Almarai Company

Food & Agriculture Sector

ALMARAI AB: Saudi Arabia

01 February 2011

الراجحي المالية
Al Rajhi Capital

US$6.16bn	35.8%	US$7.68mn
Market cap	Free float	Avg. daily volume

Target price	118. 7	18.1% over current
Consensus price	118.0	17.4% over current
Current price	100.5	as at 31/1/2011

Research Department
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Underweight | Neutral | **Overweight**

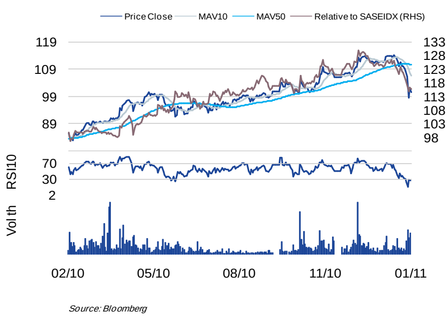
Key themes

We believe that the food industry will continue to grow strongly. Almarai has a very strong position in the GCC dairy market. We believe that Almarai will continue to enter new segments through start-ups or acquisitions to maintain its outstanding growth.

Implications

Almarai is our preferred stock in the agriculture & food sector. Almarai is performing well operationally and offers growth in the near term at a reasonable valuation. We expect high transparency to continue to support Almarai's share price, and think it will find favour with international investors if the Saudi stock market is fully opened up.

Performance

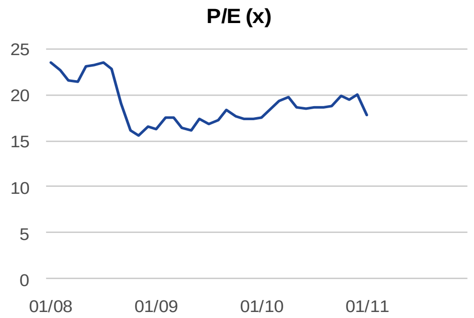


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	6,931	7,993	9,156	10,424
Revenue Growth	18.1%	15.3%	14.5%	13.9%
EBITDA (mn)	2,040	2,333	2,671	3,041
EBITDA Growth	17.8%	14.3%	14.5%	13.9%
EPS	5.59	6.33	7.44	8.54
EPS Growth	17.2%	13.2%	17.5%	14.8%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Almarai
Big picture is more bright

Almarai released Q4 results with strong top-line growth above our forecast, but unsatisfactory net profit. All segments grew strongly, but bakery and juice again showed the highest sales growth. The gross margin of 37.2% was lower than in Q2 and Q3, though it was slightly higher year-on-year. 2011 will be a challenging year for Almarai in terms of margins given rising prices for commodity foodstuffs and packaging. We expect Almarai to raise its product prices slightly which should alleviate margin pressure. Despite the dull Q4 results, we believe Almarai's management is smart enough to continue expanding through entering new segments and markets. Therefore, we remain Overweight and maintain our target price of SAR118, implying 18% upside.

Strong top line supports our stance: Almarai reported year-on-year sales growth of 16.2% from SAR1.55bn in Q4 2009 to SAR1.79bn in Q4 2010, above our forecast of 15.6% sales growth and supporting our positive stance on the company. All segments grew impressively; as we had expected, bakery and juice showed the highest sales growth of 31% and 21% respectively. According to Almarai, sales growth came from higher volumes rather than from higher prices. For 2011, we expect Almarai to achieve strong sales growth of above 15%.

Continuous pressure on margins: Although the gross margin improved from 36.7% in Q4 2009 to 37.2% in Q4 2010, it has contracted considerably from the average of the first three quarters of 40%. In addition to the pre-investment costs associated with the new bakery plant, we believe that increasing food commodities and packaging costs, driven by high oil prices, have squeezed the gross margin. Moreover, SG&A costs have increased as a result of the marketing activities associated with the company's new logo. We expect 2011 to be a challenging year in terms of margins. However, price increases, longer expiration dates for dairy products, and lower fixed and marketing costs ought to alleviate the margin pressure.

Big picture is more important: Despite the fact that the Q4 results were below our expectations at the net level, the full-year results were impressive and we believe that they can be repeated. In addition to improving its bakery and poultry segments, Almarai has great potential to expand by entering new areas: for example, we shall not be surprised to see the company enter new segments of the food market such as bottled water or new countries such as Iraq. Almarai has an impressive record of success after entering new market categories and we believe that it can maintain this. We also like the company's transparency and strong IR operation, which was recently recognised by the Middle East Investor Relations Society as the best such operation in Saudi Arabia. This year will definitely be a challenging year considering rising foodstuff prices, but we have confidence in the company's capability to overcome this pressure.

Conclusion and valuation: Almarai announced strong Q4 revenues but unexciting profits. The company has aggressive expansion plans and an objective of doubling its sales by 2015 and we believe in its ability to attain to this aim. Moreover, we think the company's high transparency and good IR merit a premium and should support the company's stock price if the Saudi market opens up for international investors. Therefore, we remain Overweight and maintain our target price of SAR118. This implies upside potential of 18%. Almarai currently trades on a PE of 16.0x and an EV/EBITDA multiple of 12.5x.

Corporate summary

Almarai is the largest integrated dairy foods company in the world, with a reputation for quality in the Gulf states in which it operates. Almarai began in 1976 under the leadership of HH Prince Sultan bin Mohammed bin Saud Al Kabeer, as it remains to this day. The company is based in Riyadh, the capital of Saudi Arabia. Almarai's network extends throughout the Arabian Peninsula, leading and influencing the agricultural, dairy processing and food distribution industries. Almarai started as a pure dairy company but it has greatly expanded to include cheese, bakery, juice, and poultry.

Share information

Market cap (SAR/US$)	23.11bn / 6.16bn
52-week range	83.00 - 114.3
Daily avg volume (US$)	7.68mn
Shares outstanding	230.0mn
Free float (est)	35.8%

Performance:	1M	3M	12M
Absolute	-10.1%	-7.2%	18.9%
Relative to index	-6.1%	-7.3%	17.2%

Major Shareholder:	
Savola Al-Azizia United Co	29.9%
Al-Saud Sultan Mohamed	28.6%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	6,931	7,993	9,156	10,424
EBITDA (SARmn)	2,040	2,333	2,671	3,041
Net Profit (SARmn)	1,285	1,455	1,710	1,964
EPS (SAR)	5.59	6.33	7.44	8.54
DPS (SAR)	2.00	2.00	2.20	2.42
EPS Growth	17.2%	13.2%	17.5%	14.8%
EV/EBITDA (x)	13.7	12.5	11.1	9.7
P/E (x)	18.0	15.9	13.5	11.8
P/B (x)	3.8	3.2	2.8	2.3
Dividend Yield	2.0%	2.0%	2.2%	2.4%

Source: Company data, Al Rajhi Capital

Almarai: continuous growth
Q4: strong top line, decent profits

High SG&A costs hurt Almarai's Q4 bottom line.

Almarai reported year-on-year sales growth of 16.2% from SAR1.55bn in Q4 2009 to SAR1.79bn in Q4 2010, above our forecast of 15.6%. Although the gross margin improved from 36.7% in Q4 2009 to 37.2% in Q4 2010, it has contracted considerably from the average for the first three quarters of roughly 40%. Operating and net profit were below our forecasts due to higher SG&A costs, which can be mainly attributed to the launch of the new logo and the rebranding of poultry products under the "ALYOUM" brand.

Figure 1. Almarai: 2009Q4A vs. 2010Q4A vs. 2010Q4E & FY2009A vs. FY2010A

(SAR) mn	2009Q4A	2010Q4A	YOY % chg.	2010Q4E	FY2009A	FY2010A	YOY % chg.
Fresh Dairy	704.3	810.4	15.1%	788.8	2,817.6	3,168.7	12.5%
Long Life Dairy	153.9	173.2	12.5%	183.1	562.6	658.9	17.1%
Fruit Juice	155.2	187.8	21.0%	183.2	620.2	745.1	20.1%
Cheese & Butter	286.1	327.0	14.3%	317.5	1,143.0	1,282.4	12.2%
Bakery	170.8	224.3	31.3%	223.7	618.1	821.2	32.9%
Poultry	44.5	48.0	7.9%	53.4	44.5	176.1	295.7%
Arable & Horiculture	28.4	16.0	-43.5%	34.1	28.4	47.7	68.0%
Other	5.0	12.0	138.7%	5.4	34.4	30.7	-10.8%
Total Revenues	**1,548.1**	**1,798.6**	**16.2%**	**1,789.2**	**5,868.8**	**6,930.8**	**18.1%**
Gross Profit	568.6	668.3	17.5%	688.9	2,365.8	2,735.9	15.6%
	36.7%	37.2%		38.5%	40.3%	39.5%	
Operating Profit	**281.4**	**319.2**	**13.4%**	**361.4**	**1,278.9**	**1,459.5**	**14.1%**
Net Income	**248.8**	**283.8**	**14.0%**	**315.0**	**1,096.7**	**1,285.4**	**17.2%**

Source: Company data, Al Rajhi Capital

Variety of growth opportunities
Bakery and poultry are getting better

We expect bakery and poultry segments to achieve the highest sales growth

As we had expected, bakery, poultry, and juice continue to achieve the highest sales growth. The new bakery plant in Riyadh contains new production lines that will produce new bakery products. It should also facilitate distribution to the Eastern and Northern provinces compared to the old plant located in Jeddah, which ought to guarantee better quality and freshness. Therefore, we expect robust sales growth of above 25% in this segment.

Poultry, on the other hand, was unprofitable over 2010 as it was still under development. According to Almarai, it is expanding capacity from 17mn birds p.a. in 2010 to 25mn birds p.a. in 2011 with the objective of reaching 100mn birds p.a. by end of 2012. Moreover, Almarai has already rebranded poultry products under the "ALYOUM" brand. Thus, we expect poultry sales to grow by more than 45% in 2011.

Furthermore, infant formula is under development and expected to be completed by Q2 2011, with the aim of starting commercial production by end of this year. Almarai has smartly decided to import infant food over this year until its plant is complete. In our view, this will allow Almarai to learn about this market, create awareness of the new product range, and develop its distribution channels as these products are mainly sold in pharmacies.

New segments are on the table

Almarai may be considering new food segments such as bottled water

Almarai has a clear goal of increasing its share of the household grocery basket. The company has recently entered new food segments and shown a great record of success in managing such transactions. We believe that Almarai will continue to enter new categories through acquisitions or joint ventures. We suspect that products such as bottled water, fishery products, or chocolate will be on Almarai's shortlist.

Furthermore, we note that Almarai gets some of its milk supplies from other companies such as ALMAZRAA and NADEC. Although it buys at a very low price, it might be worthwhile for Almarai to consider acquiring small dairy companies such as ALMAZRAA and NAJDIYAH. This will not only guarantee milk supply, but also increase Almarai's market share.

Imminent entrance to Iraqi market

We suspect that all large dairy companies have started setting plans to enter Iraq market

In population terms, the Iraqi market is similar in size to that of Saudi Arabia. Currently, Almarai sells some of its products in that country on a very small scale. The company ships small quantities of its products to the borders and Iraqi distributors take care of the whole operation thereafter. We know that the political situation in Iraq has not been settled yet, but there has been progress and we may see further improvement shortly. We think that all large diary companies in the region are already setting up plans to enter the Iraqi market. Therefore, we suspect that Almarai will be one of the first companies to approach the market either through a green-field project or through its IDJ, the JV with Pepsi.

Looking forward: strong results despite challenges

Price increases should mitigate rising costs

The recent increase in prices of virtually all commodity foodstuffs has put huge pressure on all food companies including Almarai. For example, corn, whose price has doubled recently, comprises more than 25% of animal feed. Prices of fruits, the main input for juice, have also sharply increased. Packaging costs have risen significantly due to high oil prices. Therefore, we think it will be difficult for Almarai to maintain last year's gross margin.

We expect price increase on dairy products to take place in Q2 this year

However, we believe that Almarai will resort to its pricing strategy to maintain a gross margin not far below last year's. The company increased its cheese prices four months ago and is planning to increase juice prices. These increases may not involve changing the visible price of the product purchased, but may involve changing package sizes, resulting in a de facto price increase. For example, Almarai may replace a 200ml juice bottle sold for SAR1 with a 180ml bottle sold for the same price.

That said, it will be more difficult to increase the price of commodity products such as milk and laban. Applying price increases in such products takes more time. We expect the price increase in milk and laban to take place in Q2 2011. Considering that Almarai is the largest dairy group in the market, we expect smaller companies immediately to follow Almarai's lead as the margin pressure on these companies will be more severe. Also, extending products expiring period from 7 to 10 days for Laban and 10 to 14 days for yogurt should slightly improve margins due to the expected decrease in waste.

2011: strong top line, reasonable profits

We expect sales and net profit to grow by 15.3% and 13.2% respectively

We expect Almarai's results in 2011 to show a similar pattern to 2010. Regarding the top line, we expect Almarai to achieve 15.3% sales growth driven by all segments, but bakery and poultry should achieve the highest sales growth. Due to increasing cost pressure, we expect the gross margin to be slightly lower than last year's, at 39.0% compared to 39.5%. We believe that Q1 will be the most difficult quarter in terms of margins as we expect price increases to take place in the middle of the year.

Figure 2. Almarai: 2010Q1A vs. 2011Q1E & FY2010A vs. FY2011E

(SAR) mn	2010Q1A	2011Q1E	YOY % chg.	FY2010A	FY2011E	YOY % chg.
Fresh Dairy	677.6	755.5	11.5%	3,168.7	3,525.0	11.2%
Long Life Dairy	170.6	196.2	15.0%	658.9	761.5	15.6%
Fruit Juice	155.3	183.2	18.0%	745.1	872.5	17.1%
Cheese & Butter	330.7	370.4	12.0%	1,282.4	1,426.3	11.2%
Bakery	178.3	224.6	26.0%	821.2	1,028.3	25.2%
Poultry	36.0	57.5	59.9%	176.1	272.7	54.9%
Arable & Horiculture	3.4	5.1	50.1%	47.7	59.4	24.5%
Other (including infant)	7.7	8.1	5.0%	30.7	47.2	53.8%
Total Revenues	**1,559.4**	**1,800.6**	**15.5%**	**6,930.8**	**7,992.8**	**15.3%**
Gross Profit	570.0	648.2	13.7%	2,735.9	3,116.2	13.9%
	36.6%	36.0%		39.5%	39.0%	
Operating Profit	**278.2**	**311.5**	**12.0%**	**1,459.5**	**1,660.9**	**13.8%**
Net Income	**234.1**	**264.8**	**13.1%**	**1,285.4**	**1,455.3**	**13.2%**

Source: Company data, Al Rajhi Capital

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Al Rajhi Capital

We expect revenues to reach SAR7.9bn this year

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**5,869**	**6,931**	**7,993**	**9,156**	**10,424**
Cost of Goods Sold	(3,503)	(4,195)	(4,877)	(5,539)	(6,306)
Gross Profit	**2,366**	**2,736**	**3,116**	**3,617**	**4,117**
Government Charges					
S.G. & A. Costs	(1,087)	(1,276)	(1,455)	(1,666)	(1,897)
Operating EBIT	**1,279**	**1,460**	**1,661**	**1,950**	**2,220**
Cash Operating Costs	(4,136)	(4,891)	(5,660)	(6,485)	(7,383)
EBITDA	1,732	2,040	2,333	2,671	3,041
Depreciation and Amortisation	(454)	(581)	(672)	(721)	(820)
Operating Profit	**1,279**	**1,460**	**1,661**	**1,950**	**2,220**
Net financing income/(costs)	(150)	(127)	(142)	(165)	(171)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
Net Profit Before Taxes	**1,129**	**1,333**	**1,519**	**1,785**	**2,050**
Taxes	(29)	(26)	(37)	(44)	(50)
Minority Interests	(3)	(22)	(26)	(31)	(35)
Net profit available to shareholders	**1,097**	**1,285**	**1,455**	**1,710**	**1,964**
Dividends	(460)	(460)	(460)	(506)	(557)
Transfer to Capital Reserve	-	-	-	-	-

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	230.0	230.0	230.0	230.0	230.0
CFPS (SAR)	6.76	8.21	9.36	10.70	12.26
EPS (SAR)	4.77	5.59	6.33	7.44	8.54
DPS (SAR)	2.000	2.000	2.000	2.200	2.420

Strong revenue growth above 14%

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	16.7%	18.1%	15.3%	14.5%	13.9%
Gross Profit Growth	14.5%	15.6%	13.9%	16.1%	13.9%
EBITDA Growth	19.5%	17.8%	14.3%	14.5%	13.9%
Operating Profit Growth	13.3%	14.1%	13.8%	17.4%	13.9%
Net Profit Growth	12.2%	17.2%	13.2%	17.5%	14.8%
EPS Growth	12.2%	17.2%	13.2%	17.5%	14.8%

We expect gross margin to remain at 39% level

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	40.3%	39.5%	39.0%	39.5%	39.5%
EBITDA margin	29.5%	29.4%	29.2%	29.2%	29.2%
Operating Margin	21.8%	21.1%	20.8%	21.3%	21.3%
Pretax profit margin	19.2%	19.2%	19.0%	19.5%	19.7%
Net profit margin	18.7%	18.5%	18.2%	18.7%	18.8%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	13.6%	13.9%	13.1%	13.0%	13.5%
ROIC	17.1%	14.6%	14.7%	14.4%	14.0%
ROE	24.4%	22.3%	21.9%	22.1%	21.6%
Effective Tax Rate	2.6%	2.0%	2.5%	2.5%	2.5%
Capex/Sales	20.9%	30.4%	28.9%	25.0%	20.0%
Dividend Payout Ratio	41.9%	35.8%	31.6%	29.6%	28.3%

High multiples are justified by the company's strong growth

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	21.1	18.0	15.9	13.5	11.8
P/CF (x)	14.9	12.2	10.7	9.4	8.2
P/B (x)	4.3	3.8	3.2	2.8	2.3
EV/Sales (x)	4.6	4.0	3.6	3.2	2.8
EV/EBITDA (x)	15.6	13.7	12.5	11.1	9.7
EV/EBIT (x)	21.2	19.1	17.5	15.2	13.4
EV/IC (x)	2.8	2.5	2.2	1.9	1.7
Dividend Yield	2.0%	2.0%	2.0%	2.2%	2.4%

Source: Company data, Al Rajhi Capital

Expanding balance sheet reflecting aggressive expansion

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	508	241	300	793	832
Current Receivables	455	620	750	922	1,049
Inventories	1,219	1,299	1,488	1,648	1,876
Other current assets	-	7	7	7	7
Total Current Assets	**2,182**	**2,160**	**2,538**	**3,364**	**3,757**
Fixed Assets	7,049	8,636	10,277	11,846	13,110
Investments	963	958	958	958	958
Goodwill	793	793	793	793	793
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	24	24	24	24
Total Non-current Assets	**8,805**	**10,411**	**12,052**	**13,620**	**14,885**
Total Assets	**10,987**	**12,571**	**14,590**	**16,984**	**18,642**
Short Term Debt	396	546	546	546	546
Accounts Payable	963	1,253	1,074	1,190	1,355
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	82	79	79	79	79
Total Current Liabilities	**1,440**	**1,878**	**1,700**	**1,815**	**1,980**
Long-Term Debt	3,981	4,301	5,478	6,475	6,475
Other LT Payables	-	-	-	-	-
Provisions	166	206	206	206	206
Total Non-current Liabilities	**4,147**	**4,507**	**5,684**	**6,681**	**6,681**
Minority interests	17	52	78	109	144
Paid-up share capital	1,150	2,300	2,300	2,300	2,300
Total Reserves	4,233	3,834	4,829	6,079	7,537
Total Shareholders' Equity	**5,383**	**6,134**	**7,129**	**8,379**	**9,837**
Total Equity	**5,400**	**6,185**	**7,207**	**8,488**	**9,981**
Total Liabilities & Shareholders' Equity	**10,987**	**12,571**	**14,590**	**16,984**	**18,642**

Reasonable gearing level

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	3,869	4,600	5,717	6,221	6,182
Net Debt/EBITDA (x)	2.23	2.25	2.45	2.33	2.03
Net Debt to Equity	71.7%	74.4%	79.3%	73.3%	61.9%
EBITDA Interest Cover (x)	11.6	16.1	16.4	16.1	17.8
BVPS (SAR)	23.40	26.67	31.00	36.43	42.77

Almarai enjoys strong cash flows

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	**1,129**	**1,333**	**1,519**	**1,785**	**2,050**
Depreciation & Amortisation	454	581	672	721	820
Decrease in Working Capital	163	(29)	(497)	(216)	(190)
Other Operating Cashflow	37	38	(37)	(44)	(50)
Cashflow from Operations	**1,783**	**1,923**	**1,656**	**2,245**	**2,629**
Capital Expenditure	(1,227)	(2,104)	(2,313)	(2,289)	(2,085)
New Investments	(484)	-	-	-	-
Others	-	(84)	-	-	-
Cashflow from investing activities	**(1,711)**	**(2,189)**	**(2,313)**	**(2,289)**	**(2,085)**
Net Operating Cashflow	**72**	**(265)**	**(657)**	**(44)**	**545**
Dividends paid to ordinary shareholders	(381)	(911)	(460)	(460)	(506)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	9	(98)	-	-	-
Cashflow from financing activities	**170**	**(539)**	**716**	**537**	**(506)**
Total cash generated	242	(805)	59	493	39
Cash at beginning of period	247	508	241	300	793
Implied cash at end of year	**489**	**(297)**	**300**	**793**	**832**

We expect Capex to remain high as we expect more expansions

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	20.9%	30.4%	28.9%	25.0%	20.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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