

Almarai Co.

Resilient Performance, with Challenges Ahead

In line with our expectations for Q2 2020, Almarai was able to achieve an 8.4% Y-o-Y increase in revenue due to the lockdown situation, despite some pressure in the Juice and foodservice segments due to COVID-19. On the other hand, gross profit remained under pressure in Q2 2020 on the back of COVID-19 related expenses coupled with alfalfa and labor expenses. Moreover, a general decrease in demand is anticipated due to the decrease in purchasing power following the VAT and expat exodus.

During Q2 2020, Almarai's revenues grew by 8.4% Y-o-Y driven by Poultry (+16.6% Y-o-Y). During the quarter, there was a shift in channel mix, where only 30% of poultry volumes were sold to foodservice (compared to 50% in Q2 2019), while the remaining 20% of the volumes sold were going to the retail sector. The shift in channel mix resulted in double-digit growth year-on-year and accounted for 17% of the total growth in Q2 2020. Almarai's revenue growth was also led by cheese, butter & cream category that contributed to total revenue growth by 21% and Long-Life Dairy by 22%.

Operating at full capacity, the bakery segment (+7.5% Y-o-Y) benefited from economies of scale, and lower marketing spend

However, the juice segment experienced significant demand losses, as juice taxes were passed on to prices, which caused the dairy and juice sector to grow by only (+6.6% Y-o-Y).

During the 2nd quarter, COGS increased by 10.7%, mainly due to additional safety measure costs related to the management of COVID-19 pandemic, in addition to higher input costs for the juice sector, high labor costs (to support growth in the retail segment) and high feed costs. That being said, the gross profit margin dropped from 38.9% in Q2 2019 to 37.6% in Q2 2020. Selling expenses and general and administrative expenses both increase by 8.4% and 5.3%, respectively.

Finance costs decreased by SAR19mn, from SAR139mn in Q2 2019, to SAR120mn in Q2 2020. The drop in finance cost is due to lower interest rates on the back of the government's support measures during the pandemic.

Net income increased by 10.5% Y-o-Y, due to the combination of the increased demand and lower cost of debt.

CAPEX cash spends decreased from SAR376mn in Q2 2019 to SAR252mn in Q2 2020, in line with Almarai's current available capacity. Approved CAPEX comprised mostly of maintenance (utilities, production lines, and vehicles). The company plans to follow a strict CAPEX strategy to maintain steady cash levels. Free cash flow increased by SAR501mn Y-o-Y, reaching SAR1,100mn in Q2 2020.

Despite the strong performance during the pandemic, which was mainly supported by the company's diverse product range and strong channel base, the company is facing significant challenges in the longer term.

The VAT tripled on the 1st of July, which the company passed along to 80% of its portfolio. Moreover, due to the pandemic, it was estimated that around 1.2 million expatriates would leave the Kingdom, while some researchers suggest that the population decline in the region could reach 3 to 4 million by 2021. The combination of weak purchasing power due to VAT and less population, in addition to alfalfa expenses, Almarai could be heading towards a challenging period after the pandemic. Moreover, with most of its segments already mature, ranking #1 choice for customers (with the exception of UHT milk), the company has no room for further long-term growth. However, in the short-term, the imposed import duty levy could be an opportunity as demand on locally produced Poultry could increase.

That being said, we believe that Almarai's slightly overpriced given the maturity of the company; therefore, **we update our 52 weeks target price SAR49.0/share while maintaining our NEUTRAL recommendation.**

15 July 2020

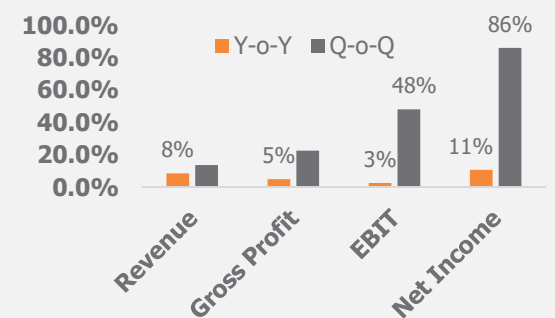
Recommendation **Neutral**

Previous Recommendation	Neutral
Current Price (15-07-2020)	SAR54.3
Target Price (52 Weeks)	SAR49.0
Upside/ (Downside)	(9.8%)
Shariah Compliance	Pass

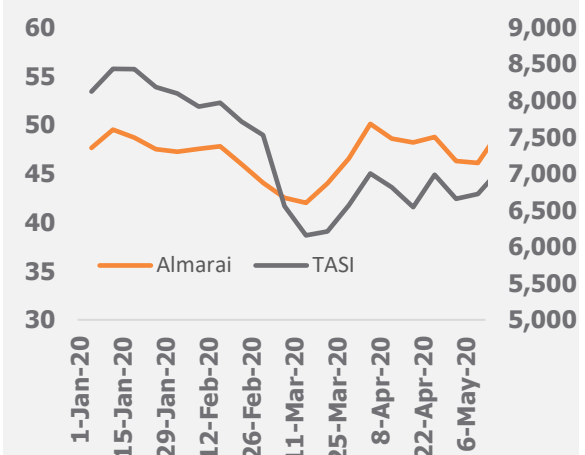
Key Financial Ratios

Ratio	Q2 2020	Q1 2020	Q2 2019
Revenue Growth	8.4%	8.6%	2.5%
Gross Margin	37.6%	34.9%	38.9%
EBIT Margin	18.6%	14.3%	19.7%
Net Margin	15.8%	10.2%	15.5%

Key Financial Results (Q2 2020)



Share Price Performance



Financial Projection

DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	4,658	5,038	5,391	5,772	6,158
Operating CF	4,201	4,954	5,205	5,654	5,899
Capex	(1,688)	(1,683)	(1,677)	(1,757)	(1,742)
FCFF	2,513	3,272	3,528	3,897	4,157
Stub Period (FCF to be discounted)	1,267	3,272	3,528	3,897	4,157
PV (FCFF)	1,213	2,866	2,798	2,795	2,654
WACC	9.0%	<p>We have valued Almarai using DCF approach, considering a WACC is equal to 9.0% (based on a risk-free rate of 4.4%, market risk premium 7.3%, Beta of 0.76).</p> <p>Based on the DCF valuation, the fair price Almarai share price is SAR49.0, which is lower than the traded value by 9.8%.</p>			
Perpetuity Growth	4.0%				
PV-FCFF	12,327				
PV-TV	50,424				
Net Debt	(12,601)				
Less: End of services benefits	(848)				
Add: Investments	232				
Less: Minority Interest	(563)				
Intrinsic Values	48,970				
Shares Outstanding	1,000				
Equity value per share	49.0				
CMP (15-07-2020)	54.3				
Upside / (Downside%)	-9.8%				

Financial Ratios

	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Return on Average Assets (%)	6.2%	5.5%	5.9%	7.0%	8.2%	9.2%	10.1%
Return on Average Equity (%)	13.7%	12.1%	12.3%	13.9%	14.8%	15.5%	15.8%
Earnings Before Zakat Margin (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income Margin (%)	14.8%	12.6%	12.7%	14.7%	16.3%	17.7%	19.1%
Revenue Growth (%)	-2.7%	5.9%	6.4%	5.7%	6.2%	6.2%	5.9%
EPS	2.0	1.8	1.9	2.4	2.8	3.2	3.7

Income Statement

	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Revenues	13,558	14,351	15,272	16,149	17,142	18,207	19,275
Cost of Revenues	(8,231)	(8,985)	(9,655)	(10,053)	(10,507)	(10,995)	(11,486)
Gross Profit	5,327	5,367	5,617	6,096	6,635	7,212	7,789
SG&A	(2,806)	(2,893)	(3,137)	(3,215)	(3,382)	(3,560)	(3,739)
Zakat	(70)	(121)	(81)	(91)	(98)	(103)	(106)
Net Income	2,008	1,802	1,947	2,373	2,787	3,229	3,674

Balance Sheet

	2018A	2019A	2020E	2021F	2022F	2023F	2024F
Current Assets	7,089	7,325	7,830	9,363	9,648	11,872	12,876
Non-Current Assets	25,693	25,823	25,334	24,859	24,398	24,035	23,668
Total Assets	32,783	33,148	33,164	34,222	34,046	35,907	36,545
Current Liabilities	5,514	5,725	4,896	6,685	5,258	7,267	5,580
Non-Current Liabilities	12,806	12,164	11,912	9,658	9,121	6,744	6,394
Total Equity	14,462	15,259	16,356	17,879	19,667	21,896	24,570
Total Liabilities and Equity	32,782	33,148	33,164	34,222	34,046	35,907	36,544

Guide to Ratings and Disclaimer

Guide to Ratings

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

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