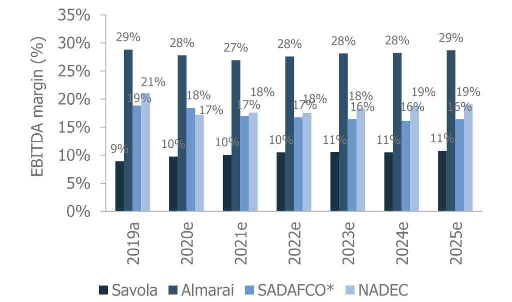
**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 20: NADEC's efficient utilization of its distribution centers to reduce high SG&A/sales



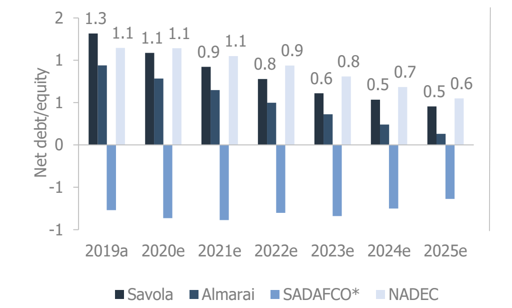
**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 21: Almarai leads on EBITDA margin



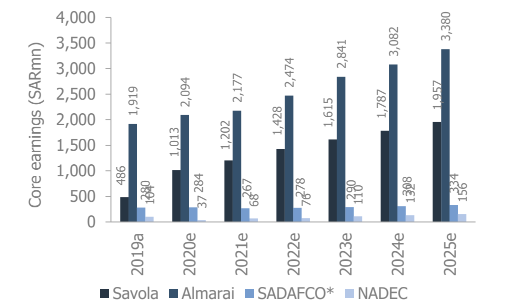
**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 22: Savola and Almarai continuing to deleverage...



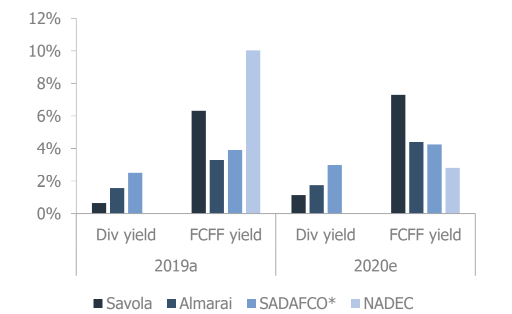
**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 23: ...driving core earnings to grow at 5-year CAGRs of 26.1% and 9.9%, respectively



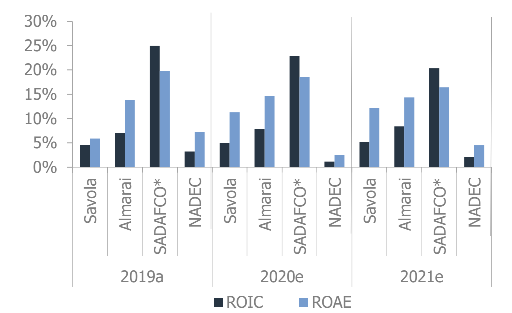
**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 24: SADAFCO provides highest dividend yield; Savola to generate high FCFF yield



**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Figure 25: SADAFCO generates highest ROIC and ROAE



**SADAFCO FY ends 31 March*
Source: Company data, Beltone estimates

Saudi dairy

I. Saudi dairy industry overview

II. Companies

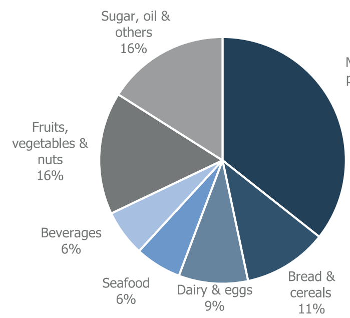
1. Almarai Company
2. The National Agricultural Development Company (NADEC)
3. Saudia Dairy and Foodstuff Company (SADAFCO)

Saudi dairy industry overview

Milk oversupply led to growing consolidation as margins tighten

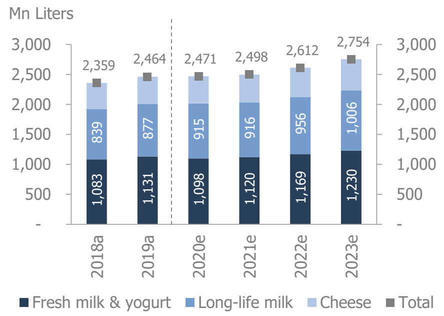
Dairy consumption, which represents 9% of food consumption in Saudi Arabia, is among the highest in the region, second after the UAE. The dairy market in the kingdom in particular, and the GCC in general, is highly concentrated with the top large-scale Saudi dairy companies (Almarai, SADAFCO, and NADEC) having a 64% market share. Owing to sizeable investments in Saudi dairy capacity over the last 40 years in tandem with a reduction in certain consumption categories has led to a milk surplus, growing consolidation among small players in the industry, and evolving long-life milk (9-month shelf life) versus fresh milk (5–10 day shelf life) as a balancing element. Accordingly, this has put pressure on profitability margins due to supplier promotions and discounts granted in 2017 and 2018 to overcome sluggish demand. While the price gap between fresh milk and long life was wide enough at the beginning, currently the growing demand for long-life milk from regional markets for storage purposes has led to a narrowing pricing gap.

Figure 26: Breakdown of average family food consumption in Saudi Arabia



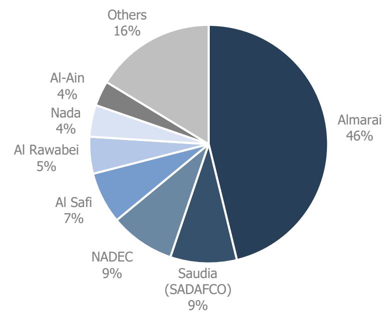
Source: General Authority for Statistics

Figure 27: Dairy volumes should maintain tepid growth



Source: Almarai, Beltone estimates

Figure 28: Dairy market by brands



Source: Almarai investor presentation, June 2020

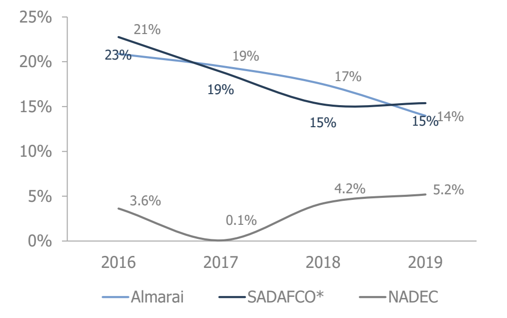
New entrants in GCC market could lead to continuous oversupply

To ensure food security and dairy self-sufficiency, 2 of the main dairy importing GCC countries have established vertically integrated dairy companies such as Mazoon in Oman and Baladna in Qatar (following the boycott). This, in addition to the expat exodus and the disrupted flow of tourism, has negatively impacted the overseas businesses of Saudi dairy producers, leading to a continuous milk oversupply, which could ultimately lead to cooling off prices or reducing milk supply as advocated by some dairy producers. Market sources estimate the following as a result: (i) price discount, especially for long-life milk, (ii) converting fresh milk to SMP for export as other major dairy producers do to balance such as Arla in Denmark and Fonterra in New Zealand, and (iii) developing new products and increasing cheese production. There has been an increasing tendency of dropping excess fresh milk in the food segment (cheese), resulting in the latest price decline.

Difficult geography in Saudi Arabia assures importance of integrated dairy processing companies

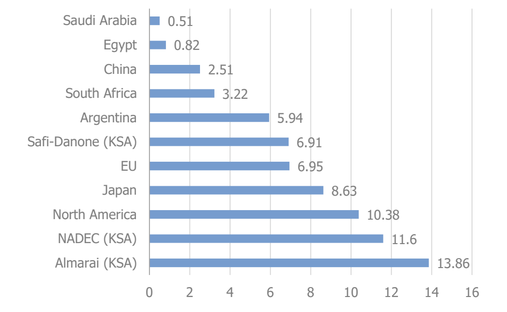
Locally produced raw milk is principally used for fresh products that require constant year-round supply. Given the lack of large-scale independent dairy farms in the GCC, this gave rise to integrated dairy processing companies maintaining their own dairy herds. Though this allows companies to have direct control over the production process, and timing of their milk supply, the cost of establishing and operating dairy herds as well as providing the necessary temperature controlled environments burdens companies' cost structures. Additionally, relying on imported forage, given the ban imposed by the Saudi government by virtue of a decree on local production of forage starting late 2018 to preserve the limited water resources, has added to the cost burden as the farms consist of milking parlours and animal housing, with adjacent sand-yards, compared to pasture farming as practiced by traditional dairy farming countries.

Figure 29: Declining net margins of dairy producers on growing price competition



Source: Dairy company data

Figure 30: Dairy herd milk production yield per cow (tons/head)

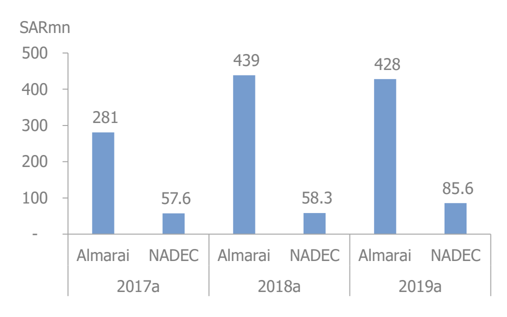


Source: Company data, FAO

Lifting subsidies on imported feed ingredients could push retail dairy prices higher or else lead to squeeze on profitability margins

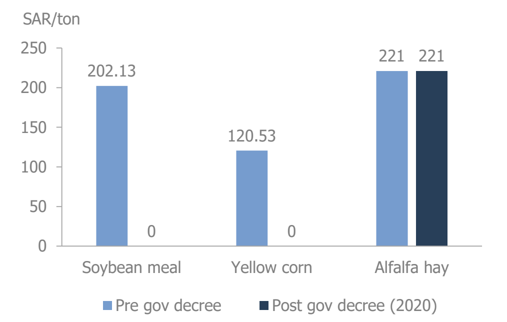
Dairy product retail prices have been relatively stable over the last 10 years, growing at a CAGR of 1%–3%, owing to the government's support and food price regulation. Starting December 2019, Saudi dairy manufacturers were exposed to higher costs of imported feed grains after the government decided to remove direct subsidies on some 23 imported grains, including yellow corn, soybean meal, and dried distillers grains with solubles (DDGS). These subsidies used to help dairy manufacturers mitigate the impact of the higher cost of imported animal feed. While the government excluded 7 green feed ingredients from the subsidy lift, including alfalfa (one third of animal feed), which is subject to a rebate of a SAR221/ton, we believe the subsidy lift on imported forage (except alfalfa) will pressure profitability margins unless companies can freely pass on the increased costs. These subsidies were calculated on a per ton basis and used to range SAR49.33–SAR202.13 per metric ton, based on the energy and protein content of each feed ingredient.

Figure 31: Subsidies received from the government



** Almarai subsidies included SAR100-150mn for the poultry segment*
Source: Companies' financials

Figure 32: Subsidies pre and post government decree

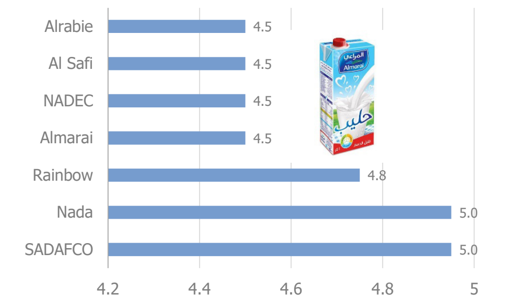


Source: USDA

Demand sensitivity post VAT amid growing price competition

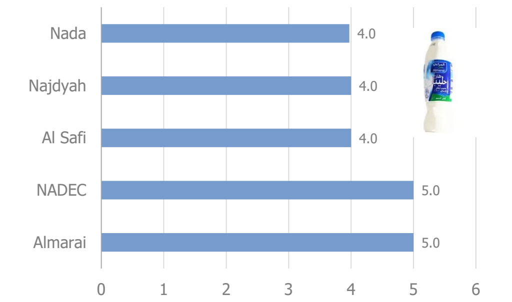
Dairy market oversupply over the 2016–18 period has led to heavy discounting, especially on the long-life milk segment, owing to weak structural demand from expat departures, the Qatar embargo, and weaker spending. We believe that tripling the VAT to 15%, effective July 2020, could affect consumption and trigger several promotions from producers, impacting overall margins. We expect SADAFCO's sales volumes to decrease in the coming period, already reflected in its latest quarterly numbers, with its milk segment growing only 2% compared to Almarai's growth of 16%. We believe this resulted from SADAFCO's forgone market share due to a 11% premium pricing scheme compared to NADEC and Almarai (NADEC and Almarai's 1-liter long-life milk product is currently priced at SAR4.5 compared to SAR5.0 for SADAFCO's Saudia brand). That said, we expect the prices of fresh milk to grow at a 2019–25e CAGR of 3% (to pass on higher feed costs) compared to an average 2% price increase for long-life milk. In this regard, NADEC and Almarai could potentially be the least impacted dairy producers among other market players due to their lower pricing scheme, which falls in favour compared to premium-priced brands such as SADAFCO.

Figure 33: Consumers tend to favor lower-priced long-life brands (SAR/liter)



Source: Al-Othaim, Carrefour KSA

Figure 34: Minimal demand growth for fresh milk on stocking up long-life brands (SAR/liter)



Source: Al-Othaim, Carrefour KSA

Rating:	**HOLD**
Fair value:	**SAR61.00**
Market price:	**SAR54.20**
Upside:	**13%**

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Mohamed Hamza
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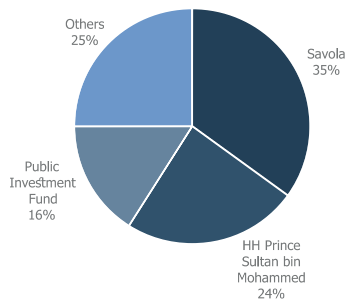
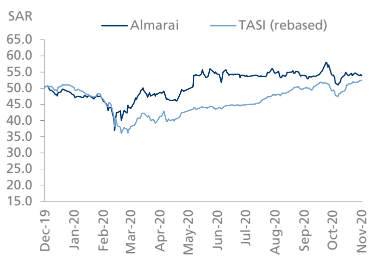
Shareholders structure





*Closing as of 29 November 2020

Stock data

Reuters	2280.SE
Bloomberg	ALMARAI AB
Shares (mn)	1,000
MKT cap	SAR54,200mn/ USD14,453mn
3M avg. daily liquidity	SAR42.5mn/ USD11.3mn
52-week high/low	SAR58.4/SAR36.5
Free float	25%

Almarai Company

Industry flagship to remain resilient despite headwinds

Food and Dairy | Saudi Arabia

Initiation of Coverage — 1 December 2020

Initiate coverage with a FV of SAR61.00/share and a Hold rating

Almarai has grown over the last 44 years to become a leading conglomerate in the Middle East, serving mainly Saudi Arabia along with other neighboring GCC markets. Leveraging on its strong brand name and wider coverage, the company is the GCC's largest producer of dairy and juice (segment generating 71% of net revenue), poultry (15% of net revenue), and bakery (12% of revenue). While Almarai spent nearly SAR15bn on CAPEX over the last 5 years on its core business, the company should efficiently utilize its free cash flow going forward to enter new segments or expend in new markets with CAPEX requirements to be centered mostly on maintenance and replacement in its existing facilities, according to its 2025 strategy. We value Almarai using a sum-of-the parts (SOTP) valuation method, reaching a FV of SAR61.00/share, with our discounted cash flow (DCF) valuation yielding 13% upside, warranting a Hold rating. We expect core earnings to grow at a 2019–25e CAGR of 10%, supported by moderate revenue growth, margin enhancement, and deleveraging.

Growing competition and milk oversupply likely to limit dairy price revision amid lower feed subsidies

Almarai expects to collect feed subsidies of SAR150mn in 2021, mainly on alfalfa imports down from SAR300mn collected on all feed imports in 2019 and 2020. The new government regulations lift subsidies on non-green imported forage, and should start to reflect on Almarai's 2021 financials as its outstanding subsidized feed is depleted. Following the volume-led growth exhibited in 9M20, we believe volumes are likely to slow in the coming 2 quarters on dampened purchasing power. Over the 2019–25e period, we estimate dairy and juice segment revenue will grow at a CAGR of 5.1%, supported by limited price adjustments on passing on higher feed cost as well as a volume recovery post 2022e as the economic impact of COVID-19 subsides. We therefore expect margins for the segment to gradually decrease in 2020e and 2021e on higher cost of imported feed as well as additional costs for juice ingredients, driven by sugar-free recipes, the expat levy, and higher trade support due to growth in modern trade.

Poultry segment to maintain strong growth despite the pandemic

Almarai is expanding its poultry business by adding a new line to its 3 existing lines, which should add an additional 50mn birds to its capacity, bringing total capacity to around 240mn birds by 2Q21. The channel shift toward the high-margin fresh retail poultry line has temporarily positively impacted the margins of the segment on lower performance of the food service segment due to closure of all restaurants during the pandemic. We do not believe the change in the poultry subsidy regime (to production based) will impact the collected subsidy amount. Meanwhile, the closure of educational institutions and travel restrictions has impacted the performance of the bakery segment on lower demand for single serve and other bakery items.

Main financial highlights (FY end Dec)

In SARmn, unless otherwise stated	2019e	2020e	2021e	2022e
Revenue	14,351	15,290	16,267	17,000
EBITDA	4,135	4,247	4,381	4,689
EBITDA margin	28.8%	27.8%	26.9%	27.6%
Recurring net income	1,919	2,094	2,177	2,474
P/E (x)*	28.3	25.9	24.9	21.9
EV/IFRS EBITDA (x)	16.2	15.5	14.7	13.3
ROAE	13.9%	14.7%	14.3%	15.4%

** based on core net income (excluding one-offs and volatile items)*
Source: Company, Beltone estimates

Financial statement | FY end Dec (SARmn)

Income statement	2019a	2020e	2021e	2022e
Revenue	*14,351*	*15,290*	*16,267*	*17,000*
COGS	*(7,812)*	*(8,481)*	*(9,160)*	*(9,462)*
Gross profit	*6,539*	*6,808*	*7,107*	*7,537*
SG&A expenses	*(2,405)*	*(2,562)*	*(2,726)*	*(2,848)*
EBITDA	*4,135*	*4,247*	*4,381*	*4,689*
Depreciation and amortization	*(1,545)*	*(1,592)*	*(1,678)*	*(1,762)*
EBIT	*2,590*	*2,655*	*2,703*	*2,927*
Net financing costs	*(585)*	*(533)*	*(447)*	*(363)*
Other income/costs	*(83)*	-	-	-
EBT	*1,922*	*2,122*	*2,256*	*2,564*
Zakat & income taxes	*(121)*	*(74)*	*(79)*	*(90)*
NPAT	*1,802*	*2,048*	*2,177*	*2,474*
Non-controlling interest	*10*	*46*	-	-
Attributable net income	*1,812*	*2,094*	*2,177*	*2,474*
Core attributable net income*	**1,919**	**2,094**	**2,177**	**2,474**

Balance sheet	2019a	2020e	2021e	2022e
Cash and equivalents	1,161	358	41	84
Accounts receivables	1,260	1,348	1,367	1,382
Inventory	4,198	4,591	4,977	5,149
Prepaid expenses and other receivables	510	546	582	598
Total current assets	**7,129**	**6,843**	**6,967**	**7,212**
Total non current assets	**26,019**	**25,292**	**24,482**	**23,592**
Total assets	**33,148**	**32,134**	**31,449**	**30,804**
Short term borrowings	271	101	251	451
CPLTD	2,031	1,877	3,498	2,103
Accounts payable	1,404	1,524	1,530	1,533
Accrued expenses and other balances	2,870	3,060	3,197	3,375
Total current liabilities	**6,575**	**6,562**	**8,477**	**7,463**
Long-Term Borrowing	11,233	9,356	5,858	5,255
Other LT liabilities	931	931	931	931
Non-controlling interest	**606**	**560**	**560**	**560**
Total non-current liabilities	**12,770**	**10,847**	**7,349**	**6,746**
Paid-in capital	10,000	10,000	10,000	10,000
Reserves	1,780	1,990	2,206	2,454
Treasury shares	(771)	(1,001)	(1,300)	(1,687)
Retained earnings	2,794	3,736	4,716	5,828
Total equity	**13,804**	**14,725**	**15,623**	**16,595**
Total liabilities and equity	**33,148**	**32,134**	**31,449**	**30,804**

Cash flow	2019a	2020e	2021e	2022e
Change in working capital	(55)	(299)	(335)	(155)
Cash flow from operations	4,732	4,504	4,598	5,075
CAPEX	(1,517)	(1,060)	(1,063)	(1,067)
Cash flow from investing	(2,944)	(1,496)	(1,499)	(1,503)
Free cash flow (FCF)	**1,788**	**3,009**	**3,099**	**3,571**
Cash flow from financing	(2,460)	(3,812)	(3,416)	(3,528)
Change in cash	(672)	(804)	(317)	43

Investment summary

Established in 1977 by HH Sultan bin Mohammed bin Saud Al Kabeer, Almarai has grown over the last 43 years to become the largest food conglomerate and the flagship of the dairy industry in the Middle East. The IPO in 2005 was a turning point in the company's history, which was followed by expanding its dairy processing line and launching the bakery and poultry lines of business. Almarai maintained its leading position across different food categories in the kingdom with a 64% share of the Saudi fresh dairy segment, 30% of packaged cheese, and 35% of the fresh poultry market. Almarai's vertically-integrated dairy segment (71 % of revenue), with a capacity of 1.5bn liters of fresh milk serves Saudi and neighboring GCC markets. Almarai's 6 farms encompass a milking herd of 107,840 Holstein cows. Growth in this phase is driven by its fresh poultry segment (15% of revenue), which captures 35% share of the Saudi fresh poultry segment. The company's bakery segment (12% of revenue) produces approximately 1.3bn bakery products annually, marketed under the L'usine brand and the 7 Days brand. The company recently acquired 100% of Premier Foods, which provides value added products (meat and poultry) to the food services industry in the Middle East.

Valuation methodology and risks

We have a Hold rating on Almarai with a FV estimate of SAR61.00/share using a SOTP methodology with a 6-year DCF, discounted at a WACC of 7%, and a terminal growth rate of 2.5% for the dairy and juice, bakery, and poultry segments. Key downside risks to our forecasts include (i) spread of infectious disease (Mastitis) negatively affecting milk yield and milk quality, (ii) risk of availability of imported forage from the international markets, especially during drought, and (iii) competition risk together with risk of milk oversupply limiting the company's ability to pass on inflated imported feed amid lower government feed subsidies.

Main ratios	2019a	2020e	2021e	2022e
Per-share data				
EPS (SAR)*	1.9	2.1	2.2	2.5
BVPS (SAR)	13.8	14.7	15.6	16.6
DPS (SAR)	0.9	0.9	1.0	1.1
Valuation data				
P/E (x)*	28.3	25.9	24.9	21.9
P/BV (x)	3.9	3.7	3.5	3.3
Dividend yield	1.6%	1.7%	1.8%	2.1%
FCF yield	3.3%	5.6%	5.7%	6.6%
EV/ IFRS EBITDA (x)	16.2	15.5	14.7	13.3
Growth (y-o-y)				
Revenue	5.9%	6.5%	6.4%	4.5%
EBITDA	-3.2%	2.7%	3.2%	7.0%
Attributable net income	-10.3%	13.7%	6.3%	13.6%
Core attributable net income*	-15.3%	9.1%	4.0%	13.6%
Profitability				
Gross profit margin (GPM)	45.6%	44.5%	43.7%	44.3%
EBITDA margin	28.8%	27.8%	26.9%	27.6%
EBIT margin	18.0%	17.4%	16.6%	17.2%
Core net profit margin (NPM)*	13.4%	13.7%	13.4%	14.6%
ROAA*	5.8%	6.4%	6.8%	7.9%
ROAE*	13.9%	14.7%	14.3%	15.4%
ROAIC	7.0%	7.9%	8.4%	9.8%
Leverage				
Net debt (cash)/equity (x)	0.9	0.8	0.6	0.5
Net debt (cash)/IFRS EBITDA (x)	3.1	2.7	2.3	1.8

** based on core net attributable income (excluding one-offs)*

Source: Company, Beltone estimates

I. Valuation

Hold recommendation with a FV of SAR61.00/share

We have a Hold recommendation on Almarai with a FV of SAR61.00/share, implying 13% upside potential. We reach this value using a SOTP valuation methodology, where each of the dairy and juice, bakery, and poultry segments are valued separately using a DCF model.

We utilize a WACC of 7% and a cost of equity of 7.3% derived from (i) a risk-free rate of 2.35% (using the average of a 4-year and 7-year sovereign sukuk yield after zakat), (ii) equity market risk premium (ERP) of 6.2% (US market risk premium plus an additional country risk premium), and (iii) a beta of 0.8. Our WACC calculations are based on a 90% weight of equity and 10% weight of debt and lease after accounting for IFRS 16 accounting standards. We also use a terminal growth rate of 2.5%.

Figure 1: Discounted cash flow (SARmn)

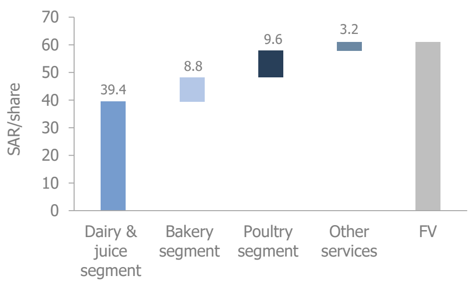
	2020e	2021e	2022e	2023e	2024e	2025e
EBIT	**2,655**	**2,703**	**2,927**	**3,216**	**3,376**	**3,610**
Zakat paid	(74)	(79)	(90)	(103)	(112)	(123)
NOPAT	2,580	2,624	2,837	3,113	3,264	3,487
Depreciation and amortization	1,592	1,678	1,762	1,796	1,877	1,967
Adjusted COPAT	4,172	4,302	4,599	4,909	5,141	5,454
Δ in net working capital	**(299)**	**(335)**	**(155)**	**(187)**	**(103)**	**(186)**
CAPEX	(1,060)	(1,063)	(1,067)	(1,071)	(1,074)	(1,078)
Increase in biological assets	(436)	(436)	(436)	(436)	(436)	(436)
Free cash flow to firm (FCFF)	**2,378**	**2,468**	**2,941**	**3,215**	**3,528**	**3,755**
Terminal value					-	82,729
PV of FCFF and terminal value	2,365	2,295	2,556	2,607	2,666	60,777
Enterprise value (EV)	73,265					
Net cash (debt) (as of 30 Sep 2020)	**(11,950)**					
Investments (as of 30 Sep2020)	244					
Minority Interest (as of 30 Sep 2020)	(552)					
Equity value	61,008					
FV/share, SAR	**61.0**					
Upside potential	13%					

Figure 2: Sensitivity of our FV to changes in WACC and terminal growth rate

		WACC				
Terminal growth rate		4.8%	5.8%	6.8%	7.8%	8.8%
	1%	42.7	42.7	42.7	42.7	42.7
	1.5%	50.2	50.2	50.2	50.2	50.2
	3%	61.0	61.0	**61.0**	61.0	61.0
	4%	77.6	77.6	77.6	77.6	77.6
	5%	106.8	106.8	106.8	106.8	106.8

Source: Beltone estimates

Figure 3: Summary of Almarai's SOTP valuation



Source: Beltone estimates

Figure 4: Summary of DCF valuation by segment

SARmn	DCF equity value	FV/share	% of value
Dairy and juice segment	39,349	39.3	65%
Bakery segment	8,810	8.8	14%
Poultry segment	9,633	9.6	16%
Other services	3,199	3.2	5%
Total valuation		**61.00**	

Source: Beltone estimates

II. Operations overview

1. Dairy and juice segment (65% of value)

Vertically integrated to secure high quality products, but comes at a cost

Having been in the business for over 40 years, the dairy business (79% of Almarai's net income) is the largest not only in the kingdom, but also across other GCC countries. The company generates almost 30% of its revenue from neighboring markets, GCC countries, Egypt, and Jordan. The introduction of a new competitor sponsored by the Omani government has led to a loss of market share in Oman, but management believes it can recapture the lost share at a later stage.

The company's success can be attributed to its ability to produce 1.5bn liters of high quality fresh milk (46% of GCC dairy consumption) out of its 6 Saudi-based farms. The fresh dairy industry is particularly concentrated in the central region of Saudi Arabia where humidity levels are low to preserve milk yield, which is negatively affected by high humidity levels.

These farms house a milking herd of 107,840 Holstein cows sourced from the US and Europe. Owing to breeding, nutrition, farm design, animal husbandry, and crop management, each of these cows yield an annual average of c14k liters, almost double the European figure and nearly 3.5k liters higher than the yield in North America.

Cows are housed and fed at a total mixed ration. To secure the supply of high quality fodder for its livestock, the company sources 40% of its alfalfa hay requirements (one third of total feed requirements) from its own farms in the US, Romania, and Argentina, with the remaining 60% of alfalfa hay besides other feed requirements (soybean, cotton seeds, etc) procured from international markets. This came following a Saudi government decree issued in 2014 that stipulated that by 2018 all local green fodder production for the purpose of herd consumption would be stopped in effort to preserve the kingdom's precious water resources. The operational cost of overseas farms adds close to SAR90mn annually to the company's total average operational costs, according to Almarai management.

SAR150mn in lost subsidies in 2021 on changes in subsidy regime

Almarai's dairy business had been previously eligible for feed subsidies ranging SAR250mn–SAR300mn to offset the high cost of imported feed. However, on 24 December 2019, the Saudi government removed subsidies on all feed imports except for 7 green fodders, including alfalfa hay, with its imports to remain subsidized at SAR221/ton. Accordingly, Almarai expects to collect a total of SAR150mn in subsidies in 2021 on alfalfa hay imports, just half of what it collected in 2019 and 2020 as the new decree will start reflecting on its 2021 financials, with the company set to record accrued amounts of SAR300mn in FY20 related to the 12-month feedstock sourced before the issuance of the decree.

Pricing opportunity for juice without added sugar given 50% selective tax imposed on sugary drinks

Almarai's juice segment margins have become squeezed as the company has not fully passed on the additional costs incurred on its sugar-free recipes to avoid the 50% selective tax imposed on sugary drinks in Saudi Arabia (consisting of water and sugar, sweeteners, concentrated liquids) effective 1 December 2019. During 9M20, juice revenue witnessed slow growth as consumers tended to focus on buying essentials. Though we believe the new tax imposed on sugary drinks should enhance demand for no-added-sugar juice (a can of a popular soda brand is 50% more expensive than 300ml carton of Almarai's fresh orange juice), management sees a pricing opportunity as the company will be able to raise the price of juice with no added sugar to levels below the new retail price of sugar-added products.

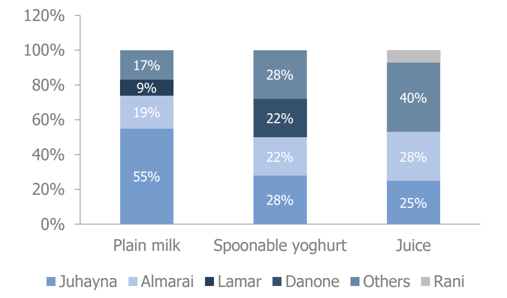
The juice segment is highly concentrated with the top 3 players holding market shares of 47% and 39% in the kingdom and across the GCC market,respectively.

Streamlining manufacturing operations in Egypt and Jordan

In 9M20, Almarai's Egyptian unit, IDJ a joint venture with Pepsi, managed to report strong 22% y-o-y growth in top line (partially supported by 5% EGP appreciation), outperforming domestic producers, with the growth stemming from strong market share positions in long-life milk, yoghurt, and juice (with introduction of new economic juice line) as well as successful distribution efforts by expanding over 30,000 coolers in clear store locations and strong brand positioning.

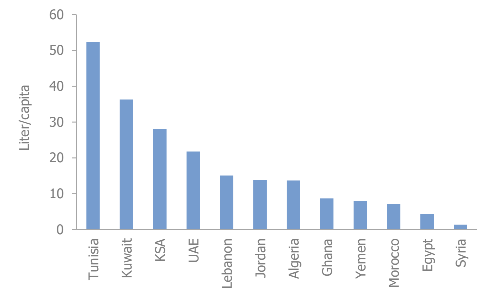
A new PET line also enabled the company to introduce attractive new packaging for its drinkable yoghurt products. Despite strong top line growth, however, International Dairy and Juice company (IDJ) continues to remain under stress on high labor (3,143 workers) and overhead costs in its Egyptian operations. Juhayna Food Industries' annual turnover/worker stood at EGP1.9mn in 2019, for example, compared to Almarai's EGP1.4mn. Accordingly, management is implementing a turnaround strategy with more focus on gross margin improvement and ROI for new CAPEX. Meanwhile, IDJ Jordan-based operations broke-even in 2020 due to its successful introduction of new products (Yoghurt Laban, Labaneh, and Almarai fresh juice), price recovery, and strict cost control measures and a focus on EBIT delivery. A farm renovation in Jordan also helped deliver high quality milk at below market prices. In 2019, IDJ recorded a total loss of SAR20mn out of its operations in Egypt and Jordan.

Figure 5: Almarai leads Egypt's juice market



Source: Juhayna Food Industries 1H20 IR presentation

Figure 6: Packaged milk consumption per capita in 2019

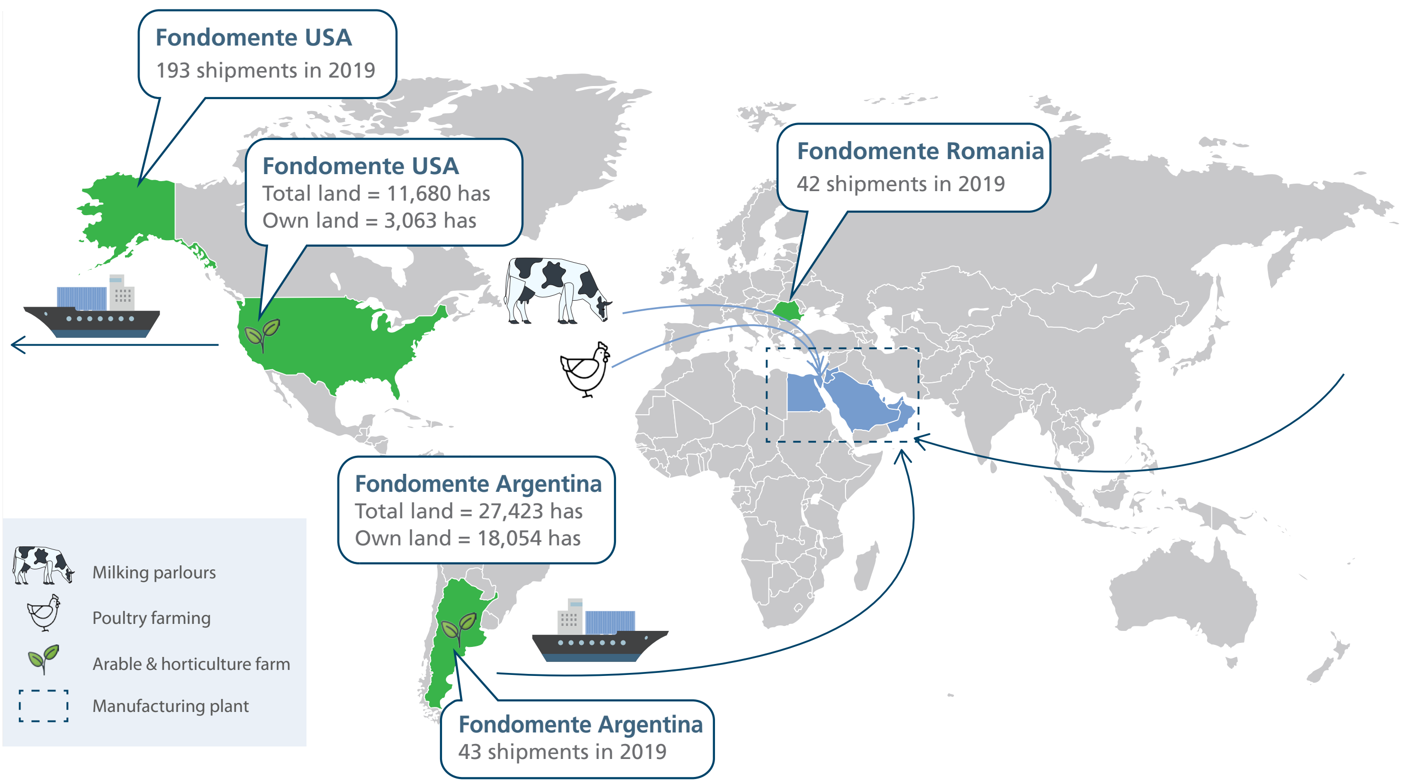


Source: Juhayna Food Industries 1H20 IR presentation

Distribution coverage presents competitive edge

Almarai benefits from an extensive distribution network, allowing fresh products to be distributed via over 9,092 trucks on the road on a daily basis, serving around 62,511 active customers within GCC countries and around 69,000 active customers within Jordan and Egypt.

Figure 7: Almarai's vertically integrated operations



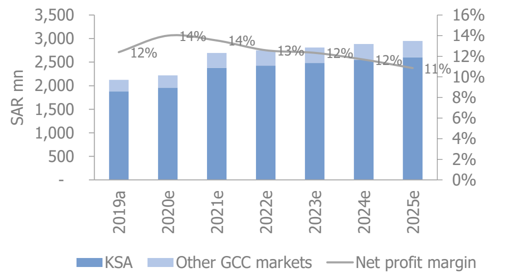
Source: Almarai investor presentation, June 2020

2. Poultry division (16% of value)

Fastest growing segment

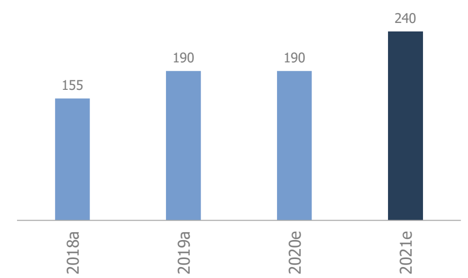
With a production capacity of 190mn birds, Almarai holds a 35% share of the Saudi fresh poultry segment and a 15% share of the total poultry market (fresh and frozen) in the kingdom. Almarai is currently adding a new production line to its 3 existing lines, which should add around 50mn birds, raising total capacity to around 240mn birds by 2Q21. Poultry revenue grew at a 3-year CAGR of 17% on the consolidation of its associate Pure Breed Company in 2018 following the acquisition of a controlling stake in 2018 as well as on diversifying beyond whole bird sales to selling boneless and mixed parts products. Operating under 2 brands, namely Alyoum and Al Bashayer, the poultry segment includes premium fresh products from whole chicken to portion packs and value-added options. Almarai also maintains its strong position in neighboring GCC markets such as the UAE and Bahrain, with a market share of 10% across the GCC poultry market, generating 12% of total poultry revenue. However, temporary bans on poultry imports in Kuwait from Saudi Arabia in February 2020 on the outbreak of the avian influenza (HPAI)A (H5N1) has affected Almarai's performance early this year in this market.

Figure 8: Poultry revenue to grow at a 6-year CAGR of 6% with margins to soften on projected higher fodder prices



Source: Company data, Beltone estimates

Figure 9: A fourth line should raise total capacity to 240mn birds (mn birds)



Source: Company data

Sector profitability improved on higher contribution of fresh retail channel on COVID-19; expected to remain unscathed from changes in subsidy regime

Due to the COVID-19 outbreak, Almarai's food service segment (relatively lower margins) was negatively impacted by the state-imposed curfews, leading to an increase in the contribution of the fresh retail channels to 70% of poultry revenue up from 51% on average. During 9M20, poultry segment revenue grew 12%, driven by volume growth as well as a higher average selling price on changes in channel mix during 2Q20. This filtered through to a higher net profit margin, rising to 15.4% from 12% in 9M19, as capacity was fully utilized. Additionally, the new 5% increase in import duties on frozen poultry to 25%, effective 20 June, supported Almarai's poultry segment growth.

In 2019, the company collected SAR150mn on poultry feed imports, and, based on management guidance, we expect the company will collect the same under the new production-based subsidy system.

Change in subsidy regime from imported feed to production based

Chicken meat producers incur a high production cost in Saudi Arabia, including the cost of controlling temperatures in chicken houses under extremely hot weather conditions and a heavy reliance on imported feed, vaccines, and equipment. To offset this high cost of production, the Saudi government provides several types of production support, including monthly production based direct financial subsidies to poultry producers, interest-free loans, and rebates on the purchase of certain poultry equipment. While poultry producers currently rely on imported feed, which accounts for about an average 70% of chicken production costs in Saudi Arabia, animal feed subsidies have been critical to the development of Saudi Arabia's poultry sector. In December 2020, Saudi Arabia eliminated most feed import subsidies and introduced production-based monthly financial payments to poultry producers. This was a move by the government to enhance the efficiency of local farms.

Figure 10: New poultry industry subsidy regime

Poultry type	Subsidy in SAR per month	Production unit
Broiler parent chicken	0.4	Per chick
Layer parent chicken	0.2	Per chick
Broiler chick	0.14	Per chick
Broiler meat	0.65	Per kg
Table eggs	15	Per carton of 360 eggs

Source: Barley Trade Quarterly, USDA, 6 Feb 2020

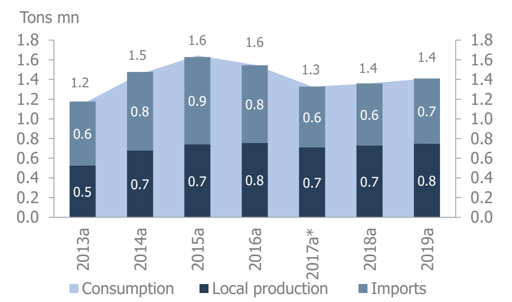
Importing high quality table eggs to cover market shortage

Almarai started importing table eggs from the Netherlands, Belgium, and Germany to cover market shortages during the pandemic, efficiently utilizing its wide distribution channel. Currently, the company is studying expansion into this side of the poultry segment. The outbreak of bird flu (H5N8) in layer farms in early February 2020 reduced the country's table egg production by approximately 30%. This together with increased at-home consumption due to COVID-19 has driven the retail price of table eggs to increase by over 50%.

Poultry consumption steadily rising on affordability and health perception

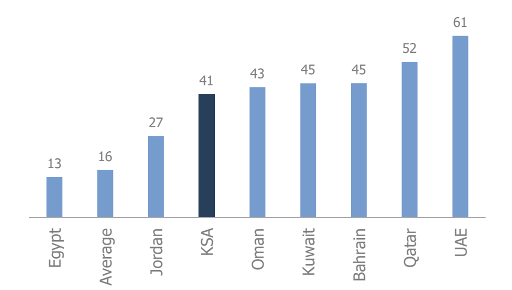
Saudi Arabia's annual poultry consumption, estimated at 1.4mn tons by the USDA, is considered the highest of all animal protein consumption, with per capita consumption in 2019 estimated at approximately 41kg, compared to 12kg for red meat, given its affordability and positive health perception over red meat. Chicken remains the most price competitive animal protein source in Saudi Arabia. Imported commercial beef is sold for up to USD12/kg, while lamb is sold for up to USD15.70.kg, and chicken at USD4.4/kg. After maintaining steady consumption growth for years, this segment's total consumption dropped, mainly on the expat exodus in 2017, though consumption has ticked up since then. The Saudi poultry meat market is cyclical in nature, with demand rising dramatically during the Umrah and Hajj seasons (prior to Eid al-Adha), particularly in the cities of Mecca and Medina where visitors go to perform the Umrah and Hajj rituals. However, consumption typically declines significantly during the month of Ramadan and during the summer months when millions of Saudis and expatriate workers leave the kingdom for vacations. During 2020, demand was supported by at-home consumption on lockdowns and travel restrictions due to the COVID-19 pandemic. That said, we expect the resumption of international flights to still support demand in 2021e. However, should the government reinstate curfew measures in the event of a second wave, we believe demand for frozen poultry will decline on disrupted tourism, a continued expat exodus, as well as the impact of social distancing measures on food service companies.

Figure 11: Size of the poultry market



**Imports dropped in 2017 on spread of the avian flu amid expat exodus*
Source: USDA Poultry and Products annual report, Sep 2020

Figure 12: Annual per capita poultry meat consumption in Egypt and the GCC (kg/capita)

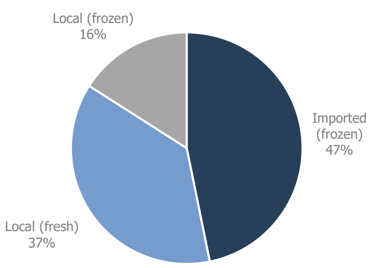


Source: USDA Poultry and Products annual report, Arab organization for Agricultural Development datastat, 2017

New government measures to increase poultry self-sufficiency

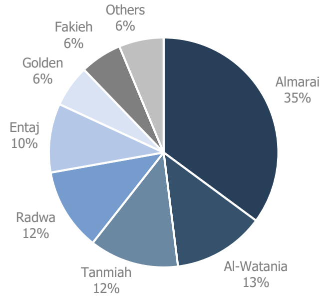
Domestic chicken meat production in Saudi Arabia reached 730k tons (covering 53% of demand) in 2019, produced by 10 vertically integrated companies controlling over 80% of production. Meanwhile, imports mainly from Brazil and France cover 47% of unmet demand. The poultry market in Saudi Arabia is divided into 2 major segments, fresh (chilled) products produced locally, with a shelf life of approximately 6 days from the production date, and frozen products, produced both locally and imported. The government introduced several measures aiming to reduce reliance on imported chicken and increase the self-sufficiency level to 80% by 2025, including offering local farmers veterinary services that have helped lower the country's average chicken mortality rate to 10% currently from 25% few years ago.

Figure 13: Saudi Arabia's poultry market structure



Source: Almarai investor presentation, June 2020

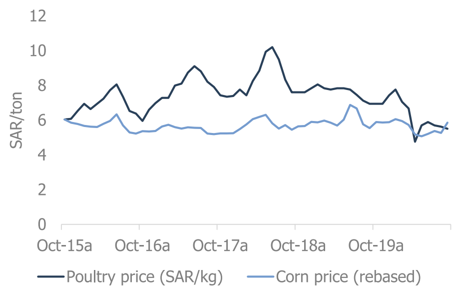
Figure 14: Retail fresh chicken market share (by sales value)



Source: Almarai investor presentation, June 2020

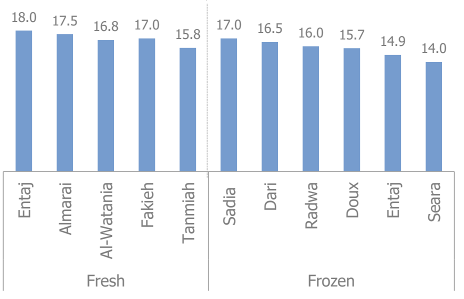
The Saudi government, as part of its measures to promote local manufacturers, raised import duties from 5% to 20% effective 2017, (or SAR1.00/kg, whichever is higher), which was then raised to 25% on 20 June 2020. This gave shield to local manufacturers to protect their market share as current retail prices of frozen poultry is only 8% lower on average compared to fresh (chilled) poultry following the VAT increase to 15% in July, making locally produced chicken meat more competitive.

Figure 15: Price of imported chicken mirrors corn price movements



Source: Indexmundi/commodities

Figure 16: Fresh and frozen chicken retail selling price (SAR/kg)



Source: Al-Othaim, Carrefour, 13 July 2020 online prices

Brazil's BRF to set up a new processing plant with a CAPEX of USD120mn

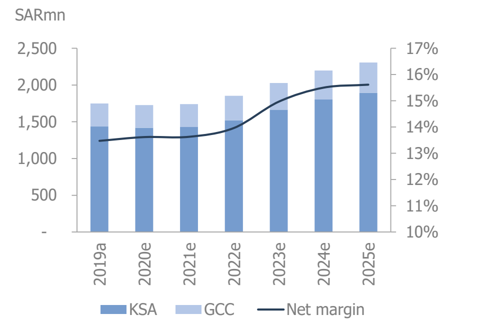
Brazilian food processor BRF SA announced its intentions to invest around USD120mn to build its first chicken processing plant in Saudi Arabia in a bid to strengthen its position in a key growth market. The plant, with an estimated production capacity of 50k tons, is slated to start operating by the end of 2021, and will focus on producing value-added products such as breaded and marinated products and burgers. According to a USDA report, the Saudi government issued new operational licenses for 107 projects with a production capacity of 500mn chickens, in addition to 77 new poultry farms with a combined production capacity of 220mn birds. No information on was provided when construction of these new projects would be completed.

3. Bakery segment (14% of value)

Flat performance of Almarai bakery segment on pandemic fallout

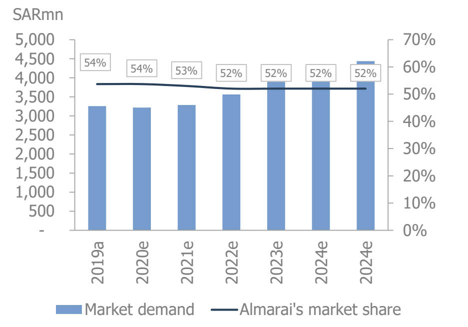
The closure of educational institutions and travel restrictions has pressured demand for single serve bakery items, which led to flat y-o-y performance of Almarai's bakery segment in 9M20, mainly supported by the increase in bread consumption. Almarai's bakery segment market share has been steadily declining, reaching 54% in August 2020 from 60% in 2016, likely on rising competition.

Figure 17: Expect bakery revenue to slow on COVID-19



Source: Company data, Beltone estimates

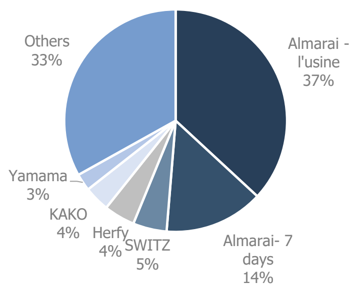
Figure 18: Expect Almarai's market share to decline gradually, but remain over 50%



Source: Company data, Beltone estimates

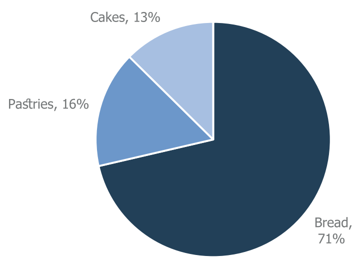
Almarai's bakery segment produces approximately 1.3bn bakery products annually, marketed under the L'usine brand (with a portfolio of bread, pastry, cakes, and biscuits) and the 7 Days brand (pastry and cakes). Ongoing production capacity expansions in Jeddah and Al Kharj have enabled a wider distribution of its products, which cover all GCC markets. L'usine is the leading player in this business segment, with 37% market share, while 7 Days has 14% market share.

Figure 19: Bakery market is concentrated in Saudi Arabia (by value)



Source: Almarai investor presentation, June 2020

Figure 20: Solid ground for market growth



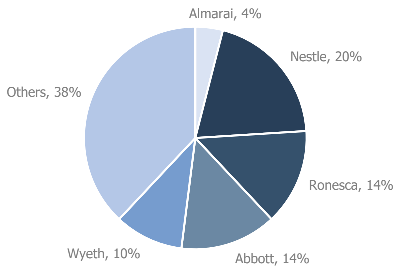
Source: Almarai investor presentation, June 2020

Subsidy removal on stage 3 infant milk disrupts segment's performance

The removal of subsidies on stage 3 infant milk formula products (12–36 months), which represent 43% of infant nutrition volumes in Saudi Arabia, in addition to restrictions on advertising and promotions, has negatively impacted the company's instant formula segment performance. However, we expect Almarai to continue to focus on revenue generating opportunities in the wholesale export markets and by participating in government tenders.

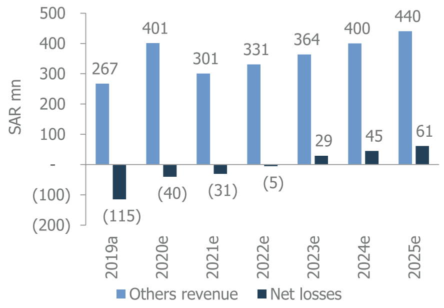
Almarai's SAR1bn state-of-the-art infant formula manufacturing facility located at Al Kharj has a production capacity of 20,000 tons and 25mn liters of liquid. The company manufactures the Nuralac and Nurababy range of products, which are distributed across the Saudi market. The facility also manufactures and exports third-party private labels that are distributed in different countries in Asia and Africa. In addition to these products, a premature and routine ready-to-feed solution is also distributed to hospitals located in Saudi Arabia. A Nuralac distribution agreement was completed with Chemical Company for Commercial Investment (CCCI) to widen distribution within the pharma industry. Also, the company was awarded the tender by National Unified Procurement Company (NUPCO) for supplying innovative Infant Nutrition Products to government hospitals.

Figure 21: Almarai holds 4% share of infant formula in Saudi Arabia; remaining 96% is imported



Source: Almarai investor presentation, June 2020

Figure 22: Infant milk and food services segment to continue to record losses for 24 months due to transfer pricing issues and required improvements in food service channel post COVID-19

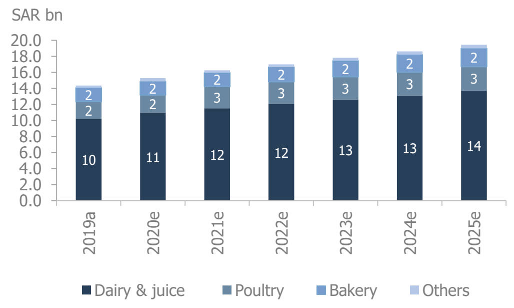


**Others revenue include revenue of infant formula and the new food service channel*
Source: Company data, Beltone estimates

Entering the food service channel

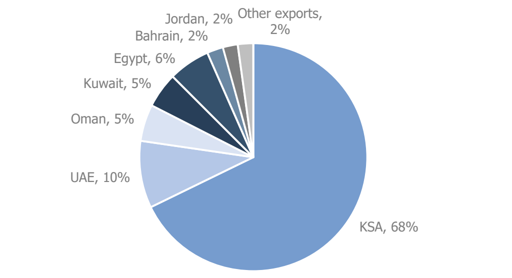
Almarai acquired a 100% stake in Premier Foods, which is mainly engaged in providing value-added products (meat and poultry) to the food services industry in the Middle East. This acquisition should further enhance Almarai's footprint for expansion in the food services channel. Management expects this segment to continue to record losses for at least 18–24 months due to transfer pricing issues and improvements required in the food services channel post COVID-19.

Figure 23: Revenue to grow at 2019–25 CAGR of 5%...



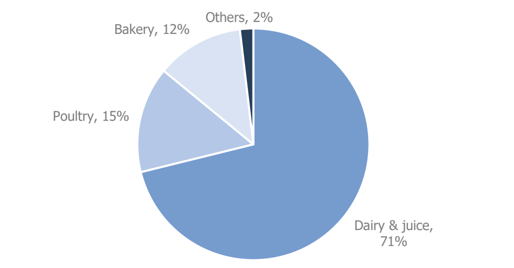
Source: Company data, Beltone estimates

Figure 24: ...supported by diversified market reach...



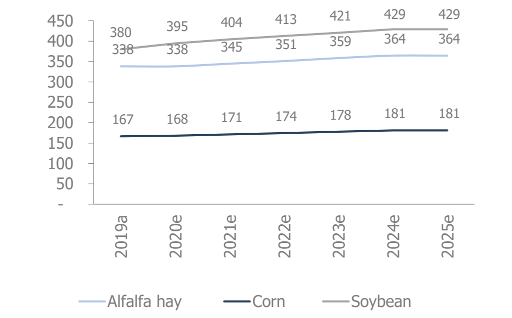
Source: Company data

Figure 25: ...and diversified product range



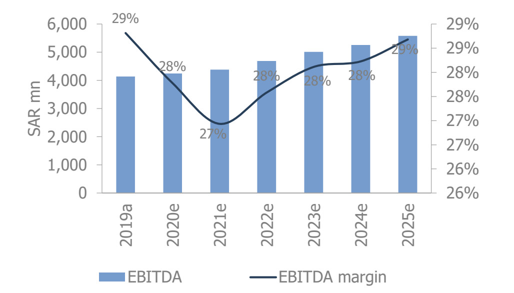
Source: Company data

Figure 26: Feed prices to grow at a 6-year CAGR of 2% (USD/ton)



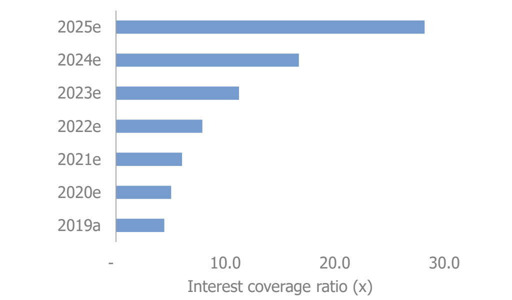
Source: FAO, Beltone estimates

Figure 27: EBITDA to grow at a 6-year CAGR of 5%, despite subsidy removal and higher feed prices



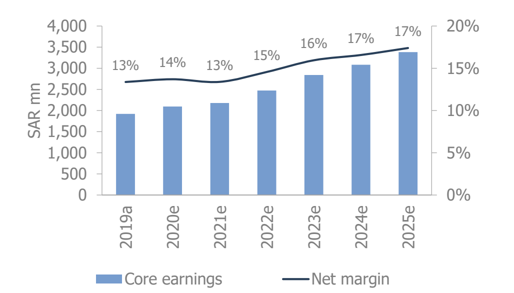
Source: Company data, Beltone estimates

Figure 28: Interest coverage ratio to improve on continuous deleveraging



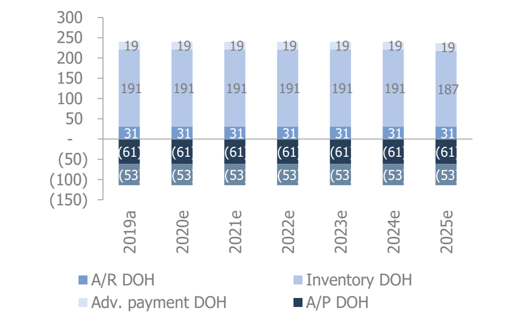
Source: Company data, Beltone estimates

Figure 29: Core earnings to grow at 6-year CAGR of 10%



Source: Company data

Figure 30: Asset conversion cycle is balanced (DOH)



Source: Company data, Beltone estimates

Rating:	**Hold**
Fair value:	**SAR33.90**
Market price:	**SAR30.00**
Upside:	**13%**

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National Agricultural Development Company (NADEC)

New management seeks new growth opportunities along with cost rationalization initiatives

Food and Dairy | Saudi Arabia

Initiation of Coverage 1 December 2020

Initiate coverage with a FV of SAR33.90/share and a Hold rating

One of the leading Saudi dairy and food companies, the National Agricultural Development Company (NADEC) has continued to capitalize on its brand power along with its competitive pricing strategy to capture higher market share in the kingdom, recording an annual uptick of 1.8ppt to 12.9% in the dairy segment and 1.0ppt in the food (cheese) segment to 5.9% as of March 2020. This is largely attributed to NADEC's vertically integrated operations, in which it produces over 1.3mn liters of raw milk daily from its own farms housing 83,000 American Holstein cows. The company's new management is exploring further growth opportunities, including expanding its organic olive oil segment to cater to growing market needs, with the company owning some 5mn organic olive trees cultivated to produce over 5mn liters of oil annually. We value NADEC using a DCF model, yielding a FV of SAR33.90/share, which wrrants a Hold rating on 13% upside potential from the current share price. We expect core earnings to grow at a 2019–25e CAGR of 7%, supported by revenue growth and margin enhancement.

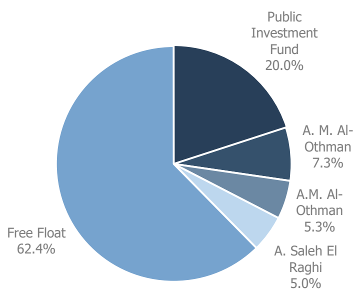
Margins to soften in 2020e on high cost of feed imports and subsidy removal

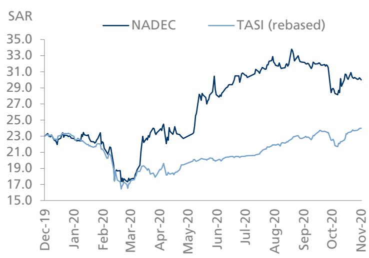
While consolidated operating margins have improved over 2017–19 on better product mix, profitablility margins were pressured in 9M20 with EBITDA margin dropping 3.5ppt to 18% from 21% in 2019 on the high cost of imported feed as well as the elimination of feed subsidies on non-green fodder imports, reflecting in NADEC's 2Q20 and 3Q20 numbers. In this regard, management is currently considering cost-saving initiatives that should gradually support margins in 2021 with the full impact to reflect in 2022. Going forward, we do not rule out gradual price adjustments for fresh milk to pass on higher feed cost starting 2021e and 2022e as purchasing power returns to pre-COVID levels.

Exploring new growth opportunities; turning focus on reactivation of unutilized land to grow fruits and vegetables

The company's new management is working on several cost-saving initiatives as well as exploring further growth opportunities. NADEC started exporting to the Egyptian market (population of over 100mn). Management also highlighted that the offer to acquire 100% of Al Safi Danone Company, the fourth largest dairy producer in Saudi Arabia, could further be reinstated, despite initial negotiations falling through back in June 2019 as the deal was not value accretive for both parties. The deal was conditional on NADEC's share market value among other criteria at the time of execution. While NADEC's share price is up 46% since the deal was terminated, we believe diversifying its product range to other high-margin non-dairy segments such as the agribusiness will add more value than expanding in the dairy business given arising cost pressures, milk oversupply following the emabargo in Qatar, entrance of new regional competitors, and price competition.

Shareholders structure





*Closing as of 29 November 2020

Stock data

Reuters	6040.SE
Bloomberg	NADEC EY
Shares (mn)	102
MKT cap	SAR3,049mn/ USD813mn
3M avg. daily liquidity	SAR30.7mn/ USD8.1mn
52-week high/low	SAR34.45/SAR16.82
Free float	62.4%

Main financial highlights (FY end Dec)

In SARmn, unless otherwise stated	2019a	2020e	2021e	2022e
Revenue	2,225	2,288	2,430	2,558
EBITDA	468	394	427	449
EBITDA margin	21.0%	17.2%	17.6%	17.6%
Recurring net income*	104	37	68	76
P/E (x)*	29	83	45	40
EV/EBITDA (x)	10	12	11	10
ROAE*	7.2%	2.5%	4.5%	4.8%

** based on core net income (excluding one-offs and volatile items)*
Source: Company, Beltone estimates

Financial statement | FY end Dec (SARmn)

Income statement	2019a	2020e	2021e	2022e
Revenue	2,225	2,288	2,430	2,558
COGS	(1,176)	(1,282)	(1,353)	(1,437)
Gross profit	**1,049**	**1,006**	**1,077**	**1,120**
SG&A expenses	(581)	(612)	(650)	(671)
EBITDA	**468**	**394**	**427**	**449**
Depreciation and amortization	277	292	305	319
EBIT	**191**	**102**	**123**	**130**
Net financing costs	(118)	(52)	(53)	(52)
Other income/costs	(76)	53	-	-
Earnings before zakat	**(3)**	**104**	**70**	**78**
Zakat	(5)	(3)	(2)	(2)
Net profit after zakat	**(8)**	**101**	**68**	**76**
Core Earnings	104	37	68	76

Balance sheet	2019a	2020e	2021e	2022e
Cash and equivalents	63	21	27	29
Accounts receivables	341	341	365	387
Inventory	548	590	606	605
Prepaid expenses and other receivables	156	164	170	176
Total current assets	**1,107**	**1,116**	**1,168**	**1,197**
Total non-current assets	**2,837**	**2,909**	**2,901**	**2,886**
Total assets	**3,944**	**4,024**	**4,068**	**4,083**
Banks short-term borrowings	316	620	870	1,050
CPLTD	308	308	281	274
Account payables	415	453	478	508
Creditors and other credit balances	204	210	214	219
Total current liabilities	1,243	1,591	1,843	2,050
Long-term debt	1,088	780	499	225
Provision for end-of-service benefits	166	170	175	179
Other liabilities	6	6	6	6
Total non-current liabilities	1,260	956	680	411
Paid-in capital	847	1,016	1,016	1,016
Reserves	201	211	218	226
Retained earnings	392	250	311	380
Total equity	1,440	1,477	1,546	1,622
Total liabilities and equity	**3,944**	**4,024**	**4,068**	**4,083**

Cash flow	2019a	2020e	2021e	2022e
Change in working capital	118	(18)	(17)	8
Cash flow from operations	551	378	413	459
CAPEX	(311)	(335)	(268)	(275)
Cash flow from investing	(236)	(363)	(297)	(304)
Free cash flow (FCF)	**316**	**15**	**117**	**155**
Cash flow from financing	(289)	(56)	(111)	(153)
Change in cash	27	(41)	6	2

Investment summary

Established in 1981, NADEC is the first agricultural shareholding company set up by a royal decree from the Saudi government to contribute to the food security and sustainability in the kingdom. Listed on the Saudi Tadawul in 1993, NADEC is currently one of the leading vertically integrated dairy producers with a 15% share in the Saudi dairy market. The company produces milk (fresh and long-life milk), laban, yoghurt, cheese and olive oil through its dairy and food arm (94% of revenue) in addition to fruits and vegetables through its agricultural arm (6% of revenue). With 4 cultivating projects in Saudi Arabia, NADEC cultivates 100,000 tons of fruits and vegetables, 3,000 tons of organic dates, and 5mn olive trees across a total land area of 25.4k hectares. NADEC's cattle farms produce over 1.27 liters of raw milk daily, with the support of 83k American Holstein cows, with main feed ingredients sourced from its 60k feddans leased in Sudan (less than 10%), the US, and European countries following the ban on locally grown forage crops. NADEC has 34 wholly owned distribution facilities and sells over 180 SKUs across 48,000 retail stores in Saudi Arabia and the GCC.

Valuation methodology and risks

We have a Hold rating on NADEC with a FV estimate of SAR33.90/share using a 6-year DCF, discounted at a WACC of 6.6%, and a terminal growth rate of 2.5%.

Key downside risks to our forecasts include (i) spread of infectious disease (Mastitis) negatively affecting milk yield and milk quality, (ii) risk of availability of imported forage from international markets especially during drought, (iii) competition risk together with risk of milk oversupply limiting the company's ability to pass on inflated imported feed.

Main ratios	2019a	2020e	2021e	2022e
Per-share data				
EPS (SAR)*	1.0	0.4	0.7	0.7
BVPS (SAR)	14.2	14.5	15.2	16.0
DPS (SAR)	-	-	-	-
Valuation data				
P/E (x)*	29.3	82.9	44.7	40.1
P/BV (x)	2.1	2.1	2.0	1.9
Dividend yield	0.0%	0.0%	0.0%	0.0%
FCF yield	10.4%	0.5%	3.8%	5.1%
EV/ IFRS EBITDA (x)	10.0	12.0	10.9	10.2
Growth (y-o-y)				
Revenue	6.2%	2.8%	6.2%	5.3%
EBITDA	16.8%	-15.9%	8.5%	5.0%
EBIT	47.3%	-46.5%	20.1%	5.8%
Attributable net income	NA	NA	-32.6%	11.4%
Core attributable net income*	97.9%	-64.6%	85.4%	11.4%
Profitability				
Gross profit margin (GPM)	47.2%	44.0%	44.3%	43.8%
EBITDA margin	21.0%	17.2%	17.6%	17.6%
EBIT margin	8.6%	4.5%	5.1%	5.1%
Core net profit margin (NPM)*	4.7%	1.6%	2.8%	3.0%
ROAA*	2.6%	0.9%	1.7%	1.9%
ROAE*	7.2%	2.5%	4.5%	4.8%
ROAIC	3.2%	1.1%	2.1%	2.3%
Leverage				
Net debt (cash)/equity (x)	1.1	1.1	1.1	0.9
Net debt (cash)/IFRS EBITDA (x)	8.6	16.5	13.2	11.7

** based on core net attributable income (excluding one-offs)*

Source: Company, Beltone estimates

I. Valuation

We have a Hold recommendation on NADEC with a FV of SAR33.90, implying a 13% upside potential. We reach this value using a FCFF valuation methodology. Our DCF model utilizes a WACC of 6.6% and a cost of equity of 7.4% derived from (i) a risk-free rate (using the average of a 4 year and 7-year sovereign sukuk yield after zakat) of 2.3%, (ii) equity market risk premium (ERP) of 6.2% (US market risk premium plus an additional country risk premium), and (iii) a beta of 0.8. Our WACC calculations are based on a 64% weight of equity. We also use a terminal growth rate of 2.5%.

Figure 1: Discounted cash flow (SARmn)

	2020e	2021e	2022e	2023e	2024e	2025e
EBIT	**102**	**123**	**130**	**162**	**183**	**199**
Zakat	(3)	(2)	(2)	(3)	(3)	(4)
NOPLAT	100	121	128	160	180	195
Depreciation and amortization	292	305	319	335	354	375
Adjusted COPLAT	391	426	447	495	534	570
CAPEX	**(285)**	**(268)**	**(275)**	**(287)**	**(305)**	**(313)**
Change in working capital	(18)	(17)	8	(15)	(25)	(22)
FCFF	89	141	180	193	203	234
Terminal value						**5,714**
PV of FCFF	88	131	157	159	156	4,276
Enterprise value (EV)	4,967					
Net debt (cash) (as of 30 Sep 2020)	**1,518**					
Equity value	3,450					
FV/share, SAR	**33.9**					
Potential return	13%					

Figure 2: Sensitivity of our FV to changes in WACC and terminal growth rate

Terminal growth rate	WACC				
	4.4%	5.4%	6.4%	7.4%	8.4%
0.5%	20.4	20.4	20.4	20.4	20.4
1.5%	25.9	25.9	25.9	25.9	25.9
2.5%	33.9	33.9	**33.9**	33.9	33.9
3.5%	47.1	47.1	47.1	47.1	47.1
4.5%	72.1	72.1	72.1	72.1	72.1

Source: Beltone estimates

II. Operations overview

1. Dairy and food segment (93% of FY19 revenue)

New management targets growth opportunities to boost top line performance

Steen Hadsberg, NADEC's new CEO, along with the rest of the team target exploring new growth opportunities to stimulate top line growth, which grew at 2016–19 CAGR of 1%. We believe the company will continue to capitalize on sustainable market demand for dairy products, especially fresh milk (47% of sales), long-life milk (18% of sales), and cheese (11% of sales). NADEC started exporting long-life milk to the Egyptian market, and has regional presence in Jordan, Lebanon, the Sychelles, along with GCC neighboring markets. Meanwhile, we believe juice sales (13% of sales) will continue to slow on growing competition and price sensitivity, especially following the kingdom's imposition of a 50% excise tax on sugar-sweetened beverages effective December 2019. NADEC's olive oil segment grew at a 2016–19 CAGR of 60%. Given the strong demand for olive oil in the kingdom, NADEC decided in March 2019 to build the second phase of the existing olive-oil mill in Al-Jouf with an estimated CAPEX of EUR3mn. The company awarded Germany-based GEA for the project, which, once finalized, should be the largest in Asia. Going forward, we estimate top line will grow at a 2019–25e CAGR of 5%, driven by recovering economic performance post 2022e as well as expected selling price adjustments and expansions into new high-growth segments.

Figure 3: GCC dairy market by brand*

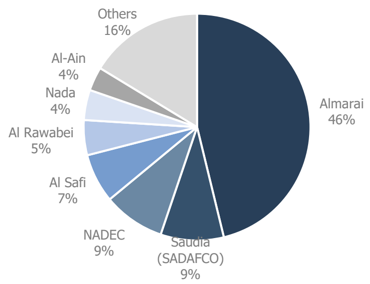


Figure 4: GCC processed cheese market by manufacturers

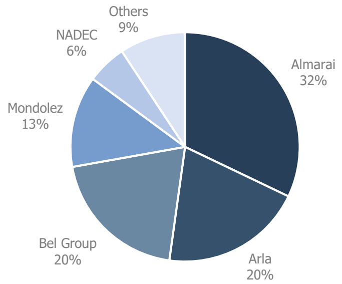
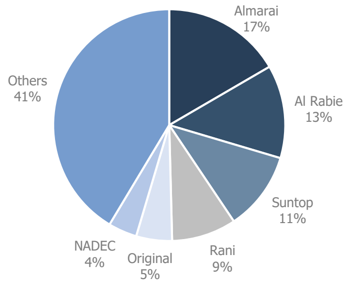


Figure 5: GCC juice market share data by brand**



**Dairy market includes fresh milk, long-life milk, laban and yoghurt*
*** Juice includes Fresh, long-life, cans and others*
Source: Nielsen company, Jun 2019/ Almarai IR presentation, 30 June 2020

Margins to soften on high cost of feed imports and subsidy removal

The increased cost of imported forage following the elimination of their subsidies (except alfalfa) and the higher feed prices have pressured NADEC's 9M20 operating margins. This, in addition to expected milk oversupply and weakening purchasing power, will also continue to pressure margins in the coming period. According to management, feed subsidies, recorded on an accrual basis, will likely drop to SAR50mn–SAR60mn in 2020 from SAR86mn in 2019 on consumed feed. NADEC operates one of the leading vertically integrated dairy operations, with over 7 cattle farms housing 83k Holeistein cows producing 1.27mn liters of fresh milk per day, and 2 processing facilities in the city of Haradh, which produces fresh milk, long-life milk, and their derivatives such as laban, yoghurt, butter, cream, and cheese. Given the ban imposed on growing forage in the kingdom to preserve water resources, the company started in 2018 to import its feed needs of yellow corn, alfalfa hay, soybean, and DDSG. Around 6% of its daily 1,500 ton needs are sourced from the company's leased farm in Sudan (60k feddans) with the balance sourced from the US and Eastern Europe.

Management considering strategic cost-saving initiatives to protect margins

To support margins, management is currently considering the following initiatives: (i) restructuring methods for the land in Sudan given the current high cost of feed sourced from Sudan compared to other countries, (ii) working on different feed recipes to balance cost by utilizing lower cost feed instead of high cost ones, (iii) outsourcing the supply chain through a vendor-managed inventory model (VMI), where the manufacturer hands over the responsibility of replenishing stock to key suppliers to supply just in time feed based on production plans and forecasts.

This should eliminate the working capital burden and storage costs, as the company usually keeps 7–8 months of alfalfa hay stock in Haradh, (iv) managing the right balance between the retail and the food service channels to achieve higher profitability given the latter's low cost of distribution, (v) efficient utilization of its distribution network, with distribution costs currently 45%–50% higher than peers, through distribution center optimization, and (vi) waste management and reducing sales return of 6% (20mn) to 5%. Management expects these initiatives to start reflecting in 2021, with the full impact to reflect on 2022 numbers.

Al Safi Danone deal negotiations terminated, but could be reinstated

Management highlighted that the offer to acquire 100% of Al Safi Danone, the fourth largest dairy producer in Saudi Arabia, could further be reinstated though negotiations were terminated in June 2019 as the deal was not value accretive for either party. Valued in 2018 at SAR1bn–SAR1.5bn, the transaction was planned to be financed by NADEC holding a SAR536mn capital increase with target shareholders owning 38.75% of NADEC and existing shareholders diluted to 61.25%. The deal was conditional on NADEC's share market value among other criteria at the time of execution. While NADEC's share price has risen 46% since the deal was terminated, we believe diversifying its product range to other high-margin non-dairy segments such as the agribusiness will add more value than expanding in the dairy business.

2. Agricultural products, feed, and others (7% of FY19 revenue)

Turning focus on reactivation of unutilized land to grow fruits and vegetables

With over 25k hectares of cultivated land across 4 major agriculture locations, we believe NADEC's agriculture segment will continue to grow, as management turns its focus on reactivation of unutilized land plots following the ban of feed cultivation in Saudi Arabia to preserve water resources. The segment was mainly focused on growing forage, such as alfalfa hay, corn, and soybean, for internal consumption of the herd, with sales of excess feed representing 5% of revenue in 2018. Now, management is increasing focus on growing value-added fruits and vegetables, including potatoes, onions, and palm, given Saudi consumers have recently been shifting food consumption patterns toward fresh products in effort to maintain healthier lifestyles, in line with global trends.

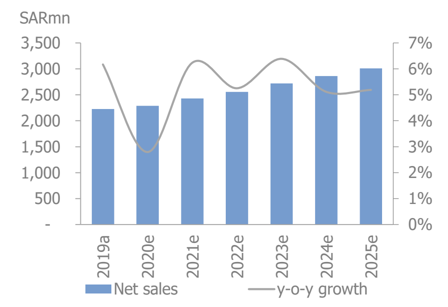
NADEC's Al-Jouf site is located 1,250km from Riyadh, with a cultivated area of 4,000 hectares and a suitable climate for the cultivation of fruit trees such as peach, apricot, and plum. With over 100,000 tons of fruits and vegetables and 280 tons of premium organic dates gathered throughout Saudi Arabia, NADEC's agricultural segment (4% of total FY19 sales) recorded the utmost improvement across all other business segments with a 23% y-o-y enhancement in 2019.

On 4 November 2020, NADEC signed a memorandum of understanding (MOU) with Pure Harvest Smart Farms Company to build and operate approximately 6 hectare high-tech hydroponic climate-controlled greenhouses as a first phase within NADEC City in Haradh. This came in a bid to produce and supply high-quality fresh fruits and vegetables to the Saudi market. The MOU will mature after 150 days from the signing date. On a macro level, the government has been endorsing drip irrigation to cope with limited water supply, with the aim of sustaining local fruit and vegetable cultivation. These undertakings are projected to diminish local necessity on imports and consequently improve national cultivation, with the size of the kingdom's fruit and vegetable capacity to grow at a 2020–25e CAGR of 5.2%, according to industry data.

Feed and others

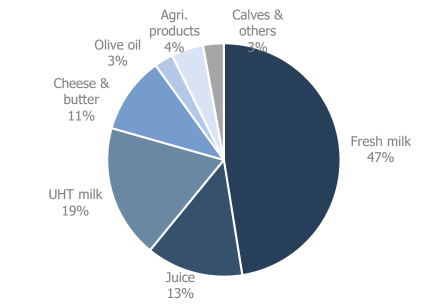
According to the United Nations Development Programme (UNDP), some 81% of Saudi Arabia's fresh water is utilized for cultivation. Accordingly, the government prohibited the harvesting of green fodder in November 2018 to preserve water levels. As a result, NADEC's 2019 feed revenue plummeted to SAR1mn from SAR109mn in the previous year. We believe the segment will continue to demonstrate insignificant levels going forward as the government maintains its policy to preserve water reserves. NADEC's other revenue category includes the sales of calves and bulls, which recorded a considerable increase of 14.7% y-o-y in FY19, possibly on the oversupply of milk production during the previous years.

Figure 6: Revenue to grow at 2019–25e CAGR of 5% supported by dairy and agriculture sector



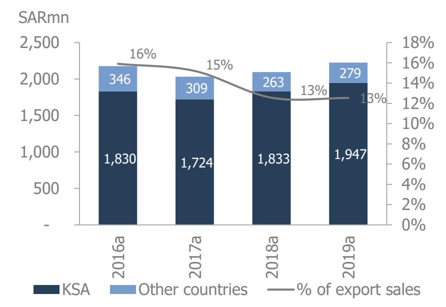
Source: Company data, Beltone estimates

Figure 7: Fresh milk to continue to lead contribution to top line



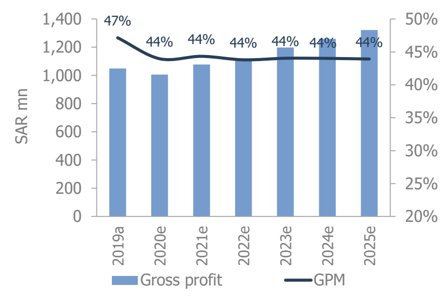
Source: Company data

Figure 8: Limited exports to the GCC, Levant, Libya, Pakistan, Australia, and the Seychelles



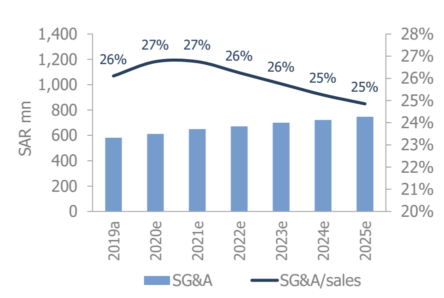
Source: Company data

Figure 9: GPM to drop on feed subsidy removal and higher feed cost, but remain supported by cost saving measures



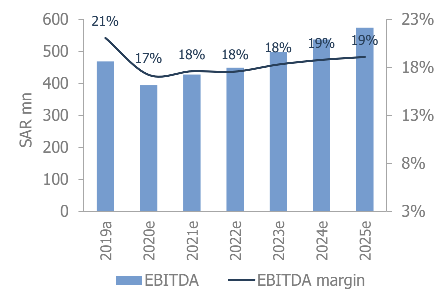
Source: Company data, Beltone estimates

Figure 10: High SG&A/sales ratio to gradually decline on cost saving initiatives



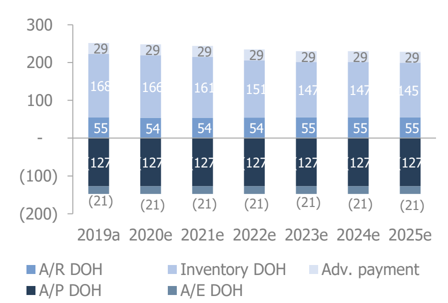
Source: Company data, Beltone estimates

Figure 11: Overall EBITDA margins to drop, but to gradually recover on cost-saving initiatives



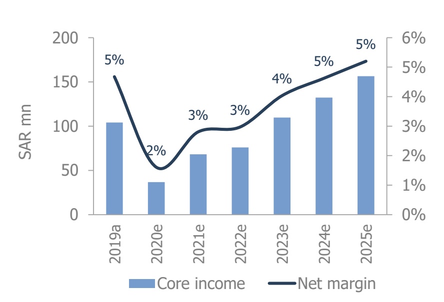
Source: Company data, Beltone estimates

Figure 12: High feed stock on hand to gradually reduce on efficient feed sourcing



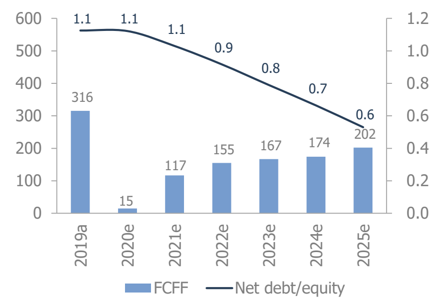
Source: Company data, Beltone estimates

Figure 13: Core earnings to grow at a 6-year CAGR of 7%



Source: Company data, Beltone estimates

Figure 14: Steady recovery of FCFF; net debt/equity to gradually decline



Source: Company data, Beltone estimates

BELTONE FINANCIAL

Rating:	**HOLD**
Fair value:	**SAR194.40**
Market price:	**SAR175.20**
Upside:	**11%**

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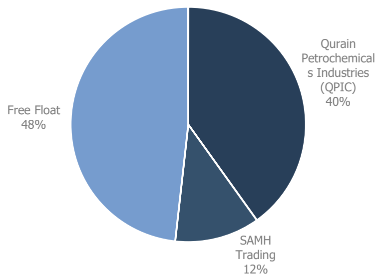
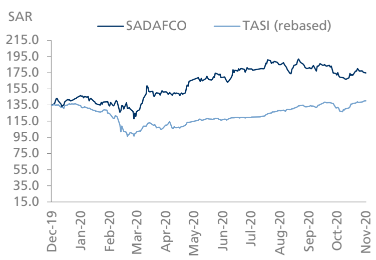
Shareholders structure





*Closing as of 29 November 2020

Stock data

Reuters	2270.SE
Bloomberg	SADAFCO AB
Shares (mn)	32
MKT cap	SAR5,603mn, USD1,494mn
3M avg. daily liquidity	SAR9.3mn, USD2.5mn
52-week high/low	SAR197/SAR114.4
Free float	48%

Saudia Dairy & Foodstuff Company (SADAFCO)

Diversification is key for higher growth

Food and Dairy | Saudi Arabia

Initiation of Coverage 1 December 2020

Initiate coverage with a FV of SAR194.40/share and a Hold rating

We initiate coverage on Saudia Dairy and Foodstuff Company (SADAFCO) with a FV of SAR194.40/share, derived via a DCF valuation, and a Hold recommendation on 11% upside potential from the current market price. SADAFCO has maintained its steady growth performance since it was established in 1976 by offering a wide product range, including ice cream and tomato paste, in addition to long-life milk. Increasing piling-up activities during the pandemic gave a boost to the company's long-life milk and tomato paste, though SADAFCO's long-life milk is priced at a premium compared to key competitors on its strong brand equity. Current weak consumer spending is likely to slow revenue growth, and accordingly the projected higher SMP prices will likely pressure operating margins. In this regard, we expect earnings to decline 6% in FY22e (FY ending March), with earnings to then grow at a 4-year CAGR of 6%, supported by revenue growth as the impact of the pandemic subsides.

Fresh milk oversupply and higher SMP prices to impact margins in 2021e; potential selling price adjustments as purchasing power restores to pre-COVID levels

We believe discounts on long-life milk selling prices will likely resume in the coming period in light of an expected fresh milk market supply glut on the expat exodus as well as the entrance of a new competitor in Oman. Ultimately, the excess milk could be converted to milk powder, and hence pressure prices lower. This, coupled with the expected 11% higher SMP prices in 2021e, will lead to pressured profitability margins, in our view, given SADAFCO's 3–6 month average SMP stocking period and as the company only secures 20% of its SMP needs from its Poland-based producer (Mlekoma). We rule out any high price adjustments in 2021e as the recent VAT increase was not fully passed on in certain product categories given weakening consumer spending. As demand returns to normal, we expect to see price adjustments starting in 2022e onward with long-life milk prices estimated to grow at a 3-year CAGR of 3% to support profitability margins.

Debt free with sizeable cash on hand for opportunistic expansions; shareholders approve up to 9% share buyback

In addition to adding distribution warehouses to minimize logistics costs and save on third-party storage facilities, the company is currently setting up a new Jeddah-based ice-cream factory at a CAPEX of SAR105mn, with operations slated for mid 2021, to cater to the growing high-margin ice cream market. The company previously expressed interest in diversifying into the meat segment by acquiring a controlling stake in livestock, and meat importer Horizon Food Factory Company, but the 3-month term of the MOU was terminated on 28 October 2020 without a final agreement reached. The company, instead, is planning to utilize the sufficient cash on hand (SAR610mn as of 30 September 2020, 30% of annual sales) to buy back up to 2.7mn of its shares, representing 9% of outstanding shares (valued at SAR482mn) within a year with a 5-year holding period, after receiving shareholder approval at its 18 November EGM.

Main financial highlights (FY end Mar)

In SARmn, unless otherwise stated	2020a	2021e	2022e	2023e
Revenue	2,056	2,177	2,288	2,459
EBITDA	388	401	389	411
EBITDA margin	19%	18%	17%	17%
Recurring net income*	280	284	267	278
P/E (x)*	20.0	19.8	21.0	20.2
EV/IFRS EBITDA (x)	13.7	13.1	13.5	12.8
ROAIC	25.0%	22.9%	20.3%	19.8%

** based on core net income (excluding one-offs and volatile items)*
Source: Company, Beltone estimates

Financial statement | FY end Mar (SARmn)

Income statement	2020a	2021e	2022e	2023e
Revenue	2,056	2,177	2,288	2,459
COGS	(1,267)	(1,357)	(1,464)	(1,574)
Gross profit	**789**	**820**	**824**	**885**
SG&A expenses	(401)	(419)	(435)	(473)
EBITDA	**388**	**401**	**389**	**411**
Depreciation and amortization	(100)	(108)	(114)	(125)
EBIT	**288**	**293**	**275**	**287**
Net financing costs	8	9	9	10
Other income/costs	(12)	(6)	(5)	(5)
Earnings before zakat	**284**	**296**	**280**	**292**
Zakat	(19)	(21)	(21)	(22)
Net profit after zakat	**265**	**275**	**258**	**269**
Attributable net income	266	277	260	271
Non-contolling interest	**(1)**	**(1)**	**(1)**	**(1)**
Core attributable net income*	**280**	**284**	**267**	**278**

Balance sheet	2020a	2021e	2022e	2023e
Cash and equivalents	646	731	750	757
Accounts receivables	203	218	226	236
Inventory	358	358	387	414
Prepaid expenses and other receivables	67	72	75	79
Total current assets	**1,273**	**1,378**	**1,438**	**1,486**
Total non-current assets	**901**	**963**	**1,030**	**1,099**
Total assets	**2,174**	**2,342**	**2,468**	**2,585**
CPLTD of lease liability	12	20	20	20
Trade & other payables	221	248	266	286
Accruals and other liabilities	249	277	299	321
Zakat payable	16	16	16	16
Total current liabilities	**498**	**560**	**601**	**643**
Non-controlling interest put option	29	29	29	29
Lease liability	57	57	57	57
Provision for end-of-service benefits	**113**	**113**	**113**	**113**
Total non-current liabilities	200	200	200	200
Paid-in capital	325	325	325	325
Treasury shares	(52)	(52)	(52)	(52)
Reserves	417	431	457	484
Retained earnings	**767**	**859**	**920**	**969**
Non-controlling Interest	**20**	**18**	**17**	**16**
Total equity	**1,476**	**1,582**	**1,667**	**1,742**
Total liabilities and equity	**2,174**	**2,342**	**2,468**	**2,585**

Cash flow	2020a	2021e	2022e	2023e
Change in working capital	(68)	26	(6)	(7)
Cash flow from operations	318	417	374	394
CAPEX	(75)	(150)	(161)	(173)
Cash flow from investing	(91)	(170)	(181)	(193)
Free cash flow (FCF)	**227**	**247**	**193**	**201**
Cash flow from financing	(163)	(162)	(173)	(194)
Change in cash	64	85	19	7

Investment summary

Since its establishment in 1976, Saudia Dairy and Foodstuff Company (SADAFCO) has been a leader in the Saudi long-life milk market, with the Saudia brand capturing over 60% of the long-life milk market and almost a quarter of total drinking milk. SADAFCO was formed initially as a JV between Saudi and Kuwaiti investors together with Danish Turnkey Dairies before it was publicly listed on the Saudi Tadawul in 2005. From producing long-life milk initially, the company has diversified its product portfolio to include 130 stock keeping units (SKU), including ice cream, tomato paste (market leader), Feta cheese (through a JV with New Zealand Dairy Board), hommos, juice drinks, among others. SADAFCO sells products produced by third-party manufacturers, such as French fries, butter, and triangle cheese. SADAFCO's products are marketed under the Saudia, Crispy, and Majestique brands across the region. Its manufacturing facilities are located in Jeddah (2 factories) and Dammam in addition to a plant in Poland. The company targets the Saudi and neighboring markets through wide regional distribution centers (RDCs) in Riyadh, Jeddah, and Dammam as well as 20 depots across Saudi Arabia and neighboring GCC markets. We expect top line and core earnings to grow at 6-year CAGRs of 7% and 3%, respectively.

Valuation methodology and risks

We have a Hold rating on SADAFCO with a FV estimate of SAR194.40/share using a 6-year DCF, discounted at a WACC of 6.4%, and a terminal growth rate of 2.5%. Key downside risks to our forecasts include (i) inflation of key raw material prices (SMP, AMF, tomato paste concentrate), which together with (ii) competition risk from fresh milk producers that utilize their oversupply of fresh milk in UHT manufacturing, could limit the company's cost passing abilities, and (iii) changes in consumer preferences toward fresh healthy products over recombined products could adversely impact performance of long-life milk.

Main ratios	2020a	2021e	2022e	2023e
Per-share data				
EPS (SAR)*	8.8	8.9	8.3	8.7
BVPS (SAR)	46.2	49.5	52.1	54.5
DPS (SAR)	4.5	5.3	5.4	6.1
Valuation data				
P/E (x)*	20.0	19.8	21.0	20.2
P/BV (x)	3.8	3.5	3.4	3.2
Dividend yield	2.6%	3.0%	3.1%	3.5%
FCF yield	4.0%	4.4%	3.4%	3.6%
EV/ IFRS EBITDA (x)	13.7	13.1	13.5	12.8
Growth (y-o-y)				
Revenue	13.4%	5.9%	5.1%	7.5%
EBITDA	33.5%	3.5%	-3.1%	5.8%
Earnings	23.8%	3.9%	-6.1%	4.3%
Core attributable net income*	27.6%	1.1%	-6.0%	4.2%
Profitability				
Gross profit margin (GPM)	38.4%	37.7%	36.0%	36.0%
EBITDA margin	18.8%	18.4%	17.0%	16.7%
EBIT margin	14.0%	13.5%	12.0%	11.7%
Core net profit margin (NPM)*	13.6%	13.0%	11.7%	11.3%
ROAA*	13.7%	12.6%	11.1%	11.0%
ROAE*	19.8%	18.5%	16.4%	16.3%
ROAIC	25.0%	22.9%	20.3%	19.8%
Leverage				
Net debt (cash)/equity (x)	(0.2)	(0.2)	(0.2)	(0.2)
Net debt (cash)/IFRS EBITDA (x)	(0.8)	(0.9)	(0.9)	(0.8)

** based on core net attributable income (excluding one-offs)*

Source: Company, Beltone estimates

I. Valuation

We have a Hold recommendation on Sadafco with a FV of SAR194.40/share, implying an 11% upside potential. We reach this value using a FCFF valuation methodology.

Our DCF model utilizes a WACC of 6.4% and a cost of equity of 6.4% derived from (i) a risk-free rate (using the average 4-year and 7-year sovereign sukuk yield after zakat) of 2.3%, (ii) equity market risk premium (ERP) of 6.2% (US market risk premium plus an additional country risk premium), and (iii) a beta of 0.7. Our WACC calculations are based on a 100% weight of equity. We also use a terminal growth rate of 2.5%

Figure 1: Discounted cash flow (SARmn)

	2020e	2021e	2022e	2023e	2024e	2025e
EBIT	**294**	**277**	**289**	**301**	**319**	**346**
Zakat paid	(21)	(21)	(22)	(22)	(23)	(24)
NOPAT	273	256	267	279	296	323
Depreciation & amortization	108	114	125	135	144	156
Adjusted COPAT	381	370	391	414	440	479
Δ in net working capital	**26**	**(6)**	**(7)**	**2**	**(7)**	**(25)**
CAPEX	(150)	(161)	(173)	(187)	(201)	(216)
Exercise of put option of Melokoma	**-**	**-**	**-**	**(29)**	**-**	**-**
Free cash flow to firm (FCFF)	258	203	211	201	233	237
Terminal Value						6,310
PV of FCFF	253	187	183	163	178	4,711
Enterprise value (EV)	5,676					
Net cash (debt) (as of 30 Sep 2020)	**542**					
Equity value	6,217					
FV/share*, SAR	**194.40**					
Upside potential	11%					

*Based on issued no. of shares

Figure 2: Sensitivity of our FV to changes in WACC and terminal growth rate

Terminal growth rate	Terminal WACC				
	6.5%	7.5%	8.5%	9.5%	10.5%
1%	144.1	144.1	144.1	144.1	144.0
1.5%	164.1	164.1	164.1	164.0	164.0
3%	194.5	194.4	**194.4**	194.4	194.4
4%	246.1	246.1	246.0	246.0	246.0
5%	353.4	353.4	353.4	353.4	353.3

Source: Beltone estimates

II. Operations overview

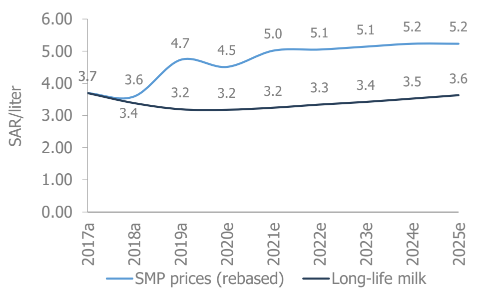
Fresh milk oversupply and higher SMP prices to impact margins in 2021e; potential selling price adjustments as purchasing power restores to pre-COVID levels

The current market imbalance due to a fresh milk oversupply on the expat exodus, interrupted tourism activities, and the entrance of a new competitor in Oman are all likely to lead to increasing conversion of excess fresh milk to SMP. This could ultimately resume the price discount wave of long-life milk, as was the case over the last few years. In light of the current weakening of consumer spending, we believe SADAFCO's top line is likely to exhibit slow revenue growth as consumers have become more price sensitive, unless the company adopts price discounts. Accordingly, the projected 11% higher SMP prices in 2021e will likely pressure operating margins given SADAFCO's 3–6 month average SMP stocking period. In this regard, we expect earnings to decline 6% in FY22e, with earnings growth to accelerate afterwards, growing at a 4-year CAGR of 6% supported by revenue growth as the impact of the pandemic subsides. We rule out higher price adjustments in 2021e as the recent VAT increase was not fully passed on by all producers, given weakening consumer spending. We expect to see price adjustments starting 2022e onward with long-life milk prices estimated to grow at a moderate 6-year CAGR of 3% given its strategic importance.

Securing 20% of SMP needs through acquisition of Polish Mlekoma

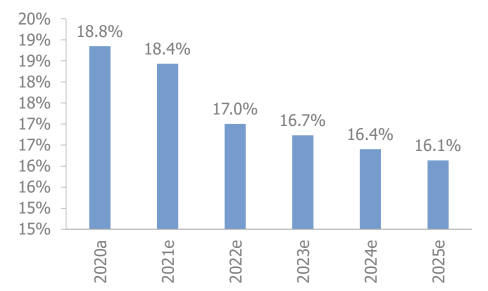
SADAFCO is exposed to fluctuations in the price of powdered milk (SMP and AMF), the primary ingredient in recombined milk production, which adversely affects the company's margins amid a supply glut and competitive environment. The company keeps an average 3–6 months of SMP stock (based on price forecast), with SMP sourced at spot prices with the option of future delivery. Furthermore, the company currently secures 20% of its powdered milk requirements from its 76%-owned Polish-based subsidiary, Mlekoma, following the SAR84mn deal executed on 2 July 2018, leading to estimated savings of SAR10mn on the consolidated level in FY19/20, while losses of the subsidiary reached SAR1.6mn for securing Mlekoma's 42k MT of SMP at better terms. Non-controlling equity holders have the option to put their remaining 24% stake in Mlekoma at the option expiry date in 2023 (fifth year of the completion date) at a higher purchase price or FY22/23 earnings multiplier based on Mlekoma's EBITDA (after deducting net debt). SADAFCO has estimated a gross cash outflow of SAR27.3mn–SAR38.7mn if it were to exercise its option. The remaining SMP requirements are sourced from Australia, New Zealand, and the US. Moreover, Sadafco mixes fresh milk sourced from domestic peers with SMP

Figure 3: Ex-factory long-life milk prices will not keep pace with higher forward SMP prices



**Estimates are based on future prices*
Source: FAO prices, barchart - futures/quotes

Figure 4: EBITDA margins to soften in the coming period in this regard



Source: Company data, Beltone estimates

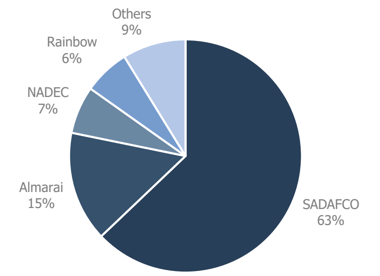
Product diversification key to sustainable growth

SADAFCO expanded its non-drink product portfolio (currently generating 35% of top line), which includes ice cream and foodstuffs (tomato paste, cheese, and snacks), through constant product differentiation over the last 30 years to meet ever-changing consumer demand and maintain its leading market positions amid growing competition and market fragmentation. However, long-life milk has remained SADAFCO's primary product, comprising a range of SKUs that include whole milk, skimmed milk, enriched milk, and flavored milk, generating close to 65% of net sales over the last 3 years, down from 68% in March 2015. The COVID-19 outbreak coupled with Ramadan stocking has fueled the overstocking appetite for long-life milk for its long validity, driving contribution to revenue to reach 66.7% in the quarter ending in June. In a step to enter the meat market, the company was planning to purchase a controlling stake in livestock and meat importer Horizon Food Factory Company from Tabuk Agricultural Development Company by capitalizing on the company's frozen storage space. However, the 3-month term of the non-binding MOU has terminated with no final agreement reached.

Expanding high-margin ice cream segment

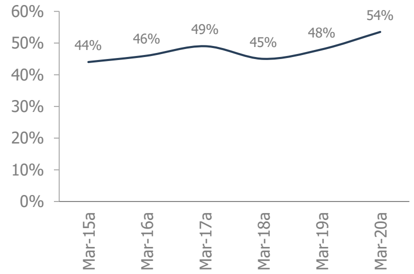
SADAFCO leads the market in the ice cream business through its continuous efforts of adding new freezers in both existing and new outlets, supported by expansion at outdoor public events. The company is currently adding a new ice cream plant (at a CAPEX of SAR105mn) scheduled to commence operations in 2021 to cater to the growing Ice cream market and to expand SADAFCO's market share. During the pandemic, ice cream products witnessed only 2% y-o-y revenue growth due to significant reduction in consumption and the closure of restaurants and juice shops (main customers). Ice cream revenue contribution grew to 19.9% in 2Q20 from 10% in March 2015.

Figure 5: SADAFCO's leadership maintained in long-life milk



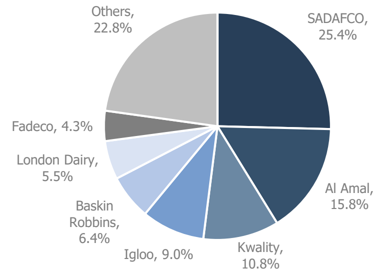
Source: SADAFCO investor presentation, June 2020

Figure 6: Growing share of SADAFCO in the tomato paste market



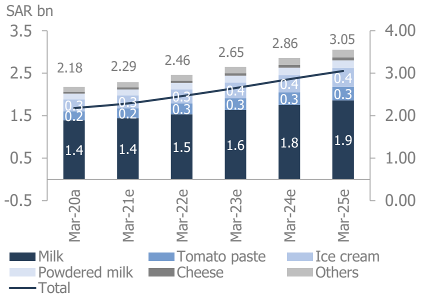
Source: SADAFCO investor presentation, June 2020

Figure 7: SADAFCO leads the Saudi ice cream market



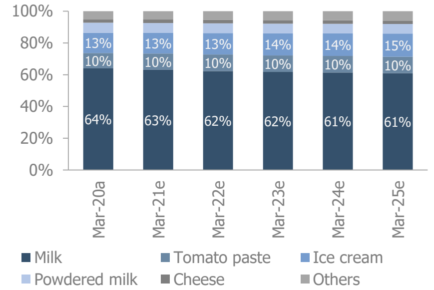
Source: SADAFCO investor presentation, June 2020

Figure 8: Revenue to grow at 2020–25e CAGR of 7%



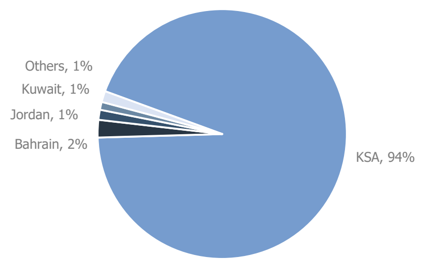
Source: Company data, Beltone estimates

Figure 9: Long-life milk to remain main revenue contributor; other business lines to see moderate growth



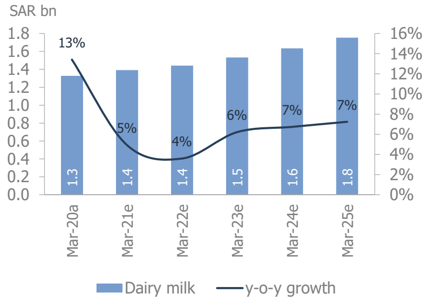
Source: Company data, Beltone estimates

Figure 10: Main reliance on Saudi market



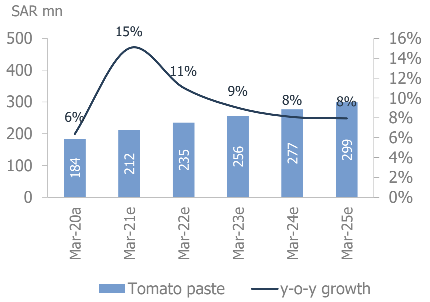
Source: Sadafco investor presentation

Figure 11: Dairy segment to maintain growth despite short-term sluggish performance on expected price discounts



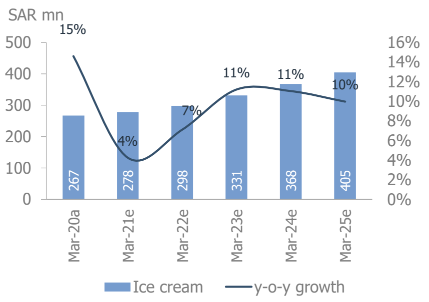
Source: Company data, Beltone estimates

Figure 12: Tomato paste to continue to grow at high single digits



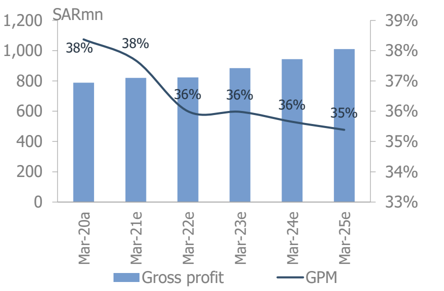
Source: Company data, Beltone estimates

Figure 13: Ice cream to grow further on new plant



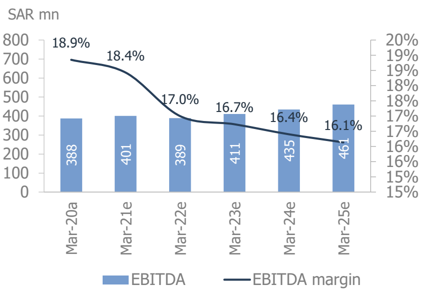
Source: Company data, Beltone estimates

Figure 14: GPM to decline on higher SMP prices amid fresh milk supply glut



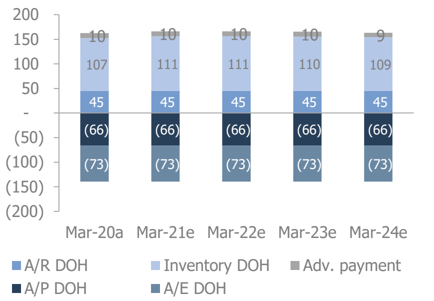
Source: Company data, Beltone estimates

Figure 15: EBITDA margin to also slightly decline on nearly stable SG&A/sales



Source: Company data, Beltone estimates

Figure 16: Stable asset conversion cycle (Days)



Source: Company data, Beltone estimates

Food Producer | Savola Group

Rating: **Hold**

Fair value: **SAR49.3**

Market price: **SAR45.8**

Upside: **8%**

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Savola Group

Retail recovery enhancing operational performance; valuation dominated by non-core investments

Food and Dairy | Saudi Arabia

Initiation of Coverage — 1 December 2020

Initiate coverage with FV of SAR49.3/share and Hold rating; Almarai constitutes 77% of Savola's valuation

Operating in 9 countries in the MENAT (Middle East, North Africa, and Turkey) region and exporting its products to over 50 countries, Savola Group is considered the largest grocery store chain (Panda), with over 106mn retail purchases via a series of hypermarkets and supermarkets in Saudi Arabia and Egypt. Its second-largest contributor (41% of total group sales), Savola Food (SF), is a leading regional consumer staple producer of primarily edible oils (65% of SF revenue), sugar (28% of SF revenue), pasta (6% of SF revenue), and emerging categories (2% of SF revenue). We value Savola using a SOTP DCF valuation, reaching a FV of SAR49.3/share, yielding 8% upside potential from the current market price, therefore warranting a Hold rating. We project EBITDA will grow at a 2019–25e CAGR of 5.3%, with margins to see stable growth across the board. Core operations constitute 23% of Savola's valuation, while the remaining 77% is derived from its stake in Almarai.

Retail turnaround story to be extended via efficiency measures and store additions

Management's transformation program, initiated in 2016 after turning to a net loss of SAR773mn in FY16 from a net profit of SAR146mn in FY15, has started to reap rewards in 2020, with the company reporting a net income of SAR173mn as of 9M20. This is attributed to the successful shut down of inefficient stores and enriching blueprint in effort to enhance food consumption behavior, which has been negatively impacted since the government announced a record budget deficit of USD98bn in 2015. In the short and medium term, we anticipate Panda will focus on Saudi operations as management continues to optimize operations and ensure continued improvement in store yields. Following a 2-year period (FY20–21) of stable operations, management will be looking to expand its customer base, potentially raising total retail space up to 641,000sqm from 628,000sqm in FY20 and adding 1–3 new stores annually by 2025. Accordingly, we project Panda's top line will grow at a 2019–25e CAGR of 3.6%, with our gross margin forecast averaging 24% versus 21% during 2017–19.

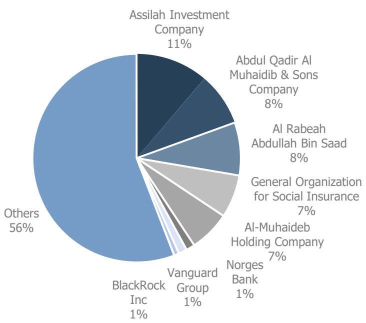
Global prices and country-specific dynamics to continue pressuring food performance

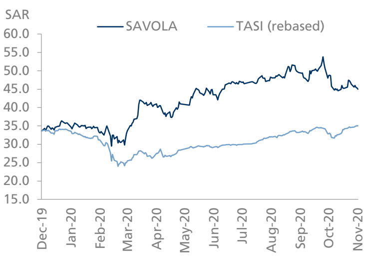
Operating across 7 countries, SF has been challenged with (i) volatile global edible oil and sugar prices, (ii) raw material supply challenges, (iii) currency fluctuations, and (iv) increased competition from 2017 to 2020, particularly during the COVID-19 outbreak. Consequently, total food sales declined at a 2016–19 CAGR of 8%, and, on our numbers, will maintain its downward performance during FY20 to record a 9% y-o-y drop. We anticipate oil segment revenue (65% of SF sales) will decline at a 2019–25e CAGR of -1.5% on the back of a drop in volumes at a CAGR of 0.7% over our forecast horizon as a result of increased competition. We also expect sugar revenue to sustain its downward pressure (2019–25e CAGR of -1.5%) on the back of volume drops in Saudi Arabia (2019–25e CAGR of -0.9%) and Egypt (2019–25e of -1.1%), despite a slight recovery of global fuel prices, which would result in greater production of ethanol as opposed to sugar (lower global stocks would support sugar price recovery). Accordingly, we project food sales to decline at a 2019–25e CAGR of -0.8% over our forecast horizon, while gross margin to rise to 17% by FY25e from 15% in FY19 on the back of increased production of high-margin products.

Consumer inclination toward ready-made food supports top line growth

Savola's investments in Herfy Food Services Company and Al Kabeer (9% of total FY19 Savola sales) continue to demonstrate growth on the back of a consumer inclination toward long-shelf life and effortlessly cooked food products, driven by ever-changing routines. Accordingly, we anticipate a 2019–25e top line CAGR of 4.9% on the back of normalized sales following the COVID-19 outbreak where several Herfy stores were temporarily shut down on government efforts to decrease infection rates. Additionally, the introduction of new meals, new product items, and intensifying plans to expand overseas should support top line enhancement, in our view. Accordingly, we expect Herfy's gross margin to stand at 23% in FY20e and intensify to 30% by FY25e, and see Al-Kabeer's gross margin averaging 40% over our forecast horizon versus 36% in FY19.

Shareholders structure





*Closing as of 29 November 2020

Stock data

Reuters	2050.SE
Bloomberg	SAVOLA AB
Shares (mn)	534mn
MKT cap	SAR24.4bn/ USD6,515mn
3M avg. daily liquidity	SAR27.1mn/ USD7.2mn
52-week high/low	SAR54/29
Free float	56%

Main financial highlights (FY end Dec)

In SARmn, unless otherwise stated	2019a	2020e	2021e	2022e
Revenue	22,243	21,816	22,367	22,981
EBITDA	1,977	2,126	2,253	2,409
EBITDA margin	8.9%	9.7%	10.1%	10.5%
Core attributable EPS (SAR)*	486	1,013	1,224	1,474
P/E (x)*	50.2	24.1	20.0	16.6
EV/IFRS EBITDA (x)	13.5	11.7	10.4	9.2
ROAIC	4.6%	5.0%	5.3%	6.1%

** based on core net income (excluding one-offs and volatile items)*
Source: Company, Beltone estimates

Financial statement | FY end Dec (SARmn)

Income statement	2019a	2020e	2021e	2022e
Revenue	22,243	21,816	22,367	22,981
COGS	(17,706)	(17,179)	(17,506)	(17,863)
Gross profit	**4,538**	**4,637**	**4,861**	**5,117**
SG&A expenses	**(3,762)**	**(3,626)**	**(3,700)**	**(3,786)**
EBIT	**776**	**1,010**	**1,161**	**1,331**
Depreciation and amortization	1,201	1,116	1,093	1,078
EBITDA	**1,977**	**2,126**	**2,253**	**2,409**
Net financing costs	(687)	(490)	(421)	(388)
Share in associates net income	639	723	752	854
Other income/costs	32	16	(28)	(29)
EBT	**761**	**1,260**	**1,463**	**1,769**
Income taxes	(104)	(118)	(137)	(165)
NPAT	**657**	**1,142**	**1,326**	**1,604**
Appropriations	181	112	131	158
Attributable net income	**476**	**1,030**	**1,196**	**1,446**
Core attributable net income*	**486**	**1,013**	**1,224**	**1,474**

Balance sheet	2019a	2020e	2021e	2022e
Cash and equivalents	941	966	784	705
Inventory	2,752	2,378	2,898	2,486
Receivables	1,191	1,081	1,248	1,144
Prepayments and other receivables	1,060	1,327	1,125	1,394
Other assets	27	27	27	27
Total current assets	**5,970**	**5,778**	**6,081**	**5,756**
Total non current assets	**20,688**	**20,379**	**20,134**	**20,042**
Total assets	**26,658**	**26,156**	**26,214**	**25,798**
Bank short-term borrowings	2,899	2,844	2,916	2,996
CPLTD	740	600	500	600
CPLTD of lease liability	677	639	639	639
Account payables	2,305	2,308	2,393	2,110
Creditors and other credit balances	2,243	2,147	2,265	1,944
Total current liabilities	**8,864**	**8,538**	**8,713**	**8,288**
Long-term debt	3,905	3,505	3,005	2,405
Long-term lease liability	3,956	3,316	2,697	2,092
Other non-current liabilities	1,394	1,394	1,394	1,394
Total non-current liabilities	**9,255**	**8,215**	**7,096**	**5,891**
Paid-in capital	5,340	5,340	5,340	5,340
Share premium	343	343	343	343
Reserves	(194)	(194)	(194)	(194)
Effect of acquisition transactions with non-controlling interest	(188)	(188)	(188)	(188)
Non-controlling interest	949	1,061	1,192	1,350
Retained Earnings	2,289	3,040	3,912	4,967
Total equity	**8,539**	**9,403**	**10,406**	**11,618**
Total liabilities and equity	**26,658**	**26,156**	**26,214**	**25,798**

Cash flow	2019a	2020e	2021e	2022e
Change in working capital	(154)	125	(282)	(358)
Cash flow from operations (CFO)	983	1,660	1,385	1,469
CAPEX	(373)	(377)	(403)	(437)
Cash flow from investing (CFI)	(373)	(84)	(77)	(98)
Cash flow from financing (CFF)	(1,311)	(1,551)	(1,490)	(1,449)
Change in cash	(702)	25	(182)	(78)

Investment summary

Established in 1979, Savola Group started its edible oil refinery operations (27% of total FY19 revenue) in Jeddah and later branched out into new business line segments to introduce Saudi Arabia's first sugar refinery company operations (11% of total FY19 revenue) following its IPO in 1992, as well as operating 2 sugar refinery facilities in Egypt. Savola has continued to expand further via a chain of organic and inorganic developments to become a market leader in the food retail business (52% of total FY19 revenue) resulting from the merger with Azizia Panda in 1998. Currently, Panda operates over 201 stores in Saudi Arabia and holds a market share of 19.8% of total modern grocery retailing. Looking to further develop its operations base, Savola delved into the Egyptian retail market with over 4 stores. In addition to being a commercial corporation, Savola is an investment holding company that focuses on investing in regional F&B conglomerates such as the UAE's Al Kabeer, a regional leader in frozen foods manufacturing and distribution, Saudi Arabia's largest fast-food chain, Herfy Food Services Company, and Almarai Company, the leading dairy producer in the MENA region. We expect the company's core earnings to grow at a 2019–25e CAGR of 28%, on account of growing net investment from its associate, Almarai (+10.5% CAGR), retail (+3.6% CAGR), and food services sales (+4.9% CAGR) over our forecast horizon. Conversely, we expect the food segment will be pressured (2019–25e CAGR of -0.8%). Over 77% of Savola's valuation is derived from its 34.5% stake in Almarai, while the remaining 23% is extracted from its core operations.

Valuation methodology and risks

We have a Hold rating on Savola Group with a FV estimate of SAR49.3/share using a SOTP methodology with a 6-year DCF, discounted at a WACC of 8.3% (derived from a weighted average cost of equity of Saudi Arabia, Egypt, and Iran), and a terminal growth rate of 2% for each business segment. Key downside risks to our forecasts include (i) global oil and sugar prices maintaining their current low-levels, effectively increasing competition with Savola, (ii) currency devaluation and hyperinflation harmfully distressing purchasing power, and (iii) slow recovery in Saudi Arabia's economy.

Main ratios	2019a	2020e	2021e	2022e
Per-share data				
EPS (SAR)*	0.9	1.9	2.2	2.7
BVPS (SAR)	16.0	17.6	19.5	21.8
DPS (SAR)	0.3	0.5	0.6	0.7
Valuation data				
P/E (x)*	50.2	24.1	20.0	16.6
P/BV (x)	2.9	2.6	2.3	2.1
Dividend yield	0.7%	1.1%	1.3%	1.6%
FCF yield	6.4%	7.3%	5.8%	5.9%
EV/ IFRS EBITDA (x)	13.5	11.7	10.4	9.2
Growth (y-o-y)				
Revenue	2.0%	-1.9%	2.5%	2.7%
EBITDA	197.6%	7.5%	6.0%	6.9%
EBIT	-892.6%	30.2%	14.9%	14.7%
Attributable net income	-191.4%	116.4%	16.1%	20.9%
Core attributable net income*	-491.9%	108.4%	20.8%	20.5%
Profitability				
Gross profit margin (GPM)	20.4%	21.3%	21.7%	22.3%
EBITDA margin	8.9%	9.7%	10.1%	10.5%
EBIT margin	3.5%	4.6%	5.2%	5.8%
Core net profit margin (NPM)*	2.2%	4.6%	5.5%	6.4%
ROAA*	2.0%	3.8%	4.7%	5.7%
ROAE*	5.9%	11.3%	12.4%	13.4%
ROAIC*	4.6%	5.0%	5.3%	6.1%
Leverage				
Net debt (cash)/equity (x)	1.3	1.1	0.9	0.7
Net debt (cash)/IFRS EBITDA (x)	5.7	4.7	4.0	3.3

** based on core net attributable income (excluding one-offs)*

Source: Company, Beltone estimates

I. Valuation

We have a Hold recommendation on Savola with a FV of SAR49.30/share, implying 8% upside potential. We reach this value using a SOTP valuation methodology, where each of the retail, oil, sugar, pasta, and investment segments are valued separately using a DCF model. We utilize a WACC of 8.3% and a weighted average cost of equity of 13% derived from Saudi Arabia, Egypt, and Iran (representing the majority of Savola's operations). For Saudi Arabia (weight of 76%), the cost of equity of 7.9% is derived from (i) a risk-free rate of 2.3%, (ii) equity market risk premium (ERP) of 6.2%, and (iii) a beta of 0.9. For Egypt (weight of 20%), our cost of equity of 17% is derived from (i) a risk-free rate of 11%, (ii) equity market risk premium (ERP) of 8%, and (iii) a beta of 0.8. For Iran (weight of 4%), our cost of equity of 35% is derived from (i) a risk-free rate of 13%, (ii) equity market risk premium (ERP) of 22%, and (iii) a beta of 1.0. Our WACC calculations are based on a 46% weight of equity and 54% weight of debt. We also use a terminal growth rate of 2%.

Figure 1: Summary of DCF valuation (SARmn)

	2020e	2021e	2022e	2023e	2024e	2025e
EBIT	**1,010**	**1,161**	**1,331**	**1,419**	**1,491**	**1,633**
Zakat paid	(118)	(137)	(165)	(190)	(213)	(237)
NOPAT	893	1,024	1,166	1,229	1,278	1,396
Depreciation and amortization	1,116	1,093	1,078	1,068	1,064	1,064
Adjusted COPAT	2,008	2,117	2,244	2,297	2,342	2,460
Δ in net working capital	**125**	**(282)**	**(358)**	**204**	**(784)**	**(568)**
Operating cash flow (OpCF)	2,133	1,834	1,886	2,501	1,558	1,891
Capex	(377)	(403)	(437)	(473)	(487)	(501)
Increase in right-of-use assets	**-**	**(19)**	**(34)**	**(30)**	**(41)**	**(37)**
Free cash flow to firm (FCFF)	1,756	1,413	1,415	1,998	1,031	1,354
Terminal Value						16,007
PV of FCFF	1,743	1,290	1,178	1,503	694	810
Sum of PV of FCFF	**7,218**					
PV of terminal value	9,572					
Enterprise value (EV)	16,791					
Net cash (debt) (as of 30 Sep 2020)	**(10,634)**					
Investment (as of 30 Sep 2020)	21,082					
Minority interest (as of 30 Sep 2020)	939					
Equity value	26,300					
FV/share, SAR	**49.30**					
Upside potential	8%					

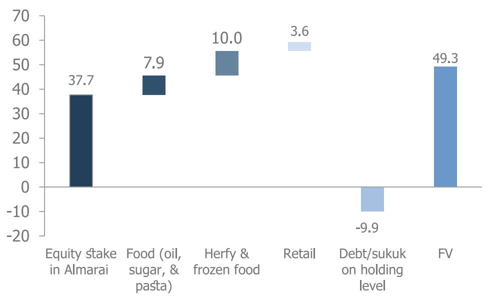
Source: Beltone estimates

Figure 2: Sensitivity to changes in terminal growth and WACC

		Terminal WACC				
		9.6%	10.1%	10.6%	11.1%	11.6%
Terminal growth rate	1.0%	49.9	48.5	47.2	46.1	45.1
	1.5%	51.2	49.6	48.2	46.9	45.8
	2.0%	52.6	50.8	**49.3**	47.9	46.7
	2.5%	54.2	52.2	50.4	48.9	47.6
	3.0%	56.0	53.7	51.8	50.1	48.6

Source: Beltone estimates

Figure 3: Summary of Savola Group's SOTP valuation



Source: Beltone estimates

Figure 4: Summary of DCF valuation by segment

SARmn	DCF equity value	Value/ share	% of value
Almarai stake	20,120	37.72	77%
Retail	1,924	3.55	7%
Herfy	3,391	6.33	13%
Oil	3,023	5.63	11%
Frozen food	1,952	3.65	7%
Sugar	976	1.82	4%
Pasta	193	0.36	1%
Emerging categories	44	0.08	0%
Holding co. debt + sukuk	(5,284)	-9.89	-20%
Total valuation	**26,300**	**49.3**	

Source: Beltone estimates

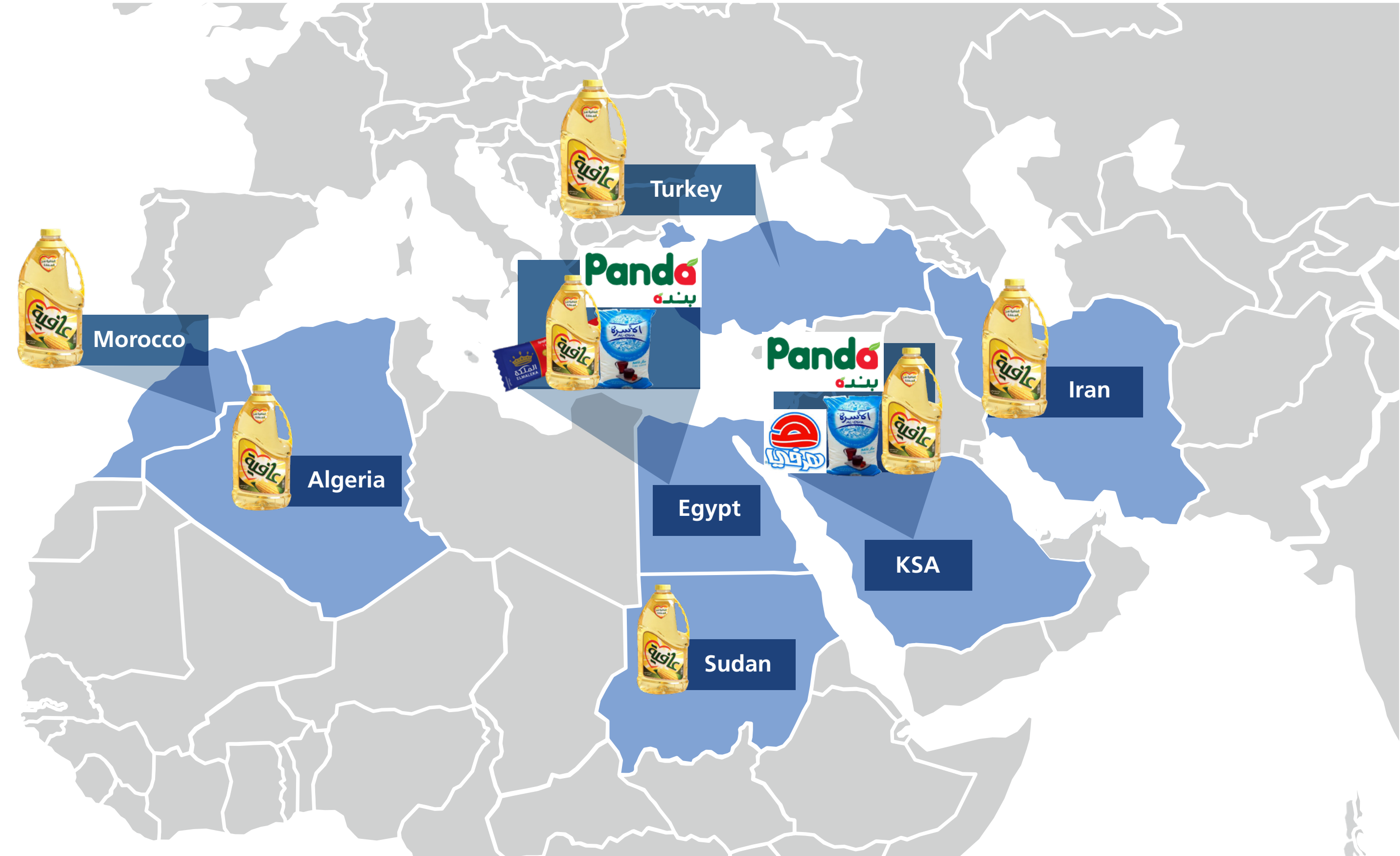
Upside risks

- Placed as a market leader in several markets in which it operates, Savola has an opportunity to boost top line by extending its customer base to under served economies or growing its product variation. Additionally, Savola could delve into interrelated categories, including condiments and ready-to-eat segments.
- Potential acquisition of competitors in the retail business would further elevate margins on the back of higher market share.
- Further improvement in relation to retail streamlining would support the turnaround recorded y-t-d, allowing management to proceed with possible expansions in terms of number of stores.
- Removal of price controls in Egypt and Iran to alleviate pressure on sugar and oil margins, respectively.
- US President-elect Joe Biden could potentially lift sanctions on Iran, boosting the country's economy.

Downside risks

- Sluggish sales improvement on the back of resilient competition from local and multinational companies, limiting Savola's potential to increase its market share.
- Escalating global inflation rates harmfully distressing purchasing power, with some countries such as Egypt implementing price ceilings for sugar products to alleviate pressure off consumers.
- Operating in politically unstable countries such as Turkey, Iran, and Sudan could potentially put downward pressure on margins.

Figure 5: Savola operates in over 7 countries in retailing, food production, and food services



Source: Company data

II. Operations overview

1-Savola retail (Panda) - 52% of total group FY19 sales

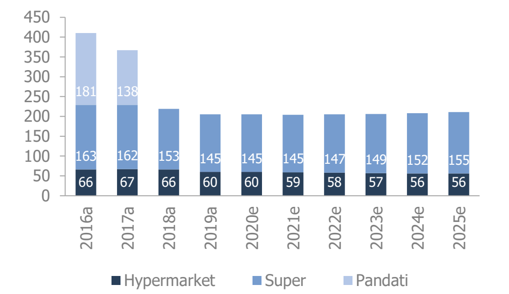
A tale of Panda's path to recovery

Panda currently operates a total network of 201 stores in Saudi Arabia and 4 in Egypt (60 hypermarkets and 145 supermarkets). Savola's pre-2016 strategy involved dynamic growth throughout the Middle East (Saudi Arabia, Egypt and the UAE) with the number of stores operating reaching their peak of 498 stores by 2015, which resulted in a high inventory buildup and recording net losses for the past 4 consecutive years (2016–19).

In Saudi Arabia, high store lease expenses and excessive store expansion led to a swift decline in Savola's grocery retail activity. As for operations in Egypt, management downsized its number of stores to curtail the impact of the EGP devaluation, diminishing consumer purchasing power, and Panda's inability to beat prominent grocery store retailers that were able to stamp out their leading market share through the implementation of wholesale price reductions, promotions, and formation of loyalty programs. Furthermore, management shut down its single UAE HyperPanda store in 2017 due to the saturated nature of the UAE retail market as well-established players such as Carrefour, Spinneys, EMKE, and Al Madina, which have already cemented their positions as market leaders.

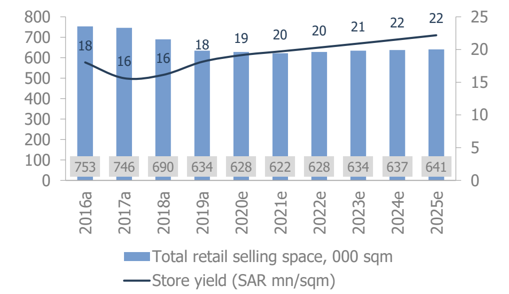
In total, Panda retail underwent an accumulated closure of 315 inefficient stores during 2016–19. Accordingly, management implemented a transformational plan that included the (i) store closure at an accumulated cost of SAR251mn during 2016–19, (ii) execution of an inventory reduction exercise at a cost of SAR377mn, (iii) revamping product mix to enhance stores' footfall, and (iv) continuous assessment of stores' performance and retail space optimization of existing stores. As a result, Panda recorded a net profit of SAR173mn in 9M20 with total retail selling space falling to 628,189 sqm by 9M20 from 753,000 sqm in 2016. COVID-19 preventative measures taken by the government resulted in high demand for groceries as consumers shifted to in-house food consumption, leading to an 18% y-o-y rise on a net sales basis.

Figure 6: Minimal store additions...



Source: Company data, Beltone estimates

Figure 7: ...translating into higher average store yield



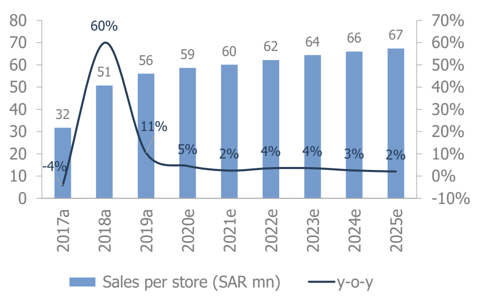
Source: Company data, Beltone estimates

Projected top line enhancement on increased efficiency and LT small-format store additions

With FY20e sales growth (+5% y-o-y) expected to beat the total retail space decline (-1% y-o-y), we project store yield to record SAR19mn per sqm versus SAR18mn per sqm in FY19, primarily on the back of intensive shutdowns in retail space in FY19, with FY20e retail space expected to average 629,000 sqm. During FY20e and FY21e, we believe Panda will continue to further maintain its transformational program and focus on strengthening its core Saudi retail operations through the enhancement of its current stores as opposed to increasing retail space via new additions. Our assumptions of stagnant growth in Panda's store count is derived from the anticipated decline in consumer purchasing power as a result of VAT tripling effective July 2020, which we expect to soften as consumers acclimate to higher prices with an average sales growth of 3% per annum from FY21e to FY25e.

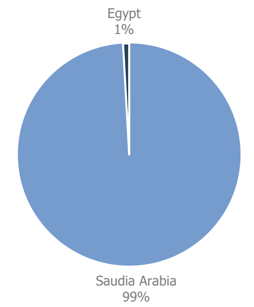
Going forward, with sustained levels of top line performance on the back of private consumption revival (+0.4% in 1Q21e and +0.8% in 2Q21e versus -2.4% in 4Q20e), we believe management could reconsider increasing its number of stores to 211 by FY25e and record a store yield of SAR22mn per sqm. However, we project Panda's store yield to expand at a slower rate (+3% during FY22–24e versus +6% during FY20–21e) as management announces new store openings and increases total retail space to 641,000 sqm by FY25e. In view of that, we estimate Panda's top line will grow at a 2019–25e CAGR of 3.6% versus -1.2% during 2014–19. Accordingly, we expect Panda's sales CAGR growth to be in line with modern retailers' sales 2019-25e CAGR of 5.5% on the back of Panda's major turnaround since 2020 and coming off a low base in 2019.

Figure 8: Transformational plan in motion...



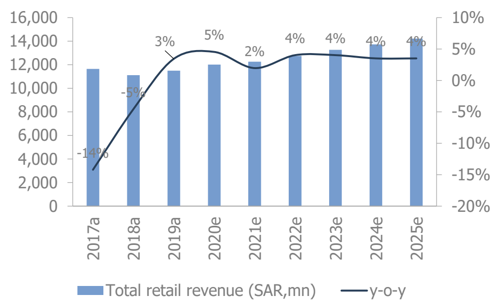
Source: Company data, Beltone estimates

Figure 9: ...focusing on the Saudi retail market with 99% of retail sales



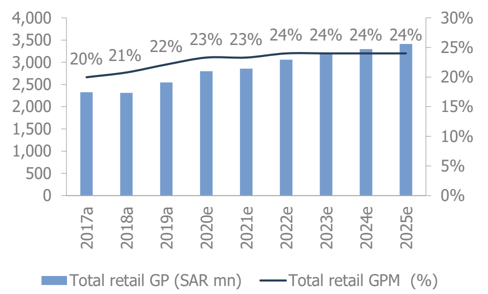
Source: Company data

Figure 10: Improved retail revenue...



Source: Company data, Beltone estimates

Figure 11: ...on the back of increased stores efficiencies



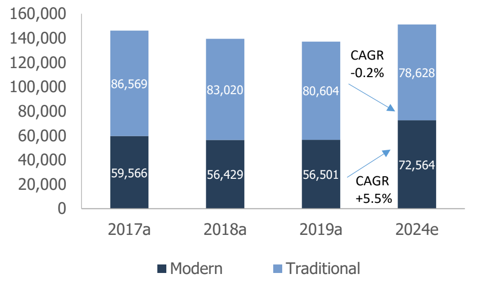
Source: Company data, Beltone estimates

Historically, major Saudi retailers have focused on expanding their customer base through the inauguration of hypermarkets as opposed to smaller-sized supermarkets given that families in the kingdom spend the majority of their social activities in mall settings on the limited avenues available at the time. However, with a significant shift to open new entertainment avenues such as cinemas, concerts, sporting events, and other leisure activities, we believe retailers, including Panda, will also shift to open supermarkets as opposed to hypermarkets. For that reason, our estimated accumulated 6 net store additions by FY25e for Panda will likely come in the format of form of supermarkets over our forecast horizon.

Saudi retail industry and market structure

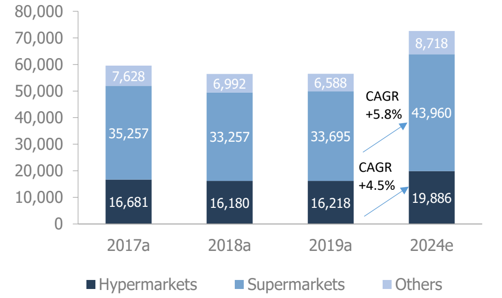
The Saudi economy encountered hard-hitting challenges succeeding the drop in global oil prices, which led to unemployment escalation, subsidy lifts, and the introduction of VAT. These conditions have gradually diminished expenditure appetite and triggered a successive deceleration in consumer outlay, with the grocery retailing market shrinking SAR9bn (USD2.4bn) to SAR137bn (USD36.6bn) in 2019. Consequently, there has been an adjustment in consumer inclinations from premium to inexpensive merchandise, which has obligated retailers to overhaul offerings to accommodate market needs. That said, we still anticipate food demand to maintain its robustness and grow in light of growing population, sizable per capita income, escalating tourism, ever-changing consumer taste, and an overall economic recovery. Market leaders were in a better position to endure market repercussions, whereas smaller stores were forced to reconsider whether to continue operating or shut down and limit their losses. According to Euromonitor, overall grocery retailing market to recuperate at a 2019–24e CAGR of 5.5%.

Figure 12: KSA grocery retailers sales value (SARmn)



Source: Euromonitor

Figure 13: KSA modern retailers sales value (SARmn)



Source: Euromonitor

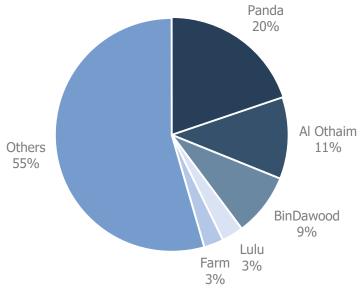
For modern retailers (41% of total 2019 retailers), supermarkets and hypermarkets constitute 88% and 79% of sales and floor space, respectively. These figures are largely credited to customers' preferences toward larger venues for major grocery procurements and compact stores for daily grocery needs. Hypermarkets (30% of 2019 modern sales) are mostly found in larger shopping outlets, which offer visitors access to procuring food supplies as well as entertainment outlets that include shopping stores, indoor amusement parks, restaurants, and movie theaters, enriching customers' overall retail experience. As for supermarkets (60% of 2019 modern sales), modern retailers target highly condensed districts to attract substantial footfall by exhibiting distinctive offerings such as private labels, imported products, fresh food, as well as extensive product availability. In contrast, the remaining 59% represents over 40,000 baqalas, which continue to dominate the market due to their expansive presence in neighborhoods. Despite increased competition from modern retailers, baqalas continue to be a conventional food retail avenue on account of their capacity to deliver greater degrees of accessibility and affordability especially in low-income districts. We believe traditional retail will remain pressured as the kingdom witnesses increased interest in developing urban centers as well as government formalities to regulate baqalas as mentioned earlier.

We anticipate consumers will favor modern grocery retailing formats as opposed to traditional baqalas, with the former's share of total grocery retail sales projected to increase 6.8ppt in 2019–24e, amassing a total 48% share by 2024e. This is in line with previous developments over 2015–19, where modern grocery stores' share of floor space and number of outlets grew 3ppts and 0.9ppts, respectively, and are estimated to grow at a FY20–24e CAGRs of 5.6% and 5.5%, respectively. Additionally, large outlets boast an advantage over smaller players as they are able to flourish with the assistance of increased operational efficiency, product differentiation, and enhanced outlet blueprints to enrich the consumer experience.

A fragmented grocery market with top 4 players control less than 50% of market share

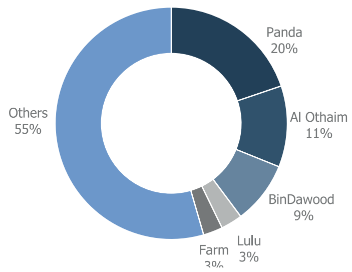
The Saudi food retail market is highly fragmented (HHI index of 914), with conglomerates such as Panda, Abdullah Al-Othaim Marketing Co (Al Othaim), BinDawood, Saudi Hypermarket LLC, and Saudi Marketing Company constituting 45% of total Saudi grocery retail sales, while small-scale retailers dominate the market with a 55% market share. As of 2019, Panda continues to be the dominant and leading market player with 19.8% market share. Despite the vast closure of stores in previous years, Panda's market share continued to display strong resistance, while other major retailers continued to enhance their market shares as baqalas and small-scaler retailers lose out. We believe Panda will continue to hold a large share of the fragmented market on the back of its dominance across all regions except for the Northern area, which it holds the second largest market share of 17.7% while Al Othaim leads with a market share of 18.1%.

Figure 14: Despite coming in second in terms of number of grocery stores...



Source: BinDawood

Figure 15: ...Savola maintains its share in a highly fragmented market



Source: Company data, BinDawood

Online platform, Pandaclick, to capitalize on growing e-commerce

Deeply ingrained in technological advancement, we believe the largely youthful Saudi population is on track to a promising future in online grocery retailing as it is anticipated to experience a 104% increase by 2024e, and is already somewhat prevalent in Saudi Arabia's 3 largest cities. Despite comprising 3% of 2019 Saudi retail sales, major grocery outlets have begun competing to dominate this segment. As this newfound segment is projected to amass SAR623mn (USD166mn) in sales by 2024e, more local players will be looking to integrate it into their current business model in effort to strengthen market share and enrich customer experience. Launched in March 2020 following the COVID-19 outbreak, Panda launched Pandaclick, an e-commerce application that allows consumers to order their grocery necessities and have them delivered to their premises via an agreement with third-party delivery partners. We believe Pandaclick will capitalize on the growing online grocery activities in the market as over 65% of Saudi inhabitants reside in major urban cities such as Riyadh, Jeddah and Dammam, resulting in prolonged commutes to congested shopping centers. As of 1H20, Panda's online sales constituted less than 3% of total sales, with management insisting that it could take up to 2–3 years to record significant contribution to total sales. This is likely on the back of continuous efforts to enhance the customer experience via increasing number of deliveries and reducing delay time, putting into consideration that the application was launched in direct response to COVID-19 and is anticipated to be enhanced further. Additionally, Panda is catching up with established food ordering companies such as Talabat and other retail outlets such as BinDawood, Carrefour, and Lulu.

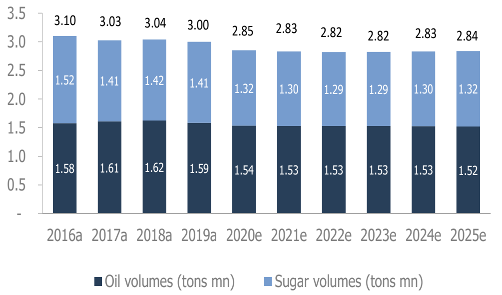
In previous decades, baqalas have been the main hub for delivering groceries to family homes. However e-commerce has recently been overturning worldwide retail businesses as consumers shift to online purchasing, resulting in offline retail profitability taking a knock. Considering the regions' low e-commerce penetration rate compared to other regions, the region's 2018–23e food demand CAGR of 5.6% exceeding the 2.3% annual growth in GCC population illustrates the sector's potential and expansion opportunities. Global economies have witnessed online retail penetration levels surge to encounter consumers' ever-changing preferences and continue to be significant in dynamic markets such as Saudi Arabia.

2-Savola Foods - 41% of total FY19 group sales

With over 40 years as a major commodity player, Savola Foods (SF) is a market leader in the production of premium edible oils (65% of SF sales), sugar (28% of SF sales), pasta (6% of SF sales), and emerging categories (2% of SF sales) and exporting to over 50 countries. Lately, the company has been dealing with swift fluctuations in geopolitical dynamics, inflation, and consumer inclinations while engaging in price wars with second-tier products. As a result, FY19 total oil, sugar, and pasta volumes dropped 1.5% y-o-y to c3mn tons, mainly from lower oil volumes in Saudi Arabia, Iran, and Sudan as well as lower sugar volumes in Egypt. To offset lower volumes, SF has been fine-tuning its advertising and packaging in effort to accommodate altering appetite and maintain its strong market share, specifically in its oil segment. Additionally, management was able to introduce new varieties in its B2C and B2B streamline and add more value-added (higher margin) products. By 9M20, gross and net margin inched up 0.4ppts y-o-y driven by +1.3ppts y-o-y in oil gross margin, while pressured by -2.4ppt y-o-y in sugar gross margin.

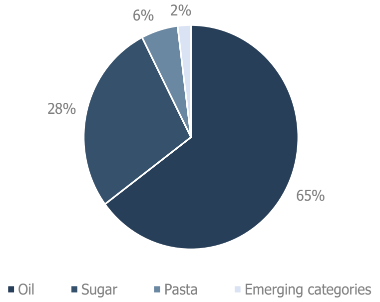
Going forward, we believe SF volumes will continue to be deterred (2019–25 CAGR of -0.8%), pressured by an oil volume CAGR of -0.7% and a sugar volume CAGR of -1.0%, despite both pasta and emerging categories recording a sales CAGR of 3.3% and 11.6%, respectively, from 2019–25e. Furthermore, we project oil will record a higher gross margin due to intense production of high-margin products offsetting a volume drop in mature markets (excluding Egypt), supported by volume increases in start-up markets. As for sugar, we expect gross margins will be pressured as we anticipate both the Saudi and Egyptian markets will decline in volumes. Accordingly, we project oil gross margin will stand at an average of 18% over our forecast horizon versus 15% in FY19, while sugar gross margin will average 12% versus 15% in FY19.

Figure 16: Food volumes to continue to be pressured…



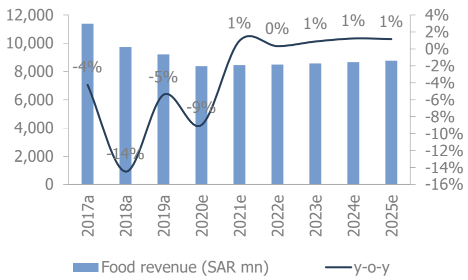
Source: Company data, Beltone estimates

Figure 17: …highly dependant on oil segment revenue contribution



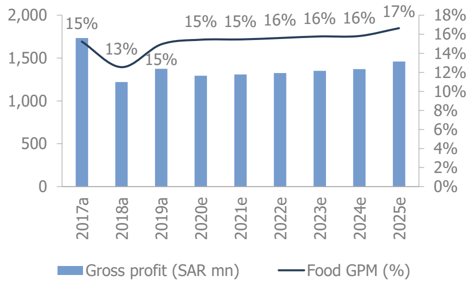
Source: Company data

Figure 18: Despite pressured food top line…



Source: Company data, Beltone estimates

Figure 19: …high-margin edible oil prodcts to support gross margin growth

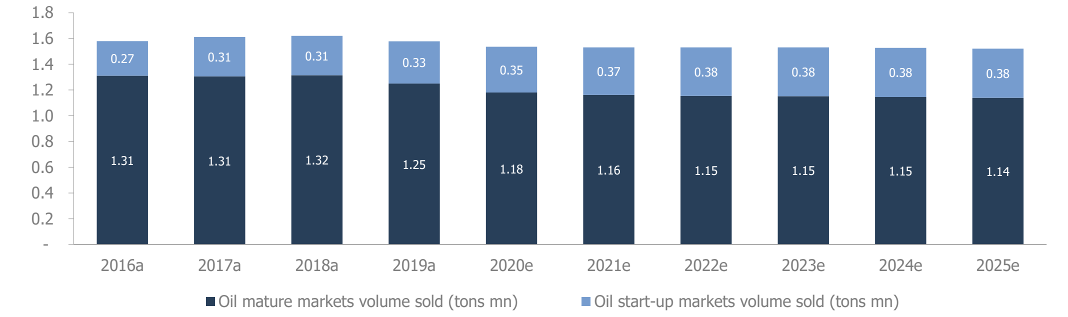


Source: Company data, Beltone estimates

2.1- SF's oil segment - (65% of total SF FY19 sales)

Operating across 7 countries with over 8 refining facilities, SF's oil segment (SFO) operates a mixed-stream business where it does not own or cultivate crops but rather sources raw oil from several countries and transforms them to variant edible oils such as corn, sunflower, sesame, and olive. SFO operates in both mature markets (Saudi Arabia, Iran, Egypt, and Turkey) and start-up markets (Algeria, Morocco, and Sudan). Management's target is to maintain strong market share in mature markets (standing at 79% as of total oil sales), while contending to gain higher market share in start-up markets, which constitutes 21% of total oil sales. Overall, with a capacity of 2mn tpa, the utilization rate reached 79%, with each facility established to cover local demand.

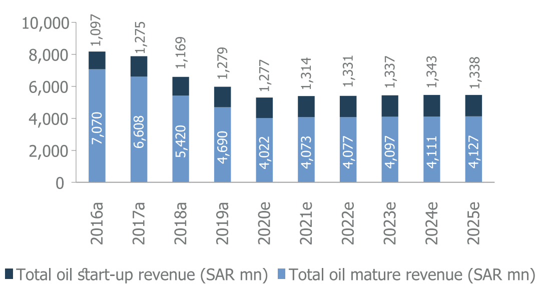
Figure 20: Volume pressure across mature markets (excluding Egypt) on the back of increased competition from second-tier producers, while start-up markets gain a lead in terms of market share



Source: Company data, Beltone estimates

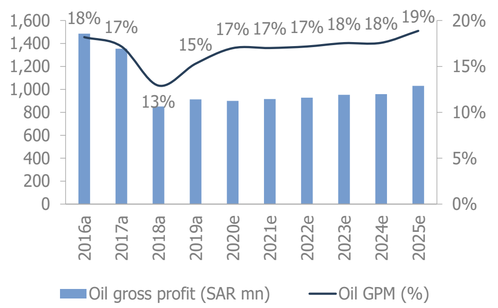
Total volumes reached 1.59mn tons in FY19, down 2% y-o-y. However, management was successful in making up for lost volumes with increased production of high-margin products, which elevated annual gross, EBIT, and net margins by 2.4ppts, 1.6ppts, and 2.7ppts, respectively. 9M20 volumes continued to drop 0.4% y-o-y, driven by Turkey (-11% y-o-y), Iran (-8% y-o-y), Saudi Arabia (-8% y-o-y), and Algeria (-4% y-o-y). Additionally, Savola's average oil price decreased in both mature and start-up markets, mainly driven by currency fluctuations and hyperinflation in Iran, Turkey, and Sudan. Management's main challenge lies ahead in its mature market, specifically Saudi Arabia, Iran, and Turkey, which continue to confront price competition, supply shortages, and macro challenges, respectively. As for its start-up markets, we are optimistic on management's strategy to continue to gain market share. Consequently, we estimate FY20e oil volumes will drop 3% y-o-y, recording a CAGR drop of 0.7% over our forecast horizon.

Figure 21: Mature markets continue to be challenged…



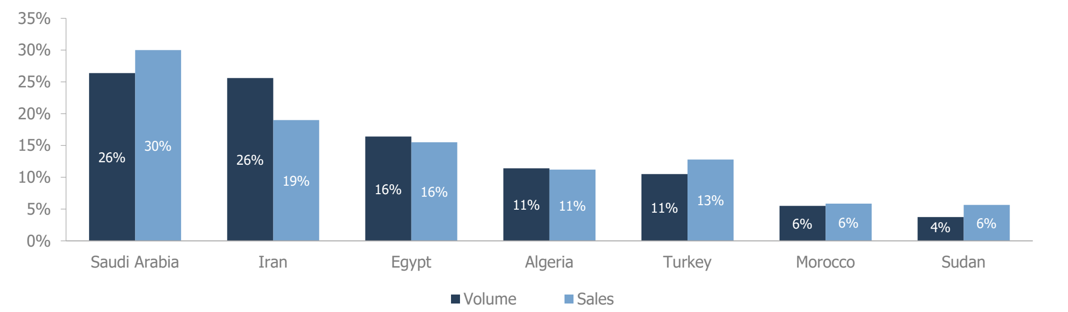
Source: Company data, Beltone estimates

Figure 22: …while oil gross margin improves on the back of increased high-margin production



Source: Company data, Beltone estimates

Figure 23: FY19 volume and sales contribution by country



Source: Company data

2.1.1-Mature markets (79% of total oil sales)

Mature markets continued to face downward pressure in 2019, with sales declining 13% y-o-y due to (i) lower global raw oil prices (-9% y-o-y) and (ii) a 5% y-o-y drop in volumes. Nevertheless, management maintained a leading market share in Saudi Arabia (30% of total FY19 oil sales), despite continued pressure from second-tier competitors (sales dropping 6% y-o-y), and Iran (19% of total FY19 oil sales) in the face of supply difficulties caused by geopolitical uncertainties (sales dropping 36% y-o-y). In Turkey (13% of total FY19 oil sales), higher volumes were attained, undeterred by unstable interest rates and currency variations (sales increasing 5% y-o-y), while Egypt (16% of total FY19 oil sales) demonstrated stagnant sales growth. 9M20 sales continued to be stressed, declining 12% y-o-y.

With the mature market projected to continue displaying market unpredictability in the coming years, we estimate sales to decline at a CAGR of 2.1% over our forecast horizon, curtailed by both volume and price pressures in Iran, Saudi Arabia, and Turkey whereas we expect Egypt to record the sole volume improvement. Conversely, we believe FY20–25e gross margins will average 20% versus 17% in FY19 on the back of resilient brand equity and portfolio expansion toward higher-margin B2B transactions.

• Saudi Arabia (38% of FY19 mature market sales)

Operations continued to witness increased competition from small-scale producers that mostly produce lower-branded products compared to Savola's premium products. Consequently, management was unsuccessful in enhancing volumes during FY19 (-4% y-o-y), despite maintaining a leading market share of over 50% as opposed to over 60% in previous years. This was attributed to consumers shifting to lower-tier products instead of consuming premium products on the back diminishing purchasing power. In 9M20, volumes continued to record -8% y-o-y, attributed to lower B2B sales (represent 40% of total Saudi oil sales) following the COVID-19 outbreak and intensified competition. With curfews lifted, we believe B2B operations will normalize to pre-COVID levels.

Despite an anticipated improvement in global oil prices (2019–24e CAGR of 2.8%), we project Saudi Arabia revenue to decline at a CAGR of 1.6% over our forecast horizon as small-scale producers continue to erode Savola's market share. For that reason, we anticipate intense promotions to continue to be in place, effectively putting downward pressure on margins. To ease off margin compression, management will continue producing higher-margin products to make up for the tripling of the VAT rate in July 2020 and lost volumes as expat numbers continue to dwindle in FY20e and FY21e.

Iran (24% of FY19 mature market sales)

FY19 volumes took a hit on the back of the Irani government's tight control on raw oil imports, where it is currently the sole importer. Additionally, global palm oil prices witnessed intense downward pressure that resulted in global panic buying and local market shortages. In view of that, Savola's supply is directly linked to Iran's strategic reserves and its facilities are currently operating at 50%–60% utilization. Similar to Saudi Arabia, production of high margin products will continue to be a mainstay in Iranian operations to maintain profitability going forward, in our view. Management reported that it has also started to produce value-for-money priced products in 1H20, which has slightly lowered average selling prices.

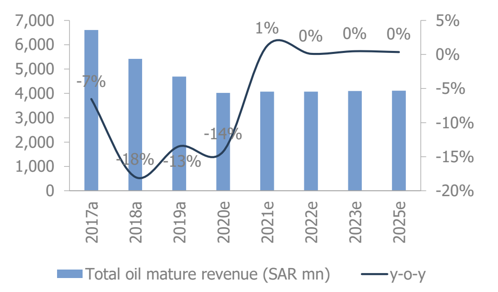
We believe Iranian operations will continue to face volume (2019–25e CAGR of -3.3%) and price pressures as it enters a state of hyperinflation, despite an anticipated recovery in global palm oil prices. Accordingly, we expect volume levels to average 0.34mn tons over our forecast horizon (well off pre-2018 levels of 0.50mn tons).

Turkey and Egypt (38% of FY19 mature market sales)

In FY19, Turkish volumes shifted toward premium and perceived healthier products such as margarine, which is derived from vegetable oils as opposed to milk-based butter. The interest in this segment has been to shift to specialty goods for additional portfolio enhancement, supported by rising demand for healthier goods. That said, 9M20 oil sales declined sharply on the back of the TRY depreciating 20% y-t-d as well as lower B2B operations due to COVID-19. We anticipate FY20 volumes to continue to be pushed down, declining 11% y-o-y. We remain cautious on Turkish recovery as political unrest continues to flatten the economy, with an anticipated volume CAGR of -4.1% over our forecast horizon.

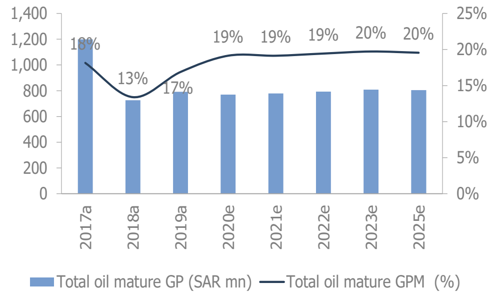
Savola's oil operations in Egypt recorded the highest annual improvement in 9M20, with sales surging 30% y-o-y. This was attributed to volume and average price enhancements of 17% y-o-y and 14% y-o-y, respectively. Accordingly, we anticipate sales to grow at a 2019–25e CAGR of 7.7%, mainly resulting from a volumes CAGR of 4.5%.

Figure 24: Low global prices impacting mature market revenue growth during 2020–21...



Source: Company data, Beltone estimates

Figure 25: ...while gross margin improves steadily on global price recovery



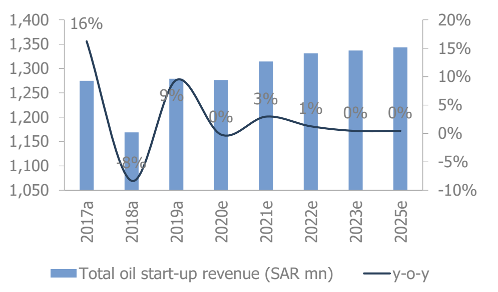
Source: Company data, Beltone estimates

2.1.2- Start-up markets (21% of total oil sales)

Management was successful in enhancing start-up FY19 top line by 9% y-o-y on the back of a 7% y-o-y volume improvement, despite the Sudanese (18% of FY19 start-up market sales) markets facing macroeconomic distress, where volumes dropped 9% y-o-y. 9M20 volumes continued to demonstrate upward levels of +7% y-o-y, driven by +60% y-o-y in Sudan volumes (21% of 9M20 start-up volumes), +4% y-o-y in Morocco volumes (28% of 9M20 start-up volumes), while Algeria volumes (51% of 9M20 start-up volumes) recorded a 5% y-o-y decline.

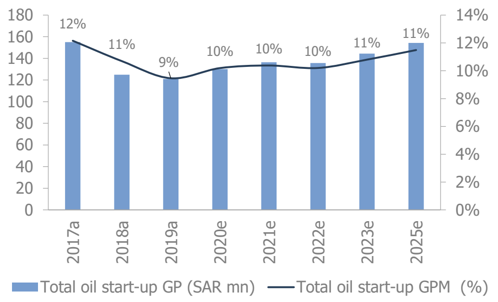
We anticipate further growth in Sudan (2019–25e volumes CAGR of 6.5%), Morocco (2019–25e volumes CAGR of 2.9%), and Algeria (2019–25e volumes CAGR of 1%) as management continues to gain market share, leading to a 2019–25e total volumes CAGR of 2.6%. As a result, we project revenue will grow by a 6-year CAGR of 0.8% with gross margins averaging 11% versus 9% in FY19.

Figure 26: Modest market share gains in start-up markets...



Source: Company data, Beltone estimates

Figure 27: ...reinforces gross margin improvement over our forecast horizon

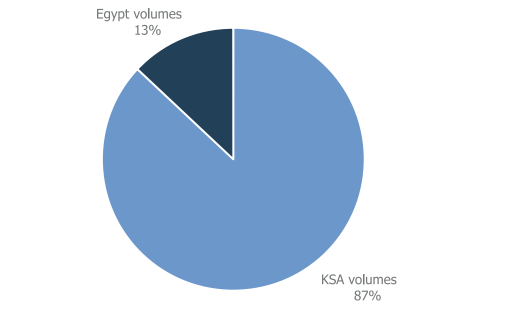


Source: Company data, Beltone estimates

2.2- SF's sugar segment - 28% of SF FY19 sales

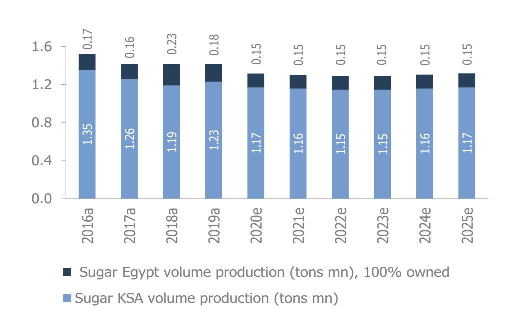
Third in line in terms of top line contribution, SF's sugar segment (SFS) constitutes 11% of consolidated revenue and operates in both Saudi Arabia (86% of SFS revenue) and Egypt (14% of SFS revenue). Savola inaugurated United Sugar Company (USC) in 1994 and recorded a production capacity of 2.2mn tons in FY19, making it one of the largest sugar refineries in the world with over 40 export markets. USC was the first sugar refining company to be established in Saudi Arabia, with 70% market share while the remaining market players import refined sugar. Some 2/3 of USC's operations are attributed to consumers while the remainder is provided to conglomerate B2B partners such as PepsiCo, Al Rabie, Almarai (an associate company of Savola), Halwani Bros, and Ulker. Under USC's portfolio, Al-Osra is a flagship premium product that is offered in different varieties, including white, brown, coarse, liquid, cube, and sachet sticks. With no cultivation of sugar cane, Saudi Arabia is entirely dependent on importing its raw sugar supplies, mainly from Brazil. Later in 2005, SFS extended its reach to the Egyptian market via its 33.8%-owned subsidiary, United Sugar Company of Egypt (USCE), begining commercial operation in 2008. Later in 2014, SFS announced a full-value chain sugar beet operation, Alexandria Sugar Company (ASC), with an agro-cultivation company associated as it cultivates its own sugar beets and operates its owned mills. According to management, all 3 facilities are running at almost full utilization with 1/3 of volumes directly sold to consumers, another to B2B, and the remainder earmarked for export markets.

Figure 28: With over 87% of sugar volumes attributed to Saudi Arabia…



Source: Company data

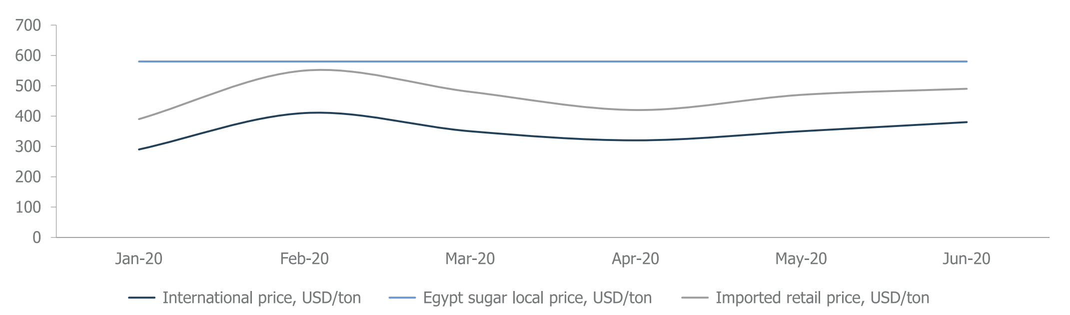
Figure 29: …volumes are projected to maintain their low levels on the back of increased competition from second-tier producers



Source: Company data, Beltone estimates
** United Sugar Company of Egypt (USCE) excluded*

Sugar prices are considered highly volatile, and USC accordingly utilizes derivative financial instruments to hedge against major price fluctuations whether for raw sugar or white premium sugar for export markets. Sugar prices in Saudi Arabia are flexible, with no government intervention to regulate procurement prices. Meanwhile, Egypt's regulated price scheme, which implements an import tax on imported sugar (international price + 25% tax + USD25/ton) in effort to protect local manufacturers. Due to the recent drop in global prices, sugar processors such as SFS have been effectively hit by higher competition from imported sugar and are therefore pressured into lowered margins. As seen in figure 37 below, imported retail prices dropped further in April 2020. Accordingly, the Egyptian government enforced an import ban on white and raw sugar in June 2020 to December 2020 in effort to protect local sugar prices from the major drop in global sugar prices since the COVID-19 outbreak. Global prices declined to SAR876/ton (USD234/ton) by 1H20 from SAR1,020/ton (USD272/ton) in FY19 due to lower demand levels and high sugar stocks from previous years.

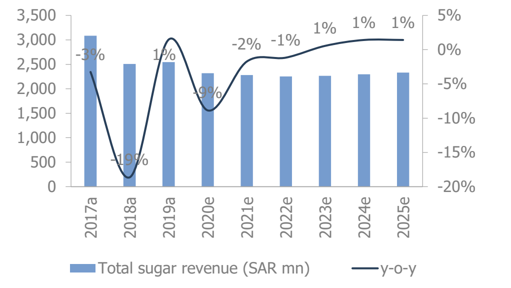
Figure 30: Prices of Egyptian-produced sugar are higher than import prices, pressuring Savola's market share



Source: FAO

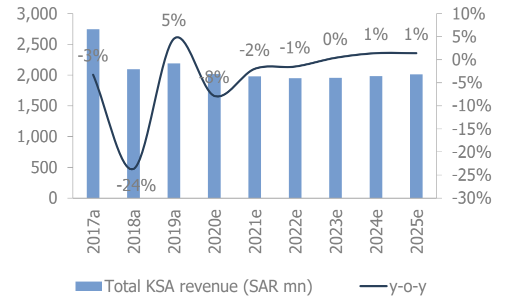
We attribute the loss in 9M20 volumes to lower B2B and exports in Saudi Arabia, as well as continued competition from lower imported prices (heavy competition from other crops) in Egypt. Accordingly, we anticipate FY20 SFS revenue will drop 9% y-o-y on the back of (i) a global sugar price decline and (ii) volume deterioration in both Saudi Arabia and Egypt. We project sugar volumes will decline further at a 2019–25e CAGR of -1.1%, attributed to a volume drop in Saudi Arabia (CAGR of -0.9%) and Egypt's volume (CAGR of -1.1%). Despite the projected improvement in global sugar prices as a result of increased ethanol production following a recovery in global oil prices, we anticipate sugar prices will continue to demonstrate lower levels over our forecast horizon versus historical prices. Therefore, we expect sugar revenue will decline at a 2019–25e CAGR of 1.5%, with GPM to drop 3ppts y-o-y during FY20 and average 12% over our forecast horizon versus 15% in FY19.

Figure 31: Sugar revenue to drop at a 2019–25e CAGR of 2%..



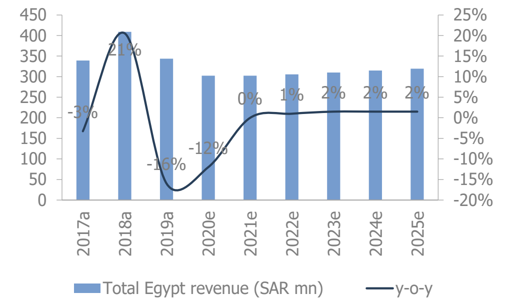
Source: Company data, Beltone estimates

Figure 32: ...on the back of Saudi Arabia's 2019–25e CAGR of -1.6%...



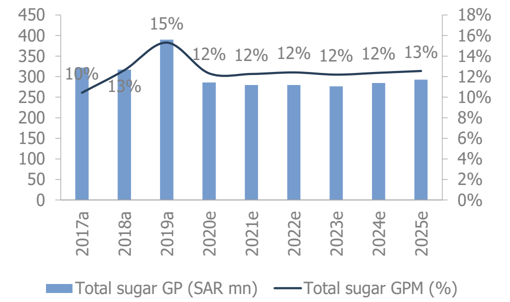
Source: Company data, Beltone estimates

Figure 33: ...and Egypt's 2019–25e CAGR of -4.5%...



Source: Company data, Beltone estimates

Figure 34: ...knocking down sugar gross margins from 15% in FY19 to 12% over our 6-year forecast period

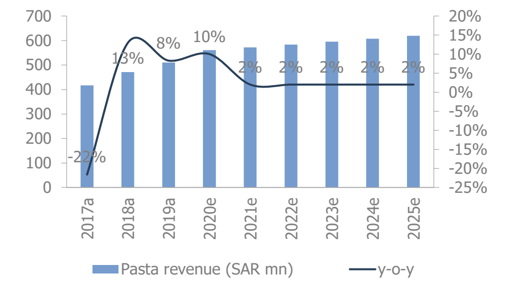


Source: Company data, Beltone estimates

2.3- Savola Pasta - 6% of SF FY19 sales

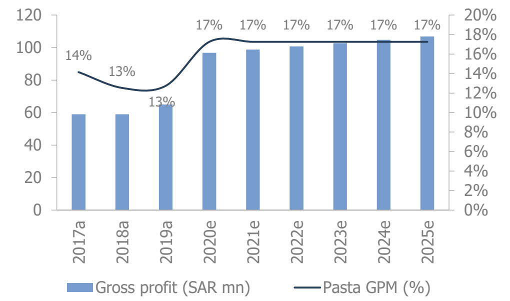
Savola entered the Egyptian pasta market via its acquisition of El Maleka Company and El Farasha Company in 2011 and currently holds a leading market share in the packed pasta market. Savola Pasta's (SP) portfolio includes notable premium pasta brands El Maleka, Macaronto, and Italiano. Recently, second-tier producers have pressured SP's market share, resulting in FY19 volumes dropping 7% y-o-y. Nevertheless, better pricing and improved product mix elevated FY19 revenue 8% y-o-y. Pasta revenue sustained its notable growth in 9M20 to record a 6% y-o-y improvement and is estimated to close at SAR559mn by the end of FY20e. We project SP revenue will grow at a 2019–25e CAGR of 3.3% on the back of continuous market share recovery and management assessing potential openings in export markets, specifically African countries, supported by SF's extensive export current channels. Accordingly, we estimate average gross margins will stand at 17% over our forecast horizon versus 13% in FY19.

Figure 35: Market share gain and exports supporting pasta top line recovery...



Source: Company data, Beltone estimates

Figure 36: ...with elevated gross margin due to improved product mix

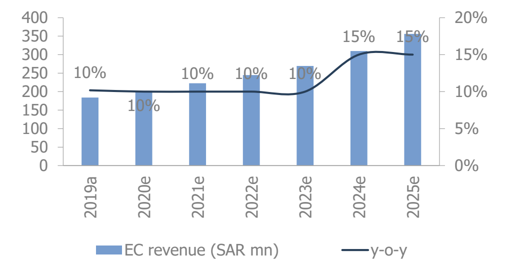


Source: Company data, Beltone estimates

2.4- Savola's emerging categories - 2% of SF FY19 sales

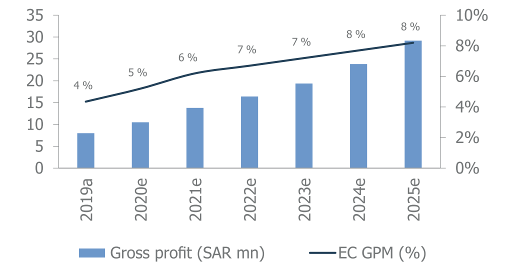
Savola's emerging categories (SEM) consist of the (i) sale of ready-to-eat baked products (Pech Pech) in Iran, (ii) JV with international canned-seafood producer, Thai Union, to promote the renowned John West trademark, and (iii) sales of specialty fats and margarine in Saudi Arabia and Turkey. SEM's FY19 revenue improved 10% y-o-y to SAR184mn, with a gross profit of SAR8mn, reversing a gross loss of SAR6mn a year earlier, but still recording a FY19 net loss of SAR32mn. In 9M20, SEM sustained a gross profit of SAR8mn, which we will anticipate will reach SAR11mn by the end of FY20e. Considering its niche nature, we believe the segment's gross margin will improve to 8% by FY25e from 4.3% in FY19 on the back of greater market penetration, supported by a 2019–25e sales CAGR of 12%.

Figure 37: Savola's niche segment growing at a CAGR of a mere 4%...



Source: Company data, Beltone estimates

Figure 38: ...translating to stable gross margin development



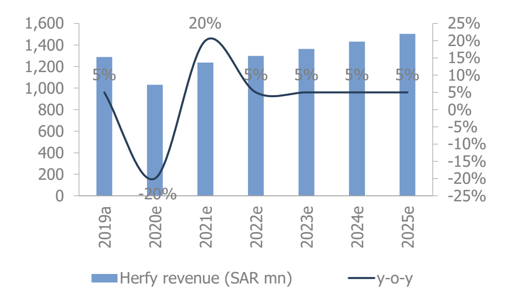
Source: Company data, Beltone estimates

3- Food Services - 9% of total group FY19 sales

3.1- Herfy - 6% of total group FY19 sales

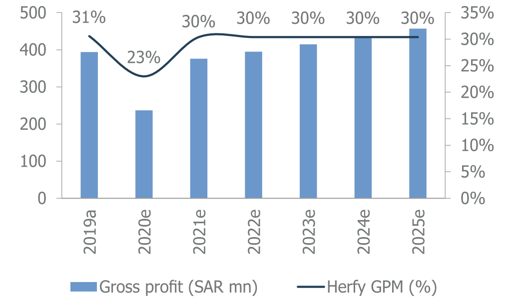
Established in 1981, Herfy is considered to be Saudi Arabia's largest fast food chain with over 394 branches across 50 cities within Saudi Arabia, Kuwait, and Bangladesh. Herfy also produces a range of packaged and frozen foods such as bread, friable chicken nuggets, and frozen burger patties. Savola initially owned 70% of Herfy following its acquisition of Panda in 1998, which has later fallen to 49% following its IPO on the Saudi Tadawul in 2011. The company's FY19 revenue improved 5% y-o-y, but 9M20 sales took a hit (-19% y-o-y) following the COVID-19 outbreak, which resulted in major store closures and limited working hours. 3Q20 sales figures witnessed a sequential turnaround (+83% q-o-q) as curfew restrictions were removed and as bakery and meat volumes improved. Accordingly, we anticipate FY20e sales to close at SAR1,030mn (-20% y-o-y), yielding a gross margin of 23%. Going forward, we project sales to grow at a 2019–25e CAGR of 2.6% on the back of normalized operations (with gross margin levels normalizing at 30% over our forecast horizon) and management's efforts to launch new meals and possibly extend its overseas presence.

Figure 39: Top line recovery post COVID-19 impact...



Source: Company disclosure, Beltone estimates

Figure 40: ...normalizing gross margins going forward

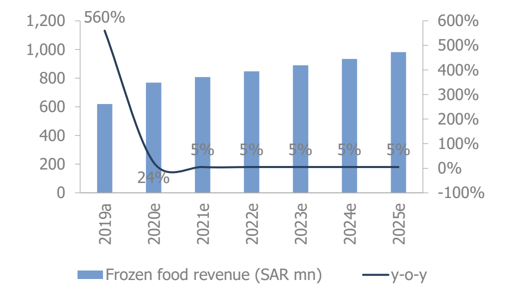


Source: Company disclosure, Beltone estimates

3.2-Frozen Food (Al Kabeer) - 3% of total group FY19 sales

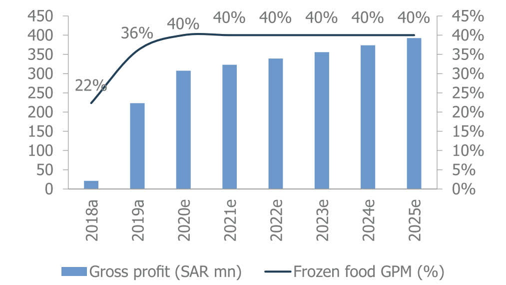
Since its acquisition in 2018, Savola has had a 51% stake in UAE-based frozen-food distributor, Al Kabeer, which operates across 11,000 outlets with 200 products in Saudi Arabia, the UAE, and other GCC countries. Management reported an elevated FY19 revenue of SAR620mn (+560% y-o-y) and net profit of SAR62mn, reversing a net loss of SAR4mn in FY18. 9M20 sustained a 29% increase in sales, with FY20e projected to close at SAR769mn (+24% y-o-y) and grow at a 2019–25e CAGR of 8% on the back of the launch of new product items along with expanding its overseas customer base. Accordingly, we anticipate gross margin to average 40% over our forecast horizon.

Figure 41: Consumer inclination toward frozen food...



Source: Company data, Beltone estimates

Figure 42: ...spurring gross margin growth of over 4ppts over our forecast horizon

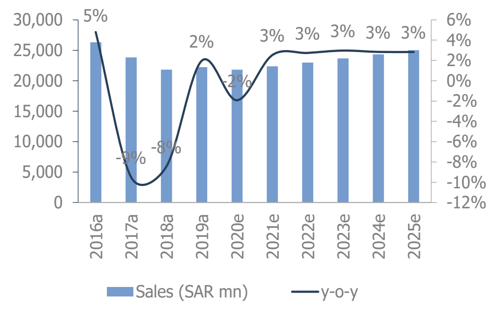


Source: Company data, Beltone estimates

3.3- Almarai - major contributor to Savola valuation

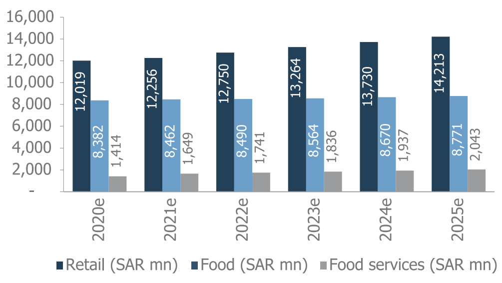
Savola is the largest shareholder of Almarai, the most recognizable brand in the kingdom, having acquired 34.5% ownership. While being the market leader across all dairy products in Saudi Arabia, the company's production also entails juice, bakery items, poultry, and infant nutrition. Spanning a presence in the GCC, Egypt, and Jordan, the company is the Middle East's largest food producer and distributor. We believe Almarai's contribution will grow at a 2019–25e CAGR of 10.5%, with its contribution constituting 77% of Savola's valuation, highlighting its importance to the 26% core earnings CAGR over our forecast horizon.

Figure 43: Savola top line to record 6-year CAGR of 2%...



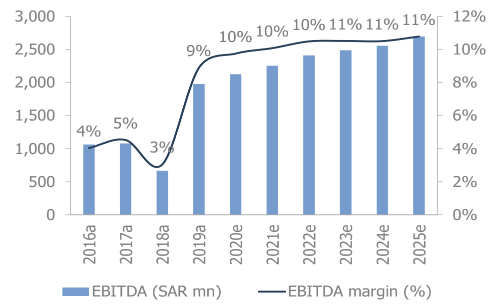
Source: Company data, Beltone estimates

Figure 44: ...driven mostly by retail and food services revenue improvements...



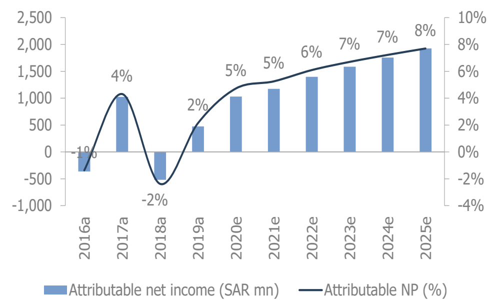
Source: Beltone estimates

Figure 45: EBITDA improvement attributed to trickled-down impact of enhanced retail recovery



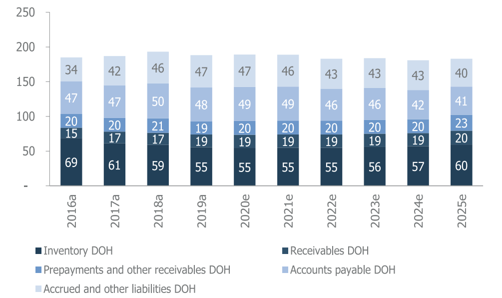
Source: Company data, Beltone estimates

Figure 46: Attributable net income surging on the back of Savola's net income share of Almarai



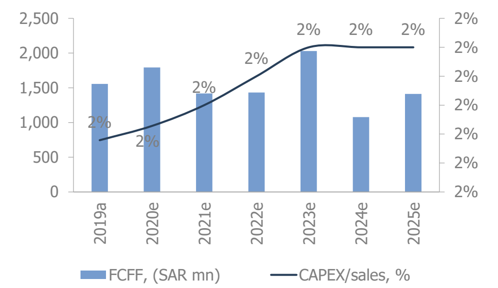
Source: Company data, Beltone estimates

Figure 47: Stable working capital across our projections...



Source: Company data, Beltone estimates

Figure 48: ...and lack of major CAPEX translating into high FCFF yield



Source: Company data, Beltone estimates

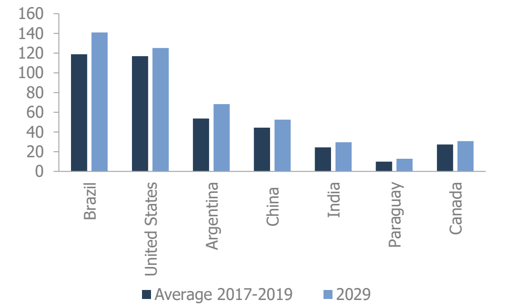
APPENDIX

Global oil industry dynamics

Oilseeds

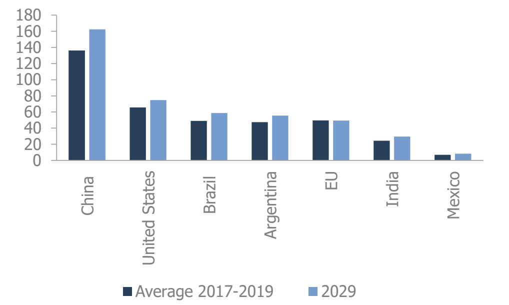
- Oilseeds, especially soybeans, are universally cultivated to extract (crush) oil and protein ingredients. These ingredients are then processed and utilized as human foods, livestock feeds, and manufacturing goods.
- Overall oilseed production recorded a 2013–19 CAGR of 2.4% with consumption growing at a higher CAGR of 3.0%, indicating increased appetite and demand.
- From 2017–19, Brazil has been the dominant producer of oilseeds at an average of 118.9mn tpa. This is highly attributed to the execution of a double-cropping scheme, where 2 different types of harvests are planted during an agricultural calendar. As a runner-up, the US produces over 117.0mn tpa.

Figure 1: Brazil and US lead global oilseed production (mn tons)



Source: OECD/FAO

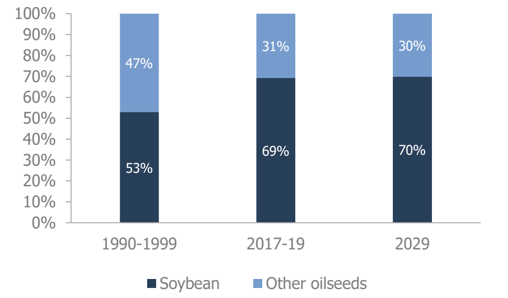
Figure 2: China being the largest importer of oilseeds directly impacts price fluctuations (mn tons)



Source: OECD/FAO

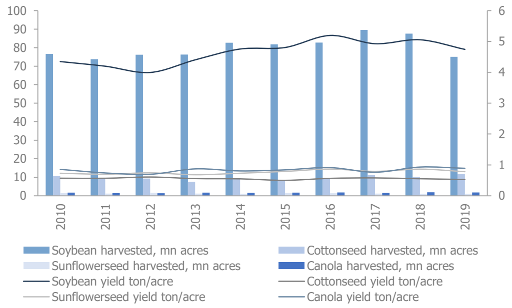
- Soybean is fundamentally branded as the major oilseed variety, increasing its contribution from 53% in the 90's to 69% from 2017–19 of total oilseed produced globally.
- Soybean's planted area increased from 74mn acres in 2000 to reach a high of 90mn acres in 2017. Other types of oilseeds such as cotton seed and sunflower seed have recorded lower planted areas over the past 20 years on the back of a lower average yield of 0.7 tons per acre versus 4.6 tons per acre for soybean. This is attributed to the (i) rise of hybrid planting where 2–3 beans are embedded in soybean plant pods at a time. Currently, farmers can embed up to 4 beans, potentially rising to 5 in some cases, (ii) escalation of global carbon dioxide ($CO2$) levels. Soybeans are categorized as C3 plants that react greater to $CO2$ levels than C4 plants such as corn, and (iii) enhancement in fertilizer and pesticide utilization.
- 2019/2020 soybean production deteriorated as a result of a 20% drop in the US. This was attributed to heavy rainfalls that spanned from January to June, leading farmers to delay harvesting in imperfect growing conditions. As a result, yield per acre dropped 15% y-o-y.
- Regardless of the deterioration in soybean production in FY19/20, prices did not surge as consumption recorded a noticeable reduction in China, the largest consumer and importer as well as third major producer of oilseeds globally. This was largely driven by the continuous damaging impact of the African swine fever on China's livestock with over 100mn pig deaths since August 2018.

Figure 3: Majority of oilseed production is attributed to soybean



Source: OECD/FAO

Figure 4: Oilseed yields and acreage dropped during past 3 years, while prices remained stagnant

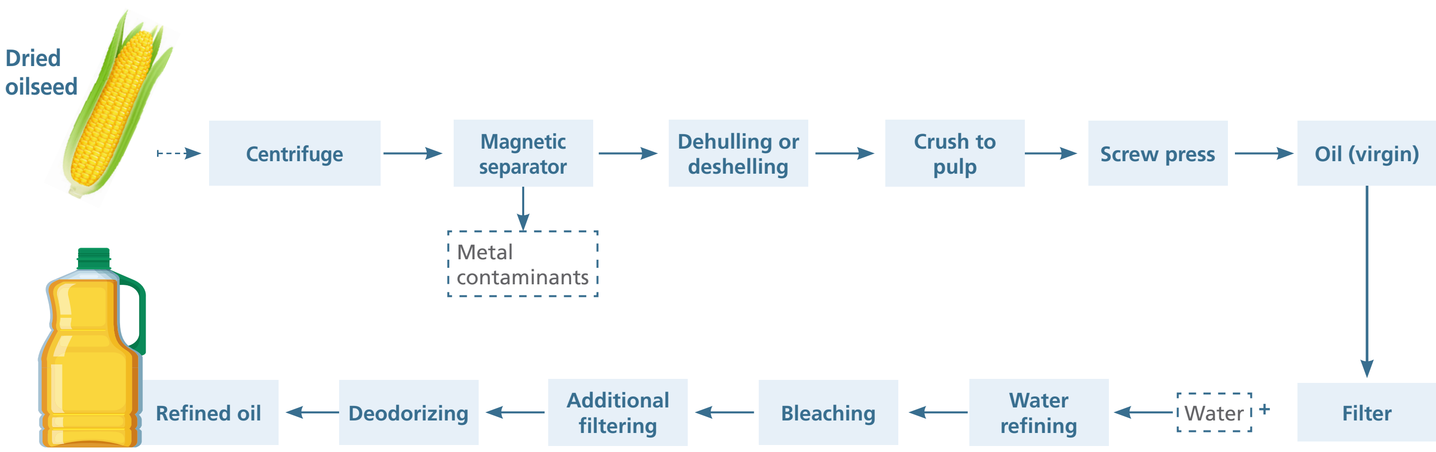


Source: USA Department of Agriculture

Vegetable oil

- Vegetable oils are oils distilled from a range of oilseeds and nuts. The majority of oils do not accommodate cold-pressing techniques since unsavory flavors would linger. Consequently, these oils undertake various processing phases beyond plain abstraction to yield a rich and edible oil.

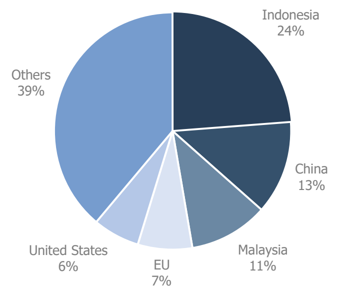
Figure 5: Oil crushing process



Source: Britannica

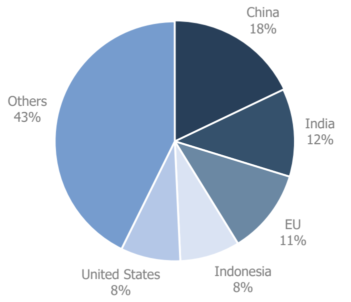
- Production is subject to oilseed crushing and the cultivation of long-standing tropical plants, particularly palm oil. In the past 10 years, palm oil harvest has eclipsed other vegetable oils.
- At the center of the COVID-19 pandemic, global vegetable oil prices witnessed demand deceleration in China and India, triggered by lockdown enforcements. For importing countries, crushing volumes were prolonged, therefore growing their seed imports to the detriment of oil and meal procurements. In view of that, key exporters of vegetable oil suffered from below customary export levels, resulting in a drop in global prices

Figure 6: Indonesia is the leading palm oil producer, one of the major vegetable oils produced…



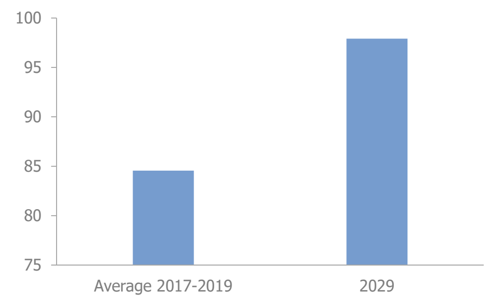
Source: OECD/FAO

Figure 7: …while China is the leading vegetable oil consumer



Source: OECD/FAO

Figure 8: Projected major hike in vegetable oil imports by 2029 (mn tons)

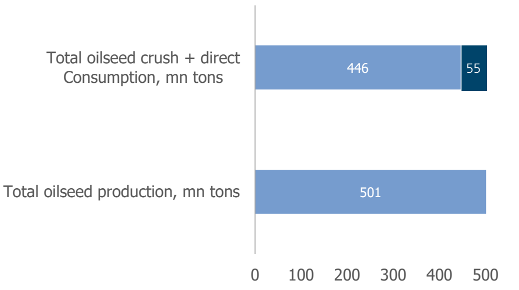


Source: OECD/FAO

Slower projected production rates on the back of weaker consumption

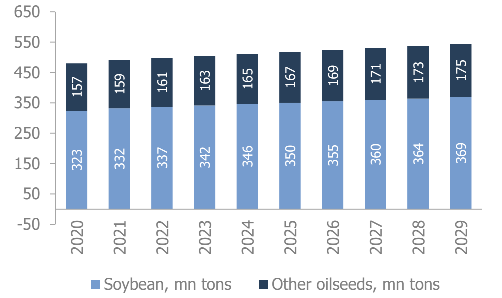
- With Brazil being renowned for its fertile landscapes, its soybean projected production growth of 1.9% per annum will beat that of the US (0.7% per annum) to reach 141mn tons versus 125.2mn tons, respectively, by 2029. China is projected to revive production levels by 1.7% from 2020–29 as the lack of policy backing for the farming of wheat (+0.6% from 2020 to 2029), which acts as a substitute for oilseeds, supports interest in oilseeds harvesting going forward.
- With consumption levels expected to record a 2020–26 CAGR of 1.4% compared to a historical 2013–19 CAGR of 3.0%, projected soybean production will accordingly record a lower CAGR of 1.2% versus historical CAGR of 2.4%. In view of that, total oilseed crush is anticipated to increase by 64mn tons by 2029, considerably less than 103mn tons during the preceding 10-year span.
- Global vegetable oil production is anticipated to grow by 1.4% annually, attributed mostly to increased food demand in developing countries as population and income levels continue to outpace developed country growth rates. Nevertheless, harvest development is anticipated to deteriorate as a result of growing resolutions to diminish deforestation instigated by palm oil factories in Indonesia and Malaysia, which constitute 33% of global vegetable oil manufacturing. This indicates that manufacturing enhancement will rise gradually from efficiency increases, together with an intensification in cultivation practices.

Figure 9: Oilseed crushing constitutes 89% of total production



Source: OECD/FAO

Figure 10: Soybean projected to dominate oilseed production going forward

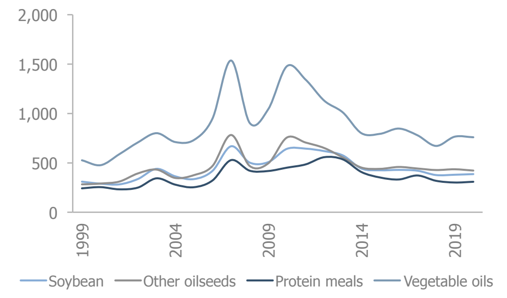


Source: OECD/FAO

Projected price recovery post major drop during 2019 and COVID-19

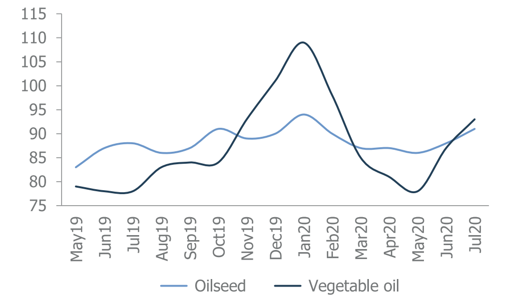
- Global oilseed prices dropped, hitting rock bottom in 2019 as a result of the decline in oils and protein meal demand, along with the unpredictability triggered by trade wars. However by the end of 2019, trade deals between the US and China were patched up, resulting in a softened immediate impact on global prices, particularly for soybeans.
- Following a period of recovery, oilseed prices witnessed a significant downfall with the spread of COVID-19, dropping 3% m-o-m in February and 4% m-o-m in March as global demand plummeted. As for vegetable oils, prices fell 10% m-o-m and 13% m-o-m during the same period.
- Global prices started to recover to end-of-2019 levels as demonstrated by FAO's oilseed and vegetable oil price indices increasing 3% y-o-y and 19% y-o-y, respectively, by July 2020. On a monthly basis, both oilseed and vegetable oil price indices increased 3% m-o-m and 7% m-o-m in July 2020.
- The recent improvements mostly mirror increases due to:
  - Below initially anticipated planting in 2020
  - Steady warm climate in numerous essential cultivating areas
  - Higher-than-projected local crushing
  - Strong export levels to China
  - Brazilian supply contraction subsequent to intensive export levels maintained global prices
- As for global vegetable oil prices, enhancement resulted from:
  - Probable production deceleration in Southeast Asia caused by floods from dense rainfalls
  - Increased import demand and persistent distress in Malaysia over continuous immigrant deportations provided supplementary sustenance to palm oil prices
  - The Indonesian government announcing that the objective to increase local biodiesel dependency to 40% is in progress and would be completed by July 2021, which would aid increase national palm oil consumption in the upcoming period
- We believe vegetable oil prices will increase by a 2020–24 CAGR of 3% on the back of stimulated demand for oils, compensated by scientific developments to record yield progression and land development. Furthermore, changes in oil usage have led to fluctuations in accessibility and pricing of substitute oil merchandises, while ever-changing consumer inclinations and governmental mandates have shifted supply and demand. The anticipated single-digit growth of oilseeds prices should reinforce the price of vegetable oils during the forecasted horizon.

Figure 11: Both oilseed and vegetable oil prices (USD/ton) have taken a hit for the past 10 years...



Source: OECD/FAO

Figure 12: ...however recent recovery on the back of increased demand and lower cultivation yields (2014-2016=100)



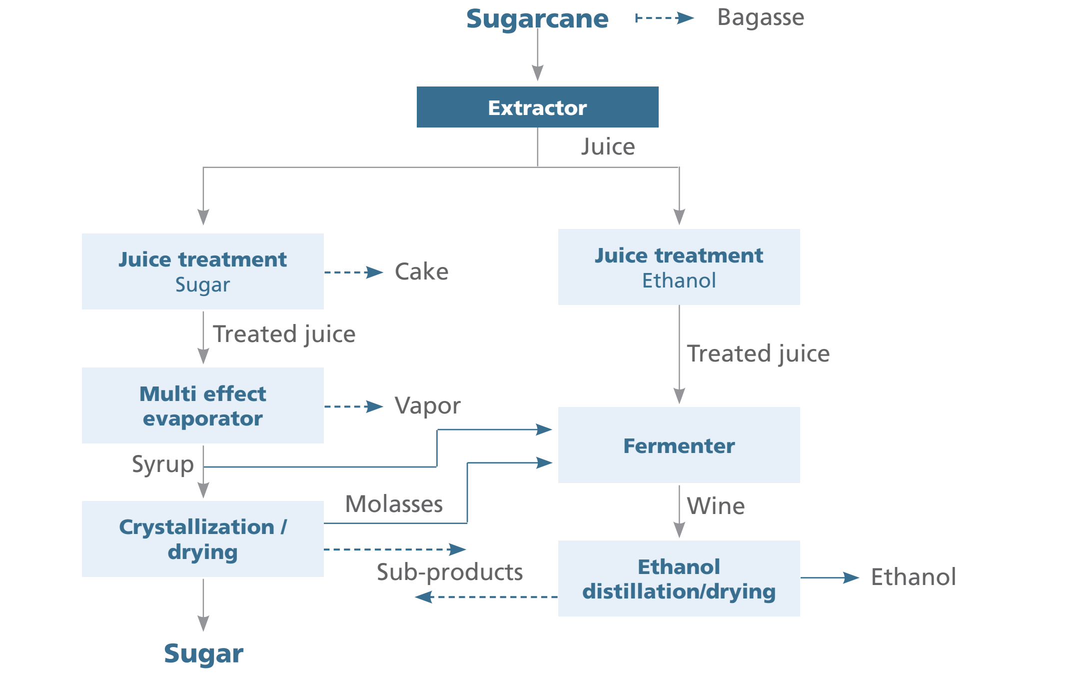
Source: FAO

Mature markets' vegetable oil consumption recorded 8.7mn tons on average during 2017–19 (4.0% of global vegetable oil consumption) and is anticipated to grow 15% by 2029. Turkey, being the largest user, consumes over 2.9mn tons (1.4% of global vegetable oil consumption and 34% of MENAT mature market consumption). Next in line, Egypt consumed an average of 2.6mn tons during the same period (1.2% of global vegetable oil consumption and 30% of MENA mature market consumption). As for Iran, which came in third, consumption averaged 2.0mn tons (1% of global vegetable oil consumption and 24% of MENAT mature market consumption). Lastly, Saudi Arabia coming from a low base of 0.9mn tons is expected to record the highest consumption growth rate of 36% by 2029 to reach 1.2mn tons. With consumption exceeding production levels, potential shortages are compensated via importation, which is estimated to surge from 5.5mn tons on average from 2017–19 to 6.1mn tons by 2029 (+10%). According to FAO estimates, mature markets' production growth is anticipated to outpace that of consumption by 9ppts, indicating a higher dependency on local harvesting going forward.

Global sugar industry

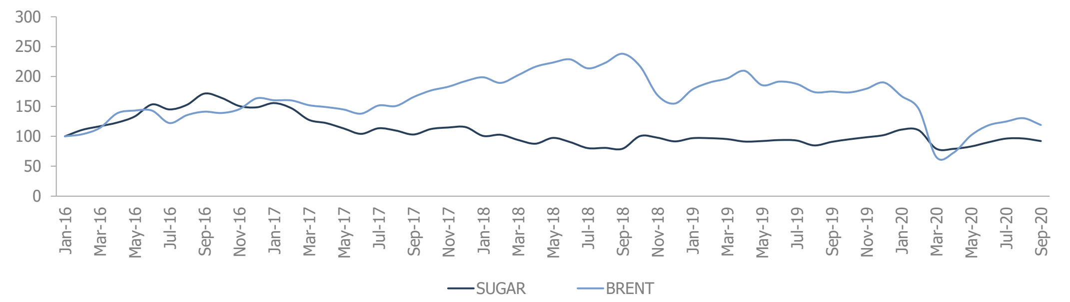
- Sugar can be manufactured from sugarcane or beet, with 86% of total volumes contributed by sugarcane while beets contribute the residual 14%.
- Sugarcane is a seasonal harvest that is cultivated repeatedly mostly in humid and wet areas, in spite of diminishing yields with each passing season. Meanwhile, beet is harvested once every season in moderate regions.
- Both harvests undergo a number of processes to extract refined sugar as well as ethanol, an alternate biofuel. Accordingly, there is a positive correlation between sugar and ethanol prices versus global fuel prices. To illustrate more, when global oil prices increase, consumers tend to fend off fuel consumption and shift toward substitute products such as ethanol, leading to less sugar production and driving higher sugar prices. As for production choice, mills can alternate between sugar and ethanol production when either by-product price declines, hedging any investment uncertainty.
- According to FAO estimates, 78% of total sugar crops will be utilized to produce sugar, while the remaining 22% will be allocated to ethanol.

Figure 13: Sugar extraction process



Source: John A.Dutton e-Education Institute

Figure 14: Direct relationship between sugar and brent global prices (USD)



Source: Bloomberg
**Rebased at 100*

Global production and price

- Global production growth levels exceeded that of consumption levels, recording an average of 9% versus 1% between 2017 and 2018.
- High levels of accrued inventories that reached a peak of 52mn tons in 2018 (+23% y-o-y) resulted in depressed global prices, recording a 5-year low of 0.1009 cents/lb versus a 5-year high of 0.2381 cents/lb (-58%). With farmers enduring deteriorating selling prices, falling below harvesting cost, several countries amplified subsidy programs and ineffectively led to market flooding.
- Following the slump, FY19 production levels were normalized and decreased by 8% y-o-y in effort to recover global prices (+29% upside).
- Following COVID-19, global sugar prices took another hit as consumption initially decreased, and later pushed down further as production levels increased in anticipation of further lockdowns.
- According to FAO, average world production entailed 176mn tpa, slated to surge 15% by FY29.
- Historically, India dominated sugar with 18% of global volumes. However, Brazil at 17% of global volumes during 2017–19 is expected to outpace India to record 37.1mn tons from 35.3mn tons by 2029.

- Brazil's sugar production growth will be driven by:
  - Devaluation of its local currency, the BRL, in drawing new investments
  - Increased efforts to limit carbon emission will escalate ethanol production and sugar trading
- India production is projected to improve from existing slumps and gradually develop to 35mn tons by 2029 (+14%), relatively supported by the government's subsidy program to support crop farmers.
- EU (10% of global volumes) is anticipated to record a single-digit drop of 1% from 2017–19 average to 2029.
- The highest gainer during the coming period will be Thailand (7% of global volumes), which anticipates production to increase from 13.0mn tons to 15.8mn tons by 2029 (+21%).
- China (6% of global volumes) is estimated to expand 13% by 2029 to record 12.2mn tons on account of China's continued efforts to fill in the consumption-production gap from similarly priced countries, allowing local farmers to compete.
- With a FY20–29 consumption CAGR of 1.42% beating historical FY10–19 CAGR of 1.26%.

Global corn industry

- The US is considered the largest corn producer with over 367mn tons produced during 2018–19. Next in line is China, which produced over 258mn tons, with the majority consumed locally. Brazil, ranked third in terms of corn production, cultivating 95mn tons of corn. Coming in forth in terms of corn production, Argentina produced over 46mn tons. Lastly, Ukraine produced over 36mn tons of corn.
- Global corn prices fell significantly during 2013–15 following a drought season in 2012, which resulted in significant price increases. In effort to offset price increase, major production volumes were yielded in subsequent years where prices dropped to USD157/ton by 2015 versus USD271/ton in 2012.
- Price recovery was instigated in 2018 and 2019 with average price reaching USD164/ton in 2018 and climbing further to USD170/ton in 2019. This was attributed to extended dry seasons in Argentina along with global demand continuing to be resilient.
- China, being the largest US corn importer, implemented a price-controlled scheme on corn from 2011–15 (standing at USD394 /ton), which accordingly stimulated intense corn harvesting. However in 2016, China ended its uneconomical corn subsidy program, which eventually led to state reserves being exhausted. Additionally, China's 2020 corn yield was severely hit by (i) a dry season, (ii) a typhoon, and (iii) African swine fever. According to estimates, local production will be insufficient to cover escalating demand as pigs recover from African swine fever. This was demonstrated as Chinese corn imports climbed to 6.7mn tons y-t-d from global suppliers.
- The US's FY20/21 corn production is estimated to drop to 368mn tons on the back of lower yields of 5.5 tons/acre. Meanwhile, US corn exports are projected to increase to 67mn tons as a result of increased demand from China as mentioned earlier. With supply deteriorating and demand growing, US corn closing stocks will drop to 43mn tons (registering a record drop since 2013/14).
- According to estimates, global maize production will grow at a 2019–29 CAGR of 1.6%, mainly driven by China's continued dependency on diminishing its production-consumption gap and accordingly result in global prices increasing to USD198/ton versus USD168/ton in 2020.

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