JULY 2023

FIRST MILLS

INITIATING COVERAGE

SNB Capital

An essential ingredient, and more!

We initiate coverage on First Mills with a Neutral rating and a PT of SAR97.0. First Mills is the leading manufacturer of flour, animal feed and other wheat derivative products in Saudi and the largest player in the flour market with an estimated value market share of 29.3% in 2022. The Saudi flour market is unique, stable and defensive in nature with the General Food Security Authority (GFSA) being the main supplier to a limited number of producers. The flour market is expected to grow steadily with a 2022-2026f CAGR of 3.5%, led by the bakery (5.5%) and pasta (5.7%) segments. We expect First Mills' net income to record a 2022-2027f CAGR of 7.4% to reach SAR311mn by 2027f driven by expansions, new products, and operational efficiencies. The stock is trading at 2023f P/E and EV/EBITDA of 26.6x and 20.5x vs the peers average of 20.2x and 12.7x, respectively.

- **The flour market - A unique market with a steady growth**
  The Saudi flour market is unique, stable and defensive in nature with the GFSA being the main supplier to a limited number of producers. To meet local demand, GFSA supplied and distributed 3.5mn tons of wheat to milling companies to produce c2.6mn tons of flour and other related products in 2021, reflecting a 2018-2021 CAGR of 0.9%. Going forward, the flour market is expected to grow steadily with a 2022-2026f CAGR of 3.5%, led by the bakery and pasta segments. The bakery segment is expected to record a 2022-2026f CAGR of 5.5% while the pasta and noodle segment is expected to grow by a CAGR of 5.7%. Additionally, new segments are expected to be introduced such as Semolina which is estimated to record a strong growth of 6.7%.
- **First Mills - A key player with a dominant market share**
  Founded and headquartered in Jeddah, First Mills is the leading manufacturer of flour, animal feed and other wheat derivative products in Saudi and it is the largest player in the flour market with an estimated value market share of 29.3% in 2022. The company sells more than 48 flour products to a wide range of customers both B2B and retail across Saudi through its four production facilities in Jeddah, Qassim, Tabuk and Al-Ahsa. The company has also presence in other regions through sales and distribution warehouses. The company's facilities have a total flour milling capacity of c1.35mn tons/annum and feed mixing capacity of c0.29mn tons/annum. Additionally, it plans to expand its Jeddah facility by 650 tons/day during 2023f-2025f, introduce new products (Pesa & Mixes) and develop new facilities to produce Semolina by the end of Q4 23f.
- **Net income to record a CAGR of 7.4% during 2022-2027f**
  We expect revenues to grow by 4.5% yoy to SAR955mn in 2023f, driven by higher utilization of wheat mills which will offset the impact of lower prices of feed and bran and we expect net income to remain largely flat in 2023f. Going forward, we expect First Mills to deliver a 5-year revenues CAGR of 5.5% to reach SAR1.19bn by 2027f. Subsequently, we expect profitability to record a 2022-2027f CAGR of 7.4% to reach SAR311mn by 2027f driven by new capacities, higher utilization rates and the introduction of new products. We expect net margins to expand from 23.8% in 2022 to 26.1% in 2027f.
- **Initiating coverage with Neutral rating and a PT of SAR97.0**
  We initiate coverage on First Mills with a Neutral rating and a PT of SAR97.0. We believe the defensive market dynamics, the company's large market share, expansion plans and operational efficiencies are the key positives, while the sector's sensitivity to the potential subsidy removal is the main concern. The stock is currently trading at 2023f P/E and EV/EBITDA of 26.6x and 20.5x vs the peers average of 20.2x and 12.7x, respectively.

Summary Financials

SAR mn	2022	2023f	2024f	2025f	2026f	2027f
Revenues	914	955	1,100	1,143	1,168	1,193
Gross profit	398	411	479	511	525	534
Gross margin (%)	*43.6*	*43.0*	*43.6*	*44.7*	*45.0*	*44.8*
EBIT	256	280	326	353	362	367
EBIT margin (%)	*28.0*	*29.3*	*29.6*	*30.8*	*31.0*	*30.8*
EBITDA	307	337	388	416	426	432
EBITDA margin (%)	*33.6*	*35.2*	*35.2*	*36.3*	*36.5*	*36.2*
Net Income	217	213	261	291	303	311
Net Income margin (%)	*23.8*	*22.3*	*23.7*	*25.4*	*26.0*	*26.1*
EPS	3.9	3.8	4.7	5.2	5.5	5.6

Source: The company, SNB Capital Research estimates

NEUTRAL

Price target (SAR)	97.0
Current price (SAR)	102.0
Upside/Downside (%)	(4.9)

VALUATION MULTIPLES

	22	23f	24f
P/E (x)	26.0	26.6	21.7
P/B (x)	7.5	6.8	6.0
EV/EBITDA (x)	22.5	20.5	17.8
Div Yield (%)	2.5	2.5	2.5

Source: SNB Capital Research estimates

MAJOR SHAREHOLDERS

Investor	% Ownership
AlMutlaq Industrial Investment Group	30%
Abdulla Abu Nayan Trading Co.	21%
Al Safi Advanced Investment Co.	12%
Foreign Ownership	1.31%

Source: Saudi Exchange, SNB Capital. As of 17 July 2023

STOCK DETAILS

M52-week range H/L (SAR)	104/64
Market cap ($mn)	1,510
Shares outstanding (mn)	55.5
Listed on exchanges	Saudi Exchange

Price perform (%)	Since IPO
Absolute	44.7
Rel. to market	41.9

Avg daily turnover (mn)	SAR	US$
Since IPO	390.7	104.2

Reuters code	2283.SE
Bloomberg code	FIRSTMIL.AB
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Investment Thesis

A unique market with a steady growth

The Saudi flour market is unique, stable and defensive in nature with one main supplier (GFSA) and a limited number of producers. To meet local demand, GFSA supplied and distributed 3.5mn tons of wheat to milling companies to produce c2.6mn tons of flour and other related products in 2021, reflecting a 2018-2021 CAGR of 0.9%. This consists of c3.1mn of imported wheat and c0.4mn tons of local production. Apart from that, Saudi imported c63,000 tons of flour which represents only c2.4% of local demand. Wheat flour/capita in Saudi is expected to increase from 45.7kg in 2021 to 51.7kg in 2026f (CAGR of 2.1%). The flour market is expected to record a 2022-2026f CAGR of 3.5% to reach c3.19mn tons driven by the bakery segment while the animal feed and bran market is expected to grow by a 2022-2026f CAGR of 2.2% due to growth in local meat production.

Bakery to drive growth

Flour is used in producing different product categories including 1) bakery, 2) pasta and noodle and 3) Semolina. The bakery segment is expected to lead the growth for flour demand in Saudi, recording a 2022-2026f CAGR of 5.5% to SAR52.3bn driven mainly by 1) higher income per capita, 2) expansion of modern trade channels, 3) increased prevalence of western style foodservice outlets which is expected to record a 2022-2026f CAGR of 12.2%. The pasta and noodle segment is also expected to record a strong CAGR of 5.7% in 2022-2026f to reach SAR5.4bn. Additionally, the new Semolina market is expected to record a 2022-2026f CAGR of 6.7% to reach SAR206.4mn with volumes reaching 79,600 tons (2022-2026f CAGR of 3.7%).

The beginning

Privatization is one of the key initiatives introduced by Vision 2030, which covers a wide range of sectors, including healthcare, education, food and aviation. Saudi has four milling companies which were established in 2017 with GFSA conducting the migration and legal framework as it allocated the 13 milling facilities to the companies. In 2020, the First Milling Company and Third Milling Company privatization was completed with the First Milling Company awarded to Raha AlSafi Consortium and the Third Milling Company awarded to Alrajhi, Ghurair and Masafi Consortium. The second phase was completed in 2021 with the Second Milling Company awarded to Alajlan, NADEC and Olam Consortium while Allana, Al Othaim and United Feed Consortium were awarded the Fourth Milling Company. First Mills was the first to be listed in the Saudi market with the remaining 3 expected to be listed in the coming period. Following to the privatization, we note that GFSA will not issue any new license to milling companies to operate in the market for 10 years.

A competitive landscape

The flour market in Saudi is dominated by four players located across the country. The companies had a combined flour market share of 88.4% in 2021, while the remaining 11.6% is imports. These companies provide most of the flour supplied to bakeries and manufacturing sector, while imported flour is mainly supplied to retail and HORECA channel. On the other hand, the animal feed market is considered highly competitive and fragmented with a large number of market players, led by ARASCO. The combined animal feed market share of milling companies was 33.3% in 2021, while 22.3% was held by ARASCO.

Fixed pricing and potential subsidy removal

Wheat is distributed to milling companies by GFSA based on specific agreed upon quantities at a fixed subsidized price of SAR180/ton. In return, flour is sold by milling companies at a fixed price of SAR500/ton to entities that are registered with the GFSA. This results in a spread of SAR320/ton. Fixed prices are implemented on bulk and 45kg flour (70%, 80% and 95% flour extraction) while 1kg-10kg products pricing is not subject to any pricing regulations. A key point to highlight is that the fixed subsidy regime is expected to expire by July 2025f with no clarity whether the subsidy will be completely removed, amended or maintained. In case the subsidy is removed, we believe flour selling prices will be adjusted upward to maintain the spread broadly stable. We also expect demand to remain unchanged as flour is a main ingredient in most staple food items. Despite that, we believe the removal of the subsidy is a major risk factor for the sector.

By-products, attractive market dynamics

Producing by-products is one of the key advantages of Saudi milling companies due to limited additional costs. Although flour pricing is generally fixed, prices of by-products are determined by global wheat prices and supply-demand factors which we believe is a key positive. Feed prices increased to SAR903/ton in 2021 from SAR782/ton in 2020 and compared SAR638/ton in 2019. We believe the sharp increase is due to higher global wheat prices which grew by c20% yoy in 2021. Bran prices followed a similar trend as it increased from SAR712/ton in 2020 to SAR970/ton in 2021 before reaching SAR995/ton in 2022. This is significantly higher than SAR708/ton in 2018. We believe variable pricing for by-products is a key earnings driver for milling companies going forward.

First Mills – A key player with a dominant market share

Founded and headquartered in Jeddah, First Mills is the leading manufacturer of flour, animal feed and other wheat derivatives products in Saudi. It is the largest player in the flour market with an estimated market share of 29.3% in 2022 (in terms of value). The company sells more than 48 flour products to a wide range of customers both B2B and retail across Saudi through its four production facilities in Jeddah, Qassim, Tabuk and Al-Ahsa. The company also has presence in other regions through sales and distribution warehouses. The company's production facilities have a total flour milling capacity of 4,200 tons/day (c1.35mn tons/annum) and feed mixing capacity of 900 tons/day (c0.29mn tons/annum). Operating rates are expected to improve from 88% in 2021 to reach 95%-97% in the medium term driven by the ongoing operational efficiency measures.

The future: new products and additional capacities

First Mills growth plans concentrate on strengthening its local presence and increase its customer base. It is also focusing on building exporting capabilities, targeting the MENA region. The company plans to expand its Jeddah facility by 650 tons/day (c0.21mn tons annually, c13% of total capacity) during 2023f-2025f. Mill C will add 250 tons/day in 2023f, Mill A will add 250 tons/day in 2024f and Mill B will add 150 tons/day in 2025f. The company is also planning to develop new facilities to produce Semolina (used in pasta and noodles), which is expected to be launched by end of Q4 23f with a total capacity of c0.096mn tons. This product will use imported wheat and will be sold at market prices to main manufacturing companies. Additionally, First Mills is planning to introduce new products such as Pesa and Mixes in 2023f.

Revenues to record a CAGR of 5.5% during 2022-2027f

We expect revenues to increase by 4.5% yoy to SAR955mn in 2023f, driven by higher utilization of wheat mills which will offset the impact of lower realized prices of feed and bran. The company is also introducing Mixes and Pesa which are expected to cumulatively contribute c2.5% to the company's topline in 2023f. Going forward, we expect the company to deliver a 5-year revenues CAGR of 5.5% to reach SAR1.19bn by 2027f. We expect flour to remain the main contributor to topline, but its contribution is expected to gradually decline to 54% by 2027f, while we expect Semolina to contribute 6% of revenues in 2024f and to reach 8% by 2027f. For Mixes and Pesa, we expect their contribution to increase to 3.0% in 2027f to SAR35.6mn.

Historically stable gross margins

Over the last 4 years (2019-22), First Mills gross margins improved from 31.5% in 2019 to 43.6% in 2022 due to a combination of 1) higher utilization rates, 2) better realized prices of feed and bran and 3) cost efficiencies. In absolute terms, gross profit increased from SAR203mn in 2019 to SAR398mn. During the same period, operating margins increased from 20.9% to 28.0% and EBITDA margins increased from 26.4% to 33.6%. Going forward, we expect gross margins to marginally decline to 43.0% in 2023f, as feed and bran prices normalize. Subsequently, we expect margins to improve to 43.6% in 2024f and to reach 44.8% in 2027f on higher utilization rates and the impact of higher contribution of Mixes and Pesa. We highlight that the introduction of Semolina would partially mitigate margin expansion. In absolute terms, margins on Semolina are higher, but in % terms its low due to higher cost. We expect EBITDA margins to improve and stabilize at c36% by 2027f. We estimate EBITDA to grow at a CAGR of 7.1% during 2022-2027f to reach SAR432mn.

Net income to record a CAGR of 7.4% during 2022-2027f

In 2022, First Mills recorded a net income growth of 9.6% yoy to SAR217mn driven by higher topline and better margins. The impact was partially offset by higher interest rate expense as the loan was transferred to the company after the merger transaction. Going forward, we expect net income to remain largely flat in 2023f. Overall, we expect profitability to record a 2022-2027f CAGR of 7.4% to reach SAR311mn by 2027f. Accordingly, we expect net margins to expand from 23.8% in 2022 to 26.1% in 2027f.

Strong working capital management supports cash flow

First Mills cash cycle is largely a function of inventory and account payable. It is worth highlighting that more than 95% the company's sales were in cash during 2019-22. Given the nature of the business, inventory and account payable are subject to fluctuations in global commodity prices (particularly corn and soybean). First Mills cash cycle has considerably improved over the last 4 years, from 90 days in 2019 to 7 days in 2022. This is largely due to corn prices which inflated account payable days. Trade receivable days have remained in the range of 9 to 20 days. Accordingly, we have kept it between 15 to 16 days going forward. Trade payable days averaged at 57 days between 2019-22. We forecast trade payable days to increase slightly to 62 days over our forecast horizon as new products are introduced.

Deleverage and stable dividends pay-out

Going forward, we believe that the company's robust cash generation will enable it to repay its debt and maintain a healthy dividend payout. As capex requirement is generally moderate, we expect the company to generate an operating cash flow of SAR1.77bn over the next five years (2023f-27f), which is sufficient to meet its capital commitments. We expect the company to generate a FCFF of SAR245mn in 2023f and to grow to SAR391mn by 2027f. For debt, we expect net debt (excluding lease liabilities) to decline from SAR1.17bn in 2022 to SAR1.10bn in 2023f and to reach SAR843mn by 2027f. We believe leverage ratios would remain healthy due to the strong cash generation. We expect Net debt/EBITDA to decrease from 3.1x in 2022 to 2.7x in 2023f and further decline to 0.9x in 2027f. Given a strong cash conversion, we expect the company to maintain a dividend pay-out of at least 60%. Accordingly, we expect the dividend yield to increase from 2.5% in 2023f to 3.1% in 2027f.

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