

SADAFCO

Target Price: SAR 385.00
Upside/ (Downside): 15.6%

Recommendation

Accumulate

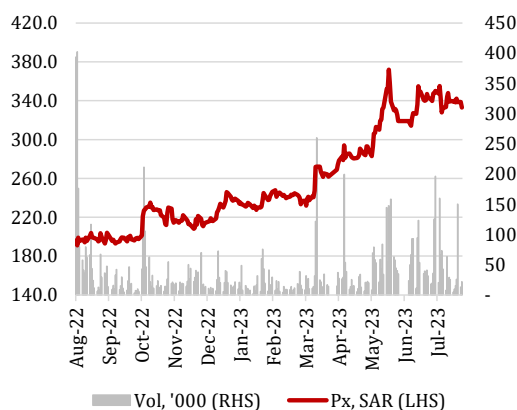
Bloomberg Ticker	SADAFCO AB
Current Market Price (SAR)	333.00
52wk High / Low (SAR)	378.200/163.800
12m Average Vol. (000)	38.6
Mkt. Cap. (USD/SAR Mn)	2,885/10,823
Shares Outstanding (mn)	32.5
Free Float (%)	60%
3m Avg Daily Turnover (SAR '000)	18,928.6
6m Avg Daily Turnover (SAR '000)	13,300.1
P/E'24e (x)	23.0
EV/EBITDA'24e (x)	16.1
Dividend Yield '24e (%)	2.1%

Price Performance:

1 month (%)	(3.0)
3 month (%)	17.0
12 month (%)	86.9

Source: Bloomberg, valued as of 21 Aug 2023

Price-Volume Performance



Source: Bloomberg

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- **SADAFCO registered solid earnings expansion over the past fiscal year, driven by healthy sales growth and margin expansion despite inflationary pressures.**
- **Consistent market share gains across product categories in the domestic market indicate strong brand loyalty, which bodes well for future growth as SADAFCO continues to generate over 80% of its top line from the Kingdom.**
- **Softening sales of the Polish subsidiary with normalization in commodity prices has been offset by strong sales growth in the GCC and other regions.**
- **The stock has climbed ~59% since our last 'Accumulate' rating.**

We review our coverage of SADAFCO and raise our target price to SAR 385.00 (previously, SAR 252.00), indicating an upside of 15.6% at the current market price. Hence, we assign an **Accumulate** rating on the stock. Backed by solid earnings expansion, the stock has surged 56% (+54% since Dec'22-end) since we rated it Accumulate on 21st Dec. 2022 with an upside of 18%. Currently, the stock trades at FY'23e P/E of 23.5x and EV/EBITDA of 16.5x, in line with its blended forward 3-year average daily P/E of 23.4x but slightly below the 3-year average blended forward daily EV/EBITDA of 17.1x.

Investment Thesis

Earnings are expected to remain on a strong growth trajectory

i) SADAFCO is focusing on continuing to exploit all the sales channels, especially e-commerce, out-of-home, and wholesale, which, coupled with a consistent launch of new SKUs, promotional activities, and entering a new geography Oman, should aid the company in further expanding its market shares. Accordingly, we have revised our FY'23-27 sales growth forecast to 7% CAGR from 2% CAGR, previously.

ii) Cost optimization initiatives, prudent inventory sourcing, and a focus on enhancing efficiencies of the production process are expected to boost margins, propelling operating, and net income at a relatively higher pace than revenue, clocking an estimated 13% and 19% CAGR, respectively, during FY'23-FY'27.

iii) The company has no debts and with strong earnings growth expected, we expect SADAFCO to fulfill business funding needs through internal cash generation.

iv) Dividend payout per share has been maintained over the past three years. However, we expect SADAFCO to raise dividends going forward, aided by solid cash flow generation amid sharp net income growth.

	FY21	FY22	FY23	FY24e	FY25e	FY26e
Revenues (SAR bn)	2.1	2.2	2.6	2.9	3.1	3.3
Net income (SAR bn)	0.3	0.2	0.3	0.5	0.5	0.6
Gross margin	33.0%	30.3%	31.1%	35.4%	35.4%	35.8%
Net profit margin	12.4%	9.6%	11.7%	15.9%	16.8%	17.5%
RoE	17.4%	13.5%	19.3%	26.2%	25.8%	24.7%
FCF (SAR/share)	8.3	3.4	8.7	15.8	15.2	16.9
DPS (SAR/share)	6.0	6.0	6.0	7.0	7.0	8.0
Dividend Yield	3.6%	3.5%	2.5%	2.1%	2.1%	2.4%
P/E (x)	20.3x	26.6x	24.6x	23.0x	20.3x	18.4x
EV/EBITDA (x)	12.2x	14.9x	15.3x	16.1x	14.0x	12.6x

Source: Company Reports, U Capital Research *Dividend Yield, EV/EBITDA, and EV/Sales from FY24 onwards calculated on current price

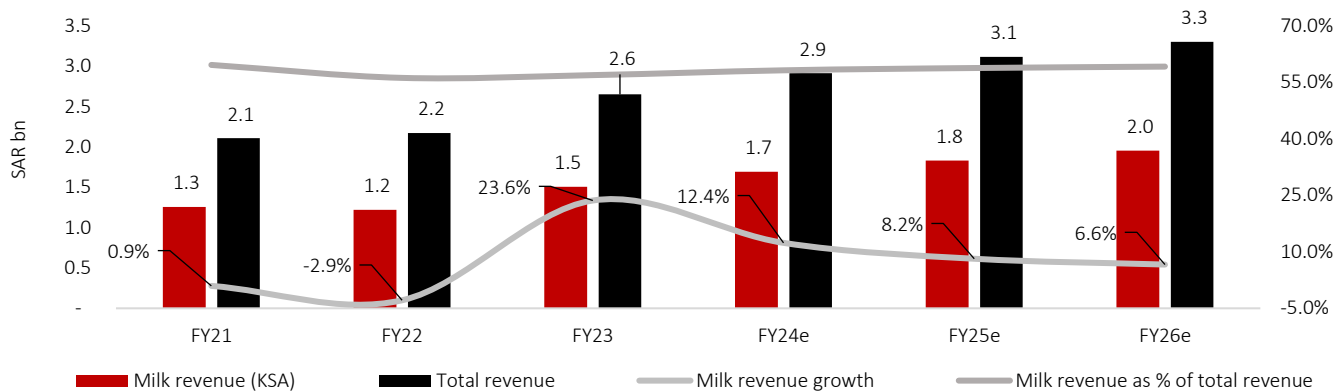
Investment thesis

Consistent market share gain with a sticky customer base bodes well for the top line to maintain its positive trend

Spearheaded by the restructuring of organizational structures at its manufacturing plants, the launch of a new ice-cream factory during Mar'22, and the introduction of new SKUs, among others, SADAFCO turnaround its operations during FY'22-23. Consequently, it registered solid growth across its product categories and geographies in FY'22-23 amid competitive and inflationary pressures and has maintained this momentum entering the new fiscal year.

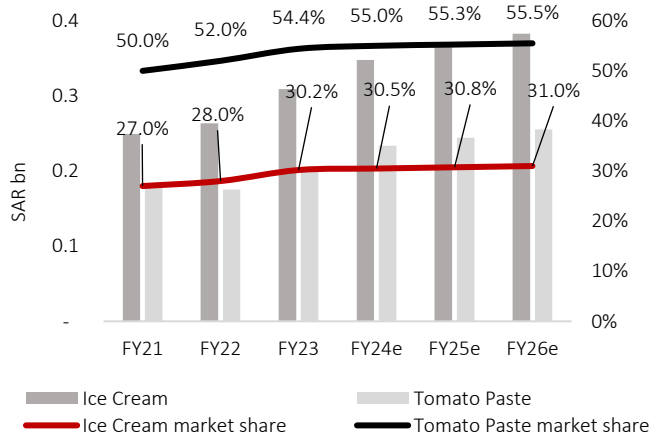
The robust revenue growth achieved by SADAFCO has been driven both by volume and price increases, which indicates strong consumer loyalty associated with the company. The company has undertaken a rebranding exercise of its Saudia brand recently in May'23, especially in the milk & dairy segment, which has been accompanied by the launch of new product varieties. SADAFCO also continues to consistently introduce new and innovative products as per the changing market requirements and preferences, like new ice-cream flavors. The company also intends to expand its product market reach by focusing more on wholesale, e-commerce, and out-of-home sales channels. With these steps, we are hopeful the company's market share will continue to tick higher going forward in the domestic market. Accordingly, we have revised our FY24 revenue growth estimate from the domestic market to slightly over 11% YoY from about 5% YoY previously, which will continue to provide the company with over 80% of its total revenue.

Fig. 1: Milk revenue from KSA to contribute between 55% and 60% of the total group revenue



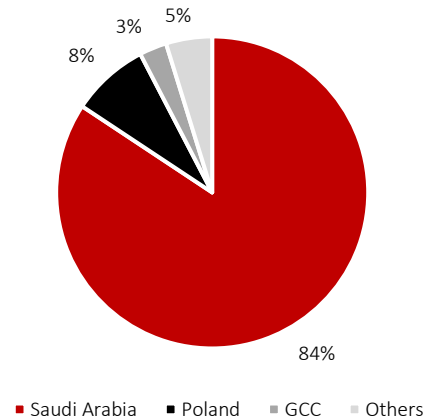
Source: Company Reports, U Capital Research

Fig. 2: Both ice cream and tomato paste gain market share



Source: Company Reports, U Capital Research data

Fig. 3: Despite diversification efforts, KSA provides bulk of the revenue



Source: Company Reports, U Capital Research; *based on FY 2022 data

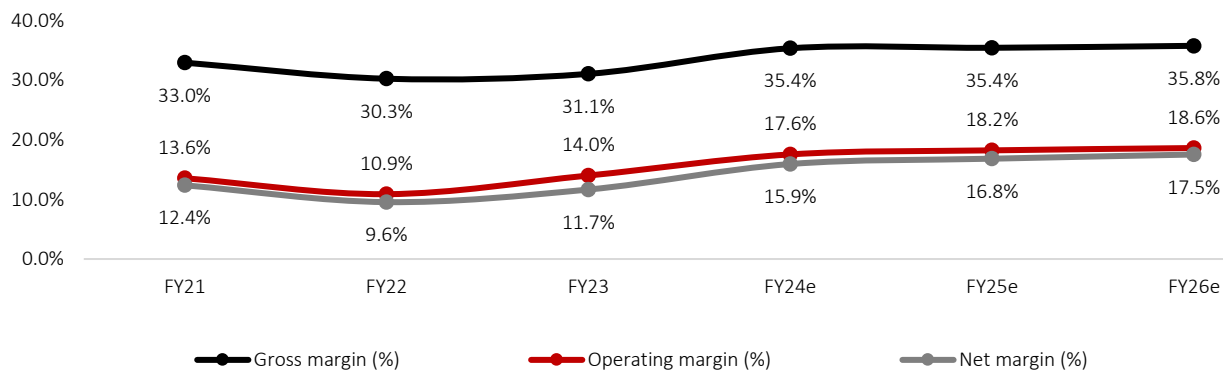
We have also raised our revenue growth estimate from the GCC and other region for FY24e to 30% YoY and 22% YoY (previously +9% YoY and +10% YoY), respectively, given the company's geographical expansion efforts, as part of which it signed a sales and exports deal of its products in Oman in Jun'23. However, owing to the normalization of commodity prices, we now expect Mlekoma to post a YoY dip in overall revenue during FY'23-24, in contrast to our earlier expectation of growth. Nevertheless, driven by the domestic and other GCC markets, our overall FY'24 top-line growth estimate now stands at c. 10% vs. between 5.5% and 6.0%, previously.

Further profitability improvement remains on the cards with cost rationalization remaining a priority

SADAFCO has not only focused on revenue growth but also worked on profitability improvement, as the company's strong growth over the past 4-5 quarters has been accompanied by margin expansion. Steps undertaken by the company like diversification of raw material supply, economical inventory sourcing, automation, and improvement of some processes in the Jeddah milk factory and Dammam factory, have supported the company in achieving profitability expansion.

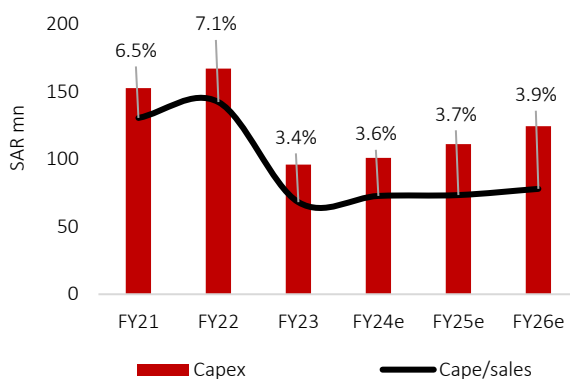
As part of its broader cost control and operational efficiency enhancement drive, SADAFCO aims to add another packaging supplier during the current fiscal year to further lower concentration risk, commence indirect raw material sourcing through a centralized procurement process with best industry practices, lower expenses in Jeddah milk factory through further improvements, commence operations of Makkah depot during FY'23-24 which could lead to better inventory management. On the back of the above-discussed initiatives, we expect margins to continue improving gradually over our forecast period, given that there remains some gap before the margins reach their pre-COVID levels of FY17/FY18.

Fig. 4: After weakening in FY'22, margins have improved and are likely to rise further with cost control efforts



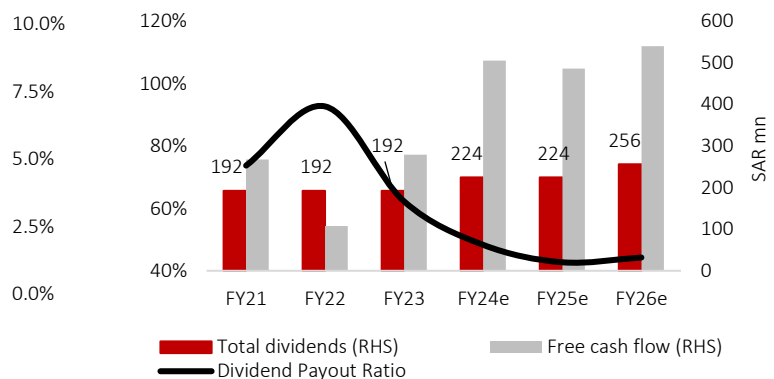
Source: Company Reports, U Capital Research

Fig. 5: Capex requirements are expected to reduce



Source: Company Reports, U Capital Research

Fig. 6: Solid cash flows could lead to an increase in dividends



Source: Company Reports, U Capital Research

Strong liquidity with solid cash flows and a likely decrease in capex could lead to an increase in dividend payouts

SADAFCO boasts of a strong balance sheet with NIL borrowings and a healthy cash balance of over SAR 800mn as of the end of the Jun'23 quarter. With the company adding a new ice cream factory recently, and the work on the New Makkah depot expected to be completed soon, we estimate capex requirements to decrease relatively. On the other hand, backed by an estimated improvement in margins, cash flow generation is expected to remain healthy, which should further strengthen the company's financial position. Accordingly, we opine SADAFCO could utilize its robust liquidity position to increase its dividend per share, which has remained flat at SAR 6 per share over the past three years.

Valuation

Our target price is based on blended valuation methodologies – (i) DDM and (ii) Relative Valuation (using P/E, and EV/EBITDA).

We revised our target price for the company to SAR 385.00 (previously, SAR 252.00), which indicates an upside of 15.6% at the current market price. Accordingly, we rate the company **Accumulate** (previously, Accumulate). Our target price increase primarily stems from the upward revision in our revenue and earnings estimate coupled with margin expansion, attributable to market share gains and cost optimization initiatives. Currently, the stock trades at a P/E of 23.0x, based on our FY'24 (ending Mar'24) estimates.

Peer Group Valuation

Name	Mkt Cap (SAR mn)	Last Px (LC)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	EV/EBITD A'23e, (x)	P/E'23e, (x)	ROE'23e, (%)	Div Yield' 23e, (%)	FCF Yield TTM (%)
Food & Beverages										
Saudia Dairy & Foodstuff Co	10,822.5	333.00	-3	17	54	16.1	23.0	26.2%	2.1%	3.7%
Almarai Co	67,500.0	67.50	2	19	26	15.7	30.6	11.4%	1.5%	4.8%
Halwani Bros Co	1,934.0	54.70	-21	-13	23	31.5	20.1	8.9%	3.7%	0.3%
Danone	147,292.8	53.06	-6	-9	8	10.3	15.5	11.7%	3.8%	5.0%
Kraft Heinz Co	154,253.5	33.480	-8	-14	-18	9.7	11.6	7.2%	1.2%	5.5%
Agthia Group	4,122.8	5.100	-1	13	28	9.0	14.0	8.9%	3.3%	8.6%
Average						15.6	18.9	13.6%	2.6%	4.5%
Median						13.0	17.8	10.1%	2.8%	4.9%

Source: Bloomberg, U Capital Research, na – not available, nm – not meaningful; *valued as of 21 August 2023

Fig. 7: F&B - Price to Earnings & Dividend Yield

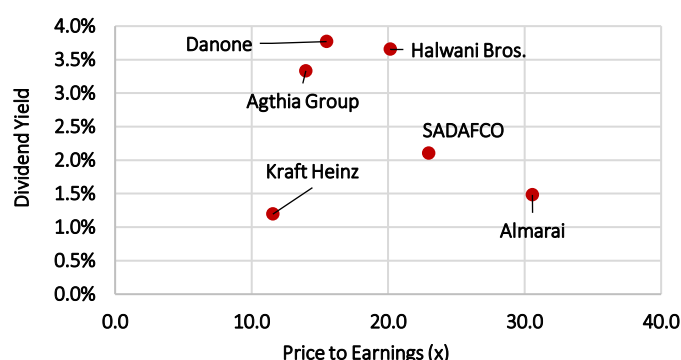
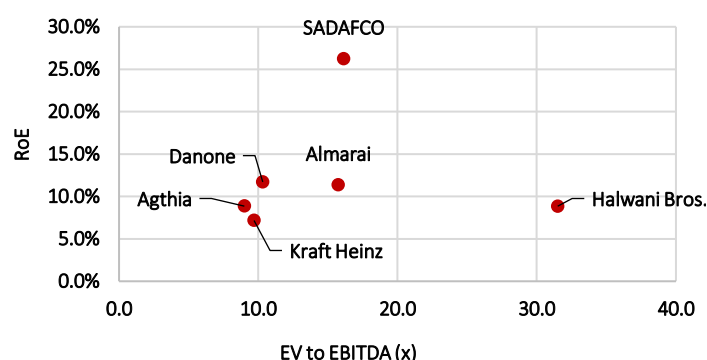


Fig. 8: F&B - RoE & EV to EBITDA



Source: Bloomberg, U Capital Research; As of 21 Aug 2023

Valuation

	SADAFCO
(Currency)	SAR
DCF (50% weight)	
PV of Free Cash Flows (mn)	
Year 1	487
Year 2	436
Year 3	454
Year 4	440
Year 5	442
Terminal Value	12,639
PV of Terminal Value	9,318
Less: Debt	(61)
Less: Minority interest	(23)
Less: Employee retirement benefits	(145)
Add: Cash & bank balances	835
Add: Investments	-
Equity value (mn)	12,184
Outstanding Shares (mn)	32.0
Assumptions	
Risk Free Rate (%)	4.9%
Adjusted Beta	0.54
Risk Premium (%)	3.6%
Cost of Equity (Ke) (%)	6.8%
WACC (%)	6.8%
Target Price	380.76
P/E based Relative Valuation (25% weight)	
Target P/E multiple (x)	31.4
EPS FY 2023-24e	14.50
Target Price	454.69
EV/EBITDA based Relative Valuation (25% weight)	
Target EV/EBITDA multiple (x)	15.3
EBITDA FY 2023-24e	636.86
Target Price	323.78
Weighted Average Target Price	385.00
Current Market Price	333.00
Upside/(Downside), %	15.6%
Recommendation	Accumulate

Source: Company Financials, Bloomberg, U Capital Research

Risks

Key downside risks:

- i) Sales growth not materializing as expected possibly due to an increase in competition or inflationary pressures impacting the product prices and/or consumer purchasing behavior.
- ii) A faster than expected rise in direct or indirect costs owing to an unexpected firming up of raw material prices, and/or spending on sales, promotional and expansion activities not generating desired returns.

Key upside risks:

- i) More-than-estimated market share gain in product categories.
- ii) Above-expected sales growth resulting from high demand for any newly launched product.
- iii) Any process improvement leading to more-than-estimated efficiency gains.

Key financials

In SAR mn, except stated otherwise	FY21	FY22	FY23	FY24e	FY25e	FY26e
Income Statement						
Revenue – net	2,105	2,170	2,648	2,910	3,115	3,299
Cost of revenue	(1,412)	(1,514)	(1,825)	(1,881)	(2,011)	(2,119)
Gross profit	694	657	823	1,029	1,104	1,180
Selling and distribution expenses	(307)	(311)	(351)	(402)	(414)	(437)
General and administrative expenses	(109)	(113)	(114)	(138)	(140)	(148)
Operating profit	285	236	371	511	568	614
Finance income	6	4	18	22	29	43
Finance costs	(8)	(7)	(50)	(8)	(3)	(2)
Income before zakat and income tax	284	234	339	525	594	655
Zakat expense	(23)	(25)	(29)	(65)	(74)	(82)
Net income for the period	261	209	310	460	520	574
Non-controlling interests	(0)	(2)	(2)	4	4	5
Net income for equity shareholders	261	207	309	464	524	579
Balance Sheet						
Inventories	302	359	420	453	466	492
Trade and other receivables	227	234	286	294	299	307
Cash and cash equivalents	713	626	290	582	865	1,185
Property, plant and equipment	861	935	926	919	902	892
Right-of-use assets	63	65	63	51	40	29
Total assets	2,229	2,286	2,484	2,798	3,069	3,401
Trade and other payables	169	192	187	266	242	255
Employee benefit obligations	120	128	140	150	160	172
Total liabilities	675	725	809	886	861	875
Issued share and paid up capital	325	325	325	325	325	325
Statutory reserve	163	163	163	163	163	163
Treasury shares	(52)	(52)	(52)	(52)	(52)	(52)
Retained earnings	822	813	894	1,123	1,423	1,745
Non-controlling interests	21	21	22	19	14	9
Total liabilities and equity	2,229	2,286	2,484	2,787	3,058	3,389
Cash Flow Statement						
Net cash generated from operating activities	415	290	384	641	636	718
Net cash generated from investing activities	(151)	(162)	(509)	(105)	(114)	(129)
Net cash (used in) provided by financing activities	(194)	(210)	(207)	(244)	(239)	(269)
Cash and cash equivalents at the end of the period	713	626	290	582	865	1,185
Key Ratios						
Gross margin (%)	33.0%	30.3%	31.1%	35.4%	35.4%	35.8%
EBITDA margin (%)	18.5%	15.7%	18.5%	21.9%	22.9%	23.2%
Operating margin (%)	13.6%	10.9%	14.0%	17.6%	18.2%	18.6%
Net margin (%)	12.4%	9.6%	11.7%	15.9%	16.8%	17.5%
ROA	11.8%	9.2%	12.9%	17.6%	17.9%	17.9%
ROE	17.4%	13.5%	19.3%	26.2%	25.8%	24.7%
Current Ratio (x)	2.7x	2.4x	2.3x	2.6x	3.1x	3.6x
Capex/Sales	6.5%	7.1%	3.4%	3.6%	3.7%	3.9%
EPS	8.1	6.5	9.6	14.5	16.4	18.1
DPS	6.0	6.0	6.0	7.0	7.0	8.0
Dividend Payout Ratio	73.7%	92.6%	62.2%	48.3%	42.7%	44.2%
Dividend Yield (%)	3.6%	3.5%	2.5%	2.1%	2.1%	2.4%
P/E (x)	20.3x	26.6x	24.6x	23.0x	20.3x	18.4x
EV/EBITDA (x)	12.2x	14.9x	15.3x	16.1x	14.0x	12.6x
Price as at period end*	165.6	172.4	237.4	333.0	333.0	333.0

Source: Company Reports


*Current market price is used for forecast periods


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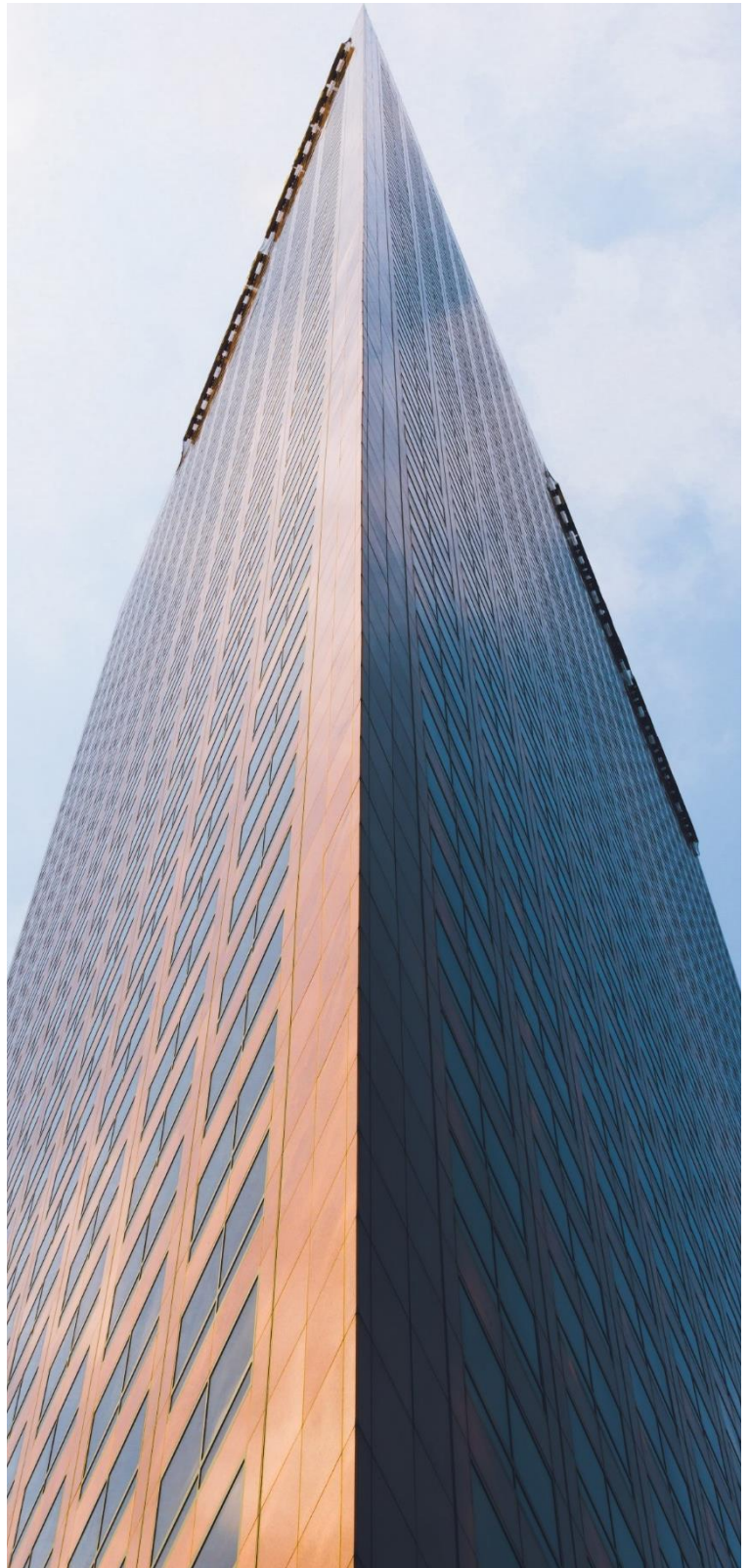
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Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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