

Almarai Company

Margins continue to lag topline growth impacting profit

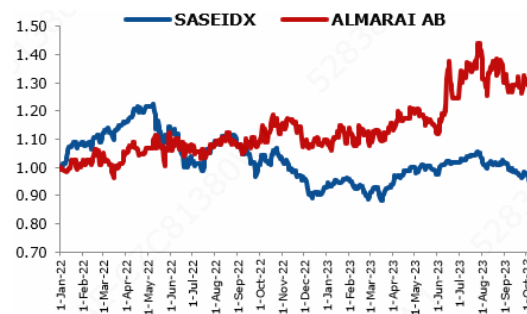
Current Price
SAR 59.80

Target Price
SAR 61.00

Upside/Downside (%)
+2%

Rating
HOLD

- Almarai revenue grew marginally 0.6% YOY in 3Q23 driven by strong growth in core markets of KSA and GCC countries, partially offset by a decline in revenue from Egypt owing to EGP devaluation.
- Pressure on gross margins owing to higher inventory cover due to delay in realizing benefit of lower commodity cost
- Generated a negative FCF of SAR 507 Mn in 3Q23 compared to a positive FCF of SAR 931 Mn in 3Q22 due to investment in working capital.
- The Company plans to invest SAR 405 Mn to expand its Fresh Bakery production capacity and enter into the Frozen Bakery sector in Saudi Arabia and other markets.



3Q23 Net Profit lower than our estimate

Almarai Company ("Almarai, "the Company") recorded 5.0% YOY growth in net profit to SAR 486 Mn in 3Q23, lower than our estimate of SAR 560 Mn. The growth in net profit is mainly driven by a marginal rise in revenue supported by volume growth in Poultry and Bakery segment partially offset by EGP devaluation, higher investment in marketing activities and delay in the phasing of commodity cost inflation of corn, soya and alfalfa in the Dairy and Juice Segment.

P&L Highlights

Almarai's revenue grew marginally 0.6% YOY to SAR 4,797 Mn in 3Q23 driven by strong growth in core markets of KSA and GCC countries, partially offset by a decline in revenue from Egypt owing to EGP devaluation. Revenue from the Poultry business increased 13.0% YOY to SAR 876 Mn in 3Q23 primarily due to strong volume growth owing to capacity addition. Revenue from the Bakery business rose 4.0% YOY to SAR 641 Mn in 3Q23 mainly due to continued growth of both bread and single-serve product sales. Revenue from the Dairy and Juice Segment remained flat at SAR 3,145 Mn in 3Q23 mainly due to decline in export sales and adversely impact of Egypt devaluation. Revenue from the Others declined 43.5% YOY to SAR 135 Mn in 3Q23. Cost of sales rose marginally 1.4% YOY to SAR 3,327 Mn in 3Q23 owing to stabilization in the commodity costs and cost optimization efforts by the company. However, gross profit declined marginally 1.3% YOY to SAR 1,469 Mn in 3Q23 owing to higher inventory cover due to delay in realizing benefit of lower commodity cost. Gross profit margin declined 58 bps YOY to 30.6% in 3Q23. Selling and Distribution expenses grew 2.2% YOY to SAR 725 Mn in 3Q23 while G&A expenses declined 0.2% YOY to SAR 96 Mn in 3Q23. EBITDA grew marginally 0.3% YOY to SAR 1,241 Mn in 3Q23.

Stock Information

Market Cap (SAR, mm)	58,000.00
Paid Up Capital (mm)	10,000.00
52 Week High	71.00
52 Week Low	51.50
3M Avg. daily value (SAR)	36,605,830

3Q23 Result Review (SAR, mm)

Total Assets	35,877
Total Liabilities	18,372
Total Equity	17,506
EBITDA	1,241
Net Profit	486

Financial Ratios

Dividend Yield (12m)	1.72
Dividend Pay-out (%)	56.82
Price-Earnings Ratio(x)	27.94
Price-to-Book Ratio (x)	3.32
Book Value (SAR)	17.49
Return-on Equity (%)	12.05

Stock Performance

5 Days	-8.66%
1 Months	-7.64%
3 Months	-13.04%
6 Months	1.93%
1 Year	6.03%
Month to Date (MTD%)	-8.81%
Quarter to Date (QTD%)	-8.81%
Year to Date (YTD%)	8.41%

Almarai's operating profit declined 5.0% YOY to SAR 649 Mn in 3Q23. Finance cost grew 15.8% YOY to SAR 129 Mn in 3Q23 owing to an increase in SAIBOR interest rates offset by the existing fixed debt portfolio. In addition, impairments expenses declined from SAR 6 Mn in 3Q22 to SAR 2 Mn in 3Q23. Zakat expenses stood higher at SAR 16 Mn in 3Q23 compared to 3Q22 due to a one-off benefit recorded in 3Q22. Income tax expense grew from SAR 6 Mn in 3Q22 to SAR 14 Mn in 3Q23.

Balance Sheet Highlights

Almarai's cash flow from operations declined from SAR 2.8 Bn in 9M22 to SAR 2.7 Bn in 9M23 despite rise in profit due to investment in working capital. Capex also grew from SAR 320 Mn in 3Q22 to SAR 680 Mn in 3Q23 primarily due to the Company's long term capex plans. As a result, the Company generated a negative free cash flow of SAR 507 Mn in 3Q23, compared to a positive free cash flow of SAR 931 Mn in 3Q22. Almarai's net debt grew from SAR 9.4 Bn in 2Q23 to SAR 9.9 Bn in 3Q23.

Target Price and Rating

We revise our rating on Almarai from REDUCE to HOLD with an unchanged target price of SAR 61.00. We anticipate Almarai gross margins to improve in the subsequent quarter and the brand loyalty of the Company's product as it managed to increase the price in quick succession. Almarai achieved a growth in profitability in 3Q23 mainly due to a slight uptick in revenue and effective operational and cost management measures. The growth in revenue was driven by strong rise in core markets of KSA and GCC countries partially offset by a decline in Egypt and Jordan. Growth in revenue was impacted by lower commodity exports and EGP devaluation. Almarai is continuously undertaking cost control measures across its segments which is expected to benefit the margins. The Company is also carrying out hedging activities and leveraging inventory stock cover to mitigate commodity price inflation. The risks related to dairy and feed commodities prices started to show signs of stability in from the previous quarter as this is expected to benefit the margin once high-cost inventory phases out. Almarai also maintained a strong balance sheet with cash and cash equivalents and deposits of SAR 2.4 Bn in 3Q23. It also incurred a capex of SAR 680 Mn in 3Q23 in line with its long-term capex plans. Furthermore, in October 2023, the company unveiled its intention to invest SAR 405 Mn in expanding its Fresh Bakery production capacity and entering into the Frozen Bakery sector in Saudi Arabia and other markets, a move that is anticipated to drive revenue going forward. Thus, based on our analysis, we assign a HOLD rating on the stock.

Almarai - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE	29.72	33.01	30.14	38.25	33.98	27.66
PB	4.31	4.08	3.81	3.71	3.59	3.35
EV/EBITDA	16.20	16.86	16.57	18.33	16.23	15.44
Dividend yield	1.4%	1.4%	1.7%	1.7%	1.7%	1.7%

FABS Estimates & Co Data

Almarai – P&L

SAR mm	3Q22	2Q23	3Q23A	3Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Sales	4,769	4,792	4,797	4,870	-1.5%	0.6%	0.1%	18,722	19,946	6.5%
Cost of Sales	-3,280	-3,225	-3,327	-3,307	0.6%	1.4%	3.2%	-13,098	-13,755	5.0%
Gross profit	1,489	1,567	1,469	1,563	-6.0%	-1.3%	-6.2%	5,624	6,191	10.1%
S&D Expenses	-710	-689	-725	-719	0.8%	2.2%	5.2%	-2,710	-2,867	5.8%
G&A expenses	-96	-117	-96	-98	-2.3%	-0.2%	-18.6%	-459	-479	4.4%
EBITDA	1,238	1,328	1,241	957	29.7%	0.3%	-6.5%	4,256	4,638	9.0%
Operating profit	683	761	649	746	-13.0%	-5.0%	-14.7%	2,456	2,846	15.9%
Investment & other income	-100	-39	-1	-8	-82.2%	NM	NM	-153	-75	-50.9%
Financial costs (net)	-111	-136	-129	-127	1.0%	15.8%	-5.8%	-428	-474	10.7%
Impairment	-4	-3	-2	0	NM	-53.8%	-42.2%	-26	-15	NA
Profit before zakat	468	582	517	610	-15.3%	10.4%	-11.2%	1,849	2,282	23.4%
Zakat	13	-23	-16	-28	-44.6%	NM	-32.8%	-63	-82	31.2%
Income Tax	-6	-2	-14	-16	-9.5%	NM	NM	-8	-16	95.0%
Profit before NCI	475	557	487	566	-14.1%	2.5%	-12.6%	1,778	2,184	22.8%
Non-controlling interests	-12	0	1	-6	NM	NM	NM	-18	-22	19.2%
Profit attributable	463	557	486	560	-13.2%	5.0%	-12.7%	1,760	2,162	22.9%

FABS estimate & Co Data

Almarai - Margins

	3Q22	2Q23	3Q23	3Q23F	YOY Ch	QOQ Ch	2022	2023F
Gross Profit	31.2%	32.7%	30.6%	32.1%	-58	-207	30.0%	31.0%
EBITDA	26.0%	27.7%	25.9%	19.7%	-8	-183	22.7%	23.3%
Operating Profit	14.3%	15.9%	13.5%	15.3%	-80	-235	13.1%	14.3%
Net Profit	9.7%	11.6%	10.1%	11.5%	43	-149	9.4%	10.8%

FABS estimate & Co Data

Valuation:

We use Discounted Free Cash Flow (DCF) and Relative Valuation (RV) method to value Almarai. We have assigned 70% weight to DCF, and 30% to RV method.

Valuation Method	Target	Weight	Weighted Value
DCF Method	61.54	70.0%	43.08
Relative Valuation (RV)	59.75	30.0%	17.92
Weighted Average Valuation (SAR)			61.00
Current market price (SAR)			59.80
Upside/Downside (%)			2.01%

1) DCF Method:

Almarai is valued using free cash flow to firm. We have discounted the cash flow using the weighted average cost of capital of 7.7%. It is arrived after using cost of equity of 8.3% and after-tax cost of debt of 4.7% with debt-to-equity ratio of 17.0%. Cost of equity is calculated by using 10-year government bond yield of 5.4%, beta of 0.64 and equity risk premium of 4.5%. Government bond yield is calculated after adding KSA 10-year CDS spread over 10-year US risk free rate. Cost of debt is calculated using cost of debt of 4.7% after adjusting a tax rate of 3.5%. Also, assumed a terminal growth rate of 2.5%.

Sum of PV (SAR, Mn)	13,711
Terminal value (SAR, Mn)	58,206
FV to Common shareholders (SAR, Mn)	61,537
No. of share (Mn)	1,000
Current Market Price (SAR)	59.80
Fair Value per share (SAR)	61.54

DCF Method

(All Figures in SAR Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
Cash Flow from Operations	5,074	5,239	5,519	5,803	6,133
CAPEX	-2,328	-2,350	-2,350	-2,348	-2,055
Free Cash Flow to Equity (FCFE)	2,747	2,890	3,169	3,455	4,079
Discounting Factor	0.98	0.91	0.85	0.79	0.73
Discounted FCFE	2,700	2,636	2,684	2,716	2,975

Source: FAB Securities

2) Relative Valuation:

We have used local as well as international peers to value Almarai and it is valued using the EV/EBITDA multiple. It is valued at EV/EBITDA multiple of 15.1x and valued in line with SADAFCO. We have applied a premium to the median valuation multiple.

Company	Market (USD Mn)	EV/EBITDA (x)		P/E (x)	
		2023F	2024F	2023F	2024F
Savola	5,526	10.8	10.1	22.4	17.6
SADAFCO	2,889	15.5	13.8	21.9	20.0
Agthia	1,108	7.7	7.0	13.0	11.5
Arabian Food Ind	72	3.3	3.0	4.4	4.1
Mezzan Holdings	511	26.3	12.2	NM	45.4
Halwani Brothers	458	14.8	12.7	11.1	17.7
National Agricultural Development Co.	1,169	10.8	9.6	26.3	17.5
Average		12.7x	9.8x	16.5x	19.1x
Median		10.8x	10.1x	17.5x	17.6x
Max		15.2x	12.5x	22.3x	18.9x
Min		9.2x	8.3x	11.6x	14.5x

Source: FAB Securities

Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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