Sector Report

Oman FMCG Sector

Oman Flour Mills	BUY
12M Price Target (RO)	0.648
CMP (RO)	0.522
Potential upside	24.1%
Market cap (RO mn)	82
P/B (FY23e)	1.10
P/E (FY23e)	23.00
Dividend Yield (FY23e)	3.80%
ROE (FY23e)	4.30%

Salalah Flour Mills	HOLD
12M Price Target (RO)	0.772
CMP (RO)	0.708
Potential upside	9.0%
Market cap (RO mn)	35
P/B (FY23e)	1.03
P/E (FY23e)	18.87
Dividend Yield (FY23e)	2.80%
ROE (FY23e)	5.50%

A'Saffa Foods	BUY
12M Price Target (RO)	0.360
CMP (RO)	0.290
Potential upside	24.1%
Market cap (RO mn)	35
P/B (FY23e)	0.90
P/E (FY23e)	10.90
Dividend Yield (FY23e)	6.90%
ROE (FY23e)	8.20%

Food industry in Oman is highly competitive with several players both local and foreign participating actively across the value chain. The young, vibrant and affluent population of the country provide a stable demand for this sector. As consumption patterns change, companies are required to continuously re-assess their product portfolios and provide the best quality to its customers. Additional investment in product innovation, development and supply chain have become inevitable for these companies. Companies in Oman have also re-invented themselves by integrating both forward and backwards. While this provides better control over the supply chain it also reduces cost and improves margins. We initiate coverage on the Fast Moving Consumer Goods (FMCG) sector in Oman which includes three companies- Oman Flour Mills (OFMI), Salalah Flour Mills (SFMI) and A'Saffa Foods (SPFI). Each of these companies have grown distinctly focusing on their core competencies and product quality.

OFMI has been more domestically focused and faster to grow diversifying itself across the entire food value chain and achieving a revenue of RO 100mn in 2022. The company has backward integrated into agriculture by establishing a farm in Australia and forward integrated by manufacturing high quality bakery products. The company has made investments other than in the flour business such as animal feed, poultry, egg farms, fisheries, food tech etc. Expansion of its flour business will increase capacities by 40% from 2023 onwards. We are positive on the prospectus of OFMI based on the proactive stance taken by the management to diversify its revenue stream and manage them efficiently through a network of subsidiaries and associates.

SFMI is the largest flour miller in the country based out of Salalah. The company also has a pasta business and manufactures Polypropylene bags. It has added animal feed to its portfolio recently which is finding good traction. SFMI has also planned to establish a bakery business which will commence production by 2024. The company has utilized its locational advantage to serve markets outside Oman especially to East Africa and GCC. The completion of certain expansion plans that were envisioned couple of years ago will start contributing from 2023-24 onwards. We expect top and bottom line to grow on the back of these expansions.

SPFI is the country's foremost producer of poultry products and has a market share of about 16%. The company has built a strong brand over the years which reflects quality, premium and taste. It has over 10 categories of products that have over 100 varieties serving different types of requirements. The recently completed expansion has doubled the capacity of the company to rear 44Mn birds and 45,000 MT of poultry in a year. We are positive on the company based on the revival in pricing power and revenue growth expectations.

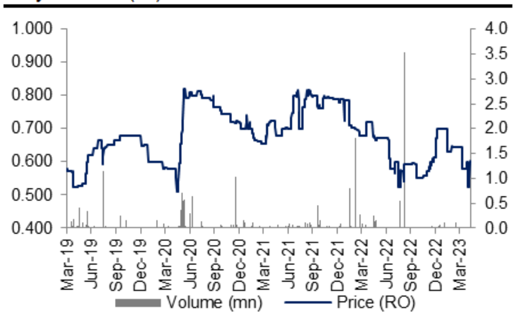
We initiate our coverage with BUY on OFMI with target price of RO 0.648, and SPFI with target price of RO 0.360; while we keep a HOLD rating on SFMI with target price of RO 0.772.

FMCG

Oman Flour Mills – On a growth path

BUY: 12M TP @ 0.648

Valuation Summary (TTM)			
Price (RO)			0.522
PER TTM (x)			29.8
P/Book (x)			1.1
P/Sales (x)			0.7
EV/Sales (x)			1.4
EV/EBITDA (x)			2.5
Dividend Yield (%)			6.5
Free Float (%)			36%
Shares O/S (mn)			158
YTD Return (%)			-25%
Beta			0.6
(mn)		**OMR**	**USD**
Market Cap		82	214
Enterprise Value		143	371
Price performance (%)	**1M**	**3M**	**12M**
Oman Flour Mill	-10%	-19%	-22%
MSX 30 Index	-2%	-3%	12%
Industry Index	-5%	1%	-1%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (RO ,000)	2	24	15
Avg Daily Volume (,000)	85	41	25
52 week	**High**	**Low**	**CTL***
Price (RO)	0.700	0.522	0.0
* CTL is % change in CMP to 52wk low			
Major shareholders			
Oman Food Inv Holding			51.1%
Civil Service Pension fund			12.7%
Others			36.2%
Other details			
Exchange			MSX
Sector			Agriculture
Index weight (%)			NA
Key ratios	**2020**	**2021**	**2022**
EPS (RO)	0.061	0.034	0.013
BVPS (RO)	0.496	0.470	0.453
DPS (RO)	0.050	0.033	0.000
Payout ratio (%)	82%	97%	0%



Oman Flour Mills (OFMI) is one of the prominent flour mill in Oman providing food security to the nation. Since its establishment in 1977, the company has grown in terms of capacity as well as product diversity. OFMI has a current capacity of 800TPD and flour brand Dahabi that caters to 15 product varieties. It has successfully ventured into feed mill which is another major contributor to revenue. OFMI has a fully integrated mill which has forward integrated to provide bakery items under the brand name Atyab. Despite several macro-economic factors such as covid and high cost of raw material, OFMI has been able to provide its products without supply shortages or significant increase in prices. This we believe indicates the management quality and intent to balance both the social impact with commercial nature of the business. We value OFMI based on the DCF method to arrive at a target price of RO 0.648/share. We are confident of the prospects of OFMI's business based on the normalization of the operations, adequate support from the government, brand equity of the products and improvement in profitability of its subsidiaries. We initiate coverage on the company with a recommendation to BUY.

Multiple product segments and brand equity augur well for revenue growth: OFMI has four major revenue segments- Flour, Animal Feed, Bakery items and income from investments which not only serve the requirement of the community but also enable revenue diversification and provides margin cushion. The brand equity built over the years has provided a solid platform to launch new products which are easily recognized by consumers. Atyab is one of the best-known brands in the food segment offering high quality bakery items across the country. We believe this is one of the biggest strengths of OFMI which it has aptly leveraged.

Spike in raw material cost partially offset by government subsidies: Given the volatile market scenario and the status of flour as an essential commodity for consumption, government intervention in the form of subsidy is instrumental. Oman government proactively decided to subsidize the cost of wheat beyond a price of $300/MT effective from May 1st, 2022. It also subsidized the cost of raw material used in manufacturing of concentrated animal feed for six months starting July 1st, 2022. This has brought partial relief to the company. The company has estimated RO 4.45mn as subsidy receivable during the financial year 2022. which is 4.6% of the overall cost of sales during the year.

Revival of Sohar Flour Mill will have positive impact on revenue and margins: Sohar Flour Mill (SFM) was established in 2017 as a joint venture between OFMI and Al Ghurair group. The objective was to increase the production and cater to the export markets where price realizations are better. We believe the teething troubles for this unit to be over and the silos for storage ready for use. The already existing wide network will be used to absorb the additional capacities within the country as well as use the same for exports. SFM has the capacity to enhance the group milling capacity by nearly 40% of the existing capacity of OFMI. We are confident that the higher production and improvement in price realization will positively impact the group revenue and margins going forward.

Valuation: We are positive on the prospects of the company based on the increase in volume sold as expanded capacities fall in place, improvement in the high margin bakery business, backward integration and support from the government. Based on our DCF valuation we arrive at a target price of RO 0.648 per share which offers an upside of 24.1% from the current price and initiate coverage with a BUY rating.

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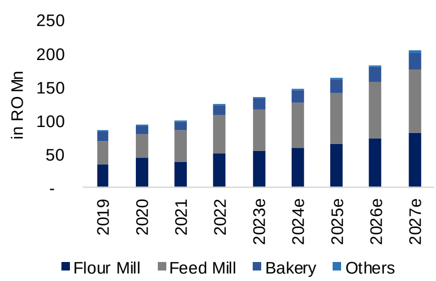
Revenue diversification into value added business offers growth and cushions margins

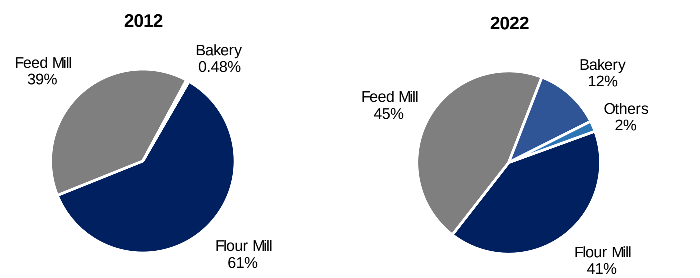
Driven by feed mill and bakery business, revenue is expected to grow by 10.5% CAGR (2022-27e)

OFMI started as a flour mill in 1977, to provide food security to the country. The company has grown its flour business from a capacity of 150TPD to the current capacity of 800TPD. Over the years, it added new products to its line such as feed mill, bakery, eggs and other related items. The additional products not only served the requirement of the consumers but also enabled revenue diversification and enhanced margin cushion. Most of the products manufactured by OFMI come under essential commodities and fall under the non-discretionary category, resulting in consistent demand irrespective of the economic situation. Currently OFMI operates four major segments which include- Flour mill (41%), Feed Mill (45%), Bakery (12%) and the rest contributed from its investments in the food ecosystem.

Consistent growth in revenue expected



Flour is no longer the main revenue contributor



Source: Company reports, US research

Over the last decade (2012-22), the overall revenue for OFMI has increased by 2x. While the flour segment has grown by 1.5x, the feed mill has increased by 2.6x. The value-added bakery business, which was an insignificant part of the top line in 2012 has witnessed the fastest growth, as this segment grew by 56x and currently contributes to about 12% of the top line. Bakery, despite being a relatively new product offering, has caught up quickly due to the brand building efforts. The bakery segment had a gross margin of 33.5% in 2022, highest amongst the basket of products sold by OFMI.

Brand equity, product differentiation, fully integrated operations, and robust supply chain management, has led to market leadership

The company has built different brands for different product segments …

OFMI has been successful in establishing a brand name that has received acceptance nation-wide amongst both Omanis and expats. The company has a domestic market share of 50% in the flour business. It offers a wide range of products for each segment and more importantly at every price point catering to all types of customers. The flour brand "Dahabi" caters to 20 product varieties starting from basic wheat flour to wheat germ and high gluten flour for professional bakers. OFMI's market base is buttressed by other generic products it offers in addition to flour. "Barakat" is a brand which sells another 20 varieties of cattle and poultry feed, of which the newly introduced Alpha is a specialized product.

The range of products also underscores the benefits derived from the company's backward and forward integration. The operations of the company begin with the production of basic flour and continues into the production and distribution of its own bakery items under the brand names "Atyab" and "Bon Vivant". Fresh chicken is sold under "A'Rayaf" and the eggs are sold as Dana in Oman and "Baledi" in GCC.

Investment in world class infrastructure has ensured quality products …

Atyab has one of the of most sophisticated bakeries in the GCC with over 300 fresh and frozen product offerings. The manufacturing facility is spread over 60,000sqm with a daily capacity to produce 24,000 buns, 6,500 packs of slice breads, 26,000 Arabic breads and wide variety of muffins, croissants, puff pastries, cakes and other specialty products. In addition, it recently gained ownership of the brand "Al Khamayel" through its acquisition of Modern Diary Factory.

Well integrated network of warehouses, fleet and marketing offices …

OFMI operates through a wide network of depots located at Barka, Saham, Muscat, Ibra, Nizwa and Ibri. The company is gradually expanding its business into UAE, Yemen, Qatar, KSA, Bahrain, Iraq and Hong Kong. The supply chain involves a vehicle fleet of over 200 trucks, delivering to 6,000 outlets every day. Other than retail, these products are also consumed by larger institutions such as restaurants, hypermarkets, universities, hotels, and other catering houses. The local market knowledge, wide distribution network and adequate production facilities ensures that the incessant demand for OFMIs products are met.

Venturing into self-sufficiency in raw material is a positive step …

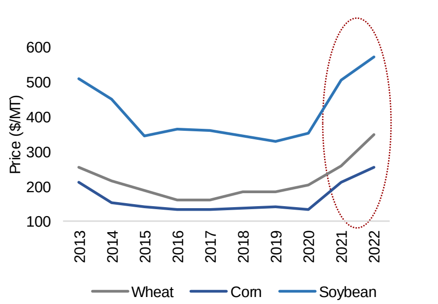
Post covid and learnings from the supply shock it created has led the company to take a significant step towards backward integration. OFMI has made a tactical change in its earlier strategy of procuring from third parties. Instead, it has set up its own direct procurement mechanism by incorporating OMAUS Pty in Australia in 2022. The objective of this company is to establish a contract farming arrangement with wheat growers in Australia, cut out the middleman, enhance margins through better pricing and most importantly ensure there are no supply side disruptions. Recently, the management has also decided to acquire land and grow wheat for its own consumption. The company will soon receive its first trial shipment of 34,500 MT of wheat from Australia. OFMI expects to achieve quality and consistency through this venture. We believe this to be a positive step towards margin stability, especially since Australia is one of the largest producers of wheat and is the most suitable place for investing in agriculture.

Spike in raw material costs led to decline in gross margins

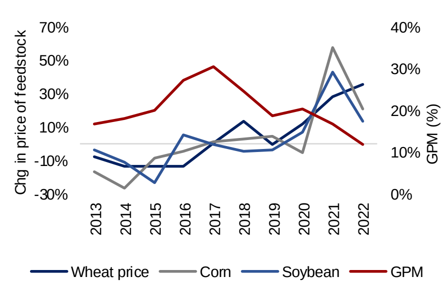
Feed stock prices reach all time high in 2022…

Russia and Ukraine are the biggest exporters of wheat; the basic raw material for OFMI. The disruption in supply which was caused due to the geo-political crisis in 2022 had a severe negative impact on the inventory cost for OFMI which resulted in a decline in their gross margins. Wheat prices that had averaged around $200/T rose to a record high of $475/T in early 2022 and remains elevated above the critical $300/T mark.

Highest price increase in a decade



High sensitivity to gross margins

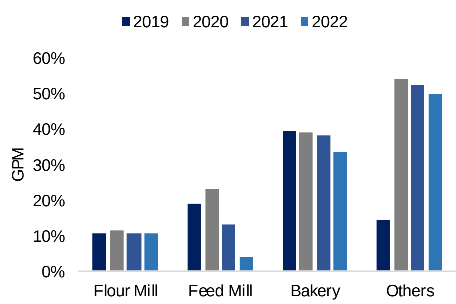


Source: www.macrotrends.com and US Research

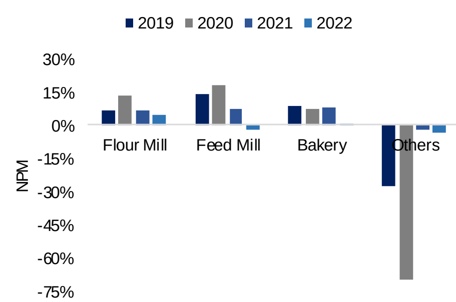
Gross margins decline to all-time lows…

OFMI is an essential food product manufacturer and any pass on effect of the higher raw material cost to the public will cause an inflationary scenario. This restricts the company from increasing the price of its products beyond a certain level, thereby making the situation extremely difficult to maintain profits. While revenue grew by 22% in 2022, cost of goods increased by 29% leading to a 354bps decline in gross margins. Cost of wheat, corn and soybean rose to the highest level seen in the company's history leading to the lowest gross margin in 2022 at 11.64%.

Gross margins of feedmill declined the most



Feed mill segment reported losses in 2022



Source: www.macrotrends.com and US Research

Government subsidy provide some relief …

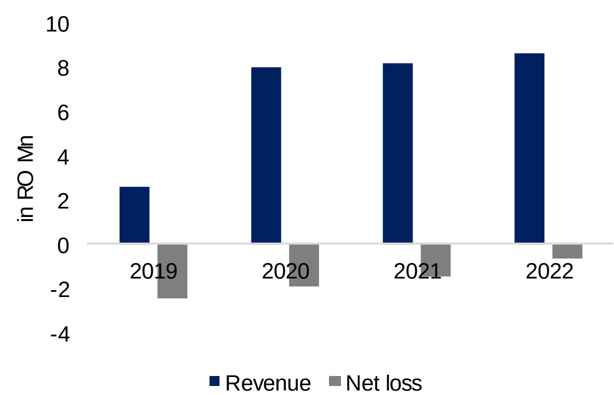
The Omani government stepped in proactively to prevent further erosion of margins and deterioration of financials of the industry. In May 2022, it was decided to provide subsidy for the raw materials of both flour and animal feed. OFMI estimates RO 4.45 Mn (RO 3.75 Mn for wheat and RO 696k for animal feed raw materials) from the government on this account for the full year 2022. This is 4.6% of the cost of materials consumed and helped offset some margin pressure. We believe the increase in global grain prices is momentary and not a result of long-term shifts in demand supply situation, rather a ripple effect of the war. However, considering the trend, we expect this government subsidy to continue in 2023 as well, till the price reverts to mean.

JV formed to set-up SFM in 2017 and to cater to export demand …

Sohar Flour Mill (SFM) will focus on exports, enhance both top as well as bottom line: OFMI along with Essa Al Ghurair Investment LLC from UAE installed the Sohar Flour Mill (SFM) in 2017 with an initial daily milling capacity of 300MT/day with an option to increase to 2000 MT/day. The project was established at a cost of RO 15mn, OFMI holds a 60% stake in this venture and provides the required operational expertise and technical know-how.

SFM was an attempt by the company to cater to the markets outside Oman where pricing power is relatively higher, with large addressable market. The products of SFM are branded separately as Reefy and exported in bulk quantities across the borders taking advantage of the facilities at the Sohar port.

Loss in Sohar mill reduces significantly



Source: Company reports and US Research

SFM ran into losses during the initial years, will become profitable soon …

Delays in setting up the factory and time to achieve a steady state have led to losses for SFM since inception. The accumulated losses had wiped out the entire capital of the subsidiary. However, both the major shareholders have reiterated that they will continue to recapitalize the company and the management is confident of turning around its operations. SFM has turned profitable at the gross level in 2021 with higher revenues and improving margins.

Completion of silos and improvement in production will aid in recovery of SFM …

We believe there are measurable improvements in the plant which will ensure stable production and supply. The additional storage space created by the installation of the silos will be a significant advantage for purchasing raw material in bulk. Bulk purchases will have a price advantage compared to the earlier process of buying in smaller quantities when the silos were not available. Further the berth at the Sohar port is directly connected to the silos giving SFM an advantage in operations. As the cost of procuring and operations decline the company will be able to compete on price with other players in the export markets. We believe this to play positively going forward and contribution from SFM to add in terms of revenue and improve realization. The yearly revenues from this entity have increased 3.3x from RO 2.6mn in 2019 to RO 8.6 mn in 2022. Losses have also declined from RO 2.4mn in 2019 to RO 646k in 2022.

Rental income from silos will add to the earnings from 2023 onwards …

The company had entered into an agreement with the Public Authority for Stores and Food Reserve (PASFR) for constructing silos to store wheat grain in Sohar. This was completed in January 2023 at a cost of RO 24.9 mn and capacity of 160,000 T. This is considered as a project of national importance as it provides adequate space to store inventory and to avoid any supply disruptions due to war or covid like events. The group will receive rental income from the government as it is the lessor. In the year 2022, the company received a rental income of RO 328k from the silos.

OFMI has invested in the food value chain though a network of subsidiaries and associates

Management must manage the commercial and social aspects of the business…

OFMI, as a producer of essential goods, has an important function to balance the social responsibility of providing quality products at affordable prices. At the same time, it must focus on the commercial interest and long-term value creation for its shareholders. Management has thus far been capable of walking this tightrope by regularly investing in new ventures that will aid the revenue and profitability of the group. The group currently consists of 18 entities along with the parent company, OFMI, which contributes 84% of the revenue.

OFMI operates through its investment arm Atyab Investments LLC which is a 100% subsidiary of the parent and has investments in 9 companies which includes 5 subsidiaries and 4 associates. The measured approach of entering new business via partnerships and JVs have reduced the overall capital outlay and risk involved in starting these new ventures.

Company	Type	Ownership	Business segment
Flour and animal feed division			
Oman Flour Mill (OFMI)	Parent		Flour mill/animal feed for domestic consumption
Sohar Flour Mills (SFM)	Subsidary of AIL	60.00%	Flour mill for exports and domestic consumption
Holding company			
Atyab Investments LLC (AIL)	Subsidary of OFM	100.00%	Holding company of OFMI, investing/managing multiple
Bakery division			
Atyab Food Industries LLC (AFI)	Subsidary of AIL	100.00%	Bakery business, presence in Oman and UAE
Egg division			
Arabian Food Production S.A.O.C (AFI	Associate of AIL	33.33%	Production of eggs
Modern Poultry Farm (MPF)	Sub of AFPC	88.48%	Production of eggs
Emirates Poultry Farm (EPF)	Sub of AFPC	100.00%	Production of eggs
Gulf Internataional Poultry Farm (GIPF)	Sub of AFPC	100.00%	Production of eggs
Poultry division			
Atyab Iffco Poultry LLC (AIP)	Associate of AIL	50.00%	Poultry products
Sohar Poultry Company (SPC)	Sub of AIP	94.37%	Poultry products
Osool Poultry Company (OPC)	Sub of AIP	9.93%	Poultry products
Dairy division			
Modern Dairy Factory	Associate of AIL	40.00%	Dairy products
Food technology/innovation/testing			
Atyab International Services LLC (AIS)	Subsidary of AIL	100.00%	Food technology
Bio Product Oman LLC (BPO)	Subsidary of AIL	33.00%	Product innovation
Atyab Technical Services LLC (ATS)	Subsidary of AIL	100.00%	sponsor of SGS (an international inspection company)
Food Techno Park LLC (FTP)	Associate of AFI	50.00%	Establishment of Food Tech Park
International operations			
Oman PTY (OMAUS)	Subsidary of AIL	100.00%	Backward integration into agriculture and direct procurn
Other			
Oman Fisheries	Strategic stake	17.27%	Fishing industry

Source: Company reports and US Research

OFMI is looking to revive the egg business by creating economies of scale…

Arabian food production company (AFPC) was established by OFMI, which has 33.33% ownership along with IFFCO group and Gulf Japan Food Fund. AFPC manages the egg division for the group has been formed to run Modern poultry (MPF) and Emirates poultry (EPF). MPF and EPF reported losses for 2022 to the tune of RO 411k and RO 267k respectively. It has also set up the Gulf International Poultry Farm (GIPF) in Ibri near Muscat. The farm has an area of 18million sqm and will be the largest in the GCC. GIPF reported a pre-operating loss of RO 211k for 2022. The three farms together produce about 2mn eggs per day. As GIPF starts full-fledged operations we expect economies of scale to come into play, which will have a positive impact on the operations of the egg farms.

Poultry business reported losses as Osool Poultry is yet to achieve steady state …

Atyab IFFCO poultry is a 50% subsidiary of OFMI which operates two poultry companies- Sohar Poultry (SPC) and Osool Poultry (OPC). SPC reported a profit to the tune of RO 218k in 2022, while OPC was incorporated in 2021 and reported a loss of RO 3.69mn. The loss was primarily on account of finance and depreciation costs incurred and the delay in achieving a steady state. The share of losses to the group stood much lower at RO 366k.

Pioneer in introducing new technology and state of the art products…

The establishment of Aytab International Services (AIS) is a clear indication of the intention by the management to add value to its stakeholders. AIS deploys new-age technology to introduce high quality products of international standards. It has engaged a highly professional team of food consultants from US, Europe and Asia in this venture These initiatives, we believe will improve the overall food ecosystem in the country. It has also set up a fully equipped laboratory in Uzbekistan which will start functioning from 2023 onwards. There are plans to set another one in Kazakhstan as well. The company has set up the food techno park which was stalled due to covid and is expected to be restarted soon.

New ventures will start producing results from 2023 onwards…

OFMI is looking to increase its presence in UAE through Atyab Food Industries (AFI). The new branch was opened in 2022 and is fully operational now. In November 2022, it acquired 40% stake in Modern Dairy Factory and relaunched the famous Al Khamayil brand of milk in February 2023. Sohar Flour mill is an important subsidiary which is on track to contribute positively from 2023 onwards. Finally, OFMI has started construction of its pre-mix and new feed mill expansion project will also come on stream in the near future.

Disciplined financials, steady growth, stable margins:

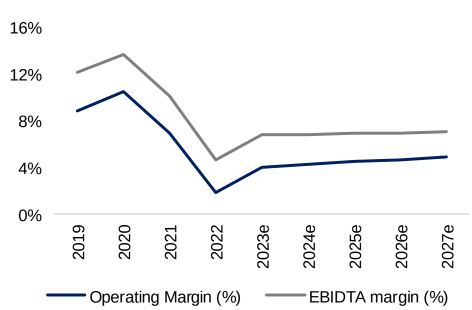
Expansion to fall in place and revenue growth to be faster …

OFMI has evidenced stability in its revenue growth over the past. Revenue has grown at the rate of 7.5% CAGR over 2012-22, with every year being a growth year since inception. With additional capacities from SFM and feed mill on stream, expansion of bakery into UAE, additional products gaining traction in the portfolio, we expect revenue growth to be higher going forward. We forecast revenue to grow at CAGR 10.5% 2022-27e.

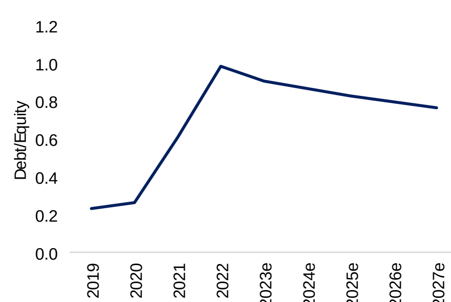
Gross margins to be partially protected from externalities …

The raw material cost currently contribute 93% of the overall cost of goods sold. The Inflationary trend in raw material costs arising out of the war in Ukraine will be partially offset by the government subsidy and backward integration of direct procurement of wheat from Australia. We expect gross margins to increase from 2023 onwards albeit gradually by 80-100bps. The end of war and normalization in raw material prices, take the gross margins back to historical levels of 20%. However, we remain conservative in our estimates and expect gross margins in the range of 12.5-13% over 2023-27e.

OPM and EBIDTA margins to recover



Debt equity ratio to remain stable

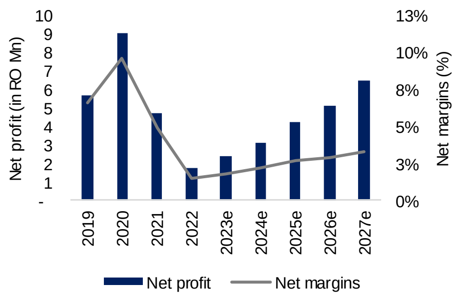


Source: Company reports and US Research

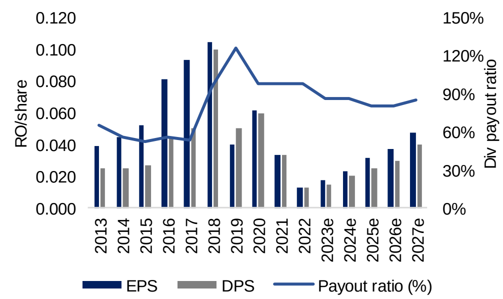
Operating efficiencies to improve as economies of scale kick in …

Operating margins are also likely to increase on account of improving economies of scale and higher revenue growth. EBIDTA margins are likely to hold at 6.5-7% from the low of 4.6% it witnessed in 2022. We do not expect any major capex going forward that can lead to significant increases in depreciation. We expect the poultry business and egg farms to achieve scale and reduce losses in 2023 and turn profitable by 2025 onwards.

2022 an abberation, bottomline growth to revert



OFMI has paid dividends regularly



Source: Company reports and US Research

Debt equity to remain stable with limited capex plans and lower inventory costs…

We do not expect an increase in the long-term debt which was taken to invest in the subsidiaries. Short term debt will most likely be reduced as it was used to purchase higher inventory and to prevent any supply shocks due to escalation of war. This is evident from the increase in inventory days from 85 levels in 2020 to 113 in 2021 and 2022. As the situation reverts to normal, we expect inventory levels to decrease, additional storage capacities will also reduce the requirement to buy higher during emergencies.

PAT expected to grow at 30% CAGR (2022-27e) …

OFMI envisions achieving a net profit of RO 50mn over the next ten years. While we are optimistic about the developments in the current investments and their contribution to group profits over the next couple of years, we find the target of RO 50 mn in profits far-fetched. The profit after tax for 2022 came in at RO 1.75mn and we expect it to gradually rise to RO 6.4mn by 2027. However, from the management commentary we understand that the company plans to take the inorganic route of acquiring new entities and expanding its current production of poultry, bakery, fisheries and dairy products. These diversifications will hold key to growth of the bottom line going forward.

Despite the vagaries of the economy and the intense competition faced in this segment from local and foreign players. OFMI has remained profitable and paid dividends each year, which is also a testament to the management quality. We expect a similar dividend payout ratio over the next few years keeping dividend yield in the range of 5%.

Return ratios have dropped to the lowest point in 2022, mostly due to externalities. As volumes build up locally and exports kick in, we believe profit growth will resume in 2023. In our base case we estimate ROE to revert to its pre-covid levels of 8.3% by 2027e.

Our DCF valuation approach resulted in fair value per share of RO 0.650 for OFMI: We have valued OFMI using a DCF valuation model. For the DCF valuation, we have used cost of equity of 10% and WACC of 10.3%. We further assumed the company's FCFF to grow at 1.0% per annum for the terminal period. Based on these assumptions we have arrived at an enterprise value of RO 161mn for the company, which translates into an equity valuation of RO 157mn or RO 0.648/share. Our DCF valuation of OFMI implies an upside potential of 24.1% from current levels.

DCF Valuation (in RO '000)	2023e	2024e	2025e	2026e	2027e
NOPLAT	4,875	5,586	6,630	6,989	8,227
Add: Depreciation	3,393	3,303	3,363	3,423	3,483
Less: capex	-2,500	-2,000	-2,000	-2,000	-2,000
Less: change in WC	4,826	7,104	3,074	7,739	5,978
FCFF	10,594	13,993	11,067	16,150	15,688
PV of FCFF	10,002	11,982	8,594	11,374	10,021
PV of Terminal Value					109,285
Enterprise Value					161,257
Less net debt					58,110
Less minorities & Pension liabilities					710
Value of equity					102,437
No of shares					157,500
Value per share (RO)					**0.650**

Valuation parameters	
Risk free rate	5.0%
Equity risk premium	10.0%
Beta	0.804
Cost of equity	13.0%
Cost of debt	6.0%
Corporate tax rate	15.0%
After tax cost of debt	5.1%
Target debt	35%
Target equity	65%
WACC	10.3%
Terminal growth rate	1.0%

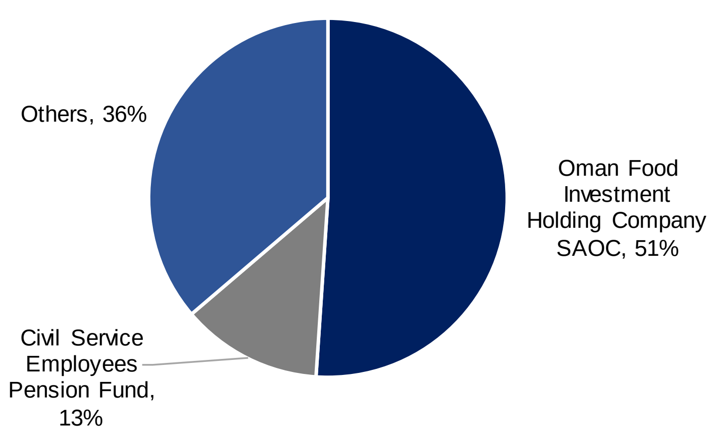
Key downside risks:

- Further rise in price of raw materials and fuel costs
- Withdrawal of subsidies
- Higher competition from foreign brands

About Oman Flour Mills

OFMI was established in 1977 by the Oman government as a flour mill with a capacity of 150TPD to provide food security to the nation. By 1983 the company expanded with the incorporation of a feed mill. With the addition of the Modern Poultry Farm in 1989, OFMI diversified into the poultry sector. Further in 2010, OFMI's presence in the poultry market was solidified via an additional facility, the Atyab Iffco Poultry. The company prudently entered retailing by forward integration of its wheat and maida flour in 2012. Atyab Bakery was incorporated, which is the most sophisticated industrial bakery unit in the GCC. It underwent major expansions in 1981, 1985, 1989, 1993, 1996, 2005 and 2020. It is currently working on expanding its animal feed mill. Expansion in the flour segment continued with the incorporation of Sohar flour mill in 2017 in partnership with players from the UAE. OFMI's expansion continued with the establishment of silos for storing soya and a crushing facility in Sohar in 2020. The silos at Port Sultan Qaboos have a storage capacity of 120,000 tons. Oman flour mills have 2 unloaders that have a combined unloading installed capacity of 750 Tons/Hour. Recently, OFMI acquired Modern Diary Factory LLC to which is credited the popular diary product brand, Al Khamayel. OFMI has grown at a steady pace over the period of its existence and has launched products that suit both the social interests of the nation at the same time meet the commercial nature of the business.

Shareholding pattern of Oman Flour Mill



BOARD OF DIRECTORS

S.NO	NAME	POSITION	CATEGORY
1	Ahmed Bin Sulaiman Al Balushi	Chairman	Independent
2	Hamed Mohammed Al Wahaibi	Vice Chairman	Independent
3	Saleem Bir Paksh Al Raisi	Director	Independent
4	Mohammad bin Talib bin Hamad Al Bu	Director	Independent
5	Hamood bin Hamad bin Rashid Al Ras	Director	Non-Independent
6	Khalifa bin Abdullah bin Musabah Al Ma	Director	Independent
7	Mohammad bin Khamis bin Khalfan Al	Director	Independent

Source: MSX, US Research

Income Statement (in RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Revenue	86,887	94,051	97,337	118,659	129,083	140,838	155,827	173,885	195,248
Cost of sales	70,807	75,046	81,110	104,847	112,465	122,961	135,816	152,349	171,042
Gross Profit	**16,080**	**19,005**	**16,227**	**13,812**	**16,618**	**17,877**	**20,011**	**21,536**	**24,206**
Other income	0	230	691	1,010	985	960	910	860	860
General/admin exp	3,451	5,367	5,527	7,077	6,454	6,690	7,012	7,390	7,810
SG&A	4,916	3,792	3,971	4,605	4,841	4,929	5,454	6,086	6,834
Operating profit	**7,713**	**9,846**	**6,729**	**2,130**	**5,323**	**6,258**	**7,545**	**8,060**	**9,562**
EBIDTA	**10,563**	**12,914**	**9,807**	**5,460**	**8,716**	**9,561**	**10,908**	**11,482**	**13,045**
Finance income	-114	255	279	313	200	200	200	200	200
Finance cost	0	631	880	2,023	3,191	2,678	2,416	1,905	1,644
Share of profit	-426	-813	-928	-574	-330	-260	-140	-75	-75
Other non op income/expenses	0	1,881	56	207	0	0	0	0	0
PBT	**7,173**	**10,768**	**5,947**	**1,063**	**2,987**	**4,479**	**6,099**	**7,140**	**8,904**
Tax	1,464	1,759	1,205	-686	448	672	915	1,071	1,336
Net profit for the period	**5,709**	**9,009**	**4,742**	**1,749**	**2,539**	**3,808**	**5,184**	**6,069**	**7,568**

Balance Sheet (RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
PPE	40,722	44,041	50,782	43,809	43,266	42,163	41,000	39,778	38,495
Investment property	37	37	37	11,133	11,133	11,133	11,133	11,133	11,133
Intangible assets other than goodwill	173	16	37	23	23	23	23	23	23
Right to use asset	3,852	3,662	3,507	3,310	2,960	2,760	2,560	2,360	2,160
Investment in associates	2,306	0	0	0	0	0	0	0	0
Investments accounted for using equity method	0	9,484	9,953	10,138	10,308	10,548	10,908	11,333	11,758
Non-current financial assets at FV thru other CI	355	355	355	355	355	355	355	355	355
Total Non-Current Assets	**47,445**	**57,595**	**64,671**	**69,617**	**68,045**	**66,982**	**65,979**	**64,982**	**63,924**
Current Inventories	17,633	17,102	33,244	31,201	33,740	36,888	36,670	39,611	34,208
Current financial assets at FV thr P&L	2,592	1,533	1,519	1,493	1,568	1,646	1,728	1,815	1,905
Trade and current receivables	18,181	22,290	24,834	43,960	43,888	35,210	34,282	26,083	28,311
Cash and bank balance	11,093	15,956	15,571	13,292	12,275	11,441	12,184	11,874	15,655
Other current assets	15,510	0	0	0	0	0	0	0	0
Total current assets	**65,009**	**56,881**	**75,168**	**89,946**	**91,470**	**85,184**	**84,865**	**79,383**	**80,080**
Total Assets	**112,454**	**114,476**	**139,839**	**159,563**	**159,515**	**152,167**	**150,844**	**144,364**	**144,004**
Share capital	15,750	15,750	15,750	15,750	15,750	15,750	15,750	15,750	15,750
Statutory reserve	6,467	6,540	6,626	6,628	6,628	6,628	6,628	6,628	6,628
Other reserves	2,605	2,605	2,605	2,605	2,605	2,605	2,605	2,605	2,605
Retained earnings	51,569	53,268	49,046	47,318	47,888	49,333	51,367	52,711	54,767
Total equity attributable to owners of parent	**76,391**	**78,163**	**74,027**	**72,301**	**72,871**	**74,316**	**76,350**	**77,694**	**79,750**
Non controlling interest	1,273	257	-76	-29	0	0	0	0	0
Total equity	**77,664**	**78,420**	**73,951**	**72,272**	**72,871**	**74,316**	**76,350**	**77,694**	**79,750**
Non-current provisions for employee benefits	914	628	543	632	710	736	771	813	859
Borrowings	16,697	18,273	21,950	21,725	21,644	21,391	21,149	20,918	20,698
Non-current lease liabilities	3,979	3,915	3,881	3,770	3,652	3,442	3,242	3,042	2,842
Deferred tax liabilities	810	843	756	484	484	484	484	484	484
Total non-current liabilities	**22,400**	**23,659**	**27,130**	**26,611**	**26,490**	**26,053**	**25,647**	**25,257**	**24,883**
Trade and other current payables	4,126	7,320	13,919	9,577	16,870	18,444	20,372	22,852	25,656
Borrowings, current	2,686	2,805	23,353	49,677	42,177	32,177	27,177	17,177	12,177
Current portion of term loans	1,173	0	0	0	0	0	0	0	0
Borrowings, current	1,513	2,805	23,353	49,677	42,177	32,177	27,177	17,177	12,177
Other current liabilities	5,578	2,272	1,486	1,426	1,107	1,176	1,298	1,383	1,538
Total current liabilities	**12,390**	**12,397**	**38,758**	**60,680**	**60,153**	**51,797**	**48,847**	**41,413**	**39,371**
Total liabilities	**34,790**	**36,056**	**65,888**	**87,291**	**86,644**	**77,850**	**74,494**	**66,670**	**64,254**
Total equity and liabilities	**112,454**	**114,476**	**139,839**	**159,563**	**159,515**	**152,167**	**150,844**	**144,364**	**144,004**

Cash Flow (RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Cash from operations	-65	13,176	-4,001	-15,799	10,758	14,215	11,620	17,230	17,029
Investing cash flow	3,948	-5,456	-10,857	-7,075	-5,691	-4,678	-4,416	-3,905	-3,644
Financing cash flow	-3,171	-6,205	14,473	20,596	-9,549	-12,616	-8,392	-14,956	-10,733
Change in cash	716	4,863	-385	-2,279	-1,017	-834	744	-310	3,781
Beginning cash	10,377	11,093	15,956	15,571	13,292	12,275	11,441	12,184	11,874
Ending cash	**11,093**	**15,956**	**15,571**	**13,292**	**12,275**	**11,441**	**12,184**	**11,874**	**15,655**

Ratio Analysis	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Per share									
EPS (RO)	0.040	0.061	0.034	0.013	0.019	0.028	0.038	0.044	0.055
BVPS (RO)	0.485	0.496	0.470	0.459	0.463	0.472	0.485	0.493	0.506
DPS (RO)	0.050	0.060	0.033	0.013	0.015	0.020	0.030	0.035	0.045
FCF per share (RO)	0.025	0.049	-0.094	-0.145	0.032	0.061	0.046	0.085	0.085
Valuation Ratios									
Market Cap (RO ,000)	104,580	126,315	124,740	110,250	83,475	83,475	83,475	83,475	83,475
EV (RO,000)	111,697	131,437	154,472	168,360	135,022	125,603	119,617	109,696	100,695
P/E (x)	13.4	8.7	15.7	41.6	28.6	19.1	14.0	12.0	9.6
EV/EBITDA (x)	10.6	10.2	15.8	30.8	15.5	13.1	11.0	9.6	7.7
Price/Book (x)	1.1	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.0
Dividend Yield (%)	7.5%	7.5%	4.2%	1.8%	2.8%	3.8%	5.7%	6.6%	8.5%
Price to sales (x)	1.20	1.34	1.28	0.93	0.65	0.59	0.54	0.48	0.43
EV to sales (x)	1.29	1.40	1.59	1.42	1.05	0.89	0.77	0.63	0.52
Liqiudity									
Cash Ratio (x)	0.90	1.29	0.40	0.22	0.20	0.22	0.25	0.29	0.40
Current Ratio (x)	5.25	4.59	1.94	1.48	1.52	1.64	1.74	1.92	2.03
Quick Ratio (x)	3.82	3.21	1.08	0.97	0.96	0.93	0.99	0.96	1.17
Return Ratios									
ROA (%)	5.1%	7.9%	3.4%	1.1%	1.6%	2.5%	3.4%	4.2%	5.3%
ROE (%)	7.4%	11.5%	6.4%	2.4%	3.5%	5.1%	6.8%	7.8%	9.5%
ROCE (%)	5.7%	8.8%	4.7%	1.8%	2.6%	3.8%	5.1%	5.9%	7.2%
Cash Cycle									
Inventory turnover (x)	4.4	4.3	3.2	3.3	3.5	3.5	3.7	4.0	4.6
Accounts Payable turnover (x)	22.5	13.1	7.6	8.9	8.5	7.0	7.0	7.0	7.1
Receivables turnover (x)	5.7	4.6	4.1	3.4	2.9	3.6	4.5	5.8	7.2
Inventory days	84	84	113	112	105	105	99	91	79
Payable Days	16	28	48	41	43	52	52	52	52
Receivables days	64	79	88	106	124	102	81	63	51
Cash Cycle	131	135	154	177	187	155	128	103	78
Profitability Ratio									
Gross Margins (%)	18.5%	20.2%	16.7%	11.6%	12.9%	12.7%	12.8%	12.4%	12.4%
EBITDA Margins (%)	12.2%	13.7%	10.1%	4.6%	6.8%	6.8%	7.0%	6.6%	6.7%
PBT Margins (%)	8.3%	11.4%	6.1%	0.9%	2.3%	3.2%	3.9%	4.1%	4.6%
Net Margins (%)	6.6%	9.6%	4.9%	1.5%	2.0%	2.7%	3.3%	3.5%	3.9%
Effective Tax Rate (%)	20.4%	16.3%	20.3%	-64.5%	15.0%	15.0%	15.0%	15.0%	15.0%
Leverage									
Total Debt (RO ,000)	18,210	21,078	45,303	71,402	63,821	53,568	48,326	38,095	32,875
Net Debt (RO ,000)	7,117	5,122	29,732	58,110	51,547	42,128	36,142	26,221	17,220
Debt/Capital (x)	1.16	1.34	2.88	4.53	4.05	3.40	3.07	2.42	2.09
Debt/Total Assets (x)	0.16	0.18	0.32	0.45	0.40	0.35	0.32	0.26	0.23
Debt/Equity (x)	0.23	0.27	0.61	0.99	0.88	0.72	0.63	0.49	0.41

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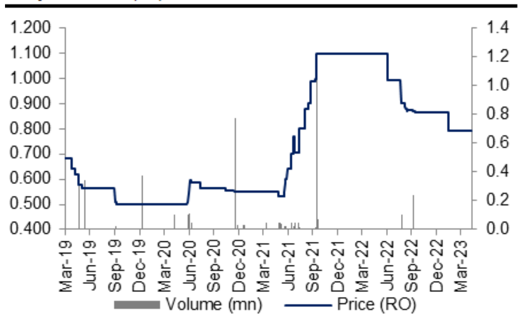
FMCG

Salalah Mills – Expansion underway

HOLD: 12M TP @ 0.772

Valuation Summary (TTM)			
Price (RO)			0.708
PER TTM (x)			15.5
P/Book (x)			1.1
P/Sales (x)			0.5
EV/Sales (x)			0.6
EV/EBITDA (x)			13.5
Dividend Yield (%)			2.8
Free Float (%)			54%
Shares O/S (mn)			50
YTD Return (%)			-18%
Beta			0.1
(mn)		**OMR**	**USD**
Market Cap		35	92
Enterprise Value		42	110
Price performance (%)	**1M**	**3M**	**12M**
Salalah Flour Mill	0%	-11%	-36%
MSX 30 Index	-2%	-3%	12%
Industry Index	-5%	1%	-1%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (RO ,000)	0	14	7
Avg Daily Volume (,000)	41	20	10
52 week	**High**	**Low**	**CTL***
Price (RO)	1.100	0.708	0.0
* CTL is % change in CMP to 52wk low			
Major shareholders			
Al Rawas Development			16.3%
Civil Service Pension fund			14.7%
OIA			14.6%
Others			54.4%
Other details			
Exchange			MSX
Sector			Food
Index weight (%)		NA	
Key ratios	**2020**	**2021**	**2022**
EPS (RO)	0.027	0.028	0.034
BVPS (RO)	0.647	0.655	0.453
DPS (RO)	0.020	0.020	0.000
Payout ratio (%)	74%	71%	0%



Salalah Mills (SFMI) is the largest flour milling company in Oman with a capacity of 1500 MT/day and a storage capacity of about 160k MT. The company has been supplying to both the local as well as export markets such as Africa and GCC. Over the years it has built a strong network and robust supply chain across the country and abroad. Management has prudently introduced further products over the years that has found acceptance, such as, pastas, macaroni, animal feed and polypropylene (PP) bags. Its recent venture into high end bakery products will add to the forward integration strategy of the company. Diverse revenue streams and timely expansion will augur well for the topline while cushioning the margins. Our base case estimate for revenue growth is 8.4% CAGR (22-27e) and profit after tax is expected to increase by 18% CAGR (22-27e). Our DCF valuation provides a target price of RO 0.772 per share. We are optimistic on the prospects of the company based on the past financial rigor witnessed and future expansions coming on stream in 2023. We initiate coverage on the company with a recommendation to HOLD.

Efforts to diversify revenue stream, expansion and brand building, are the key drivers of growth which will fructify this year: SFMI has moved in a measured fashion to expand its capacities and forward integrate itself. Most of these expansion and product additions will come on stream in 2023. In January 2022, the company started production in its animal feed factory and is already looking to double the capacity in 2023. A new facility is coming up at Barka which will produce high end bakery products. This unit is expected to commence production in mid of 2023. A second expansion of the PP bag unit will be completed by the first half of 2023, increasing the production capacity by 40%. We believe the confluence of all these events will provide a good reason for growth in topline.

Demand from Oman stable, African markets lose shine while other geographies witness significant increase: SFMI has maintained its market share in the local markets for several years, thanks to brand building efforts and quality of product. African markets have witnessed serious dumping issues at a lower price as compared to SFMI's price, hence there has been a slump in sales in the region. While revenue from Africa has remained flat since 2018 and the business in Oman grew by a CAGR 9%,(2018-22) the revenue growth from other GCC countries grew by CAGR 20% (2018-22). Clearly the de-growth in Africa has been compensated by the growth in GCC markets, leading to an overall growth in revenues

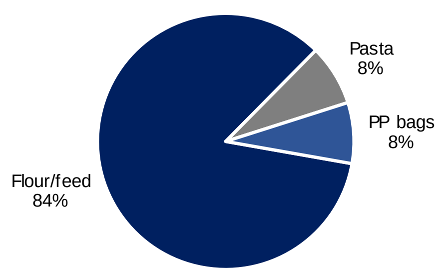
Cost pressures temporary, government subsidy to the rescue: The 2022 Russia- Ukraine crises led to sharp rise in raw material costs for companies like SFMI. While the company managed to import the required quantities, it came at a very high price. The high cost eroded margins to the lowest levels. Price caps on the essential commodity prevented passing on the impact to the customers. However, the timely government intervention has provided some cushion. The subsidy amount reported by the company for 2022 was RO 3.9Mn which is about 6.4% of the total raw material purchased.

Valuation and TP: We believe SFMI will overcome the current lag in certain markets by focusing on different products and geographies, long term debt equity ratio is nearly zero, margins are expected to remain stable and new lines of production will augur well going forward. Based on our DCF valuation we arrive at a fair value of RO 0.772/share which provides an upside of 9% from current levels. We initiate coverage on the stock with a HOLD recommendation.

Well Planned expansion over the years, new product additions ensuring growth prospects:

SFMI has three major business segments which include Flour, Pasta and Polypropylene (PP) bags. It has recently ventured into newer segments such as Bakery and Animal feed. These product additions have come at different times and depend on the market demand. The expansion of the product pipeline has augured well for both the top as well as the bottom line.

Currently 3 major business segments



Source: Company reports, US research

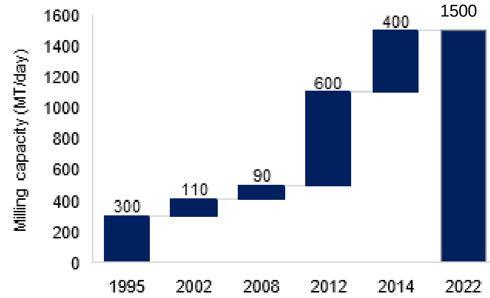
Flour an essential commodity and critical to the food security of the country…

SFMI is currently the largest producer of flour in Oman. It has four factories, 1500MT per day production capacity and 160k MT of storage capacity, enough to provide food security to the nation for a period of six months. Flour comes under the status of essential commodity and SFMI has made efforts to ensure that adequate quantities are available under any conditions. The expansion from 300MT/day in 1995 to the current 1500MT/day has come at a measured pace in every 5-6 years and depending upon the increase in food requirements. The Al Khareef brand under which the flour is sold is well recognized in Oman. The company has recently introduced barley flour and pizza flour, which is gaining acceptance.

SFMI is the largest miller in the country

Company	Established	Location	Capacity (MT/day)
Salalah flour Mills	1995	Salalah	1500
Oman flour Mills	1977	Muscat	800
Al Rasheed flour Mills	2015	Raysut	500
Al Khaleej Flour Mill	2017	Sohar	500
Suhar Flour Mill	2019	Sohar	500
Al Reef Flour Mill	2016	Raysut	300

Flour capacity additions in a measured pace



Source: Company reports, US research

Salalah Macaroni is a well-established brand in the pasta segment …

SFMI added its second product line in 2007 through a forward integration strategy. It set up a pasta and macaroni plant, under the brand name of Salalah Macaroni. Currently this facility has four lines with a total capacity of 120 MT and exports to several countries in the GCC and Africa. Salalah Macaroni has 9 different varieties of pasta products catering to various recipe usages and at different price points.

Polypropylene bags have found good demand …

Further additions to the products portfolio took place over the years such as the polypropylene bag plant which came up with a capacity of 50mn bags/year in 2017. As acceptance and demand for the product increased the company invested further in this segment in 2019 to take the capacity to 75mn bags/year. The second phase of expansion has recently been approved which will further increase capacity to 100mn bags/year. The expansion of the unit will be completed by the first half of 2023.

Regular addition of products to the pipeline over the last three decades

Source: Company reports, US research

Upcoming Bakery segment will have higher margins …

Over the last couple of years, the company has taken significant steps to develop its forward integration strategy and diversify its revenue stream. In October 2021 the company signed an agreement with Khazaen Economic City to lease 20,000 sqm of industrial land in Barka and set up a food production facility. The company will offer branded high quality bakery items such as semi-cooked pastries, frozen cakes, snack items, noodles, and biscuits. It is expected that the facility will commence production by the mid of 2024. More importantly, unlike the basic flour which suffers from price caps, these value-added branded products will have higher realizations. Excess capacities can also be put to efficient use via internal consumption for these additional products. The local competitor, Oman Flour Mill (OFMI) has progressed well with this kind of forward integration strategy, and we feel SFMI will also reap the benefits of the same in future.

We find the entry into bakery as an important game changer for the company, which not only offers scope for faster growth in topline but also cushions the vagaries in the current line of businesses and will lead to improvement in margins. We forecast the bakery business to have 30% gross margins and 25% net margins. The scalability of the business will be critical to the company going forward.

Animal feed segment will witness doubling of capacity in 2023 …

In January 2022, the company started production of Animal Feed and is already looking to double the capacity. The unit will complement the flour business which has similar raw material requirements and provide for a fast-growing segment in the food ecosystem. The unit will have a capacity of 240 tons/day. Animal feed will be an extension of the flour business and serve a larger community in the food ecosystem. The operational efficiency built over the years, and well recognized brands augur well for the upcoming new product portfolios as well. This segment will also have a higher margin than the existing flour business. Considering the margins of peers, we estimate the gross margin of animal feed to be in the mid double digits around 13-15% and net margins at 7-9%.

Aggressive expansion strategies envisioned two years ago to fall in place from 2023…

SFMI had envisioned the above expansion plans in 2020 and they are falling in place and commercial productions begins from 2023-24e onwards. Further as per the management commentary, the company hopes to expand significantly over the next 3 years between 2023-25e, in the areas of food grain trading and storage, manufacturing of new flour blends, vitamins and minerals for bakeries, fodder factories, fish and pet food, flexible packaging and plastic medical supplies. While most of the revenues, c84%, still come from the main business of flour milling, such forward integration facilities will complement the revenue streams. We expect revenue to grow at 8.4% CAGR over 2022-27e.

Exports contribute 51% of the revenue…

Demand from Oman stable, African markets lose shine while other geographies witness significant increase: Unlike its peer OFMI, Salalah Mills is more prominently focused on the export market. The plant is strategically located only 3kms from the Salalah port. While Yemen and Somalia are the primary export markets, others include several countries in East Africa such as Djibouti, Ethiopia, Tanzania and Kenya. Over the period it has also covered markets on the western African coast like Ghana, Angola and Cameroon as well. SFMI also has presence in neighboring Qatar and Saudi.

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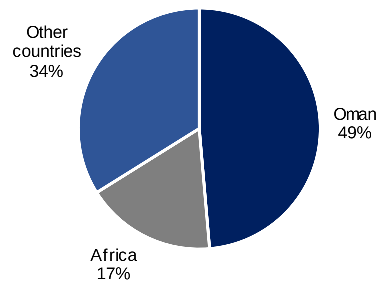
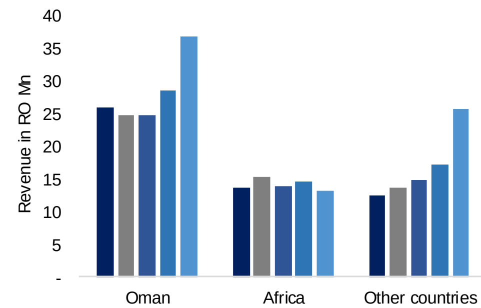
Export contribution significant



Revenue contribution from Africa has decreased



Source: Company reports, US research

Shifting from Africa to other countries evident…

While steady production and a well-entrenched supply chain has ensured timely availability of products catering to the stable demand locally, the international sales have witnessed certain changes. Local sales have been hovering in the range of RO 25-26 Mn, which is about 50% of the total revenue. Africa contributed 26% of the revenue in 2018 vs. 17.5% in 2022. The management is expecting to build a new line in Africa to reduce costs.

Africa highly price sensitive and competitive…

The African market which used to be the second largest in terms of revenue, is currently witnessing significant headwinds in terms of intense competition. Africa is home to a very young and growing demography where demand for consumables is rising at the fastest pace in the world. Companies from across the globe are lining up to capture this increased demand. Some companies have resorted to extreme measures of undercutting competition by pricing products very low, backed by support of respective local governments in the form of subsidies and other tax sops. We find this dumping of products a disturbing trend and could continue for as long as concerted measures are taken to restrict this globally.

SFMI unlikely to compete on price, rather will look for other opportunities to grow …

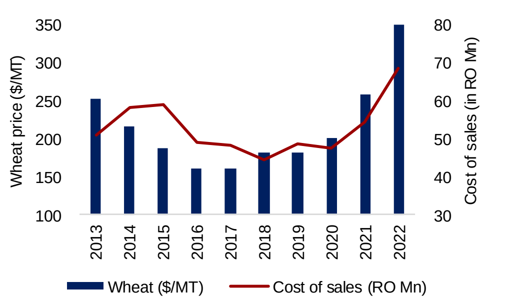
SFMI follows stringent international quality standards and local policies with all intent. It has taken the tactical decision of not compromising on quality and not competing excessively on price. This has resulted in loss of market share in the African markets which is extremely price sensitive. While we don't see a significant change in the situation going forward, the company has proactively compensated for the loss in market share in Africa with rise in sales volume in other geographies in the GCC.

Revenue growth from other countries has been at 20% CAGR (2018-22) and as a percentage of overall revenue, it has grown from 24% in 2018 to 34% in 2022. We expect similar growth trends going forward and the contribution from countries other than Africa to increase to 47% by 2027e.

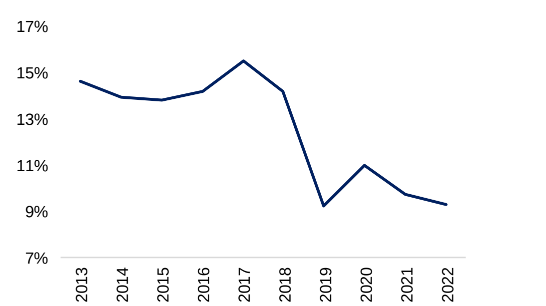
Government subsidy will partially reduce the cost of goods…

Cost pressures temporary, government subsidy to the rescue: SFMI procures most of the wheat, which is the essential raw material for the flour, from countries such as Australia, Argentina, Canada, Germany and Russia. The recent Ukraine-Russia conflict led to a steep increase in the price of wheat in 2022. This along with export ban in some countries like India led to an extremely difficult situation for the company. While SFMI managed to import the required quantities, it came at a very high price never seen before. The high cost eroded margins to unsustainable levels. Price caps on the essential commodity prevented passing on the price so as to reduce impact on the customers.

Wheat prices spiked in 2022



…resulting in sharp decline in Gross margins



Import of wheat inevitable, vagaries in price a bane to the industry …

Despite efforts by the government to produce wheat locally and control prices, the climatic conditions prevent mass production of the grain. The country imports a significant quantity of about 500,000 MT a year, this forms the majority of the domestic requirement. Hence the country has limited option, but to depend on external sources for sourcing the grain, exposing it to price vagaries especially under extreme situations. On the other side the government is also required to maintain inflation levels so that it does not affect the local population. Hence price caps are in place for such essential commodities. To balance both the commercial nature of the companies like SFMI and social issue of price rise, the government has introduced subsidies on the raw materials above a certain price ($300/MT). This subsidy came into effect retrospectively from May 1st, 2022. SFMI will benefit from this payment from the government and partially resolve the high-cost issue at least until the situation stabilizes. The company has accounted RO 3.9Mn as subsidies from the Government in 2022 on purchases of wheat for local sales and feed in Oman. This is 6.4% of the total cost of the raw material purchased during the year.

Financials stable, momentary impact from high inventory cost: SFMI has exhibited relatively stable financial performance over the past several years. Three major expansion projects will come on stream within the next 12-18 months- doubling of animal feed capacity, bakery segment at Khazaen and production of PP bag capacity to 100mn from current 75mn. As expanded capacities and new products fall in place revenue is expected to grow faster. Overall consolidated revenue increased by 25.5% in 2022 and profits grew by 20% compared to the same period in the previous year.

Growth in flour segment highest, while PP grows modestly, pasta de-grows …

Gross margins have taken a hit in 2022 on account of higher costs, however we believe this to be momentary and unsustainable for the company as well as the industry. Gross margins, which hovered around 15.3% in 1Q21 have declined to 11.4% in 1Q23 primarily on account of decline in margins in the pasta division and high costs in the flour business. We expect EBIDTA margins to hold steady while EBIDTA will increase by CAGR 8.5% in line with the revenue.

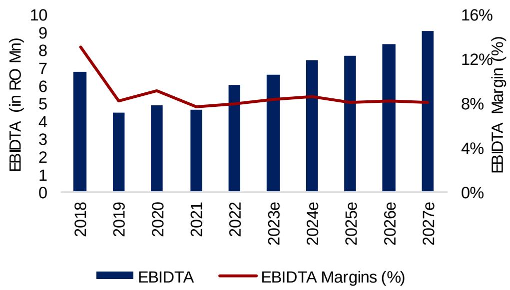
Margins have bottomed out will improve from 2023 onwards …

The company has been gradually adding new lines of products and expanding existing facilities. The new unit coming up at Barka is at a total cost of RO 12.5mn, this is funded by a bank loan of RO10mn. The new facility will produce value-added superior bakery products as part of the forward integration plan of the company. Expansion of the PP bag facility from the current 75mn bags/day to 100mn bags/day will be at an expense of RO 3mn.

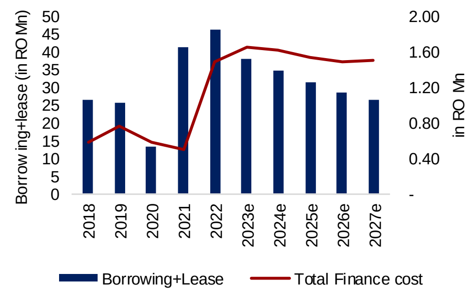
Inventory costs exceptionally high in 2022 …

Inventory costs rose significantly this year due to increase in raw material prices on account of the ongoing Russia-Ukraine conflict. The company had to purchase grains at higher cost and maintain a higher amount of inventory as a precaution to prevent future supply shocks.

EBIDTA expected to increase



Finance cost to remain stable

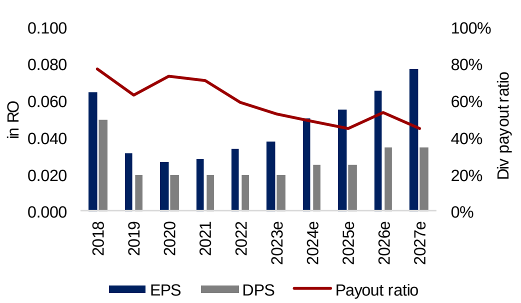


Source: Company reports, US research

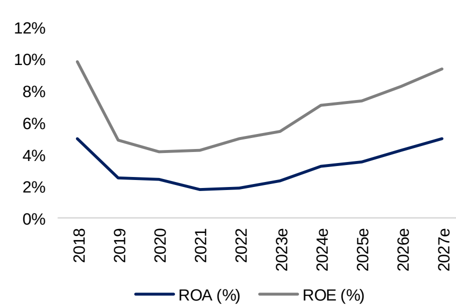
Long term debt is low, short term working capital loan to reduce …

To fund the expansion projects which had a gestation period of 12-18 months and to pay for the excess inventory costs, the company increased its short-term borrowings. Short term loans which were at RO 20 mn in 2019 have increased to RO 37 mn in 2022. We expect most of the expansion projects to be completed in 2023 and revenues from them will start trickling in. The cash flow from additional revenue streams will be used to reduce the short-term debt over the next two years. The Long-term loan which was taken in 2019 to the tune of RO 5 Mn to fund the feed mill project and expand the plastic division, stands reduced to RO 1.8 Mn. Gearing ratio is currently at 1.3x and we expect the same to decline from 2023 onwards.

Dividend payout expected to be steady



Return ratios to pick up from 2023 onwards



Source: Company reports, US research

Dividend payout trends to remain stable …

Since the company operates in the commodity space net margins are highly sensitive to the production cost. The rise in raw material, and increase in interest costs played negatively on the margins of the company in 2022. We expect profitability to increase on account of normalization of operations, reduction in feed cost and lower interest outflow. However, we forecast the profits conservatively at a CAGR of 18.2% over 2022-27e with marginal increase in net margins.

SFMI has a total equity of RO 32mn, adequate for dividend payouts even during times of low profitability. It has consistently rewarded its shareholders by paying dividends each year, the approximate payout ratio has been about 50-60%. We expect the dividend payout trend to continue, offering a dividend yield of about 3%.

Key downside risks:

- Further rise in price of raw materials and fuel costs
- Withdrawal of subsidies
- Higher competition from foreign brands
- Delay in expansion plans, cost overruns and lesser than expected revenue growth

DCF provides an upside potential of 9% …

Our DCF valuation resulted in fair value per share of RO 0.772: We have employed DCF valuation for SFMI to arrive at the intrinsic value of the company. The cost of equity of 16.4% derived from risk free rate of 5.0% and equity risk premium of 10% (considering the illiquid nature of the stock) and equity beta is at 1.14. Our base case valuation assumed that the company's cash flow would remain stable at 1% beyond the forecasted period. We have arrived at a DCF value of RO 0.772/share of SFMI, which is 9% higher than the current price of RO 0.708/share.

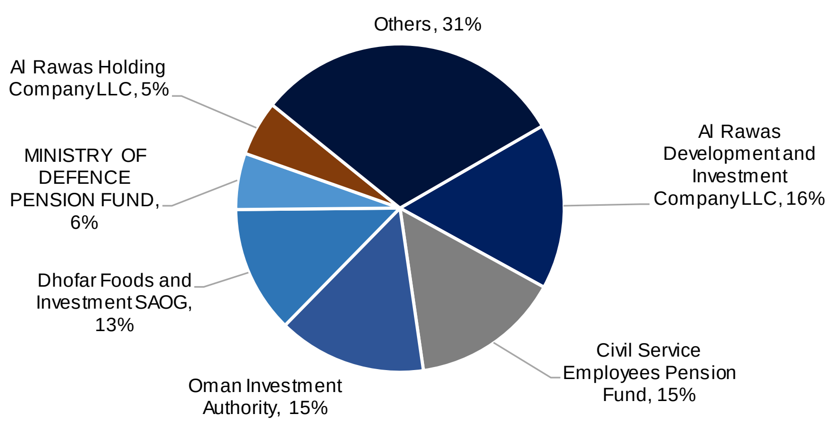
DCF Valuation	2023e	2024e	2025e	2026e	2027e
NOPLAT	3,524	4,141	4,288	4,754	5,381
Add: Depreciation	2,794	2,894	2,994	3,094	3,194
Less: capex	-1,500	-2,000	-2,000	-2,000	-2,000
Less: change in WC	5,383	326	2,475	-570	-2,346
FCFF	10,201	5,361	7,758	5,278	4,230
PV of FCFF	9,383	4,279	5,372	3,171	2,205
PV of Terminal Value					15,627
Enterprise Value					40,038
Less net debt					924
Less minorities & Pension liabilities					551
Value of equity					38,562
No of shares					49,963
Value per share (RO)					**0.772**

Valuation parameters	
Risk free rate	5.0%
Equity risk premium	10.0%
Beta	1.138
Cost of equity	16.4%
Cost of debt	6.0%
Corporate tax rate	15.0%
After tax cost of debt	5.1%
Target debt	10.0%
Target equity	90.0%
WACC	15.3%
Terminal growth rate	1.0%

About Salalah Mills

Salalah Mills (SFMI) was incorporated in 1995 as a flour milling company with a capacity of 300 tons/day. Currently it is the largest flour producer with a total capacity of 1500 ton/day across four factories in various parts of the country. The company also maintains a grain storage silo that has a capacity of about 160k tons and permanent unloading facilities at the Salalah port for its logistical support. Other than catering to the local demand, SFMI also exports its products to several countries in the GCC and Africa regions. It ventured into pasta and macaroni related food products in 2007 under the brand name Salalah Macaroni. SFMI also ventured into the making of polypropylene bags in 2017 with a capacity of 5mn bags/day. This capacity has been enhanced to reach 10mn bags/day by 2023. The latest foray for the company is into Animal feed and bakery products. While the Animal feed production has started in 2022, bakery division will commence in 2023.

Shareholding pattern of Salalah Mills



BOARD OF DIRECTORS

S.NO	NAME	POSITION	CATEGORY
1	Faisal Abdullah Said Al Rawas	Chairman	Non-Independent
2	Sheikh Ahmed SAID MUSTAHIL ALMASANI	Deputy Chairman	Independent
3	SAED SAIF NASSER AL SADI	Director	Independent
4	AHMED ABDULLAH MOHAMMED AL DHAHLI	Director	Independent
5	Sheikh Ahmed Abdullah Saeed Al Rawas	Director	Non-Independent
6	SAID HLIAL AHMED AL HABSI	Director	Non-Independent
7	MAJID SULAIMAN AL FARSI	Director	Independent
8	ABDUL RAHMAN AWADH ABDULLAH BARHAM	Director	Independent
9	Nasser Ahmed Musallam Al Maashani	Director	Independent
10	Musallam Ali Mohammed Al Mashani	Director	Independent
11	Yasser Abdullah Said Al Rawas	Director	Non-Independent

Source: MSX, US Research

Income Statement (in RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Revenue	53,663	53,513	60,145	75,494	79,479	86,322	94,790	101,215	112,938
Cost of sales	48,717	47,633	54,304	68,488	71,884	77,841	85,921	91,226	101,601
Gross Profit	**4,946**	**5,881**	**5,841**	**7,006**	**7,595**	**8,480**	**8,869**	**9,989**	**11,337**
Other income	633	268	274	829	750	769	788	808	828
General/admin exp	3,416	3,734	4,055	4,269	4,371	4,532	4,739	5,314	5,929
SG&A	125	76	90	119	119	129	142	152	169
Operating profit	**2,079**	**2,339**	**1,969**	**3,454**	**3,854**	**4,588**	**4,775**	**5,331**	**6,066**
EBIDTA	**4,434**	**4,895**	**4,603**	**6,028**	**6,649**	**7,482**	**7,769**	**8,426**	**9,261**
Finance cost	751	580	491	1,478	1,649	1,609	1,532	1,486	1,499
PBT	**1,327**	**1,759**	**1,478**	**1,975**	**2,206**	**2,979**	**3,243**	**3,845**	**4,567**
Tax	-255	406	79	295	331	447	486	577	685
Net profit	**1,582**	**1,353**	**1,399**	**1,680**	**1,875**	**2,532**	**2,756**	**3,268**	**3,882**

Balance Sheet (RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
PPE	28,170	28,852	27,371	25,905	24,611	23,716	22,722	21,627	20,433
Right to use asset	534	926	2,053	3,634	3,490	3,833	4,163	4,483	4,791
Investment in subsidaries	0	0	50	0	50	50	50	50	50
Total Non-Current Assets	**28,705**	**29,778**	**29,475**	**29,540**	**28,151**	**27,599**	**26,935**	**26,160**	**25,274**
Current Inventories	14,221	10,085	24,708	34,116	25,159	23,352	17,184	18,245	20,320
Current financial assets at FV thr P&L	387	398	348	355	355	355	355	355	355
Trade and current receivables	15,499	10,103	19,197	18,085	20,665	22,444	26,541	26,316	27,105
Cash and bank balance	2,959	5,979	5,827	5,120	5,749	4,883	6,376	6,074	5,085
Total current assets	**33,065**	**26,564**	**50,079**	**57,676**	**51,927**	**51,034**	**50,456**	**50,989**	**52,864**
Total Assets	**61,770**	**56,343**	**79,554**	**87,216**	**80,078**	**78,633**	**77,391**	**77,149**	**78,138**
Share capital	4,996	4,996	4,996	4,996	4,996	4,996	4,996	4,996	4,996
Share premium	3,588	3,588	3,588	3,588	3,588	3,588	3,588	3,588	3,588
Legal reserve	2,089	2,089	2,089	2,089	2,089	2,089	2,089	2,089	2,089
General reserve	2,892	2,892	2,892	2,892	2,892	2,892	2,892	2,892	2,892
Retained earnings	18,428	18,782	19,182	19,862	20,738	22,271	23,778	25,797	27,930
Total equity	**31,993**	**32,347**	**32,747**	**33,427**	**34,303**	**35,836**	**37,343**	**39,362**	**41,495**
Non-current provisions for employee benefits	470	487	535	551	551	551	551	551	551
Borrowings	5,000	1,559	1,837	6,044	3,544	2,544	1,544	1,000	1,500
Non-current lease liabilities	503	942	1,733	3,406	3,476	3,643	3,911	4,339	4,584
Deferred tax liabilities	1,023	1,146	967	915	915	915	915	915	915
Total non-current liabilities	**6,996**	**4,134**	**5,071**	**10,916**	**8,487**	**7,654**	**6,922**	**6,805**	**7,550**
Trade and other current payables	1,983	8,536	2,899	4,588	3,594	3,892	4,296	4,561	5,080
Borrowings, current	20,647	11,005	38,232	37,823	32,823	30,323	27,823	25,323	22,823
Current lease liabilities	42	38	323	113	474	497	533	592	625
Current tax liabilities	109	283	282	348	397	432	474	506	565
Total current liabilities	**22,781**	**19,863**	**41,736**	**42,872**	**37,288**	**35,143**	**33,126**	**30,982**	**29,093**
Total liabilities	**29,777**	**23,996**	**46,807**	**53,788**	**45,775**	**42,797**	**40,048**	**37,787**	**36,643**
Total equity and liabilities	**61,770**	**56,343**	**79,554**	**87,216**	**80,078**	**78,633**	**77,391**	**77,149**	**78,138**

Cash Flow (RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Cash from operations	4,713	20,292	-25,537	-2,450	12,032	7,808	10,244	7,855	6,915
Investing cash flow	-743	-3,190	-1,121	-1,106	-1,500	-2,000	-2,000	-2,000	-2,000
Financing cash flow	-3,318	-14,083	26,506	2,799	-8,499	-4,749	-4,749	-4,793	-3,749
Change in cash	**653**	**3,019**	**-152**	**-757**	**629**	**-865**	**1,492**	**-302**	**-989**
Beginning cash	2,306	2,959	5,979	5,877	5,120	5,749	4,883	6,376	6,074
Ending cash	**2,959**	**5,979**	**5,827**	**5,120**	**5,749**	**4,883**	**6,376**	**6,074**	**5,085**

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Ratio Analysis	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Per share									
EPS (RO)	0.032	0.027	0.028	0.034	0.038	0.051	0.055	0.065	0.078
BVPS (RO)	0.640	0.647	0.655	0.669	0.687	0.717	0.747	0.788	0.831
DPS (RO)	0.020	0.020	0.020	0.020	0.020	0.025	0.025	0.035	0.035
FCF per share (RO)	0.079	0.342	-0.534	-0.071	0.211	0.116	0.165	0.117	0.098
Valuation Ratios									
Market Cap (RO ,000)	23,483	27,480	49,963	43,168	35,374	35,374	35,374	35,374	35,374
EV (RO,000)	46,170	34,065	84,205	81,915	65,992	63,358	58,366	55,623	54,612
P/E (x)	14.84	20.31	35.71	25.70	18.87	13.97	12.83	10.82	9.11
EV/EBITDA (x)	10.41	6.96	18.29	13.59	9.93	8.47	7.51	6.60	5.90
Price/Book (x)	0.73	0.85	1.53	1.29	1.03	0.99	0.95	0.90	0.85
Dividend Yield (%)	0.04	0.04	0.02	0.02	0.03	0.04	0.04	0.05	0.05
Price to sales (x)	0.44	0.51	0.83	0.57	0.45	0.41	0.37	0.35	0.31
EV to sales (x)	0.86	0.64	1.40	1.09	0.83	0.73	0.62	0.55	0.48
Liqiudity									
Cash Ratio (x)	0.13	0.30	0.14	0.12	0.15	0.14	0.19	0.20	0.17
Current Ratio (x)	1.45	1.34	1.20	1.35	1.39	1.45	1.52	1.65	1.82
Quick Ratio (x)	0.83	0.83	0.61	0.55	0.72	0.79	1.00	1.06	1.12
Return Ratios									
ROA (%)	2.6%	2.4%	1.8%	1.9%	2.3%	3.2%	3.6%	4.2%	5.0%
ROE (%)	4.9%	4.2%	4.3%	5.0%	5.5%	7.1%	7.4%	8.3%	9.4%
ROCE (%)	4.1%	3.7%	3.7%	3.8%	4.4%	5.8%	6.2%	7.1%	7.9%
Cash Cycle									
Inventory turnover (x)	2.96	3.92	3.12	2.33	2.43	3.21	4.24	5.15	5.27
Accounts Payable turnover (x)	22.14	9.06	9.50	18.29	17.57	20.80	20.99	20.60	21.08
Receivables turnover (x)	3.75	4.18	4.11	4.05	4.10	4.00	3.87	3.83	4.23
Inventory days	123.11	93.13	116.93	156.75	150.49	113.74	86.10	70.88	69.27
Payable Days	16.49	40.31	38.43	19.95	20.77	17.55	17.39	17.72	17.32
Receivables days	97.28	87.31	88.91	90.13	88.98	91.14	94.31	95.31	86.32
Cash Cycle	203.91	140.13	167.40	226.92	218.69	187.32	163.02	148.46	138.28
Profitability Ratio									
Gross Margins (%)	9.2%	11.0%	9.7%	9.3%	9.6%	9.8%	9.4%	9.9%	10.0%
EBITDA Margins (%)	8.3%	9.1%	7.7%	8.0%	8.4%	8.7%	8.2%	8.3%	8.2%
PBT Margins (%)	2.5%	3.3%	2.5%	2.6%	2.8%	3.5%	3.4%	3.8%	4.0%
Net Margins (%)	2.9%	2.5%	2.3%	2.2%	2.4%	2.9%	2.9%	3.2%	3.4%
Effective Tax Rate (%)	-19.2%	23.1%	5.3%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
Leverage									
Total Debt (RO ,000)	25,647	12,564	40,069	43,867	36,367	32,867	29,367	26,323	24,323
Net Debt (RO ,000)	22,687	6,585	34,242	38,747	30,619	27,984	22,992	20,249	19,238
Debt/Capital (x)	5.13	2.51	8.02	8.78	7.28	6.58	5.88	5.27	4.87
Debt/Total Assets (x)	0.42	0.22	0.50	0.50	0.45	0.42	0.38	0.34	0.31
Debt/Equity (x)	0.80	0.39	1.22	1.31	1.06	0.92	0.79	0.67	0.59

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INVESTMENT RESEARCH | OMAN

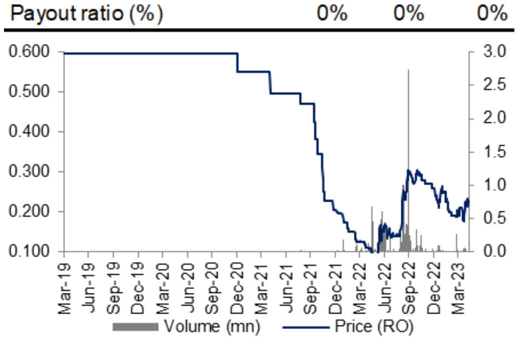
المتحدة للأوراق المالية ش م م
UNITED SECURITIES LLC

FMCG

A'Saffa Foods – Premium warranted

BUY: 12M TP @ 0.360

Valuation Summary (TTM)			
Price (RO)			0.290
PER TTM (x)			18.4
P/Book (x)			0.9
P/Sales (x)			0.6
EV/Sales (x)			1.3
EV/EBITDA (x)			8.6
Dividend Yield (%)			0.0
Free Float (%)			34%
Shares O/S (mn)			120
YTD Return (%)			13%
Beta			0.2
(mn)		**OMR**	**USD**
Market Cap		35	90
Enterprise Value		83	214
Price performance (%)	**1M**	**3M**	**12M**
A'Saffa	0%	41%	93%
MSX 30 Index	-2%	-3%	12%
Industry Index	-5%	1%	-1%
Trading liquidity (,000)	**1M**	**3M**	**6M**
Avg daily turnover (RO ,000)	7	12	8
Avg Daily Volume (,000)	76	42	29
52 week	**High**	**Low**	**CTL***
Price (RO)	0.320	0.134	116.4
* CTL is % change in CMP to 52wk low			
Major shareholders			
Zalal Investment			33.2%
Gulf Investment Corp			20.0%
Al Hosn Investment			13.2%
Others			33.6%
Other details			
Exchange			MSX
Sector			Food
Index weight (%)		NA	
Key ratios	**2020**	**2021**	**2022**
EPS (RO)	0.020	-0.015	0.006
BVPS (RO)	0.364	0.329	0.453
DPS (RO)	0.000	0.000	0.000
Payout ratio (%)	0%	0%	0%



A'Saffa Foods (SPFI) is the largest provider of poultry products in the Sultanate of Oman. The company has earned a reputation for maintaining high-quality natural farms with international accreditation. The product quality warrants a premium pricing which the company has managed to establish since its inception. SPFI has over the years built a wide network of distribution and sales offices across the cities and interior regions to ensure availability of the products across the country. Currently SPFI produces 10 categories of products within which it has nearly 100 types of items that are sold. The wide range catering to all price points and tastes makes A'Saffa a favorite choice. The company doubled its capacity last year, the impact of which is reflected in the topline growth of 2022. For 2022 the revenues grew by 48.7% compared to the same period the previous year. Bottom line bounced back to profits in 2022 despite a difficult year which included record rise in feed costs, supply shocks, inflationary pressure and intense competition. Based on the leadership position of the company, prospects from expanded capacities we have a positive outlook on the company. We evaluate the company on the based on DCF approach. We arrive at a target price of RO 0.360 per share which provides an upside of 23.9%. We initiate coverage on the stock with a recommendation to BUY.

Wide network, brand equity and premium pricing will drive revenue growth: With over 100 products in 10 different categories, A'Saffa is a well-known brand in Oman and rest of the GCC countries. The entrenched brand has helped diversify the product portfolio and introduce newer items to its pipeline. The company has an integrated production facility which ensures continuous supply of products to over 1600 outlets, catering units, butcheries and other retail stores. We believe the company has over the years created a solid platform on the back of building a brand with a high recall and logistics network that can scale its operations. Our base case estimate for revenue growth is 8.4% CAGR over 2022-27e. We expect the trajectory will lead to improvement its market share locally as well as in the region.

Exports increasing, local expansion in place: The company has made significant inroads into the GCC markets such as UAE, Qatar, Bahrain and Yemen. As of 2021 exports contributed to nearly 25% of the overall revenue. It also completed a two-phase expansion project to double its rearing capacity to 44mn birds and 45,000 MT of poultry meat in May 2021, the impact of which is reflected in the topline growth in 2022. We believe the expansion has come at the right time when macro situation has reverted to normalcy and demand is rising. The expanded capacities will cater to both local and international markets auguring well for the top line growth.

Exhobirant rise in feed input price, partially offset by subsidies: The Government has reacted proactively to the rise in feed cost. It has decided to subsidise the same for a period of six months starting from July 1, 2022. The company estimates to receive RO 170k on account if this subsidy which will partially offset the rise in input costs

Valuation: SPFI warrants a premium on account of being the only company in the poultry business to be listed in Oman. Its leadership position and brand equity also provide adequate cushion to valuation. We arrive at a target price of RO 0.360 per share based on the DCF valuation. At the target price of RO 0.360, the stock trades at 13.6x 2023 PE.

A'Saffa is the undisputed leader in poultry in Oman with a well-established brand, scalable supply chain and premium pricing …

Wide network, brand equity and premium pricing will drive revenue growth: ASaffa (SPFI) is the largest and fully integrated poultry player in Oman with about 16% market share in the country. It has a state of art facility in Thumrait near Salalah. Across 50 sqkm, the facility produces fresh and frozen chicken under several brand names and categories to suit the tastes of the local consumer. The wide network of distribution and sales offices across the cities and interior regions ensure availability of the products across the country. SPFI has distribution hubs located in Muscat, Salalah, Sohar, Nizwa and Al Kamil. It covers over 1600 outlets, restaurants, catering companies and butcheries. The fleet of 45 reefer trucks ensure timely and fresh delivery of the product to every outlet. ASaffa food processing and ASaffa logistics was incorporated seperately as subsidaries to provide 24x7 support to the parent's expanding supply chain.

S.No	Category	Types
1	A'Saffa Frozen Chicken	9
2	A'Saffa Fresh Chicken	11
3	A'Saffa Delicacies	22
4	Zingle Range	3
5	Khayrat Delicacies	10
6	Taybat Delicacies	11
7	Taybat Fresh Chicken	11
8	Taybat Frozen Chicken	10
9	Khayrat Fruit & Fruit Pulps	8
10	Khayrat Frozen Vegetable	3
	Total	**98**

Source: Company reports, US research

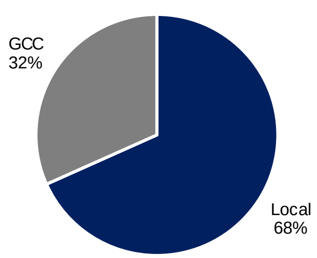
The brand equity created over the years has enabled the company to further expand its product profile. SPFI has ventured into a range of frozen vegetables, fruits and sea food adding to its already existing successful portfolio. The wide range catering to all price points and tastes make ASaffa a favourite choice.

Inroads into Saudi can provide the fillip for growth …

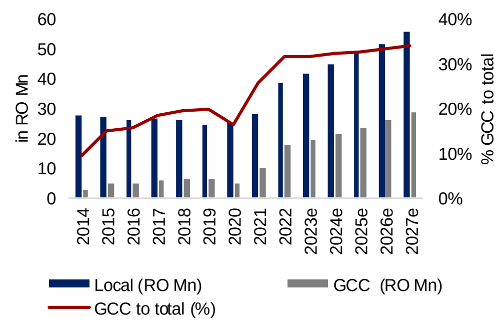
Exports increasing, Saudi to be a game changer:

The company has made significant inroads into the GCC markets such as UAE, Qatar, Bahrain and Yemen. As of 2022 exports contributed to 32% of the overall revenue. We expect the establishment of the brand across the borders will augur well for revenue growth, our base forecast expects the contribution from this segment to grow at a CAGR 9.8% 2022-27e. Higher realization in the GCC and African markets will also help in offsetting the local decline in price realization locally. In 2022, the company signed an agreement with Stallions United Trading Company to export its high quality products to Saudi Arabia. Saudi is the largest market in the region and we believe if ASaffa can establish itself in this market, then, it would be a game changer for the company.

Contribution from local market c68% in 2022



GCC contrition gradually rising



Source: Company reports, US research

Expanded capacities will be absorbed locally and across the border …

Expansion in place, market share expected to double

ASaffa completed an expansion project of its facility in Thumrait in May 2021. Post this expansion, the production capacity has doubled to 42,000 MT, 44mn chicks, 180 broiler farms and feed mill capacity of 105k MT/year. The company also expanded its food processing unit taking the total capacity to 4500 MT/year of ASaffa, Khayrat and Taybat. The new facilities include 10 new environmentally protected farms with a total of 90 poultry houses built across an area of 1650sqm with a capacity to hold over 32000 birds each. The current hatcheries also witnessed doubling of the capacity resulting in an increase in production from 22mn birds to 44mn.The new slaughterhouse is built across an area of 75,000 sqm and is the biggest in the region with a culling capacity for 12,000 birds an hour and 150k birds per day producing 160T of poultry meat a day. It is pertinent to note that the company had engaged with the best-in-class equipment providers and contractors for this expansion mostly from Germany, USA, and Netherlands. With this new capacity in place, the company hopes to bolster its current market share from 16% to over 30% going forward. The total capex for this project was RO 45mn spread across the three years starting from 2019. The revenue spike of 48.7% witnessed in 2022 was on account of this expanded capacities. We expect a top line to grow by 8.4% CAGR (2022-27e).

Subsidiaries compliment in operations, investments facing headwinds

Food processing and logistics supported by two subsidiaries …

A'Saffa Food processing LLC and A'Saffa logistics LLC are two subsidiaries in which the parent has 100% ownership. The parent invested RO 1.35Mn in the food processing unit in 2011 and RO 1.6Mn in 2014 in the logistics division. The food processing unit produces value added products with a capacity of 4500 MT/year. The logistics company provides high quality storage service including cold rooms, dry rooms (controlled temperature), chilled rooms, and a packaging room. The services of these subsidiaries are available for companies other than A'Saffa as well hence provides additional revenue stream to the group. The food processing unit achieved a revenue of RO 4.5Mn and profit of RO 529k in 2022, whereas the logistics reached a revenue of RO1.1Mn and reported profits of RO 208k during the same period.

Investment in OPC likely to turn profitable from 2024 onwards…

Osool poultry (OPC) was incorporated in 2016 and is currently an associate company of SPFI. SPFI holds a stake of 23.47% in Osool at a carrying value of RO 6.6Mn. Year 2022 was the first full year of operation of OPC and it reported RO 14.5Mn in revenue and a loss of RO 3.5Mn. The share of losses attributable to the group was at RO 821k. We believe that OPC will reach steady state soon and losses will decline going forward. We expect this division to add positively to the group's bottom line from 2024.

Investments in Namaa poultry written off due to uncertainty…

A'Namaa Poultry Company (APC) is another investment that SPFI made along with the government related entities. APC was envisaged to become the largest poultry plant in the country and to ensure food security to the nation. It was intended to produce high quality poultry meat and meat products through its farm in Ibri, near Muscat. The project was planned at a massive scale over 5 plots of land covering 68sqkm and expected to increase domestic poultry production by 36%. This was an initiative of the government through the Oman Food and Investment Holding Company (OFIH) and started in 2019 with an investment of about RO 110mn. The carrying value of SPFI's investment in APC was RO 2.4Mn as of 2022.

However, cost overruns and delays have led to reassessing this project in 2022. Post the evaluation, the board has concluded that there could be an inordinate delay in the completion of the project and this would lead to a significant time delay in achieving the expected production level, profitability and break-even returns. It would also require further infusion of capital from the existing shareholders, which remains uncertain. Based on the assessment the board of SPFI decided to completely write off the investment made in this venture of RO2.4Mn. This is reflected in the comprehensive income in 2022 resulting a consolidated loss of RO 1.7Mn, after provisions.

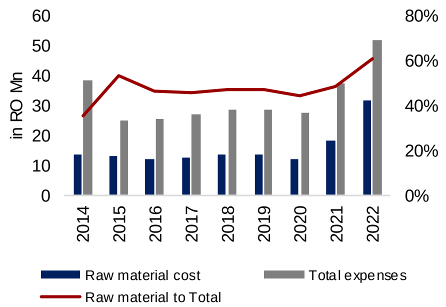
Stable operational cost impacted by exorbitant rise in feed input price and power costs:

Government subsidy offers partial relief from feed cost increase …

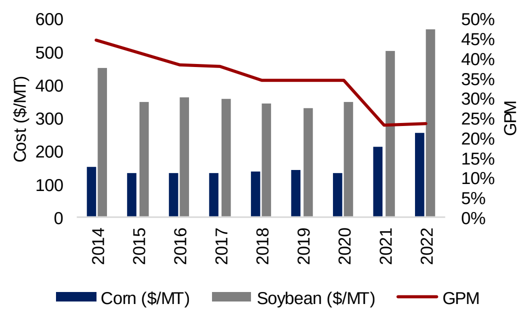
ASaffa enjoys the benefit of a fully integrated plant. The production facilty includes hatcheries to full grown chickens ready for sale. The facility is isolated from rest of the city hence the threat of contagious diseases such as brid flu is minimised. Parent farms ensure consistency in production and quality. Since most of the products are directly sold there is minimal intermediary cost. These factors enabled the company maintain stable margins in its past. However, recently over the last two years unexpected outlier events have caused stress in margins. In 2020, covid related protocols created a supply issue as transport was restricted. The next spoiler came in the form of Russia Ukraine war in 2022. Corn and Soybean are the main ingredients for the feed and the prices shot to a level never seen before, causing significant stress for playes like SPFI. Raw materials and conumables increased by 74% in

2022 compared to a revenue growth of 49%. Raw material contribution to total expsenes increased sharply to 61% in 2022 compared to 48% in 2021.

Raw material costs increased to 61% of total in 2022



… leading to erosion of gross margins



Source: Company reports, US research

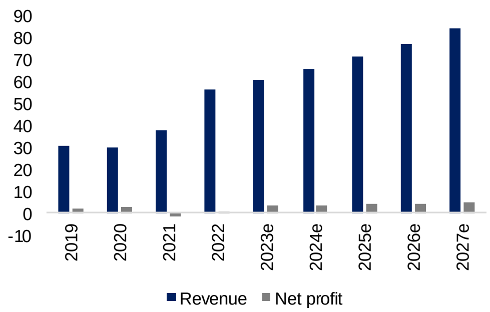
Gross margins which were in the range of 34-40% declined to 23.8% in 2022. Despite significant growth of 49% in the topline in 2022, the company reported meagre profits of RO 699k. The Government reacted proactively to the rise in feed cost. by subsidising the cost for the same for a period of six months starting from July 1, 2022 for all players in the industry. SPFI expects to receive a subsidy of RO 170,000 for the year 2022, which will partially offset the rise in input costs. The subsidy is likely to to continue till the feed cost price reverts to normal.

Financials disrupted due to externalities; intrinsic control still robust:

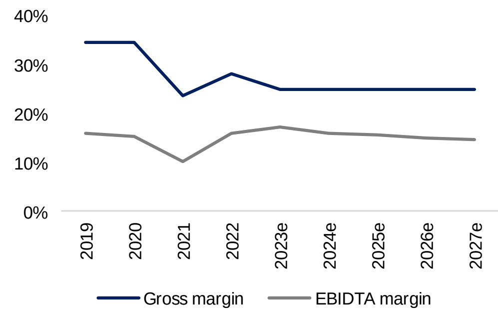
SPFI recovering from losses, profits to normalize from 2023 …

Despite increasing revenue, the company faced covid related headwinds over the past couple of years, resulting in a loss for the company in 2021 to the tune of RO 1.82Mn. With additional capacities in place the revenue grew to a record high of RO 56Mn in 2022, however margins remained thin on account of high raw material input costs. The company managed to report meager profits of RO 0.699k in 2022. We expect these issues to be resolved in 2023 and normalization of profits to return. Gross and EBIDTA margins have bottomed out and will revert to pre-covid levels. Further, the larger scale of operations will make the company more efficient in terms of operations.

Expansion led revenue growth, profits to follow



Margins bottomed out in 2021



Source: Company reports, US research

Pressure on price abating, bulk orders provide support …

The company faces cheap imports from nearby countries hence, to compete and retain market share A'Saffa has had to lower its price in the recent past. Despite lowering the prices, the cost of the products still remains at a premium compared to their peers. The management has reiterated that it will not compromise on the quality and will retain A'Saffa as a premium brand. We do not expect further contraction of margins on account of price reduction. Further, the re-opening of restaurants and bulk sales locally have provided adequate local demand and pricing power is back with the producer.

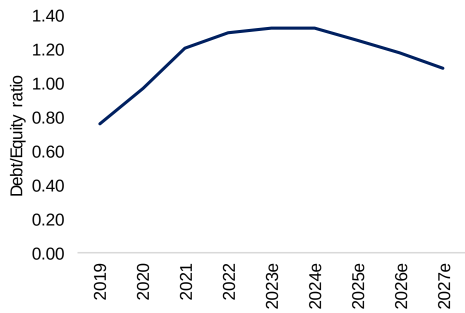
Solar plant to reduce fuel costs…

The company had experienced power outages in the 1H22 and had to run the slaughter houses on diesel generators resulting in a higher cost of fuel to the tune of RO 500k. ASaffa has decided to install a solar power plant at its facility in Thumrait. It signed an agreement with Total Energies Renewables Orient LLC to construct a 7MW power plant. Fuel forms 5-7% of the over all cost of production, and we believe the solar project will help reduce the same going forward, cushion margins and protect the cost structure to a large extent.

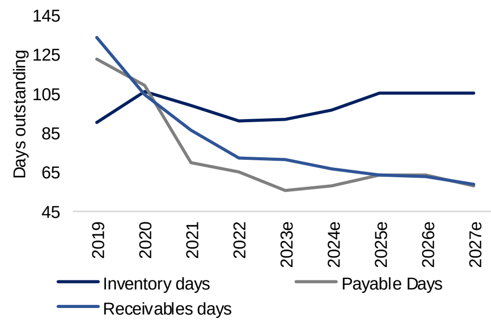
Debt equity ratio to reduce going forward with limited capex plans …

SPFI took up additional debt to fund its expansion and investments in subsidiaries which has led to rise in debt equity ratio. Debt to equity was stable at 0.11x prior to 2018 and has currently moved to over 1.0x. The expanded capacities were commissioned, and production started from mid-2021. As the additional revenues start generating cash flows, we expect the debt to be paid off and debt equity to revert to erstwhile levels. We do not expect a further increase in the overall debt levels.

Debt-Equity ratio to decline from 2023 onwards



Working capital management has been stable

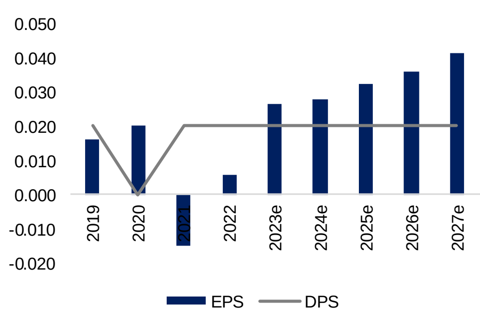


Source: Company reports, US research

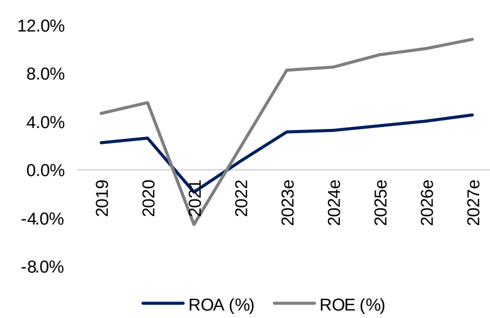
Working capital under control …

The company follows a prudent and policy driven inventory management, this has augured well in times of stress and even during the 2020 covid times. Inventory days have stayed well within the range of 3 months. A'Saffa has not faced significant receivables issues as most sales take place directly to the end customers. The overall cash cycle has held steady in the past and we do not expect any major changes in this trend going forward.

Steady dividend payment to continue



Return ratios to take off



Source: Company reports, US research

Stable dividends in the past, likely to maintain in future …

Volume driven profit growth will increase the ROE levels of the company from the current bottom. We expect net profit achieve pre-pandemic levels from 2023 onwards. The 1Q23 results have been promising and we estimate full year net profit for 2023 at RO 3.1mn. Our forecast expects a reversion of ROE to the level of 10% by 2025 on the back of expanded capacities, higher price realization, and lower cost of production. SPFI holds adequate reserves through the earnings of the past years and limited capex spending. This provides sufficient buffer to continue the dividend payment in the coming years. The company has not paid dividends in 2021 and 2022, we expect resumption in dividends from 2023 onwards of RO 0.020. At the current market prices and based on the expectation of consistent future dividends, the stock currently trades at an attractive yield of 6.9%.

Our DCF valuation resulted in fair value per share of RO 0.360:

DCF provides an upside potential of 24% …

We have employed DCF valuation for SPFI to arrive at the intrinsic value of the company. The cost of equity of 14.5% derived from risk free rate of 5.0% and equity risk premium of 15% (considering the illiquid nature of the stock we have provided a higher premium). We have used a beta of 0.630. Our base case valuation assumed that the company's cash flow would remain stable at 1.0% beyond the forecasted period. We have arrived at a DCF value of RO 0.360/share of SFMI, which is 24.1% higher than the current price of RO 0.290/share.

DCF Valuation	2023e	2024e	2025e	2026e	2027e
NOPLAT	5,749	5,736	6,149	6,424	6,916
Add: Depreciation	3,593	3,673	3,753	3,833	3,913
Less: capex	-2,000	-2,000	-2,000	-2,000	-2,000
Less: change in WC	-4,359	-781	-1,768	249	1,372
FCFF	2,983	6,628	6,134	8,507	10,201
PV of FCFF	2,812	5,645	4,720	5,915	6,409
PV of Terminal Value					66,925
Enterprise Value					92,427
Less net debt					47,999
Less minorities & Pension liabilities					1,250
Value of equity					43,178
No of shares					120,000
Value per share (RO)					0.360

Valuation parameters	
Risk free rate	5.0%
Equity risk premium	15.0%
Beta	0.63
Cost of equity	14.5%
Cost of debt	5.9%
Corporate tax rate	15.0%
After tax cost of debt	5.0%
Target debt	40.0%
Target equity	60.0%
WACC	10.7%
Terminal growth rate	1.0%

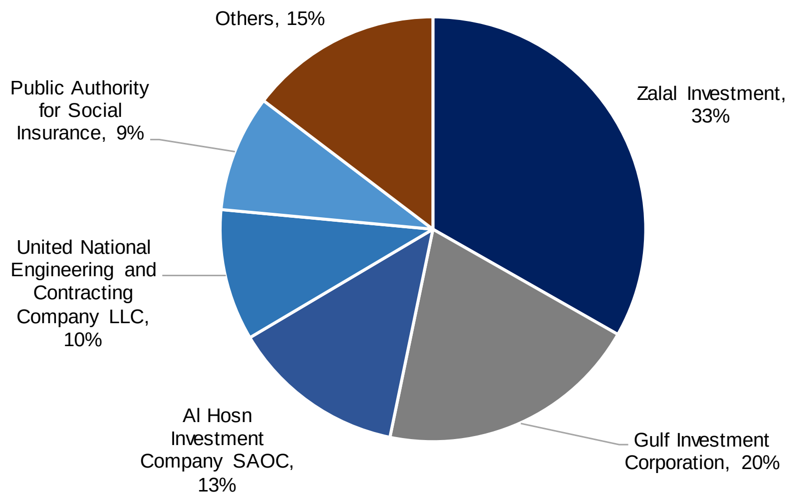
Key downside risks:

- Further rise in price of raw materials and fuel costs
- Withdrawal of subsidies
- Higher competition from foreign brands

About A'Saffa Foods

A'Saffa Foods (SPFI) was incorporated in 2001 and is the largest provider of poultry products in the Sultanate of Oman. The company has earned a reputation for maintaining high-quality natural farms, devoid of using any kind of artificial preservatives, hormones, or colors. It has been accredited by ISO, HACCP and TUV for its quality management and hygiene. The poultry farms are strategically located in the southern part of Oman about 100kms from Salalah at Thumrait. Value added products such as "A'Saffa", "Khayrat" and "Taybat are manufactured in its automated processing plant in Muscat. The company caters to micro segments as well by retailing processed products such as Chicken Franks, Chicken Mince, Chicken Breaded Burgers, Chicken Fillets, Chicken Fingers, Chicken Nuggets, Chicken Spring Rolls, Chicken Samosas, Beef Burger and Beef Mince. The Thumrait location provides isolation and protection from common infections such as bird flu that may affect the production, while on the other hand the nearness to the port provides easy access for exports to GCC and Africa. Additionally, SPFI also provides a range of branded frozen vegetables, fruits and fruit pulps along with frozen and processed sea food.

Shareholding pattern of ASaffa Foods



BOARD OF DIRECTORS

S.NO	NAME	POSITION	CATEGORY
1	Eng. Ali Hilal Ali Al Kuwari	Chairman	Non-Independent
2	Mr. Qais Abdullah Musa Al Kharusi	Deputy Chairman	Non-Independent
3	Ms. Areej Muhammad Ibrahim AlKulaib	Director	Non-Independent
4	Mr. Asim Salim Ali AlGhailani	Director	Non-Independent
5	Mr.AlNoubay Salem Hamed Aladbi	Director	Independent
6	Ms Radhiya Mohammed Al-Mahrouqi	Director	Independent
7	Mr. Hashim Said Nasser Al Maskary	Director	Independent

Source: MSX, US Research

المتحدة للأوراق المالية ش.م.م
UNITED SECURITIES LLC

Income Statement (in RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Revenue	30,872	29,733	37,845	56,293	60,795	66,044	71,528	77,351	84,312
Cost of sales	20,166	19,419	29,091	42,916	45,597	49,533	53,646	58,013	63,234
Gross Profit	**10,706**	**10,314**	**8,754**	**13,377**	**15,199**	**16,511**	**17,882**	**19,338**	**21,078**
Other income	5	57	10	230	230	230	230	230	230
General/admin exp	2,281	2,311	2,272	2,224	2,432	2,807	3,040	3,481	3,372
SG&A	5,183	5,209	5,877	6,477	6,687	7,595	8,226	8,895	10,117
Operating profit	**3,247**	**2,851**	**614**	**4,906**	**6,310**	**6,339**	**6,847**	**7,192**	**7,818**
EBIDTA	**4,921**	**4,525**	**3,877**	**8,945**	**10,508**	**10,431**	**11,051**	**11,512**	**12,258**
Finance income	77	68	75	67	50	50	50	50	50
Finance cost	556	583	2,622	3,017	2,820	2,817	2,767	2,720	2,539
Impairment (reversal) on financial assets	-258	27	0	222	0	0	0	0	0
Share of profit	-95	0	0	-822	196	450	518	596	685
Gains (losses) on net monetary position	0	207	-139	0	0	0	0	0	0
PBT	**2,415**	**2,569**	**-2,071**	**913**	**3,736**	**4,023**	**4,648**	**5,117**	**6,014**
Tax	480	130	-254	214	560	603	697	768	902
Net profit for the period	**1,935**	**2,439**	**-1,817**	**699**	**3,175**	**3,419**	**3,951**	**4,350**	**5,112**

Balance Sheet (RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
PPE	56,172	64,858	66,094	62,563	60,969	59,296	57,543	55,710	53,796
Intangible assets other than goodwill	39	17	3	1	0	0	0	0	0
Right to use asset	1,589	1,906	1,909	1,562	1,558	1,546	1,537	1,530	1,525
Investments accounted for using equity method	6,402	9,209	6,639	5,817	6,014	6,464	6,982	7,578	8,263
Other non-current assets	2,489	1,033	2,541	48	48	48	48	48	48
Total Non-Current Assets	**66,691**	**77,024**	**77,186**	**69,991**	**68,589**	**67,354**	**66,110**	**64,865**	**63,632**
Current Inventories	5,420	5,862	9,908	11,554	11,399	12,383	12,339	14,503	15,492
Trade and current receivables	9,688	7,381	10,453	11,666	18,239	19,813	21,458	21,658	23,186
Current biological assets	1,404	1,831	2,934	3,003	3,040	3,302	3,576	3,868	4,216
Other current financial assets	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Cash and bank balance	307	-1,133	-3,254	-892	1,711	3,046	2,851	5,342	7,057
Total current assets	**18,819**	**15,941**	**22,041**	**27,331**	**36,389**	**40,544**	**42,224**	**47,371**	**51,951**
Total Assets	**85,509**	**92,965**	**99,227**	**97,321**	**104,977**	**107,899**	**108,334**	**112,236**	**115,582**
Share capital	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000
Statutory reserve	4,231	4,316	4,423	2,066	2,066	2,066	2,066	2,066	2,066
Retained earnings	25,049	27,403	23,075	23,704	26,879	27,898	29,449	31,399	34,111
Total equity	**41,280**	**43,719**	**39,498**	**37,770**	**40,945**	**41,964**	**43,515**	**45,465**	**48,177**
Non-current provisions for employee benefits	824	1,011	1,120	1,223	851	982	912	1,044	1,012
Borrowings	25,576	36,289	36,360	35,464	36,826	38,279	37,858	37,514	37,229
Non-current lease liabilities	1,457	1,768	1,747	1,504	1,472	1,460	1,452	1,445	1,440
Deferred tax liabilities	832	835	374	454	454	454	454	454	454
Total non-current liabilities	**28,689**	**39,903**	**39,601**	**38,644**	**39,602**	**41,176**	**40,675**	**40,457**	**40,134**
Trade and other current payables	8,739	2,897	8,219	7,061	9,119	10,897	10,729	13,343	17,231
Borrowings, current	5,770	5,974	11,367	13,443	14,443	12,943	12,443	11,943	8,943
Current lease liabilities	552	326	366	245	260	258	256	255	254
Current tax liabilities	480	145	176	159	608	660	715	774	843
Total current liabilities	**15,541**	**9,343**	**20,128**	**20,908**	**24,430**	**24,758**	**24,143**	**26,314**	**27,271**
Total liabilities	**44,229**	**49,245**	**59,729**	**59,552**	**64,032**	**65,934**	**64,819**	**66,771**	**67,406**
Total equity and liabilities	**85,509**	**92,965**	**99,227**	**97,321**	**104,977**	**107,899**	**108,334**	**112,236**	**115,582**

Cash Flow (RO '000)	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Cash from operations	11,091	3,483	-2,462	4,590	6,394	10,150	9,851	12,407	14,364
Investing cash flow	-33,612	-11,412	-3,524	131	-2,000	-2,000	-2,000	-2,000	-2,000
Financing cash flow	21,406	10,039	3,866	-2,359	-2,857	-5,264	-6,088	-5,964	-8,224
Change in cash	2,434	-1,441	-2,121	2,362	2,603	1,334	-195	2,491	1,715
Beginning cash	-2,126	307	-1,133	-3,254	-892	1,711	3,046	2,851	5,342
Ending cash	**307**	**-1,133**	**-3,254**	**-892**	**1,711**	**3,046**	**2,851**	**5,342**	**7,057**

Ratio Analysis	2019	2020	2021	2022	2023e	2024e	2025e	2026e	2027e
Per share									
EPS (RO)	0.016	0.020	-0.015	0.006	0.026	0.028	0.033	0.036	0.043
BVPS (RO)	0.344	0.364	0.329	0.315	0.341	0.350	0.363	0.379	0.401
DPS (RO)	0.020	0.020	0.000	0.000	0.020	0.020	0.020	0.020	0.020
FCF per share (RO)	-0.188	-0.066	-0.050	0.039	0.037	0.068	0.065	0.087	0.103
Valuation Ratios									
Market Cap (RO ,000)	62,400	66,000	22,800	27,480	34,800	34,800	34,800	34,800	34,800
EV (RO,000)	93,439	109,396	73,781	77,278	84,358	82,977	82,250	78,915	73,915
P/E (x)	18.0	14.3	-19.2	49.8	11.0	10.2	8.8	8.0	6.8
EV/EBITDA (x)	19.0	24.2	19.0	8.6	8.0	8.0	7.4	6.9	6.0
Price/Book (x)	0.84	0.80	0.88	0.92	0.85	0.83	0.80	0.77	0.72
Dividend Yield (%)	3.8%	3.6%	0.0%	0.0%	6.9%	6.9%	6.9%	6.9%	6.9%
Price to sales (x)	2.02	2.22	0.60	0.49	0.57	0.53	0.49	0.45	0.41
EV to sales (x)	3.03	3.68	1.95	1.37	1.39	1.26	1.15	1.02	0.88
Liqiudity									
Cash Ratio (x)	0.02	-0.12	-0.16	-0.04	0.07	0.12	0.12	0.20	0.26
Current Ratio (x)	1.21	1.71	1.10	1.31	1.49	1.64	1.75	1.80	1.90
Quick Ratio (x)	0.86	1.08	0.60	0.75	1.02	1.14	1.24	1.25	1.34
Return Ratios									
ROA (%)	2.3%	2.6%	-1.8%	0.7%	3.0%	3.2%	3.6%	3.9%	4.4%
ROE (%)	4.7%	5.6%	-4.6%	1.9%	7.8%	8.1%	9.1%	9.6%	10.6%
ROCE (%)	2.8%	2.9%	-2.3%	0.9%	3.9%	4.1%	4.7%	5.1%	5.8%
Cash Cycle									
Inventory turnover (x)	4.0	3.4	3.7	4.0	4.0	4.2	4.3	4.3	4.2
Accounts Payable turnover (x)	3.0	3.3	5.2	5.6	5.6	4.9	5.0	4.8	4.1
Receivables turnover (x)	2.7	3.5	4.2	5.1	4.1	3.5	3.5	3.6	3.8
Inventory days	90.2	106.0	98.9	91.3	91.9	87.6	84.1	84.4	86.6
Payable Days	122.3	109.4	69.7	65.0	64.8	73.7	73.6	75.7	88.2
Receivables days	133.9	104.8	86.0	71.7	89.8	105.1	105.3	101.7	97.1
Cash Cycle	101.9	101.4	115.2	98.0	116.9	119.0	115.8	110.4	95.4
Profitability Ratio									
Gross Margins (%)	34.7%	34.7%	23.1%	23.8%	25.0%	25.0%	25.0%	25.0%	25.0%
EBITDA Margins (%)	15.9%	15.2%	10.2%	15.9%	17.3%	15.8%	15.4%	14.9%	14.5%
PBT Margins (%)	7.8%	8.6%	-5.5%	1.6%	6.1%	6.1%	6.5%	6.6%	7.1%
Net Margins (%)	6.3%	8.2%	-4.8%	1.2%	5.2%	5.2%	5.5%	5.6%	6.1%
Effective Tax Rate (%)	19.9%	5.1%	12.3%	23.4%	15.0%	15.0%	15.0%	15.0%	15.0%
Leverage									
Total Debt (RO ,000)	31,346	42,263	47,727	48,906	51,269	51,222	50,301	49,457	46,172
Net Debt (RO ,000)	31,039	43,396	50,981	49,798	49,558	48,177	47,450	44,115	39,115
Debt/Capital (x)	2.6	3.5	4.0	4.1	4.3	4.3	4.2	4.1	3.8
Debt/Total Assets (x)	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4
Debt/Equity (x)	0.8	1.0	1.2	1.3	1.3	1.2	1.2	1.1	1.0

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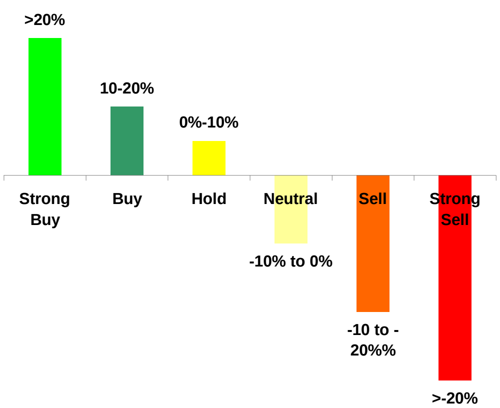
Rating Criteria and Definitions

Rating



Rating Definitions

Strong Buy	This recommendation is used for stocks whose current market price offers a deep discount to our 12-Month target price and has an upside potential in excess of 20%
Buy	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 10% to 20%
Hold	This recommendation is used for stocks whose current market price offers a discount to our 12-Month target price and has an upside potential between 0% to 10%
Neutral	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between 0% to -10%
Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential between -10% to -20%
Strong Sell	This recommendation is used for stocks whose current market price offers a premium to our 12-Month target price and has a downside side potential in excess of 20%
Not rated	This recommendation used for stocks which does not form part of Coverage Universe

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