

Initiation Coverage
January 25, 2017

Recommendation	Neutral
Current Price (SAR)	53.2
Target Price (SAR)	51.4
Upside/Downside (%)	(3.5%)

As of January 23, 2018
Key Data (Source: Bloomberg)

Market Cap (SAR bn)	53.2
52 Wk High (SAR)	78.6
52 Wk Low (SAR)	51.8
Total Outstanding shares (in mn)	1,000.0
Free Float (%)	21.9%

Almarai Vs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	(3.6%)	4.5%
6m	(5.3%)	24.2%
12m	(5.2%)	10.1%

Major Shareholders (%)	%
Savola Group Co	34.52
Al-Saud Sultan Mohamed	23.69
Public Investment Fund	16.32

Quarterly Sales (SAR mn) and Operating Margin

Source: Bloomberg, Company Financials, FALCOM Research; Data as of 23th January 2018

Almarai Co. (Almarai) reported flat FY17 earnings of SAR 2182.3mn (0.5% YoY). Earnings were supported by improved performance of the poultry business and cost optimization, but weighed down by weak market conditions.

Strong market position, favourable demographics, and experienced management are key positives for Almarai. However, the company was hit by regional instability and softening consumer demand. Considering the countervailing factors, we recommend a neutral with a target price of SAR 51.4.

Strong brand, dominant market position:

Almarai is the Middle East's leading food and beverage company. It is also the world's largest vertically integrated dairy company and among the most trusted brands in the region. According to YouGov's BrandIndex, it is the most positively perceived brand in Saudi Arabia for the last three years. Customer loyalty and strong brand image hold the company in good stead to benefit from the opportunities in a market with one of the fastest population growth rates in the world.

Margin expansion due to cost rationalisation:

The company's operating margins consistently expanded over the last few years (18.5% in FY17 vs. 17.6% in FY16) as the company continued its endeavour to cut costs whilst maintaining the quality of offerings. The company's consistency in margin expansion reinforces our belief it is led by a competent and efficient management, which would continue to lead the company along the path of sustainable growth.

Poultry turnaround, sign of better times ahead:

The company has managed to turn around its hitherto struggling poultry division by improving its supply chain management and price realisation. We expect further improvement in FY18, which would reflect well on the company's top and bottom-line. Furthermore, we expect the company to corner an increasing share of the frozen segment which will shore up the segment's performance.

Geopolitical tensions, a concern:

The Middle East region has, in recent past, seen escalating geo political conflicts which have adversely impacted the company's business. If geopolitical tensions in the region escalate further, Almarai, with presence across the region, will be negatively impacted.

Consumer sentiment could dampen due to VAT implementation:

The imposition of VAT by the Saudi government could dampen consumer sentiment and negatively impact the company's performance going forward. Also, additional fiscal streamlining measures could be implemented by the government, which could further impact demand in the company's largest market.

Valuation: We valued Almarai using the DCF Approach to arrive at a fair value of SAR 51.4 per share. We considered WACC at 9.6%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	13.9	15.3	16.6	18.1
Operating Profit (SAR bn)	2.6	2.9	3.5	4.2
EPS (SAR)	2.2	2.5	3.1	3.8
Operating Margin (%)	18.5%	19.2%	21.2%	23.2%
D/E (x)	0.9	0.8	0.7	0.7
RoE (%)	14.5%	15.0%	16.2%	17.0%
P/E (x)	24.2	21.4	17.4	14.3
Price/BV (x)	3.5	3.2	2.8	2.4
EV/EBITDA (x)	14.2	13.5	11.4	9.4

Source: Company Financials, FALCOM Research

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Valuation Summary

Explanation of valuation methodology and assumptions

We valued Almarai using the DCF Approach to arrive at a fair value of SAR 51.4 per share. We considered WACC at 9.6% with a terminal growth rate of 2.0%.

In relative terms, Almarai is trading at 1yr forward PE of 21.4x, at a premium of 1.7% to its sector peers and 56.2% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	2,583	2,933	3,525	4,202	4,976	
Taxes	(42)	(49)	(60)	(73)	(88)	
Depreciation, amortization and impairment	1,920	1,725	1,829	1,927	2,019	
Changes in working capital	1,012	464	296	342	393	
Net capital expenditure	(2,901)	(2,858)	(2,278)	(2,119)	(1,915)	
Free Cash Flow to firm	2,572	2,216	3,312	4,280	5,386	
<i>Discount Factor</i>		0.9	0.8	0.8	0.7	
PV of free cash flow to firm		2,033	2,773	3,270	3,755	
Net Present Value (A)					11,831	
PV Terminal Value (B)					50,390	
Assumed Terminal Growth Rate					2.0%	
Discount Rate					9.6%	
Enterprise Value (A+B)	62,221	WACC Assumptions				
Total Cash	1,892	Risk free rate				2.7%
Total Debt	12,802	Equity Risk Premium				9.3%
Minority Interest	397	Beta				0.9x
Equity Value in SAR mn	50,914	Cost of equity				11.2%
Number of shares in mn	991	Post tax cost of debt				3.1%
Target Price in SAR per share	51.35	Weight of equity in capital structure				80.0%
CMP in SAR as on January 23th, 2018	53.2	Weight of debt in capital structure				20.0%
Upside/(Downside) to current market price	(3.5%)	WACC				9.6%

Source: Company Financials, FALCOM Research Estimates

Risks

Upside Risks:

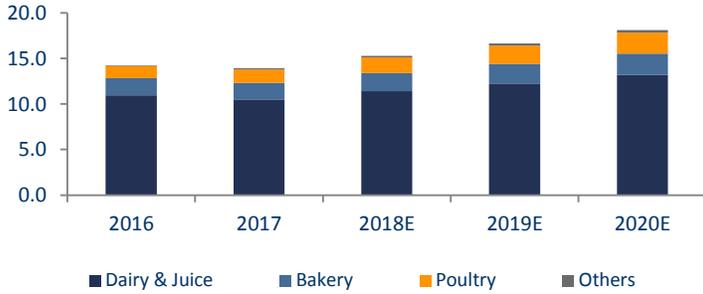
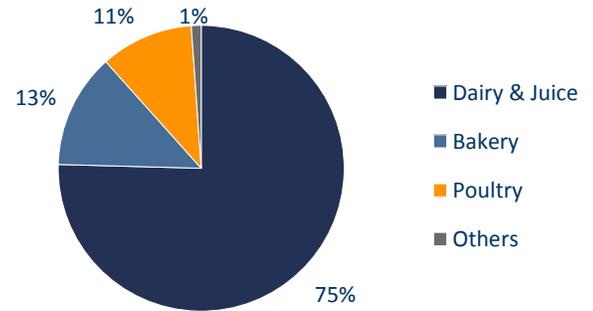
- Geo political tensions in the region could subside, providing a boost to the company.
- Better-than-expected operational performance, particularly in the poultry segment, could be witnessed.
- Stronger-than-expected volume growth could be seen.

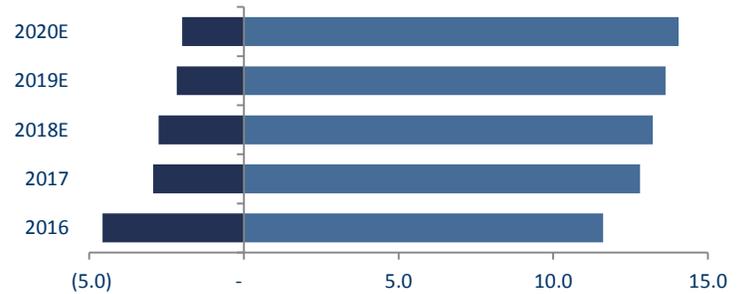
Downside Risks

- Household spending budget and disposable income may be under more pressure than anticipated, impacting Almarai more severely than we assumed.
- Global dairy prices may rise substantially, reducing margins on Almarai's dairy products.
- Oil prices could come under pressure in the coming year.
- Further removal of government subsidies would impact the company negatively.

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Key Charts
Revenue (SAR bn)

Revenue Split (2017)

EBITDA & Margins

CAPEX and Debt

Price to Earnings

EV/EBITDA

Dividend Yield

Free Cash Flow Yield


Source: FALCOM Research Estimates

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Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Sales	13,936	15,293	16,643	18,127
Gross Profit	5,584	5,893	6,663	7,529
EBITDA	4,503	4,658	5,354	6,129
EBIT	2,583	2,933	3,525	4,202
Earnings from Associates	13	17	23	31
Net Interest	(401)	(414)	(427)	(440)
Other	-	-	-	-
PBT	2,202	2,537	3,121	3,793
Minorities	(42)	(49)	(60)	(73)
Zakat	22	(21)	(20)	(19)
Net Income	2,182	2,467	3,042	3,702
EPS	2.2	2.5	3.1	3.8
DPS	0.8	0.7	0.7	0.7

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	1,892	3,596	6,120	9,589
Current Assets	4,921	4,991	5,064	5,123
Fixed Assets	23,685	24,865	25,361	25,600
Intangibles	1,047	1,000	953	906
Investments in associates and JVs	129	173	232	311
Total Assets	31,896	34,847	37,953	41,751
Current Liabilities	3,512	4,046	4,415	4,816
Short Term Debt	2,259	2,515	2,515	2,515
Long Term Debt	10,543	10,958	11,373	11,787
Shareholders Equities	14,881	16,628	18,950	21,932
Total Liabilities	31,896	34,847	37,953	41,751

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	3,602	4,190	4,869	5,627
Working Capital Changes	1,012	464	296	342
Cash Flow from Operating Activities	4,614	4,654	5,165	5,969
Capex	(2,901)	(2,858)	(2,278)	(2,119)
Cash Flow from Investing Activities	(3,310)	(2,902)	(2,337)	(2,198)
Changes in Debt	1,105	670	415	415
Dividends	(718)	(718)	(718)	(718)
Cash Flow from Financing Activities	(241)	(48)	(303)	(303)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	(2.8%)	9.7%	8.8%	8.9%
EBITDA	3.9%	3.5%	14.9%	14.5%
Operating profit	2.6%	13.5%	20.2%	19.2%
PBT	(1.0%)	15.2%	23.1%	21.5%
Net Income	0.5%	15.2%	23.1%	21.5%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	40.1%	38.5%	40.0%	41.5%
EBITDA Margin	32.3%	30.5%	32.2%	33.8%
EBIT Margin	18.5%	19.2%	21.2%	23.2%
Net Margin	15.5%	16.3%	18.4%	20.5%
ROE	14.5%	15.0%	16.2%	17.0%
ROCE	9.9%	10.4%	11.4%	12.2%
ROA	6.8%	7.1%	8.1%	8.9%
Debt/Equity	0.9x	0.8x	0.7x	0.7x
Net Debt/EBITDA	2.4x	2.1x	1.5x	0.8x
FCF Yield	4.9%	4.2%	6.3%	8.1%
Dividend Yield	1.4%	1.3%	1.3%	1.3%

Valuation	2017	2018E	2019E	2020E
PE	24.2x	21.4x	17.4x	14.3x
PB	3.5x	3.2x	2.8x	2.4x
EV/EBITDA	14.2x	13.5x	11.4x	9.4x
EV/EBIT	24.8x	21.5x	17.3x	13.8x
EV/Sales	4.6x	4.1x	3.7x	3.2x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Savola	25.8x	16.6x
Abdullah Al Othaim Markets	16.9x	12.7x
Saudia Dairy & Foodstuff Co	13.9x	9.2x
The National Agriculture Dev	47.5x	10.3x
Halwani Bros Co	21.0x	12.2x
Saudi Marketing Co	16.9x	12.4x
Al Jouf Agriculture Developm	23.7x	N/A
Almarai Co	21.4x	13.5x
Sector Median	21.0x	12.3x
TASI	13.7x	11.6x

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FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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