

Almarai: 3Q2017 earnings above our estimate due to higher than expected gross margin and lower SG & A expenses by SAR 31.2mn. Production efficiencies and improving inputs costs in 3Q2017 supported 287 bps increase in gross margin. Higher other expenses and weak Egyptian exchange rate contributed negatively to the bottom line. The company's ability to achieve higher control on inputs costs contributes positively to margins and improves our future outlook on the company. Strong recovery in poultry segment to support the company's outlook. Recommendation updated to 'Neutral'.

- 3Q2017 net profit came above our expectation and showed a deviation of 12.4% from our estimates and 11.4% higher than the market consensus of SAR 598.9mn. Almarai Company posted net income of SAR 667.0mn; indicating an increase of 0.4%YoY and a fall of 1.5%QoQ. The company attributed the YoY growth to i) Lower cost of sales, despite higher alfalfa costs, due to better cost management, lower commodity costs and enhanced production efficiencies, resulting in gross profit increase of 2.1%. ii) Decline in OPEX by SAR 40.0mn driven by cost control and operational efficiencies iii) Decline in Poultry losses by 90.8%YoY to SAR 6.6mn compared to last year corresponding quarter losses of SAR 71.9mn. On the other hand, the deviation of 3Q2017 earnings from our estimates is mainly attributed to i) higher than expected gross margin due to better cost management. iii) lower SG&A expenses by SAR 31.2mn due to better than expected operational efficiencies. However, sales came below our estimates, impacted by a decline in Dairy & Juice sales which could be ascribed to the change in individual spending habits with the current purchasing power, economic slowdown of GCC markets and the depreciation of Egyptian pound rate.
- The company reported a 4.5%YoY decline in revenue for 3Q2017 to SAR 3,372.4mn, which is below AJC estimate of 3,546mn with a deviation of 4.9%. We believe the sales growth in Poultry were offset by 9.4% decline in its largest segment performance (dairy & Juice) due to market conditions, accelerated decline within discretionary categories (Juice, Jar Cheese, Ghista and Cheese Slides), higher Alfalfa cost and GCC and Egypt economic situation. Its other key segments registered mixed performance, where Bakery led with a 27.5%YoY decline in net profit as a result of key categories growth being stalled, whereas poultry reported breakeven results at EBIT level and its net losses declined from SAR 71.9mn to losses of SAR 6.6mn in 3Q2017 down 90.8%YoY. On the other hand, we believe that the implementation of 20% custom fees on imported poultry should improve the competitive advantage and margins of local producer.
- The company's gross margin expanded 287 bps YoY to 44.95% recording the highest margin since FY2016 due to better cost management. Almarai reported a 2.1%YoY rise in gross profit for 3Q2017 to SAR 1.51bn. This is due to lower cost of sales, lower commodity, and despite the higher alfalfa cost. On the other hand, operating expenses declined by SAR 40.0mn driven by cost control and operational efficiencies.

AJC view: Despite the impact of upcoming VAT, we believe the reversal in government employees salary cuts and bonuses, combined with "Citizens Account", economic recovery and low inflation environment would ensure that purchasing power recovers and supports Almarai's prime segments and growth in other food retailing segments. Furthermore, We expect that the company will continue to focus on business efficiency and cost optimization to mitigate the impact of future high fuel/electricity costs. In addition, the company would be able to phase out local consumption of Alfalfa production by 2019 and importing all of its animal fodder needs without any major impact on margins due to the company's higher control on inputs cost. The Company in 3Q2017 managed to reduce operating losses in the poultry segments by 90.8%; indicating higher operating efficiency and a sign of recovery in the near future. We update our recommendation to "Neutral" on Almarai with a PT of SAR 58.80/share indicating a potential upside of 3.2%. Based on our estimates, Almarai trades at forward PE and PB multiples of 25.1x and 4.5x, respectively, for FY17E, with a expected dividend yield of 1.3% (SAR 0.75 DPS) for FY2017.

Results Summary

SARmn (unless specified)	Q3-2016	Q2-2017	Q3-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Revenue	3,530.3	3,760.4	3,372.9	-4.5%	-10.3%	-4.9%
Gross Profit	1,485.4	1,554.9	1,516	2.1%	-2.5%	2.4%
Gross Margin	42.08%	41.35%	44.95%	-	-	-
EBIT	752.1	788.2	775.5	3.1%	-1.6%	9.4%
Net Profit	664.3	674.1	667	0.4%	-1.1%	12.4%
EPS	0.66	0.67	0.67	-	-	-

Source: Company reports, Aljazira Capital

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Recommendation	Neutral
Current Price* (SAR)	57.00
Target Price (SAR)	58.80
Upside / (Downside)	3.2%

Source: Tadawul *prices as of 19th of October 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenue	13,795	14,339	14,043
Growth %	9.4%	3.9%	-2.1%
Net Income	1,916	2,135	2,273
Growth %	15.9%	4.3%	6.4%
EPS	1.92	2.14	2.27

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	38.3%	38.4%	40.8%
Net Margin	13.9%	14.9%	16.2%
P/E	24.50x	25.67x	25.08x
P/B	4.53x	4.84x	4.49x
EV/EBITDA (x)	14.62x	15.28x	16.44x
Dividend Yield	0.9%	1.0%	1.3%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (bn)	57.10
YTD %	4.02%
52 Week (High)	78.60
52 Week (Low)	44.00
Shares Outstanding (mn)	1000.0

Source: Company reports, Aljazira Capital

Price Performance



Source: Bloomberg, Aljazira Capital

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3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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