Almarai Co.

Consumer Staples | Almarai | 2280

INTELLIGENT INVESTMENT IDEAS

3Q 2018 Results Update

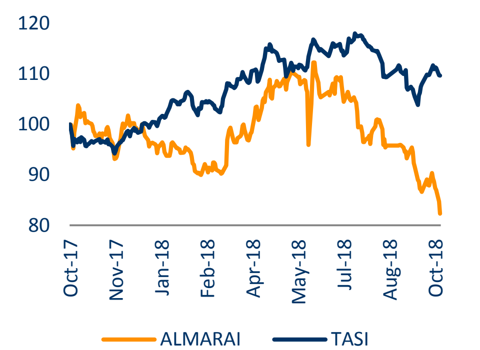
October 10, 2018

Recommendation	**Neutral**
Previous Recommendation	Neutral
Current Price (SAR)	45.8
Target Price (SAR)	46.8
Upside/Downside (%)	2.1%

As of October 09th, 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	45.3
52 Wk High (SAR)	62.8
52 Wk Low (SAR)	44.7
Total Outstanding shares (in mn)	989
Free Float (%)	22.0%

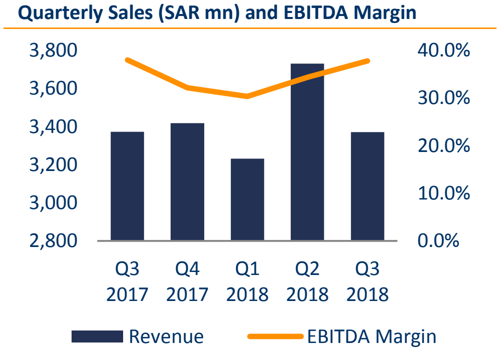
ALMARAI vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(12.3%)	(14.9%)
6m	(19.1%)	(18.1%)
12m	(17.7%)	(27.4%)

Major Shareholders (%)	
Savola Group Company	34.52%
Prince Sultan M.S. Al Saud	23.69%
Public Investment Fund	16.32%

Quarterly Sales (SAR mn) and EBITDA Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 09th October 2018

Almarai's bottom line drops due to higher costs and market contraction

Almarai reported a 4.9% YoY drop in 3Q18 net profits slightly ahead of consensus driven by higher cost of sales and broad contraction in the market. Net profits declined 4.0% QoQ primarily due to full seasonal impact of Ramadan month during 2Q18. Despite continuous contraction in the consumer market, Almarai remained resilient in 3Q18, primarily due to robust performance in Poultry segment, while Dairy and Juice segment was utmost impacted by slowdown. The company implemented select price increase (3%-6%) for the first time in 10 years in dairy segment to offset the impact of rising operating costs. The price rise partially offsets the decline in volumes, which impacted the overall profitability in this segment.

The management indicated its plan to focus on organic growth in a challenging market environment as an alternative to inorganic growth through any potential acquisitions. In-line with our expectations, Almarai continued its strong growth in Egypt maintaining its dominant position in Juice. The company is also on track to save SAR200mn in 2018 under its cost optimization program, which would boost its bottom line. Considering the loss of business in Qatar, economic uncertainty, and loss of consumer spending power due to subsidy removal, we maintain a low single-digit growth outlook for the company.

- Almarai's sales dropped 0.1% YoY to SAR 3,371mn driven by general market contraction and change in product and channel mix. Revenue from dairy segment declined -5% YoY, while sales from poultry segment expanded +39% YoY. Sequentially, the revenue dropped -9.7% QoQ, due to decline in export sales, change in demographics and increase in product promotions.
- Gross profit declined -4.2% YoY to SAR 1,452mn due to a 3.3% YoY increase in the cost of sales resulting from higher alfalfa cost, increased promotions, and an increase in labour costs partially offset by improved cost management, stable input costs and enhanced production efficiencies.
- Operating income declined -2.6% YoY to SAR 755mn (Q3 2017: SAR 776mn). Subsequently, the operating margin dropped 59bps YoY to 22% in Q3 2018. Better efficiencies in route to market, trade operations, back office functions was offset by higher labour costs and other expenses.
- Almarai's net profit declined -5.4% YoY to SAR 615mn, driven by aforesaid reasons. Also, exchange loss was higher by SAR3.8mn in the quarter due to adverse movement in currencies. Dairy and Juice segment net profits declined by 14.5% YoY, followed by Bakery segment (-13.8%), while Poultry segment reported a net profit of SAR51mn versus a loss of SAR7mn last year.
- In Sep'2018, UK-registered unit of Saudi Agricultural and Livestock Investment Company (SALIC) bought Ukrainian agroholding Mriya. Mriya will be incorporated with 'Continental Farmers Group (CFG)', which is owned by a consortium of three KSA entities including Almarai. We believe the deal may not be able to show-up immediate synergies as CFG plans to invest heavily in technology, infrastructure and consolidation of farmland over the next two years. Besides, Myria recently restructured its USD1.1bn debt in August 2018, while in 2014 the company was saved from bankruptcy by foreign creditors.
- Almarai fully redeemed SAR 1.7bn worth of senior Sukuk on 30th Sep'2018. Besides, the company plans to reduce its funding costs through refinancing existing debt facilities and issuing a new Sukuk towards the end of 2018. We anticipate lower finance charges to support the bottom line from 2019 onwards.

Valuation: We revised our target price downwards to SAR 46.8 per share on the back of subdued results amid constant market decline. We have maintained our "Neutral" rating for the stock.

	3Q'18	**3Q'17**	**% YoY**	**FY18E**	**FY17**	**% YoY**
Revenues (SAR mn)	3,370.8	3,372.9	-0.1%	13,997.0	13,935.5	0.4%
Gross Profit (SAR mn)	1,452.2	1,516.0	-4.2%	5,668.3	5,583.6	1.5%
EBITDA (SAR mn)	1,275.7	1,281.1	-0.4%	4,575.9	4,503.0	1.6%
Net Profit (SAR mn)	614.8	649.8	-5.4%	2,293.5	2,147.8	6.8%
EPS basic (SAR)	0.62	0.66	-5.2%	2.31	2.17	6.8%
Gross Margin (%)	43.1%	44.9%	-1.9%	40.5%	40.1%	0.4%
EBITDA Margin (%)	37.8%	38.0%	-0.1%	32.7%	32.3%	0.4%
Net Profit Margin (%)	19.0%	19.7%	-0.7%	16.9%	15.5%	1.4%

Source: Company Financials, FALCOM Research

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by ≥ 10%.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by ≥ 10%.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company`s performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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