



US\$14.68bn Market cap
36% Free float
US\$7.97mn Avg. daily volume

Target price **50.0** -12.3% over current
Current price **57.0** as at 8/4/2018

Existing rating

Underweight

Neutral

Overweight

Performance



Earnings

Period End (SAR)	12/16A	12/17A	12/18E	12/19E
Revenue (mn)	14,339	13,936	13,839	14,145
Revenue growth	3.9%	-2.8%	-0.7%	2.2%
EBIT (mn)	2,609	2,794	2,928	2,996
EBIT growth	15.3%	7.1%	4.8%	2.3%
EPS	2.15	2.18	2.34	2.45
EPS growth	12.1%	1.6%	7.2%	4.9%

Source: Company data, Al Rajhi Capital; **Note:** Our estimates exclude Pure Breed financials consolidation from Q2 2018

Valuation

Period End (SAR)	12/16A	12/17E	12/18E	12/19E
P/E (x)	25.6	25.2	23.5	22.4
P/B (x)	4.1	3.7	3.4	3.1
EV/EBITDA (x)	14.7	14.0	13.6	13.3
RoE (%)	16.5%	15.1%	14.6%	14.0%

Source: Al Rajhi Capital

Almarai

Q1: Margin beat drives earnings surprise

Almarai's Q1 2018 earnings at SAR344mn was ahead of our and consensus estimates (SAR312mn & SAR318mn respectively), led by a significant beat on gross margin (38.8%, up 400bps y-o-y vs. our estimate of 35.0%). Stable commodity prices and improved operating performance of Poultry and Infant nutrition segments aided gross margins, which were already factored into our estimates. However, we assumed certain increase in alfalfa costs which likely did not materialize, and the company also reported higher receipts of subsidy payments which supported gross margin expansion – the key driver for earnings surprise, especially as revenue at SAR3,232bn was in-line with our estimate. Going forward, we cut our revenue estimates by 3-4% for FY18/FY19 based on our revised expectation of dependent levy impact and overall impact of reforms on consumer spending in the Kingdom. Almarai stated in its earning release that it continues to see strong turnaround in Poultry and Infant nutrition, and better volume growth in Egypt – we incorporate the same into our estimates and raise our gross margin estimates by 50-75bps over the next two years, which leads to ~4% upward revision in PAT estimates for each FY18 & FY19. Based on our revised estimates, our Dec-2018 TP is raised to SAR50 per share (earlier SAR48.2), which implies 12.3% downside from the current price. Downgrade to Underweight (earlier Neutral).

- Outlook:** We believe the non-discretionary FMCG market size in the Kingdom will be under pressure for the next few quarters, which combined with Almarai's already high market share (65-70% in Milk, Laban and Bread) precludes revenue growth via market share gains in these key categories. Further, industry consolidation may also heighten competitive intensity – for e.g. NADEC and Al Safi-Danone merger may create a credible #2 player in the industry that aims to expand its market share on the back of their combined balance sheet. This external backdrop clouds the visibility of earnings growth over the medium to long term, even as internal performance enhancements (cost rationalization program, turnaround in smaller segments like Poultry and Infant nutrition etc) yielded results.
- Operating and net profit:** Despite material gross profit beat by SAR113mn, the net profit beat stood at just SAR32mn mainly due to impairment of trade receivables (adverse macro and change to IFRS 9), and forex loss (adverse euro movement).
- Valuation:** We continue to value Almarai on equal weights for DCF (3% terminal growth, 35% debt in capital structure and 7.9% WACC) and relative valuation (20x FY19 EPS), yielding the Dec-2018 target price of SAR50 per share. Downgrade to underweight (earlier Neutral)

Figure 1 Almarai: Summary of Q1 2018 results

	Q1 2017	Q4 2017	Q1 2018	% chg y-o-y	% chg q-o-q	ARC est
Revenue	3,384	3,419	3,232	-4.5%	-5.5%	3,256
Gross profit	1,177	1,335	1,253	6.4%	-6.2%	1,140
Gross profit margin (%)	34.8%	39.1%	38.8%			35.0%
Operating profit	421	598	481	14.2%	-19.6%	419
Net profit	328	513	344	4.9%	-32.9%	312

Source: Company data, Al Rajhi Capital



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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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