Agriculture & Food Sector

Food-Diversified
Saudi Arabia
03 April 2010

الراجحي المالية
Al Rajhi Capital

US$ 10.5 bn	54.9%	US$11.8mn
Market cap	Free float	Avg. daily volume

Target mkt cap	SAR46bn	17.2%over current
Consensus mkt cap.	SAR43bn	10.5% over current
Current mkt cap.	SAR39bn	as at 29/03/2010

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Underweight	Neutral	**Overweight**

Key themes

Driven by rising population and improving education, we expect the food sector in Saudi Arabia to continue growing. The top player, Almarai, has made its name in dairy produce but new areas like juice and bakery products now offer more potential. Rising shopping in supermarkets and hypermarkets should support food sales and benefit Savola with its presence in retailing as well as food. Both groups have grown via M&A and this trend should continue. Almaraiôs high economic profit shows it has integrated acquisitions well, while Savolaôs underling returns are better than they look.

Implications

We rate both Almarai and Savola as Overweight. Almarai has shown strong operating and financial performance, while Savola is back on track with excellent results for 2009. While both stocks have performed well already, we expect high transparency to continue to support their share prices, and think they will find favour with international investors if the Saudi stock market is fully opened up.

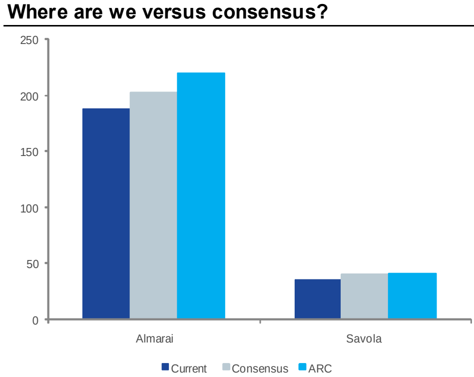
What do we think?

Stock	Rating	Price Target
Almarai	Overweight	SAR220.0
Savola	Overweight	SAR41.1

Why do we think it?

Stock	3 year EBITDA CAGR	2010 EV/EBITDA
Almarai	12%	12.3x
Savola	11%	9.6x

Where are we versus consensus?



Source Bloomberg, ARC Research

Agriculture & Food Sector:
Pick the fruits

Rising population and better education are fuelling growth in the Saudi food sector. Competition in dairy items is intensifying, but other areas offer new potential for the market leader, Almarai. Stable commodity food prices and the trend towards shopping in large retail outlets should support Savola. Almarai's high economic profit shows its success in absorbing acquisitions, while Savola's core returns are better than they seem. We rate both companies as Overweight.

Food market is promising. With a rising population and high GDP/capita, the food sector in Saudi Arabia and the GCC region is set to grow further. Education and new lifestyles are stimulating healthy food segments such as dairy produce. Almarai and Savola dominate the sector, with smaller players under pressure.

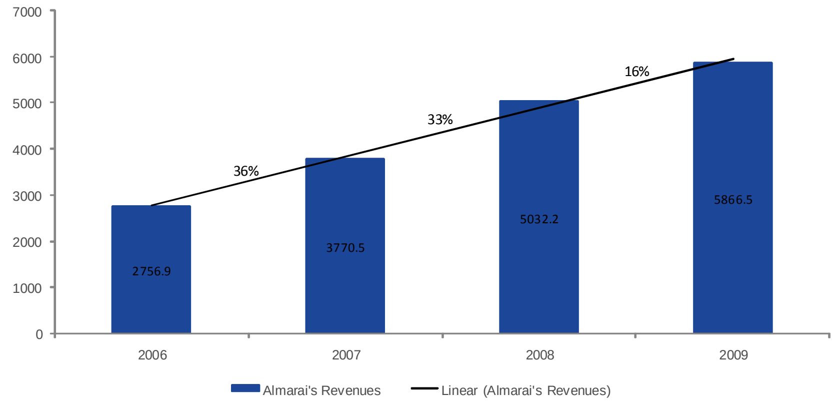
Dairy and food markets: strong prospects despite challenges. Almarai is the top dairy player in the GCC. While we expect competition here to intensify, Almarai has greatly reduced its dependence on dairy sales. Almarai should grow faster from now in areas like juice, bakery products and cheese. After steep falls in 2008, prices of commodity foodstuffs look stable. We expect Savola's sugar and edible oils units to grow steadily; expansion in other areas is also likely. The trend towards shopping in larger retail outlets is positive for food sales. Savola's retail segment should improve in 2010 as it rationalises newly acquired stores.

M&A is the chief mode of growth. Almarai has pursued growth through M&A, notably Hadco. Almarai has maintained high economic profit, showing it has been able to integrate new operations successfully. Debt has gone up to fund acquisitions, but gearing is well under control. Savola's headline returns are held down by its business mix and the fact that a large portion of invested capital is tied up in investments. However, we estimate that Savola achieved a core economic profit spread of about 4% in 2009. We should also stress that Savola's investments, notably Almarai and Herfy, have been highly successful.

Stock conclusions. We rate Almarai as Overweight with a price target of SAR220, implying 17.1% upside. We rate Savola as Overweight with a price target of SAR41.1, implying 17.4% upside. The stocks have performed well and are not obviously cheap on EV/EBITDA ratios of 12.3x and 9.6x respectively. However, we expect high transparency and likely popularity with international investors to drive further share price appreciation.

Almarai has maintained strong growth during the last four years

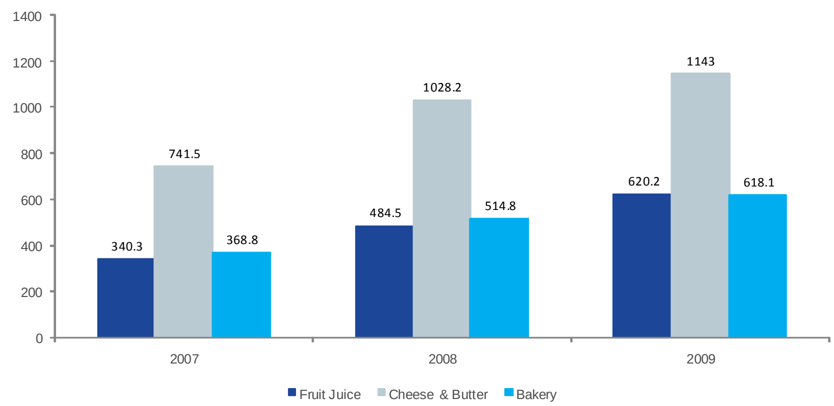
Figure 1. Almarai's revenue growth



Source: Company data, ARC Research

Almarai has mastered any new product category it has entered

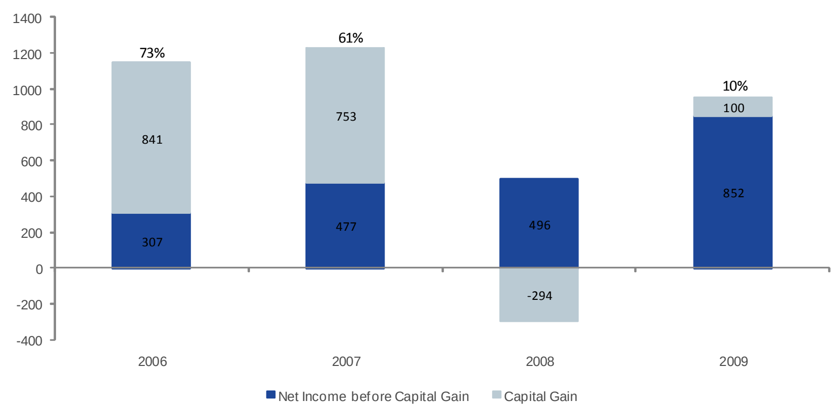
Figure 2. Almarai's revenues from new segments



Source: Company data, ARC Research

Savola has dramatically decreased its reliance profits from capital gains

Figure 3. Savola net income breakdown



Source: Company data, ARC Research

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Food market is promising: demographics and education fuel growth

Young and fast-growing population and high per capita GDP help enlarge the market

The demographic profile of the GCC region supports a positive stance on the food production sector

In this report, we launch coverage of the two leading Saudi food producers, Almarai and Savola. Besides food production, Savola is also engaged in retailing and investment activities. We believe that the young and expanding population of the GCC region plays a vital role in stimulating the food market, to the benefit of both companies. Across the GCC, annual population growth is about 2.5%. Saudi Arabia is the largest market in the region with a population of about 25mn and one of the highest growth rates; it is particularly worth stressing that 41% of the Saudi population is below 15 years of age. Although lower than that of most other GCC countries, Saudi GDP/capita of around $19,000 also supports a positive stance on the food sector.

Figure 4. GCC demographics

	KSA	UAE	Kuwait	Oman	Bahrain	Qatar	Iraq
Population - Millions	25.9	5.2	3.5	2.5	0.75	1.1	28.5
Population Growth (%)	2.4%	5.0%	3.5%	1.1%	2.0%	10.5%	2.3%
Population Below 15 (%)	41.0%	29.0%	24.0%	30.0%	33.0%	29.0%	38.0%
GDP/Capita $	18,639	52,020	43,917	20,231	26,500	93,000	3,140

Source: IMF - World Economic Outlook, ARC Research

Improving education and a shift to larger retail outlets are also supporting the market

The young population increases food consumption, especially in the dairy sector which represents a large portion of the food sector. This fact is stimulated by improving education as people become more conscious of the benefits of healthy food, in particular dairy products. At the same time, people's desire to follow a modern lifestyle is fuelling demand as people buy more because they enjoy the experience of shopping in supermarkets and hypermarkets. This is especially true in Saudi Arabia, where supermarkets and hypermarkets account for only 30-35% of aggregate sales from retail outlets by our estimate. A similar statistic is the fact that large retail outlets account only about 30% of total investment in the retailing sector, according to the newspaper Al Watan, while traditional smaller stores still account for the remaining 70%. Against this background, we regard the shift to larger retail outlets as an almost inevitable long-term trend. Increasing volumes in supermarkets and hypermarkets benefit the food production sector too.

Agriculture & food sector: big players are attractive

Almarai and Savola, with the highest market value, are fundamentally strong

The food sector in the Tadawul can be classified as second tier. It is not one of the leading sectors, but neither is it one of the smallest. The food sector encompasses different food segments from dairy and agriculture to commodities and added value products. There are currently 15 listed companies in this sector; the table below presents these companies with some vital figures and ratios.

Figure 5. TASI: Agriculture & Food Sector

Company	Market Cap	Div Yield %	Price/ Revenues	EPS (SAR)	P/E	P/B	P/CF	ROA (%)	ROE (%)
SAVOLA Group	18350	2.7	1.0	1.90	19.0	2.6	11.1	5.5%	13.7%
Food Company	406	0	5.7	0.29	70.6	2.3	32.3	2.9%	3.2%
SADAFCO	1463	3.3	1.5	2.71	16.6	2.5	11.7	10.3%	14.9%
Almarai	20585	2.2	3.5	9.54	18.8	3.8	12.8	10.0%	20.4%
Anaam Holding	668	0	10.2	N/A	N/A	6.0	N/A	-3.3%	-6.7%
H B	903	4.7	1.5	1.49	21.2	1.9	14.2	7.9%	9.5%
Herfy	1607	0	N/A	0.00	5.2	N/A	N/A	N/A	N/A
NADEC	1776	2.5	1.3	N/A	N/A	1.8	11.2	-1.5%	-3.9%
Qassim Agriculture	490	0	5.8	N/A	N/A	1.2	59.9	-1.2%	-1.7%
Tabuk Agriculture	499	2	3.0	0.35	70.8	1.4	15.0	1.7%	1.9%
Saudi Fisheries	1055	0	8.9	N/A	N/A	7.8	N/A	-15.3%	-21.1%
Sharqiya Dev Co	255	0	7.9	N/A	N/A	3.0	N/A	-4.1%	-5.6%
Jouff Agriculture	710	5.6	2.7	3.52	10.1	1.3	6.6	10.9%	11.7%
Jazan Development	708	3.5	16.9	N/A	N/A	1.1	57.6	0.6%	0.7%

Source: Tadawul. ARC Research

Almarai and Savola account for 79% of the aggregate market capitalisation of the food sector

Almarai has the highest market capitalisation in the sector at SR21bn. Despite the fact that Almarai and Nadec have operations other than dairy produce, in effect they represent the dairy segment in the food sector as dairy products comprises the biggest portion of their business. Food Company and Halwani Brothers produce diverse food products. The pure agriculture segment is represented by five companies which are relatively small: Jouff, Tabuk, Qassim, Sharqiya, and Jazan. Saudi Fisheries Company operates in the fish market where it sells different value-added products. Finally, there is Savola which has a unique business as it mainly produces food commodities (edible oil and sugar) but also operates in the retail market (largely through the Panda chain). In addition, Savola has many valuable investments, e.g. its stakes of 28% in Almarai and 49% in Herfy. Savola has the second highest market capitalisation in the sector, at SAR18bn. Together, Almarai and Savola account for 79% of the aggregate market capitalisation of the sector.

As mentioned and shown in the table above, most companies in the food sector are relatively small. The large players are well-positioned in their markets where they enjoy high market shares and robust growth. In contrast to the smaller players (some of which are loss-making), they also trade on reasonable valuation multiples and offer respectable dividend yields and returns on equity. Therefore, we chose to cover the largest two companies: Almarai and Savola. We selected these two firms because not only they represent more than 70% of this sector market capitalisation, but also they are fundamentally strong and have shown impressive financial performance.

Dairy and food markets: strong prospects despite challenges

Dairy market is growing, but competition will be fierce

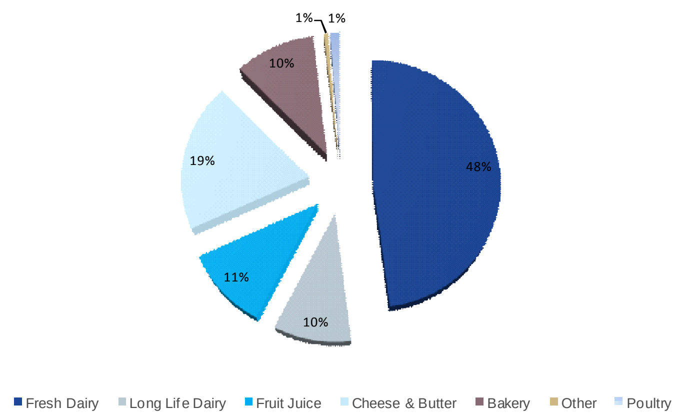
The GCC dairy market has six key categories

With a size of about $2,800mn in the GCC, we think that dairy market is set to grow further considering the region's sound demographic profile. The GCC dairy market is made up of six key product categories which are fresh milk, long-life milk, milk powder, fresh laban (a traditional Arabic drink which resembles buttermilk or a cross between sour milk and buttermilk), recombined laban and zabadi (yogurt). Saudi Arabia is the biggest market and comprises more than 61% of GCC dairy market.

Almarai has impressively decreased its reliance on dairy from 100% to 60%

Almarai dominates the GCC dairy market with an average market share of around 30%; and it enjoys a market share of more than 39% in the biggest market, Saudi Arabia. Almarai started life as a pure dairy producer. However, it has built up its high share by focusing on the cash cow products, i.e. the commodities or non value-added products – notably fresh milk and laban in which it enjoys market shares of 49% and 44% respectively in GCC, and by using its income from these products to develop other product lines. As shown in the graph below, fresh dairy products contribute about 48% of Almarai's sales. Dairy products in aggregate now account for about 60% of sales, down from 100% originally.

Figure 6. Almarai: revenue breakdown 2009

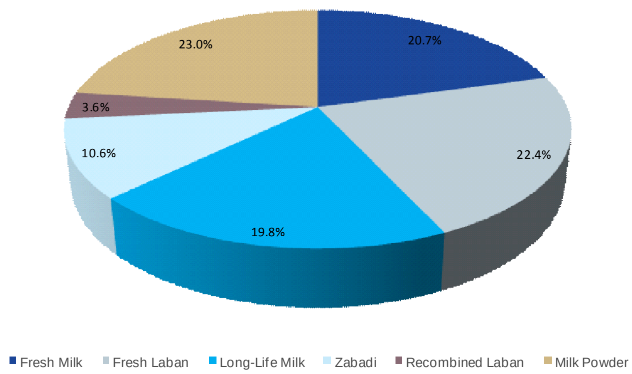


Source: Company data, ARC Research

Fresh dairy produce should grow at the expense of the abnormally large powdered milk in the GCC region

As mentioned, we expect the growing population in the GCC region, coupled with people's increasing consciousness about health, to drive growth in the food production market. Moreover, looking at the breakdown of this business, we see clear potential for the fresh dairy market to grow at the expense of powdered milk which currently comprises 23% of the GCC dairy market. Compared to dairy markets in other regions, the share of powdered milk share is relatively large.

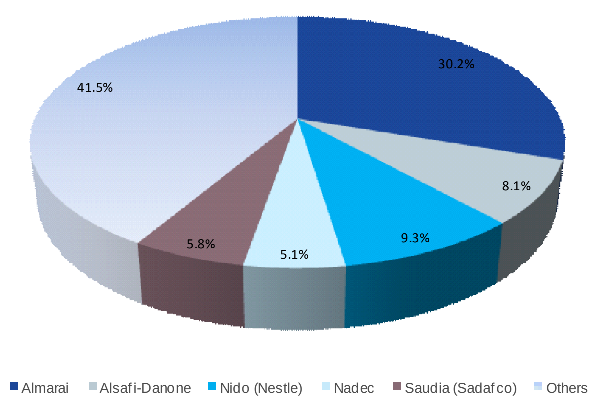
Figure 7. GCC region: dairy market share by product in 2009



Source: Company data, ARC Research

Almarai dominates the dairy produce market in the GCC with a share of around 30%. However, several other players are present. These include multinational companies such as Nestle (second in the GCC with market share of about 9%) and local players such as Alsafi-Danone, Nadec, and Sadafco.

Figure 8. GCC region: dairy market share



Source: Company data, ARC research

The weakness of other players in Saudi Arabia helps explain Almarai's dominance of the GCC dairy produce market

Although we give much credit to Almarai's efficient operations, management's clear strategy, and innovative marketing activity, we believe that the weakness of other big players in Saudi Arabia (70% of Almarai's revenues comes from the Saudi market) has helped Almarai to advance and dominate the market. In our opinion, the unlisted Alsafi-Danone, the second-placed company in the dairy market in Saudi Arabia and the third in GCC region as a whole, has lost track since Alsafi's joint venture with Danone. This joint venture had been anticipated to be strategically promising for Alsafi; however, we believe that it has been hurting Alsafi rather than helping. Alsafi has benefited from Danone's R&D in developing innovative products and value-added products, but it has completely ignored the most fruitful products, fresh milk and laban. On the other hand, we think the third company in the Saudi market, Nadec, has been suffering with no clear strategy; as a result, it has recently announced a loss of around SAR38mn for 2009.

Fierce competition in dairy market will slow down Almarai's growth in this category

Despite the relative weakness of competitors today, we expect Almarai's growth in the dairy produce market to slow down from 13.5% in 2009 to about 6% in 2010. The reason is that Almarai already has high market share and it will be hard to raise this further. Moreover, we expect competition to intensify over the next few years. We believe that Alsafi-Danone and other players will pay more attention to fresh milk and laban and try to take advantage of Almarai's focus on new acquired segments. Almarai enjoys a well-recognised brand name which is preferred by consumers. Therefore, we see price cutting and promotions looming in order for smaller players to pressure Almarai's main source of income, fresh dairy produce, and gain market share. Despite the fact that Almarai dominates the market and can match prices set by competitors due to greater economies of scale, we believe that greater competition will eventually hurt Almarai's income in dairy produce, which comprises 48% of its total sales. That said, the fierce competition that we anticipate should have the positive effect of helping to expand the whole market.

We expect M&A activity in the GCC dairy produce sector to continue

We believe that the dairy market in the GCC, mainly Saudi Arabia, will see more M&A transactions. Big players may continue to acquire small companies in the same or adjacent businesses. Small dairy companies, on the other hand, may begin to merge to form stronger companies and a few others will eventually fade away. We have reached this conclusion based on the fact that many small dairy companies are struggling. The big players, on the other hand, are struggling to grow and one way to achieve this is through M&A.

Water could be a threat, but alternatives are available

We think the water issue is exaggerated; solutions are available

One issue that has affected the dairy companies recently is debate concerning excessive use of water. This poses a risk for dairy companies because a ban on dairy exports is widely expected. The Saudi Shura Council, or Consultative Assembly, has already recommended that restrictions be imposed on dairy companies' exports. The government's concern stems from the fact that each litre of milk requires around 500 litres of water (mainly to grow alfalfa as feedstock) and in our view it is justified considering water scarcity in the kingdom. However, we think that this threat is abating as many solutions are available. Almarai has already proposed a solution that is satisfying to all parties; the proposal is to import alfalfa as much as dairy exports require.

If accepted, which is most likely to happen, we see this as a fair solution although it may hurt Almarai's bottom line slightly. But it is still much better than discontinuing exports. If not accepted, the water issue will remain a threat but we believe that there are a few alternatives that dairy companies may consider. For example, they could open small plants in the UAE and buy raw milk from there. Another solution would be to buy farms or form joint ventures to supply raw milk. Also, instead of using raw milk, dairy companies may use more powdered milk in producing dairy products.

Commodity foodstuffs market is stable

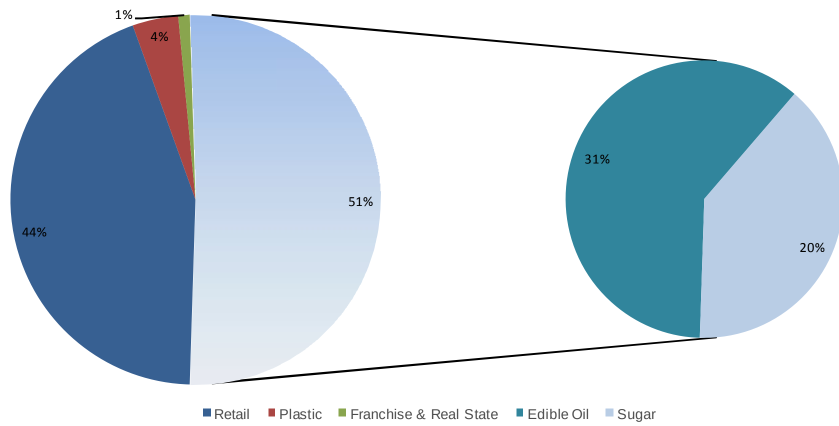
Prospects for sugar and edible oils

With stable economy and oil prices, we expect commodities prices to be stable

The market for commodity foodstuffs suffered during 2008 and early 2009 as a result of the economic downturn. Oil prices and commodity foodstuff prices, which are mostly positively correlated, plummeted late in 2008 and early 2009. Prices dropped sharply to affect the results of many companies. Savola was one of the companies which were seriously affected by the economic drop. The sharp decline in commodity prices in Q4 2008 decreased the company's gross margin from 17% to almost 7%, almost completely eating up the profits that were made in the first three quarters of the same year. The group made total provisions of SAR673mn for the year 2008, including impairment provisioning of SAR474mn against investments as a result of the crises. With a recovering global and strong domestic economy supported by stable crude oil prices at US$80 a barrel, we expect commodity foodstuff prices to be fairly stable from now on.

The commodity foodstuffs market is huge and has several players. In this report we are mainly concerned with the edible oil and sugar categories, as Savola is one of biggest producers in these segments. Savola has many plants in different countries that produce various types of edible oil and sugar. According to the company, Savola currently holds a market share of 62% in edible oils and of 68% in sugar in Saudi Arabia. The food segment contributes 51% of Savola's revenues.

Figure 9. Savola: revenue distribution by segment 2009



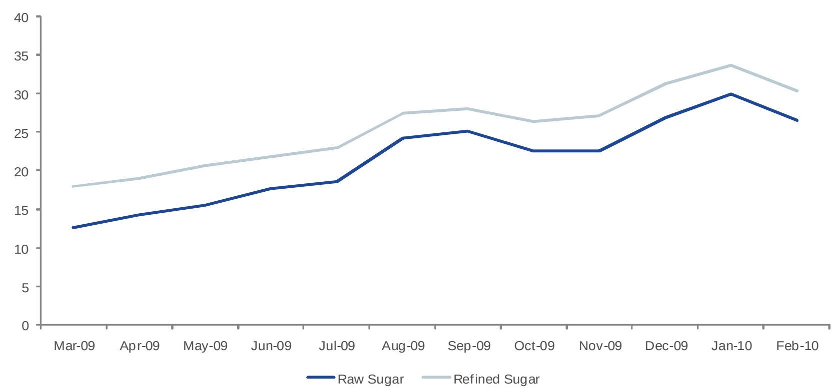
Source: Company data, ARC Research

Outlook for the sugar market is relatively stable

The outlook for the sugar market is relatively stable. The market is highly liquid and Savola is 100% hedged against price fluctuations. Savola sells refined sugar to industrial, retail, and wholesale consumers with an even breakdown of about 30% for each. Savola's sugar sales are geographically diversified since the Saudi market comprises about 65% and exports represent the remaining 35%.

In our view, two main challenges confront Savola in the sugar market. The first is people's increasing awareness of sugar's harms to health, which is stimulated by education. The second is the recent increase in the price of soda drinks: the price of a small can of soda in Saudi Arabia has recently increased by around 50% from SAR1.00 to SAR1.50. This may affect demand for soda drinks, and hence for refined sugar.

Figure 10. Sugar: recent price trends (USD)



Source: Reuters, Bloomberg, ARC Research

The outlook for edible oils is less certain, though the high proportion of branded oils in total production affords Savola some protection

The outlook for edible oils is more risky as there is no liquid traded market and a sharp fluctuation in prices could hurt Savola badly, as was the case in 2008. On the positive side, around 50% of Savola's production is branded edible oil. In the case of branded oils it is easier for Savola to pass any major increase in edible oil input prices to consumers, giving Savola greater scope to protect its margins. Besides the direction of prices, we believe that the challenge of increasing awareness of health issues applies to Savola's edible oils category too. It is worth noting that Savola's edible oil sales are geographically diversified, with the Saudi market comprising only about 20% of the total.

We think Savola needs to pay more attention to health issues in the edible oils market

Despite the fact that Savola has launched various products in response to health concerns such as cholesterol-free, soya and sunflower oil, we think that Savola should be more proactive and pay more attention to this issue. While health concerns seem less likely to affect consumption of edible oils than consumption of sugar, we nevertheless see a risk that consumption will start to decline. That said, we do not expect this issue to affect Savola's results significantly in the near term.

Figure 11. Palm oil: recent price trends (USD)

Note. Palm oil prices are used by Savola as an overall guide to edible oil prices.
Source: Reuters, ARC Research

Potential to expand in new areas

New pasta factory in Egypt should make a major contribution to revenues

We should note that we see considerable potential for Savola to grow in other food categories, e.g. wheat-based products. For example, Savola is launching an SAR120mn new pasta factory in Egypt; with a planne capacity of 50,000 tones, this factory is expected to increase revenues by SAR500mn. This new production line is set to diversify Savola's food segment and add to its top line, although we not expect the factory to start making a material contribution to revenues before 2011. We believe that Savola can and ought to enter new food segments as it already has the biggest market shares in sugar and edible oil. It will be able to create synergies by capitalisng on its food production knowhow and its strong position in retail market. The pasta factory is an excellent step to test the potential of other food categories.

We expect solid growth of 6% in Savola's food production business

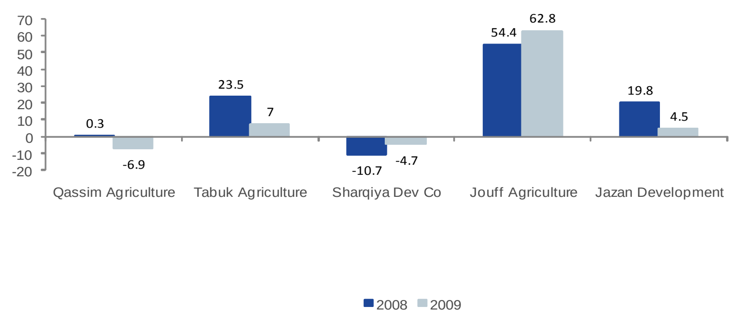
With regard to Savola's food production operations, our overall assumption is that the expanding population of the GCC region, coupled with reasonably stable price levels, should drive respectable growth. In addition, we see good potential for Savola to enhance its position in the sugar and edible oils markets, which it already dominates, and to develop new food product categories. Savola's intention to capitalise on its strong position in food products is clear from the many investments and acquisitions that the company has made to increase capacity. We believe that Savola will be able to maintain respectable growth of about 6% in food revenues over the next few years.

The agricultural companies are small and not performing particularly well

Pure agriculture market is struggling

Although Saudi Arabia is mostly desert, it has some regions where agriculturally suitable environments are found. With major irrigation projects, the agriculture sector has been developed. However, as shown in the table at the beginning of this report, most listed companies in the Tadawul's agriculture and food sector have not been performing very well operationally. Furthermore, they are relatively small in terms of market capitalisation. Jouff Agriculture is one of the few agricultural companies that seem to be doing well. It increased its net income by 15% from 2008 to 2009. The company has strong financial ratios but is small. As shown in the graph below, except for Jouff, agricultural companies announced unpromising results in 2008 and 2009 . Therefore, we are not inclined to cover the agricultural companies for the time being.

Figure 12. Pure agricultural companies: net income in 2008 and 2009 (SARmn)



Source: Tadawul, ARC Research

Almarai has recently entered the agriculture business through its purchase of Hadco

Nevertheless, there are two issues that we should highlight about the agricultural companies subsector. Firstly, companies in purely agricultural business are confronted with the challenges of water scarcity and climate change in Saudi Arabia. This partially explains the unstable performance of companies in this sector. Secondly, Almarai has entered this subsector through its recent acquisition of Hadco, a sizable company with revenues of around SAR395mn in 2008. With a core business in poultry, we consider Hadco to be one of the more promising companies in the agriculture subsector. As Almarai has demonstrated an impressive record on entering new segments, we believe it will do well in this market too by implementing its management methods and by utilising its resources to help create operating synergies.

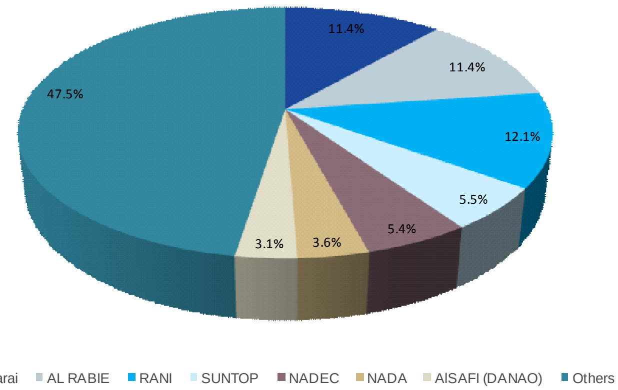
Other food segments are flourishing

Good growth potential for Almarai in the fragmented juice market

The juice market in the GCC is relatively immature

There are certain other major food segments that are worth discussing; we try to focus on those that are most relevant to our research. The juice category in the GCC is relatively immature, and remains dominated by small brands. There are different players in this segment, both public and private companies. The publicly listed companies, Almarai, Nadec and Halwani, produce and sell various juice products; there are other private players such as Rani, Rabie, and Alsafi-Danone with its milk-juice products (Danao) which can be classified as milk or juice. Big brands cover about 40% of the market while small players cover the remainder.

Figure 13. Saudi Arabia: Juice market share 2009



Source: Company data, ARC Research

We expect juice sales to expand further for Almarai this year

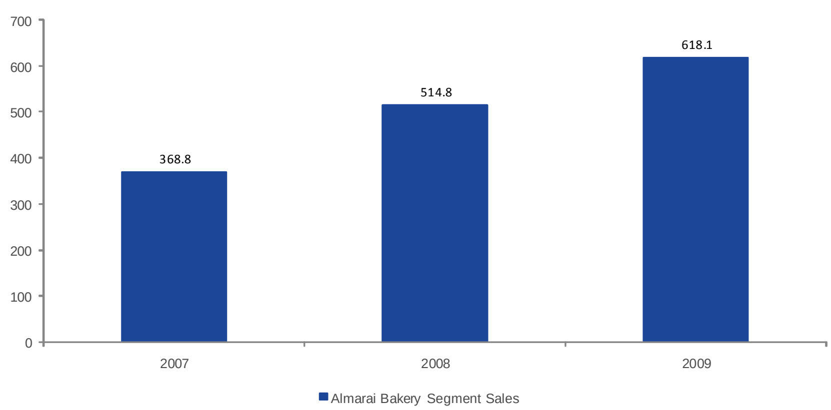
We believe that the fragmented juice category will show rapid growth. The juice segment contributes about 11% of Almarai's total revenues, and sales in this area increased by 28% in 2009 from 2008. We expect Almarai to achieve growth of around 15% in 2010 in this category, partly through market share gains.

Almarai has performed strongly in bakery sales; Savola is present too

Impressive record: Almarai has increased bakery revenues by 68% in two years

Bakery produce is another major food segment in Saudi Arabia and other GCC countries. The bakery market is made up of several categories including pastries, cakes, bread, biscuits, and others. We believe that this segment is highly fragmented: small and local stores dominate the market, besides supermarket brands. However, there are a few important players such as Lusine, Alrashed, Americana and Herfy. Unlike Lusine which sells a wide range of bakery products, the other players seem to concentrate on a limited range of products. Lusine was acquired by Almarai in 2007 and its sales have been growing strongly since then. Almarai has created synergy by utilising its huge distribution network to improve Lusine's operations. As shown in the chart below, Almarai has increased Lusine's sales by 68% since the acquisition in 2007. Almarai's bakery revenue grew by 20.1% in 2009; we expect Almarai to maintain strong growth in 2010.

Figure 14. Almarai: bakery segment sales (SAR mn)



Source: Company data, ARC Research

For its part, up to now Savola has conducted its bakery operations through a subsidiary, Herfy, which was recently listed in an IPO. Herfy is primarily a restaurant chain but also runs bakery operations. Herfy has been contributing constant net income of over SR100mn to

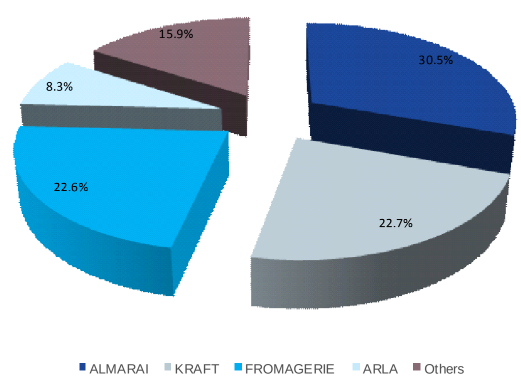
Savola; managing the company has required almost no effort as it has been run by minority holders. Following the IPO, Savola's stake in Herfy has fallen from 70% to 49%; it recorded a capital gain of SAR200mn on the transaction. We believe that the bakery market has potential to grow further and to become more dominated by large players. This ought to benefit Savola indirectly through Herfy and Almarai directly through its bakery segment.

Almarai outperforms competitors in cheese and butter

Diligent advance planning has allowed Almarai to build high market share in cheese and butter

Another food sector to highlight is cheese and butter. This includes several international brands, e.g. Kraft, Puck, and Lurpak, as well as local brands such as Almarai and Nadec. Although Almarai has only been in the cheese market for a relatively short period, it has surprisingly been outperforming the big international brands such as Kraft and currently hold a market share of around 30% in GCC. In our opinion, this success reflects Almarai's diligent planning and studying prior to entering any new market segment; as a result, when Almarai enters a new segment, it tends to master it and become the market leader quite quickly. We believe that this is one of the major strengths that contributes to Almarai success. Another factor that may have played a role in ensuring Almarai's success in cheese and butter has been an unofficial boycott by consumers of certain foreign brands, especially those from Denmark, caused by controversy over allegedly anti-Islamic cartoons published in the press in that country.

Figure 15. GCC: cheese market share in 2009



Source: Company data, ARC Research

However, achieving further growth will be more difficult from now on

Despite Almarai's success in increasing cheese and butter sales, we think that Almarai has already gained impressive market share and that it will, therefore, be difficult to maintain last year's sales growth of 11%. We assume that the cheese and butter segment will grow steadily, and Almarai ought to maintain respectable growth in this segment of around of 7%.

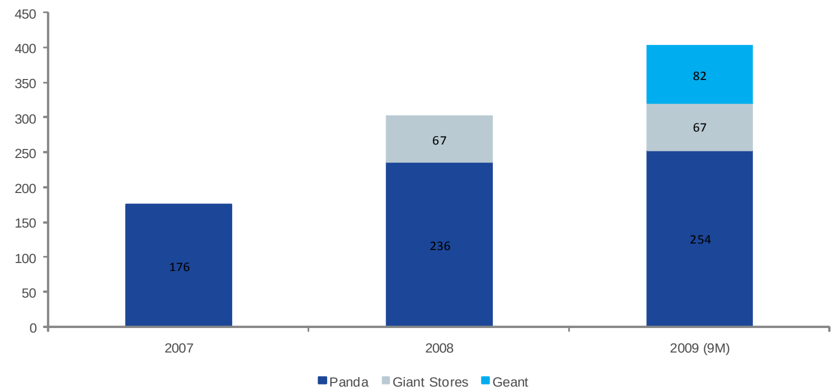
Flourishing retailing is stimulating the food sector too

The trend towards shopping in supermarkets and hypermarkets is positive for food sales

It is essential to discuss the retail sector not only because it contributes more than 40% of Savola's total revenues, but also because it encourages food sales. As we noted earlier, we estiamte supermarkets and hypermarkets account for only 30-35% of aggregate sales from retail outlets in Saudi Arabia. On this basis, we believe that the retail market is set to grow considerably. Accurate data about the retail market in the Kingdom are limited: for example, according to the IIR Company the retail market already exceeds US$100bn in size, while according to a report on Saudi Arabia by Business Monitor International (BMI) the retail market should grow from US$76bn in 2009 to US$97bn by 2013. Despite the paucity of hard data, there is ample circumstantial evidence that Saudi people enjoy shopping in convenient supermarkets and hypermarkets where they buy things that they do not necessarily actually need. We expect food sales in particular to benefit from the increasing trend towards shopping in supermarkets and hypermarkets because shopping for food is usually the easiest and most entertaining form of shopping.

Savola owns Panda, the biggest supermarket and hypermarket chain in Saudi Arabia. Panda has expanded through several mergers and acquisitions, and we expect this trend to continue. Savola has demonstrated impressive efficiency in managing its retail sector, and has achieved very high average sales per square metre. The graph below shows average sales per square metre for Panda, together with the Giant and Geant stores that Panda has acquired over the past year and a half or so.

Figure 16. Savola: retail segment sales per square metre (SAR)



Source: Company data, ARC Research

We expect Savola to make further acquisitions in the retail market

The retail market in Saudi Arabia features several different major players including Safeway, Carrefour, and Alothaim. We believe that Carrefour is suffering in the Saudi market, whereas Alothaim and Safeway are in a good shape. Although we expect the retail market to grow annually by 6% to 7%, we believe that Savola is capable of growing by about 9%. We expect Savola's retail chain to expand its market share by making further acquisitions, which should be reflected in faster sales growth.

Savolaœ̂s retail segment should improve in 2010 after it rationalises newly acquired stores

We believe that Savola can further expand its retail revenues by increasing the efficiency (as measured by sales per square metre) in its newly acquired stores. This assumption is built into our forecasts for Savola for 2010. However, we have one concern regarding Savola's continuing push into the retail market through acquisitions. Through Panda, Giant and Geant, we estimate that Savola already accounts for 35-40% of large retail outlets in Saudi Arabia. Increasing dominance of the market by Savola could reduce the number of store formats available, and limit innovation. Over the past couple of years, we believe that the retail market has been stimulated by new entrants such as Carrefour and Geant. We believe that different players are required to help drive growth in the sector overall.

M&A is the chief driver of growth innovation is less important

The food production sector in Saudi Arabia has witnessed major acquisition activity over the past few years. Almarai and Savola have been the driving forces behind these transactions. Almarai started focusing on acquisitions in order to diversify its business and increase its geographic reach. In contrast, Savola pursued acquisitions in order to enlarge its retail segment and increase edible oil and sugar production capacity. We expect both companies to make further acquisitions in pursuit of their strategic goals. Although Almarai has an innovative marketing activity, we do not see a focus on internal innovation in either company as a strategy for driving growth.

Almarai: acquisition strategy is succeeding

Almarai made many acquisitions in 2009

Almarai is pursuing expansion through both M&A and a joint venture with PepsiCo

Almarai has adopted an acquisitions strategy to expand over the past couple of years. We approve of this move as it diversifies Almarai's portfolio of products and broadens its geographic reach. We discuss some of Almarai's recent acquisitions below.

Teeba Investment

Early in 2009, Almarai completed the acquisition of 75% of Teeba Investment for Developed Food Processing Company in Jordan. An amount of SR271 million was paid to the founding shareholders. However, in June 2009, Almarai transferred its 75% investment in Teeba to International Dairy and Juice Limited (IDJ) for equity and cash. Note: IDJ is Almarai's joint venture with Pepsi Cola, discussed below.

Beyti

According to Almarai's 2009 annual report, a new subsidiary, Almarai International Holding W.L.L. was incorporated as a holding company for the acquisition of the International Company for Agro Industrial Projects (Beyti) in Egypt. The transaction was completed on 30 September 2009 and the Company paid cash consideration of US$127.1 million (SR478mn). Recently, Almarai transferred 100% of Beyti to IDJ for equity and cash.

HADCO

In October 2009, Almarai acquired 100% of the outstanding share capital of HADCO, an agricultural company with a core business in poultry, in exchange for 6.0mn new shares issued by Almarai in the ratio of one new Almarai share for every five HADCO shares and a payment of SR0.50 per HADCO share. The net cash consideration in the deal amounted to just SR15.0mn; however, the total acquisition cost of HADCO including acquisition expenses amounted to SR1,082mn based on an issued share price of SR174.75 at close of market on 14 October 2009. We believe that expansion into the poultry sector will further diversify Almarai's portfolio of food products. In addition, we expect the acquisition to contribute about 10% of Almarai's revenues in 2010.

Joint venture with PepsiCo

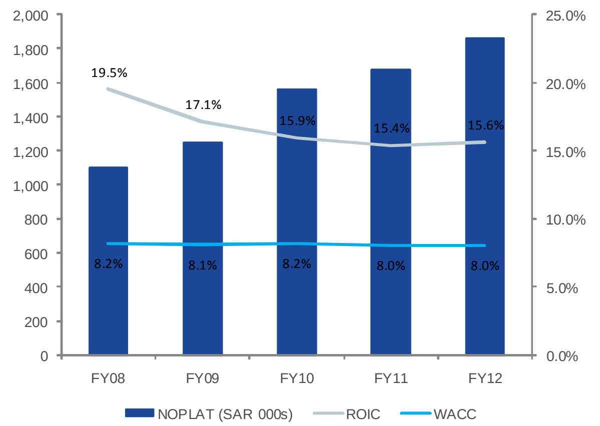
In addition to its M&A transactions in recent years, Almarai has formed a joint venture with Pepsi Cola, the US multinational corporation, to explore new business opportunities in dairy and juice products in Southeast Asia, Africa and the Middle East excluding the GCC countries. According to Almarai, the new joint venture, called International Dairy and Juice Limited (IDJ), of which Almarai holds 48%, has been incorporated with an initial paid-up capital of $7.0mn. The parent Pepsico has shown its intention to enter the healthy food segment by approaching the biggest players in different regions. Approaching Almarai proves its well known reputation. Almarai will provide technical expertise while PepsiCo will provide its strong network and understanding of the targeted market. Although the precise objective of this joint venture is in our view somewhat ambiguous, we believe that it may well pay off in the long run considering the involved parties and the announced intention. In the same way that Alsafi has benefited from its relationship with Danone, we believe that Almarai can benefit from a relationship with PepsiCo as a large multinational company in developing its staff and by utilising Pepsi's research and development efforts.

High economic profit confirms success of M&A policy

Almarai achieves a ROIC of 17-20%, compared to WACC of around 8%

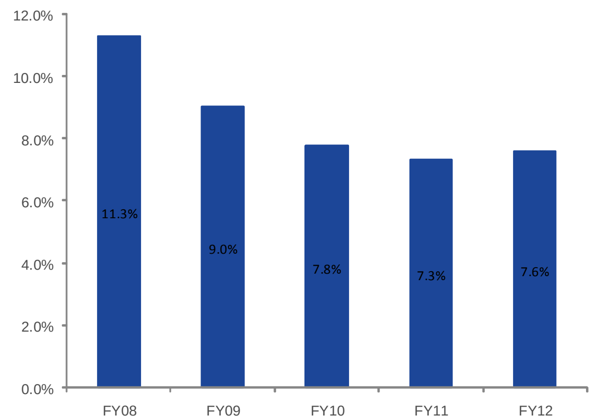
The success of Almarai's M&A strategy can be seen in the fact that acquiring and integrating new operations has not prevented the company from maintaining a high economic profit, i.e. return above cost of capital. By our estimate, over the period 2008-2009 Almarai achieved a return on invested capital (ROIC) of 17-20% This is more than double our estimate of the company's weighted average cost of capital (WACC) of 8.1%, implying that the company achieved an economic profit spread (ROIC – WACC) of 9-11%. We expect Almarai's economic profit spread to decline slightly from this year onwards, but nevertheless believe that the company can maintain a 7-8% economic return over the period 2010-2012.

Figure 17.1 Almarai: NOPLAT and return on invested capital



Source: Company data, Al Rajhi Capital

Figure 17.2 Almarai: economic profit spread (ROIC - WACC)

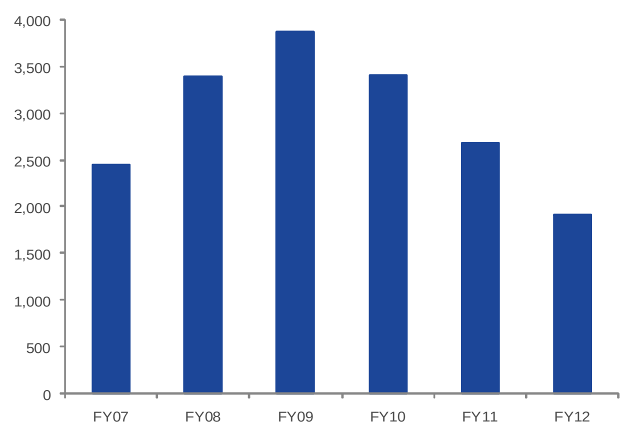


Source: Company data, Al Rajhi Capital

Almarai's debt has increased to finance major acquisitions

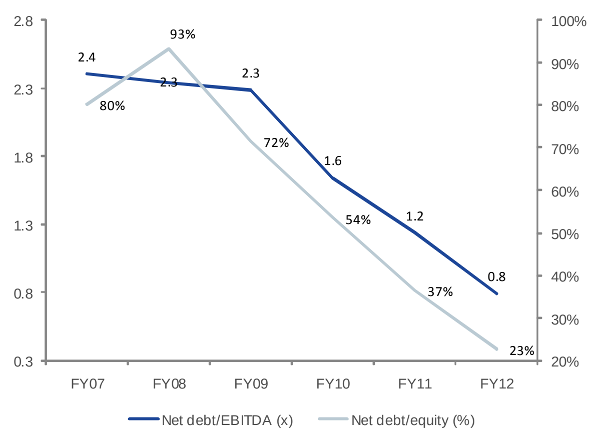
Almarai has resorted to debt to fund its M&A transactions. We think this decision is financially justified considering Almarai's high cash flow, the cheap cost of debt in 2009, and the high company's interest coverage ratio at around 9x. While net debt increased significantly over the three years to 2009, measures of balance sheet health such as the net debt/EBITDA ratio have been under control. The current net debt/EBITDA ratio of 2.3x is quite healthy for a well-respected company operating in a stable and growing market. We illustrate this point in the charts below.

Figure 18.1 Net debt (SAR mn)



Source: Company data, Al Rajhi Capital

Figure 18.2 Gearing measures



Source: Company data, Al Rajhi Capital

Over the next few years, our models currently assume that Almarai's gearing will steadily decline. However, this partly reflects the fact that it is very difficult to predict M&A

operations in advance. Experience suggests that Almarai will stage additional acquisitions, in which case the company's debt level will not fall off in line with our projections. That said, our confidence in Almarai's ability to integrate new acquisitions means that we are not excessively concerned on this point.

Almaraiõs aggressive expansion is challenging, but expected to be worthwhile

Almarai has shown an impressive capability in entering and managing new business segments financially and operationally. As a result, we believe that it will succeed in managing its recent acquisitions and expect it to maintain its expansion trend. However, we ought to draw attention to a few concerns. First, aggressive expansion through acquisitions may distract Almarai and risk its market share in its core segment, dairy. Second, entering many segments will increase rivals which means fighting on different fronts. Third, as mentioned earlier the purpose of Almarai's joint venture with PepsiCo is somewhat obscure for us, and we are concerned about the possible the effect on Almarai's name – since, in our view, the joint venture contradicts with Almarai's overall objective of providing high quality and mainly healthy food. Nevertheless, we still think that these acquisitions are worthwhile and will be more fruitful if Almarai can overcome these challenges.

Furthermore, Almarai has invested SAR700mn to develop infant milk formula. We expect this segment to be launched in 2011 and to comprise about 5% of Almarai's top line. However, we ought to bring to light that this category will need another investment to set up a distribution network for it. The reason is that it is sold mainly in pharmacies; supermarkets cover around 20% only of this segment's sales.

Savola: underlying returns are better than they look

Savola is expanding both organically and through M&A

Savola spent SAR1,200mn on acquisitions in 2009

In accordance with its recent strategy of focusing more closely on its core businesses, Savola has completed many successful acquisitions in food and retail categories. It has bought the stakes of minority shareholders in Afia Egypt, New Marina Plastics Egypt, and Tate & Lyle in the sugar business. In addition to its 80% interest of Giant Stores Trading Company, Savola has completed a major retail acquisition by buying the assets of Saudi Geant (eleven stores). According to Savola, the company spent SAR1,200mn on acquisitions in 2009.

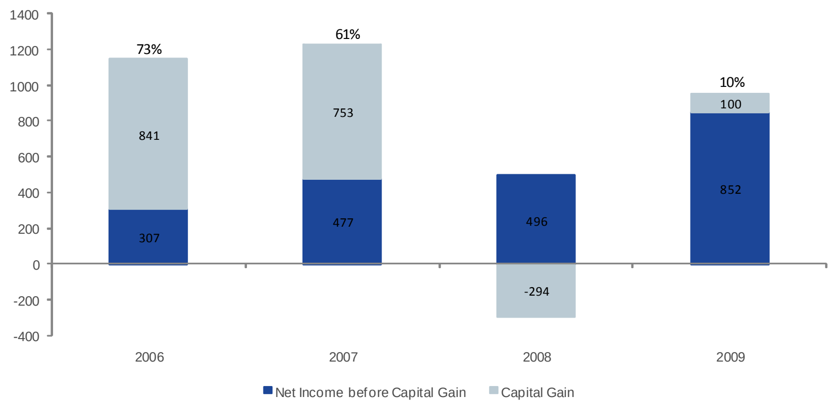
Savola has also been growing organically in the food sector

On the other hand, Savola has been committed to expanding organically too. Many projects to increase edible oil and sugar production capacity are underway. The company has started the construction of a beet sugar refinery in Egypt and has increased production capacity in the Saudi edible oil refinery by 120,000 metric tonnes. It has also opened new Panda stores (three hypermarkets, seven supermarkets). Furthermore, Savola is launching a SAR120mn pasta factory in Egypt; with a capacity of 50,000 tones, this factory is expected to increase revenues by SAR500mn. This step is diversifying Savola's food segment and allowing it to continue grow rapidly.

Capital gains have declined to represent only about 10% of net profit

We believe that these accomplishments not only show Savola's commitment to its strategy and confidence in its core business, but have also put the company back on track. Savola has already started to reap the fruits: it announced outstanding results for 2009. As shown in the graph, Savola has enormously reduced its reliance on capital gains, which declined to represent only 10% of net profit in 2009. Equally significantly, underlying net profit excluding capital gains increased by 72% from SAR496mn in 2008 to SAR852mn in 2009.

Figure 19. Savola net income breakdown



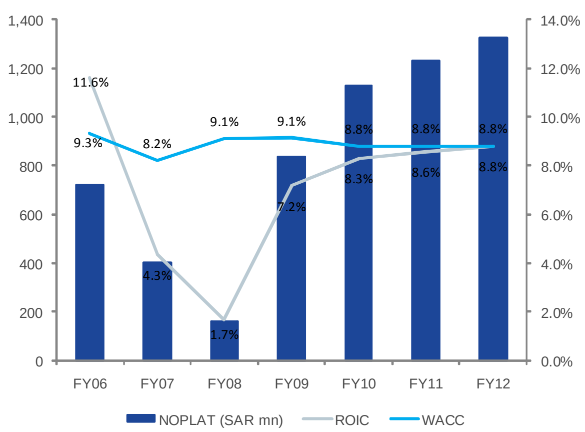
Source: Company data, ARC Research

Savola: good returns on core operations excluding its investments

In contrast to Almarai, Savola does not generate a headline economic profit

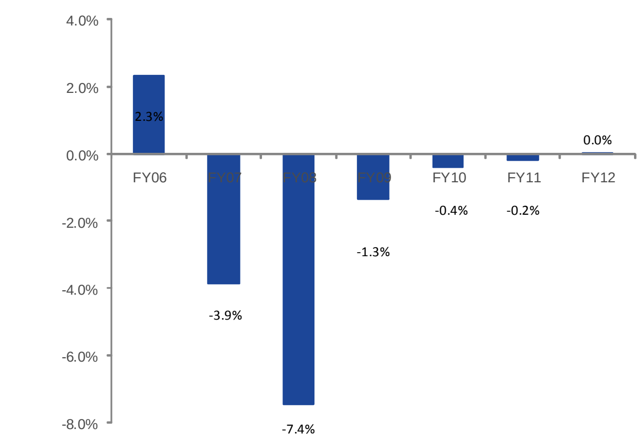
Although Savola's underlying profitability has improved, in contrast to Almarai the company does not generate a headline economic profit. By our estimate, Savola achieved a return on invested capital of just 1.7% in 2008. Given that we estimate weighted average cost of capital for Savola at 9.1%, this means that Savola generated a large negative economic profit spread (-7.4%). However, the strong improvement in Savola's results in 2009 resulted in a major reduction of the company's economic loss; we calculate the economic profit spread (ROIC – WACC) for that year at-1.3%. We expect further improvement in Savola's economic performance over the next few years, although we do not expect the economic spread to turn handsomely positive.

Figure 20.1 Savola: NOPLAT and return on invested capital



Source: Company data, Al Rajhi Capital

Figure 20.2 Savola: economic profit spread (ROIC - WACC)



Source: Company data, Al Rajhi Capital

Savola's low economic returns compared to Almarai do not reflect poor management execution. On the contrary, they reflect two principal factors:

- Lower margins than Almarai

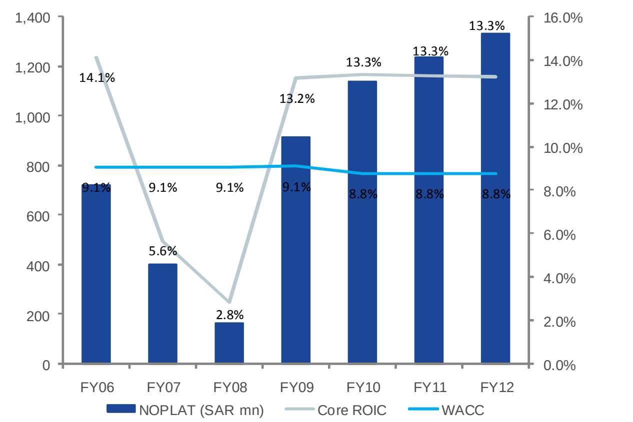
Savola achieved an EBITDA margin of 7.4% in 2009, whereas Almarai achieved an EBITDA margin of 28.9%. This in turn is a reflection of Savola's different business mix, with a heavy weighting towards retailing (about 41% of revenues in 2009); supermarkets and other retailers traditionally have low profit margins.

- The fact that a large portion of invested capital is tied up in investments

We estimate that Savola achieved a core economic profit spread of about 4% in 2009

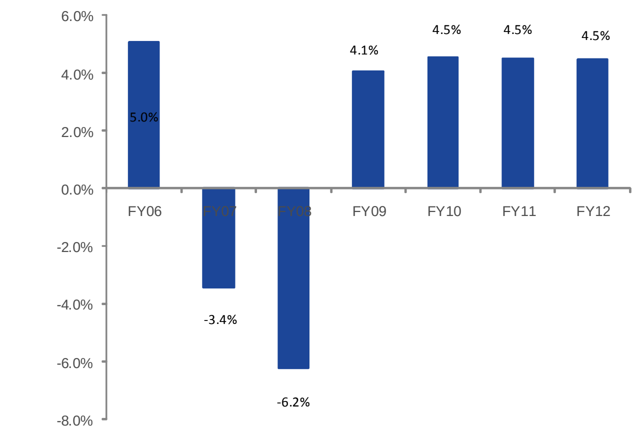
This is the consequence of a conscious strategic decision. As we comment below, Savola holds a large portfolio of investments, of which its holding in Almarai is by far the largest. These investments are treated as equity associates, and so only contribute to Savola's results through equity income; they make no contribution to revenues or operating profit. As the chart below shows, Savola's return on "core" invested capital excluding the investments is much higher, at about 13% in 2009. On this basis, Savola achieved a core economic profit spread of around 4% last year, a figure which we expect to trend upwards from this year on.

Figure 21.1 Savola: NOPLAT and return on core invested capital



Source: Company data, Al Rajhi Capital

Figure 21.2 Savola: core ROIC - WACC



Source: Company data, Al Rajhi Capital

Savola holds valuable strategic investments; Almarai has a questionable one

Savola takes its investments operation very seriously

Savola has three business segments: manufacturing/wholesale (including sugar, edible oils and plastics), retailing, and investment and other activities. Investors considering purchasing shares in Savola must understand that the company takes the third of these segments as seriously as the other two. The investment segment generates no revenues, but is very important in terms of assets: non-current investment assets on Savola's balance sheet amounted to SAR5,056mn at the end of 2009, with equity associates representing SAR3,374mn or 67% of this total.

Figure 22. Savola: Strategic Investments

Investments in associates (SAR)	Ownership (%)	Book value
Almarai Company	29.9%	1,842
Kinan International for Real Estate	30.0%	546
Intaj Capital Limited	49.0%	393
Al-seara City company for real estate	40.0%	134
Alexandria sugar company	45.5%	175
Knowledge Economic City Development company	17.0%	13
Diyar Almshrq		235
Emerge Investment Ltd	20.0%	23
Kinan Arabia for real estate	20.0%	0.4
Other Real estate investments in Saudi Arabia		804
Swicorp Joussour company	14.0%	209
Swicorp Arabia Company	15.0%	116
Dar altamleek	5.0%	26
Knowledge City	6.4%	217
Other investments/asset impairments		286
Total		**5,019**

Note: As at end 2009 before additional purchases of Almarai
Source: Company data, ARC Research

One of Savola's most valuable assets is its 29.9% stake in Almarai. We should note that, while Almarai is a customer of Savola's Plastics division, it does not purchase any food products from Savola. The two companies thus have a close and strong relationship, but the relationship is entirely at arm's length; Savola exercises no management control over Almarai, and its investment in Almarai is not necessary for the two companies to have their commercial relationship. One might ask, therefore, why Savola holds the stake.

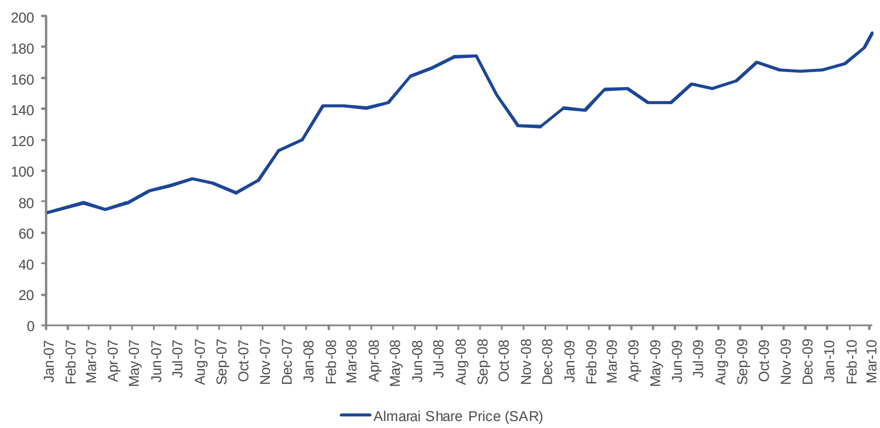
Savola has held its stake in Almarai since 1991. The stake has been valuable and we see no reason for the status quo to change

Frankly speaking, it is probably not strategically essential for Savola to hold the stake. Nevertheless, we approve of the holding because:

1. It is as a highly valuable investment that comprises about 20% of Savola's fair equity value;
2. Savola has held the stake since 1991 as a long-term investment, and we see no reason for the status quo to change;
3. We see Almarai as one of the best food companies in the world, which helps explain why the investment has been highly successful for Savola

This third point is particularly worth stressing. The book value of Savola's holding in Almarai was SAR1,842mn at the end of 2009, but the market value of the stake is currently SAR6,232mn. (Note that Savola has increased its stake in Almarai from 26.5% at the end of last year to 29.9% now.)

Figure 23. Almarai's historical share price (SAR)



Source: Bloomberg, ARC Research

Herfy, recently listed in the TASI, is another valuable investment. Savola made a capital gain of around SR200mn when Herfy went public through an IPO in February 2010. Savola's holding is Herfy is now 47.6%, and the holding is worth around SAR790mn. Until 2009 Herfy was a full subsidiary of Savola; however, from this year onwards we expect Savola to treat the company as an equity associate.

However, we are dubious about Savola's investment in real estate. The company has several investments in real estate companies and major infrastructure projects in Saudi Arabia such as Kinan, King Abdullah Economic City, and Knowledge City. Our concern stems from the ambiguity of this step and the risks associated with such megaprojects. We would also argue that Savola has no particular expertise in the real estate business. However, Savola's real estate investments may prove to be valuable over the long run considering the booming real estate in the Kingdom.

Almaraiés investment in Zain is questionable, but it is not a big concern

In contrast to Savola, Almarai does not hold many strategic investments except a stake in Zain KSA and a few other very small investments. Regarding Zain, Almarai holds a stake of 35mn shares or 2.5%, which is currently worth SAR343mn. Rather than adding value, we think that this investment poses a risk. We have arrived at this pessimistic view not only because we are concerned about Zain's high debt levels (see our comprehensive report *Saudi Telecoms Sector: We prefer jam today* dated 25 January, 2010; note that our investment rating on Zain KSA is Underweight), but also because we do not see the strategic rationale for a food company to have an investment in a telecoms operator.

Innovation seems to be on hold

Innovation is one of the major factors necessary to maintain a competitive advantage. It is arguable that many of those corporations which have survived the recent global economic downturn in a strong position have been those which have focused on innovation as a strategy. Thus, we believe that it is important to highlight the innovativeness of Almarai and Savola.

Alsafi-Dabone has launched many more new products than Almarai

Although Almarai has an innovative marketing activities, its innovation in product development seems to be on hold. We believe that its recent strategy of expanding inorganically has slowed down its innovation. Although many new products have failed, Almarai used to launch innovative products more frequently than it does now. This is the only area where we see Alsafi-Danone, the second dairy company in Saudi Arabia, as outperforming Almarai. We believe that Alsafi-Danone has benefited from the research and development activities of its mother company, Danone, as it can simply choose products that will fit the Saudi market from Danone's wide variety. We still, however, consider Almarai as one of the most innovative companies in MENA.

Savola, on the other hand, seems to be less interested in product innovation although it has shown some innovative marketing activity. This can be partly justified by the company's business nature, commodity foods and retailing. However, we still value strategic innovation as a major aspect to drive growth and sustain competitive advantage on the long term. Therefore, we see this issue as one of the weaknesses of Savola.

Valuation: both Almarai and Savola still offer good value

Summary of our approach and conclusions

Our key long-run method of forecasting is discounted economic profit (DEP) forecasting

Our key method of valuation for the Saudi food producers is long-run discounted economic profit (DEP), sometimes also called discounted long-run EVA ("economic value added"). This is a simple variation on discounted cash flow and is mathematically equivalent. In our models, we make explicit forecasts for income statement, balance sheet and cash flow out to 2020. We then assume a steady fading of return on invested capital, i.e. excess return, down to the cost of capital over a period of up to 50 years from end of our period of explicit forecasting. This approach avoids a common problem in long-run modelling: namely, that the analyst stops forecasting at some arbitrary point when the company in question is still generating high returns. In terms of financial theory this is implausible, and excess returns will eventually disappear through competition, regulation or some other means.

Our DEP valuations are sensitive to many factors, including assumed revenue growth, EBITDA margin and capex/sales ratio in 2020, i.e. the last year of explicit forecasting. Another important variable is the assumed duration of the period of competitive advantage, i.e. the period during which the company generates returns above weighted average cost of capital (WACC). Deciding on the length of the period of the competitive advantage is naturally a subjective exercise. We have assumed 30 years for both companies, Savola and Almarai, on the grounds that they are the leaders in their markets and that it would take several years for rivals to challenge them effectively.

Almarai benefits from a low effective rate of interest which reduces its WACC

However, as with any DCF-based approach, the factor to which the DEP valuation is most sensitive is WACC. We have assumed a WACC of around 9.1% for Savola; we think that this comparatively high figure can be attributed to the company's international operations. For Almarai, we have assumed a lower WACC of 8.1% which stems from its low interest on debts: by our calculation, Almarai pays an effective interest rate on gross debt of 3.7%. We attribute this low rate to the fact that a significant portion of Almarai's loans comes from the Saudi Development Industrial Fund and Saudi Development Agricultural Fund; these loans carry a very low or zero interest rate.

WACC is in turn highly sensitive to assumed terminal capital structure. Estimating terminal capital structure is again a rather subjective exercise. We have assumed a terminal debt/(debt plus equity) ratio of 30% for both Savola and Almarai, compared to about 30% and 40% respectively at present.

We use comparative multiples analysis in addition to DEP

In addition to long-run DEP, we use comparative multiples analysis to value Almarai and Savola in relation to other strong multinational players. Under this approach we use comparisons of valuation measures – notably, EV/EBITDA and PE multiples– with other listed multinational food producers to estimate fair value. We have taken a weighted average of the two methods as our target price by giving a weight of 70% to the long-run DEP method and 30% to the comparative multiples analysis method. Arguably we should be using only the long-run DCF or DEP method, not only because it is theoretically more defensible, but also because it is well-suited to a sector like food with reasonably predictable cash flows. However, we see the comparative multiples method as a good indicator of performance and pricing in the real world.

We rate Almarai Overweight and set a target price of SAR220, implying 17.1% upside potential. We rate Savola Overweight as well and set a target price of SAR41.1, implying 17.4% upside potential. Almarai and Savola offer dividend yields of 2.2% and 2.7% respectively. We believe that dividends in both companies have potential to grow considering that they enjoy strong cash flows. Currently, the low dividend yield partly can be attributed to the expansion stage both companies are undergoing. Almarai and Savola currently have a dividend payout ratio of 42% and 48% respectively.

High transparency likely to continue to support both companiesôshare prices

While the share prices of both Almarai and Savola have performed strongly already, we believe that they can rise further. One of the key reasons for this is the transparency of both companies. The Middle East Investor Relations Society (ME-IR Society) declared Almarai to have the best investor relations operation in Saudi Arabia in 2009. For its part, Savola has taken a major step forward in transparency by announcing estimated results for this year. The commitment to high transparency not only demonstrates the professional standards of the two companies, but also shows their high confidence in their businesses. We believe that institutional investors, especially international investors, are more interested in investing in transparent companies than in others.

Once the market is opened, we expect international investors to buy Almarai and Savola

In this context, it is worth stressing that we expect both Almarai and Savola to attract strong buying interest once international investors are allowed to participate fully in the Saudi stock market. We note that the Saudi Capital Market Authority (CMA) has recently approved the launch of exchange-traded funds (ETFs) in the Saudi market. International investors should be allowed to invest in ETFs initially, and it is widely expected that they will be allowed to invest directly in Saudi stocks in the future.

Below we discuss fair value for the two companies in detail.

Almarai

We have selected two multinational food companies as benchmarks for Almarai

As mentioned, we use two valuation methods: long-run EVA and comparative multiples analysis. For the multiple analysis, we use EV/EBITDA multiple and PE multiples. We believe that we have been very selective and conservative by choosing strong multinational companies as benchmarks. Those two companies are Danone and Nestle. Despite their high market capitalisation compared to Almarai's, we believe that they provide perfect comparables considering their business nature. We see Almarai in the MENA region as enjoying the same strength as these companies in their regions. The table below shows these companies' major figures and ratios compared to Almarai's.

Figure 24. Almarai: comparative multiples analysis

Company	Market	Sector	Mkt Cap (US$mn)	P/E	EV/ EBITDA	EPS	Bloomberg Code
Danone	EN Paris	Food-Misc/Diversified	36,552	15.4	12.2	3.6	BN FP
Nestle	SIX Swiss Ex	Food-Misc/Diversified	168,680	16.8	11.9	3.08	NESN VX
Almarai	Tadawul	Food & Agriculture	5,173	16.9	12.3	3.3	ALMARAI AB

Source: Bloomberg, ARC Research

Using the average of the benchmark companies' PE and EV/EBITDA ratios for 2010, we estimate a fair share price for Almarai at SR186. As noted, we have given a 30% weight to this method.

In the long-run DEP method of estimating Almarai's fair value, we use a WACC of 8.1%. We calculate WACC as shown in the table below.

Figure 25. Almarai: weighted average cost of capital (WACC)

Risk-free Rate	3.2%
Market Risk Premium	8.0%
Adjusted Beta	0.9
Cost of Equity	10.0%
Pre-tax Cost of Debt	3.7%
Effective Tax rate	2.6%
After-tax Cost of Debt	3.6%
Target D/(D+E)	30.0%
WACC	**8.1%**

Source: ARC Research

We see DEP fair value for Almarai at SAR235

Using our core assumption of a period of competitive advantage of 30 years, we estimate fair value per share for Almarai at SAR235. The table below shows fair value assuming different periods of competitive advantage, but with all other long-run assumptions unchanged.

Figure 26. Almarai: fair value per share assuming different durations of competitive advantage

	Fair value per share (SAR)
25 years	217
30 years (Core Scenario)	**235**
35 years	252
40 years	271

Source: ARC Research

We set our target price for Almarai at SAR220

We set our target price per share for Almarai at SAR220. We have arrived at this target price by giving a weight of 70% to the long-run EVA method (SAR235 fair value per share), and 30% to multiples (SAR186 fair value per share). We believe that the difference between these two methods can partly be attributed to the fact that Almarai is currently undergoing aggressive expansion through acquisitions.

Savola

We selected two international food companies and one retail company as benchmarks for Savolaœ business

Like Almarai, we use two valuation methods to arrive at our target price for Savola: long-run EVA and comparative multiples analysis. For the multiple analysis, we use EV/EBITDA multiple and PE multiples. We have been very selective and conservative in our benchmarking. Since Savola operates mainly in commodity food (sugar and edible oil) and retail which contribute about 52% and 44% to its top line respectively, we selected three multinational companies in which two are food producers (sugar & pasta) and one in retail. Those three companies are: Suedzucker AG (Food), Tate & Lyle PLC (food), and Carrefour (retail). Those companies have similar market capitalisation to Savola's except Carrefour which is much larger; nevertheless, we believe that they all provide good comparables considering their combined business nature compared to Savola's. The table below illustrates these companies' major valuation ratios compared to Almarai's.

Figure 27. Savola: comparative multiples analysis

Company	Market	Sector	Mkt Cap (US$mn)	P/E	EV/ EBITDA	EPS	Bloomberg Code
Suedzucker AG	Xetra (Germany)	Food (Sugar)	4,233	16.1	11.4	1.4	SZU GY
Tate & Lyle PLC	London	Food	2,884	10.8	11.7	0.6	TATE LN
Carrefour	EN Paris	Retail - Food	33,657	17.8	7.7	3.2	CA FP
Savola	Tadawul	Food & Agriculture	4,467	16.7	9.6	0.6	SAVOLA AB

Source: Bloomberg, ARC Research

Using the average of the benchmark companies' PE and EV/EBITDA ratios for 2010, we estimate a fair share price for Savola at SAR36.2. As noted, we have given a 30% weight to this method.

In the long-run DEP method of estimating Savola's fair value, we use a WACC of 9.1%. We calculate WACC as shown in the table below.

Figure 28. Savola: cost of capital

Risk-free Rate	**3.2%**
Market Risk Premium	8.0%
Adjusted Beta	1.0
Cost of Equity	11.3%
Pre-tax Cost of Debt	4.3%
Effective Tax rate	6.7%
After-tax Cost of Debt	4.0%
Target D/(D+E)	30.0%
WACC	**9.1%**

Source: ARC Research

We see DEP fair value for Savola at SAR41.1

Using our core assumption of a period of competitive advantage of 30 years, we estimate fair value per share for Savola at SAR43.2. The table below shows fair value assuming different periods of competitive advantage, but with all other long-run assumptions unchanged.

Figure 29. Savola: fair value per share assuming different durations of competitive advantage

	Fair value Per Share (SAR)
25 years	40.5
30 years (Core Scenario)	**43.2**
35 years	44.1
40 years	46.5

Source: ARC Research

In our fair value calculation, we include the stakes in Almarai and Herfy at market value

In the long-run DEP method, it is essential to highlight that, when calculating Savola's fair equity value, we take into consideration the market value of the company's stakes in Almarai and Herfy. This is shown in the table below.

Figure 30. Savola: fair equity value

	(SAR) mn
Estimated fair enterprise value	18,675
Less: net debt	(3,641)
Less: market value of the stake in Herfy	(778)
Less: other minority interest	(2,495)
Add: market value of stake in Almarai	6,533
Add: other investments at book value	2,519
Estimated fair equity value	20,814
Estimated fair equity value per share	43.2

Notes: 1. For associates other than Almarai we give our estimate of book value at end Q1 2010.
2. Here we still treat Herfy as a subsidiary, as it was until end 2009, although from 2010 onwards we expect it to be treated as an equity associate.

Source: Company data, ARC Research

We set our target price for Savola at SAR39.5

We set our target price per share for Savola at SAR41.1. We have arrived at this target price by giving a weight of 70% to the long-run DEP method (SAR43.2 fair value per share), and 30% to the comparative multiples method (SAR36.2 fair value per share).

DEP fair value for Savola would be SAR47 if we took the stake in Almarai at our estimate of fair value

Naturally, we could have chosen to include Savola's stake in Almarai in our fair value calculation at our estimate of Almarai's fair value, rather than its market value. We have not done so in order to be conservative. However, if we were to do so, then fair value per share for Savola would be SAR47. We should add that strong share price performance by Almarai ought to support Savola's share price too.

Companies section

Figure 31. Almarai: Revenues Breakdown

(SAR) mn	2009A	2010E	% chg.	Assumptions
Fresh Dairy	2,818	2,987	6%	We expect fierce competition in the dairy market; besides Almarai has a high market share
Long Life Dairy	563	596	6%	
Fruit Juice	620	713	15%	The juice market is fragmented, we expect Almarai to gain more market share
Cheese & Butter	1,143	1,223	7%	We expect decent growth as Almarai has already gained high market share
Bakery	618	698	13%	The bakery market is fragmented, we expect Almarai to gain more market share
Poultry	73	406	457%	Poultry is a new segment (HADCO) that was acquired in Q4 2009
Other	34	37	8%	Other products growth was based on historical average growth
Total Revenues	**5,869**	**6,661**	**13%**	As discussed above
Gross Profit	2,366	2,768	17%	
	40%	41%		We expect Almarai to maintain its strong gross margin
EBITDA	**1,732**	**2,045**	**18%**	See below
EBITDA margin (%)	30%	30%		We believe that Almarai can maintain its EBITDA margin at around 30%.
Net Income	**1,095**	**1,278**	**17%**	Net income should increase as a result of revenue growth and higher efficiency (HADCO)
Capex/Sales	**1,227**	**799**	**-35%**	We expect capex to decline as a result of the company's intention to hold up acquisitions in order to focus on integration of the recently acquired businesses
Capex/Sales	21%	12%		
Net Debt	**3,869**	**3,588**	**-7%**	We expect net debt to decline slightly in 2010

Source: Company data, ARC Research

Figure 32. Savola: Revenues Breakdown

(SAR) mn	2009A	2010E	% chg.	Assumptions
Sugar	3,408	3,640	6%	We expect stable growth for the food category as Savola already has high market share
Edible oil	5,809	6,171	6%	We expect stable growth for the food category as Savola already has high market share
Retail	7,523	8,200	9%	Retail should improve as a result of new acquistions and rationalisation of recently acquired stores
Plastics	743	817	10%	We believe that Savola will maintain strong growth in the plastics segment
Other	435	460	6%	We expect other strategic investment income to increase slightly
Total Revenues	**17,917**	**19,288**	**8%**	
Gross Profit	3,116	3,349	7%	We expect Savola to maintain its gross profit margin
	17%	17%		
EBITDA	**1,331**	**1,540**	**16%**	EBITDA should improve as a result of rationalising recent acquired businesses
EBITDA margin (%)	7.4%	8.0%		
Net Income	**952**	**1,048**	**10%**	We expect the retail margin to improve and stable to better results in other areas
Capex/Sales	**1,003**	**772**	**-23%**	We expect Savola to continue its acquisition activity especially in the retail market, but to slow down in other segments, which would reduce its capex
Capex/Sales	6%	4%		
Net Debt	**3,908**	**3,641**	**-7%**	We expect net debt to decline in 2010, partly due to lower capex

Source: Company data, ARC Research

Almarai Company

Agriculture & Food Sector

ALMARAI AB: Saudi Arabia

03 April 2010

Al Rajhi Capital الراجحي المالية

USD5.7bn	44.7%	US$8.00mn
Market cap	Free float	Avg. daily volume

Target price	220.1	17.1% over current
Consensus price	202.0	7.4% over current
Current price	188.0	as at 29/3/2010

Equity Research Department
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Underweight | Neutral | **Overweight**

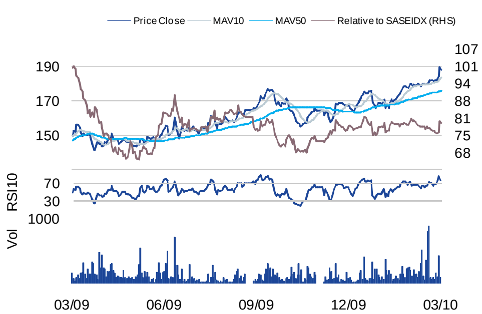
Key themes

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 startup 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

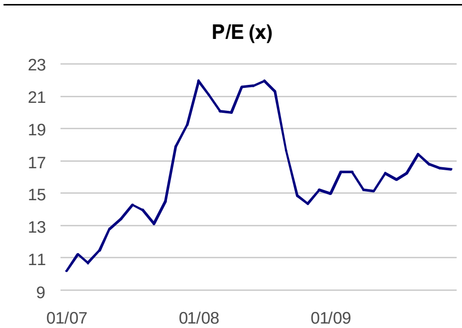


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	5,869	6,661	7,460	8,281
Revenue Growth	16.7%	13.5%	12.0%	11.0%
EBITDA (SARmn)	1,732	2,045	2,175	2,415
EBITDA Growth	19.5%	18.0%	6.4%	11.0%
EPS	9.78	11.11	13.51	15.40
EPS Growth	9.0%	13.6%	21.6%	14.0%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Almarai
Always fruitful

Almarai is the biggest company in its sector by market capitalisation and is financially strong. It has maintained impressive growth over the past couple of years. This growth was derived from Almarai's strong position in dairy and entering new food segments. We believe Almarai will continue its expansion trend although it may hold this in 2010 in order to integrate recently acquired businesses (mainly HADCO). Almarai has an outstanding record in managing and mastering new segments; thus, we think it will thrive with HADCO as well.

Market: We believe that the young (50% below 20) and rapidly growing population play a vital role in stimulating the food market. The GCC has a young population with an annual growth of 2.5%; Saudi Arabia is the largest market with a population of about 25mn and per capita GDP of about $19,000; we tend to focus on the Kingdom as it represents more than 50% of the GCC market. Furthermore, education is driving dairy growth as people become more conscious of the benefits of healthy food, which may hurt other unhealthy food categoriess in the long run.

M&A and new opportunities: In addition to Almarai's acquisition of HADCO (which represents about 8% of our estimate of 2010 sales), it has invested around SAR700mn in infant formula (baby food). We believe that these two segments (poultry & baby food), plus bakery and juice, will drive the company's growth over the next few years. Furthermore, Almarai has an opportunity to expand geographically in North Africa and other MENA countries if its joint venture with PepsiCo proves to be successful. The Iraqi market, which is as large as that in Saudi Arabia, is another strategic region for expansion if political issues are resolved.

Water issue is exaggerated: Concern about excessive use of water in dairy food production is an issue that has weighed on Almarai's share price. According to Almarai and other dairy companies, the water issue is close to being resolved. Almarai has already proposed importing alfalfa that is sufficient for exported dairy products; this proposal is 90% approved according to the company. This will not hurt margins excessively considering that exports make up less than 30% of Almarai's top line. Also, we believe that Almarai may form a joint venture or buy farms outside the kingdom to solve this issue permanently.

Valuation: Almarai still offers value: Using long-run discounted economic profit valuation, we estimate fair value per share for Almarai at SAR235. On a comparative multiples analysis basis, we estimate fair value at SAR186. Our target price for Almarai of SAR220 is a weighted average of the two estimates with a weight of 70% to the long run DEP method and 30% to the multiples. Our target price implies 17.1% upside from current levels. Almarai is trading on a 2010 EV/EBITDA multiple of 12.3x, a 2010 PE ratio of 16.9x, and offering a yield of 2.2%. While no longer cheap, Almarai's valuation is in line with that of international peers such as Nestle and Danone. We also believe that the valuation is justified for a company which 1) very transparent, with strong investor relations, and 2) yields a handsome economic profit: Almarai's return on invested capital of 15.9% (our estimate for 2010) is double its WACC of 8.1%.

Corporate summary

Almarai is the largest integrated dairy foods company in the world, with a reputation for quality within the Gulf countries 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 the Kingdom of Saudi Arabia. Almarai Company'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 and has greatly expanded to include cheese, bakery, juice, and poultry.

Share information

Market cap (SAR/US$)	22.0bn / 5.9bn
52-week range	141.5 - 189.8
Daily avg volume (US$)	7.90mn
Shares outstanding	115.0mn
Free float (est)	44.7%

Performance:	1M	3M	12M
Absolute	4.6%	13.4%	24.1%
Relative to index	-0.6%	2.8%	-19.1%

Major Shareholder:	
Savola Group	29.9%
Prince Sultan bin Mohammed Alkbeer	28.6%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	5,869	6,661	7,460	8,281
EBITDA (SARmn)	1,732	2,045	2,175	2,415
Net Profit (SARmn)	1,095	1,278	1,554	1,771
EPS (SAR)	9.78	11.11	13.51	15.40
DPS (SAR)	4.00	4.00	5.00	6.25
EPS Growth	9.0%	13.6%	21.6%	14.0%
EV/EBITDA (x)	14.4	12.4	11.3	9.9
P/E (x)	19.2	16.9	13.9	12.2
P/B (x)	4.0	3.5	3.0	2.6
Dividend Yield	2.1%	2.1%	2.7%	3.3%

Source: Company data, Al Rajhi Capital

Almarai is growing rapidly

Acquisitions are the current mode

Acquisitions and joint venture with PepsiCo are driving current growth

Almarai has adopted an acquisitions strategy to expand for the last couple of years. We applaud this move as it diversifies Almarai's portfolio and broadens its geographic reach. In addition to its M&A transactions in recent years, Almarai has formed a joint venture with PepsiCo to explore new business opportunities in dairy and juice products in Southeast Asia, Africa and the Middle East excluding the GCC countries. According to Almarai, the new joint venture, called International Dairy and Juice Limited (IDJ), of which Almarai holds 48%, has been incorporated with an initial paid-up capital of $7.0mn. The parent Pepsico has shown its intention to enter the healthy foods segment by approaching the biggest players in different regions. Approaching Almarai proves its well known reputation. Almarai will bring the technical knowhow while PepsiCo will utilise its strong network and understanding of the targeted market. Although this JV is somewhat ambiguous, we believe it may pay back in the long run considering the involved parties and the announced intent. As Alsafi has benefited from its relationship with Danone, Almarai may at least benefit from PepsiCo as a multinational company in developing its staff and transferring knowledge.

Early in 2009, Almarai completed the purchase of 75% of Teeba Investment for Developed Food Processing Company in Jordan, paying SAR271mn to the founding shareholders. However, in June 2009, Almarai transferred its 75% investment in Teeba to IDJ for equity and cash. Furthermore, according to Almarai's 2009 annual report, a new subsidiary, Almarai International Holding WLL was incorporated as a holding company for the purchase of the International Company for Agro Industrial Projects (Beyti) in Egypt. The transaction was completed on 30 September 2009 and Almarai paid cash consideration of $127mn (SAR478mn). Recently, Almarai transferred 100% of Beyti to IDJ for equity and cash.

In October 2009, Almarai acquired 100% of the outstanding share capital of HADCO, an agricultural company with a core business in poultry in exchange for 6.0mn new shares issued by Almarai in the ratio of one new Almarai share for every five HADCO shares and a payment of SR0.50 per HADCO share. The net cash consideration amounted to SAR15mn. The total acquisition cost of HADCO including acquisition expenses amounts to SR1,082mn based on an issued share price of SR174.75 at close of market on 14 October 2009. We believe that this acquisition will not only diversify Almarai's products portfolio, but also contribute about 8% to Almarai's top line in 2010.

Strong record in entering and managing new business areas

Almarai has shown an impressive capability in entering and managing new business segments financially and operationally. As a result, we believe that it will succeed in managing its recent acquisitions and expect it to maintain its expansion trend. The company's success in absorbing and integrating new acquisitions is illustrated by its high economic profit spread: by our calculation return on invested capital is roughly double the company's cost of capital.

However, we ought to draw attention to a few concerns. First, aggressive expansion through acquisitions may distract Almarai and risk its market share in its core segment, dairy.

Second, entering many segments will increase rivals which means fighting on different fronts. Third, as we have pointed out the purpose of Almarai's joint venture with PepsiCo is somewhat obscure to us, and we are concerned about the effect on Almarai's name; in our view, this joint venture runs counter to Almarai's strategy of providing high quality and mainly healthy food. Nevertheless, we still think that these acquisitions are worthwhile and will be more fruitful if Almarai can overcome these challenges.

Being the best IR in the Kingdom is not a coincidence

Finally, we ought to highlight the transparency and cooperation of Almarai's Investor Relations (IR). Almarai's IR operation was rewarded and recognised by The Middle East Investor Relations Society (ME-IR Society) as the best IR in the Kingdom and as one of the best IR operations in the MENA region in 2009. We believe that this recognition reflects the company's professionalism. The ME-IR Society aims to support the further development and practice of investor relations across the Middle East in line with the rapid growth of the region's capital markets and increasing demand from both regional and global investors for greater disclosure and transparency.

Almarai is well positioned
SWOT Analysis

Strengths

- Highly efficient operations.
- Strong distribution which results in an outstanding geographic reach.
- Well recognised and preferable brand name by consumers.
- Innovative marketing activity.

Weaknesses

- Almarai lacks organic growth through innovation, the only area where we believe Alsafi-Danone outperforms Almarai by benefiting from Danone's huge R&D.
- Revenues are not geographically well diversified (about 70% comes from Saudi Arabia).

Opportunities

Iraq market might become a great opportunity to expand geographically.

- Education is encouraging dairy consumption as people are becoming more health conscious.
- The young and rapidly growing population is fuelling growth.
- Increasing market share in the new acquired segments, mainly poultry and bakery.
- Expanding by entering new markets (MENA) or existing markets with new products (new acquired Businesses).
- Continuing the acquisitions trend to grow horizontally and vertically.
- Growing retail market is stimulating FMCG in general.
- The Iraqio market which as big as the Saudi market will be an opportunity if political issues are resolved.

Threats

- The reliance on fresh dairy produce may hurt the bottom line as we expect price-cutting moves by other companies.
- Government restriction on water use. Around 500 litres of water are required to produce 1 litre of milk. This water consumption is questionable considering its scarcity in Saudi Arabia.
- Aggressive expansion may distract the company; Almarai, as a result, may lose focus on core business and give up its strong position.
- Fluctuation in feedstock prices.
- Questionable share in a potentially unsuccessful business, Zain KSA, which may result in a loss of investment.

Valuation

We selected two multinational food companies as benchmarks

We use two valuation methods: long-run EVA and relative multiples analysis. For the multiples analysis, we use EV/EBITDA multiple and PE multiples. We believe that we have been selective and conservative by choosing two strong multinational companies, Danone and Nestle, as benchmarks. Despite their high market capitalisation compared to Almarai's, we believe that are almost perfect peers considering their business nature. We consider Almarai in the MENA region to be as strong as these companies in their respective regions.

Figure 33. Almarai: comparative multiples analysis

Coompany	Market	Sector	MKT Cap	P/E	EV/ EBITDA	EPS	Bloomberg Code
Danone	EN Paris	Food-Misc/Diversified	36552	15.4	12.2	3.6	BN FP
Nestle	SIX Swiss Ex	Food-Misc/Diversified	168680	16.8	11.9	3.08	NESN VX
Almarai	Tadawul	Food & Agriculture	5173.3	16.9	12.3	3.3	ALMARAI AB

Source: Bloomberg, ARC Research

Using the average of the benchmark companies' PE and EV/EBITDA ratios, we calculate the price of Almarai share at SR186. We utilise long-run EVA, on the other hand, to calculate Almarai's fair value using a WACC of about 8.1%. Using our core assumption of a period of competitive advantage of 30 years, we estimate fair value per share for Almarai at SAR235.

We set our target price per share for Almarai at SAR220. We have arrived at this target price by giving a weight of 70% to the long-run EVA method (SAR235 fair value per share), and 30% to the multiples method (186 fair value per share). We believe that price divergence between the two methods can be attributed to the fact that Almarai is currently undergoing aggressive expansion through acquisitions.

Stock split or stock dividends ought to stimulate Almarai's share price

Moreover, we think consumers perceive Almarai's current share price as expensive compared to other stocks. This is, in our view, simply a reflection of Almarai's high absolute share price. We believe that a stock split or stock dividends would be a strong catalyst to stimulate Almarai's share price.

Risks associated with our assumptions

It is important to highlight that our valuation relies heavily on future forecasts which are uncertain. We have come up with several assumptions including growth, cost of capital, and market trend to predict future performance. We have tried to arrive at the most accurate assumptions; however, reality may deviate from our forecasts depending on new micro or macro factors. Competition is another factor that can influence our assumptions. New entrants or/and transformation of current rivals' would cause a change in the whole market, and hence in our estimates.

Impressive revenue growth supported by new segments

Almarai is expected to maintain its strong growth above 11% for the next three years

HADCO acquisition hurt 2009 margin, Almarai is expected to retain gross margin above 41%

We expect EV/EBITDA & EV/sales to improve

Income Statement (SARmn)	**12/08A**	**12/09A**	**12/10E**	**12/11E**	**12/12E**
Revenue	**5,030**	**5,869**	**6,661**	**7,460**	**8,281**
Cost of Goods Sold	(2,963)	(3,503)	(3,892)	(4,401)	(4,886)
Gross Profit	**2,067**	**2,366**	**2,768**	**3,059**	**3,395**
Government Charges					
S.G. & A. Costs	(938)	(1,087)	(1,272)	(1,343)	(1,491)
Operating EBIT	**1,129**	**1,279**	**1,496**	**1,716**	**1,905**
Cash Operating Costs	(3,580)	(4,136)	(4,616)	(5,285)	(5,866)
EBITDA	1,450	1,732	2,045	2,175	2,415
Depreciation and Amortisation	(321)	(454)	(549)	(460)	(510)
Operating Profit	**1,129**	**1,279**	**1,496**	**1,716**	**1,905**
Net financing income/(costs)	(125)	(151)	(175)	(109)	(74)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
Minority Interests	(1)	(3)	(11)	(13)	(15)
Net Profit Before Taxes	**1,003**	**1,125**	**1,311**	**1,594**	**1,816**
Taxes	(25)	(29)	(33)	(40)	(45)
Net Profit	**978**	**1,095**	**1,278**	**1,554**	**1,771**
Dividends	(380)	(460)	(460)	(575)	(719)
Transfer to Capital Reserve	-	-	-	-	-

	12/08A	**12/09A**	**12/10E**	**12/11E**	**12/12E**
Adjusted Shares Out (mn)	109.0	115.0	115.0	115.0	115.0
CFPS (SAR)	11.92	13.83	15.89	17.51	19.83
EPS (SAR)	8.97	9.78	11.11	13.51	15.40
DPS (SAR)	3.49	4.00	4.00	5.00	6.25

Growth	**12/08A**	**12/09A**	**12/10E**	**12/11E**	**12/12E**
Revenue Growth	33.4%	16.7%	13.5%	12.0%	11.0%
Gross Profit Growth	38.4%	14.5%	17.0%	10.5%	11.0%
EBITDA Growth	42.2%	19.5%	18.0%	6.4%	11.0%
Operating Profit Growth	44.6%	13.3%	17.0%	14.7%	11.0%
Net Profit Growth	46.5%	12.0%	16.7%	21.6%	14.0%
EPS Growth	46.5%	9.0%	13.6%	21.6%	14.0%

Margins	**12/08A**	**12/09A**	**12/10E**	**12/11E**	**12/12E**
Gross profit margin	41.1%	40.3%	41.6%	41.0%	41.0%
EBITDA margin	28.8%	29.5%	30.7%	29.2%	29.2%
Operating Margin	22.4%	21.8%	22.5%	23.0%	23.0%
Pretax profit margin	19.9%	19.2%	19.7%	21.4%	21.9%
Net profit margin	19.4%	18.7%	19.2%	20.8%	21.4%

Other Ratios	**12/08A**	**12/09A**	**12/10E**	**12/11E**	**12/12E**
ROCE	16.7%	13.6%	14.3%	14.9%	15.2%
ROIC	19.5%	17.1%	14.9%	15.4%	15.6%
ROE	29.3%	24.3%	22.1%	23.2%	23.0%
Effective Tax Rate	2.5%	2.6%	2.5%	2.5%	2.5%
Capex/Sales	31.3%	20.9%	12.0%	10.0%	10.0%
Dividend Payout Ratio	38.9%	42.0%	36.0%	37.0%	40.6%

Valuation Measures	**12/08A**	**12/09A**	**12/10E**	**12/11E**	**12/12E**
P/E (x)	21.0	19.2	16.9	13.9	12.2
P/CF (x)	15.8	13.6	11.8	10.7	9.5
P/B (x)	5.7	4.0	3.5	3.0	2.6
EV/Sales (x)	4.8	4.2	3.8	3.3	2.9
EV/EBITDA (x)	16.5	14.4	12.4	11.3	9.9
EV/EBIT (x)	21.2	19.5	16.9	14.3	12.5
EV/IC (x)	3.3	2.6	2.3	2.1	1.8
Dividend Yield	1.9%	2.1%	2.1%	2.7%	3.3%

Source: Company data, Al Rajhi Capital

Almarai's balance sheet is expanding as a result of recent aggressive expansion

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	247	508	1,072	1,781	2,550
Current Receivables	294	455	672	746	828
Inventories	1,097	1,219	1,210	1,343	1,491
Other current assets	107	-	-	-	-
Total Current Assets	**1,760**	**2,182**	**2,954**	**3,870**	**4,869**
Fixed Assets	5,343	7,049	7,299	7,586	7,904
Investments	489	963	963	963	963
Goodwill	549	793	793	793	793
Other Intangible Assets	40	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**6,422**	**8,805**	**9,056**	**9,342**	**9,660**
Total Assets	**8,181**	**10,987**	**12,010**	**13,212**	**14,529**
Short Term Debt	511	396	396	396	396
Trade Payables	600	963	874	970	1,076
Dividends Payable	-	-	-	115	259
Other Current Liabilities	154	82	82	82	82
Total Current Liabilities	**1,266**	**1,440**	**1,351**	**1,562**	**1,813**
Long-Term Debt	3,133	3,981	4,264	4,264	4,264
Other LT Payables	-	-	-	-	-
Provisions	151	166	166	166	166
Total Non-current Liabilities	**3,284**	**4,147**	**4,430**	**4,430**	**4,430**
Minority interests	14	17	28	40	55
Paid-up share capital	1,090	1,150	1,150	1,150	1,150
Total Reserves	2,527	4,233	5,051	6,029	7,081
Total Shareholders' Equity	**3,617**	**5,383**	**6,201**	**7,179**	**8,231**
Total Equity	**3,631**	**5,400**	**6,228**	**7,220**	**8,286**
Total Liabilities & Shareholders' Equity	**8,181**	**10,987**	**12,010**	**13,212**	**14,529**

Very strong EBITDA interest cover ratio justifies resorting to debt

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	3,391	3,869	3,588	2,879	2,110
Net Debt/EBITDA (x)	2.34	2.23	1.75	1.32	0.87
Net Debt to Equity	93.4%	71.7%	57.6%	39.9%	25.5%
EBITDA Interest Cover (x)	11.6	11.5	11.7	19.9	32.6
BVPS (SAR)	33.18	46.81	53.92	62.43	71.58

Almarai's cash flow is very strong

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	1,003	1,128	1,321	1,606	1,831
Depreciation & Amortisation	321	454	549	460	510
Decrease in Working Capital	(296)	(174)	(297)	(111)	(123)
Other Operating Cashflow	23	1,581	(33)	(40)	(45)
Cashflow from Operations	**1,051**	**2,989**	**1,541**	**1,915**	**2,172**
Capital Expenditure	(1,572)	(1,227)	(799)	(746)	(828)
New Investments	-	(484)	-	-	-
Others	-	-	-	-	-
Cashflow from investing activities	**(1,572)**	**(1,711)**	**(799)**	**(746)**	**(828)**
Net Operating Cashflow	**(521)**	**1,278**	**741**	**1,169**	**1,344**
Dividends paid to ordinary shareholders	(271)	(381)	(460)	(460)	(575)
Proceeds from issue of shares	-	-	-	-	-
Increase in Loans	927	542	283	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	8	9	-	-	-
Cashflow from financing activities	**665**	**170**	**(177)**	**(460)**	**(575)**
Total cash generated	144	1,448	564	709	769
Cash at beginning of period	138	247	508	1,072	1,781
Implied cash at end of year	**282**	**1,694**	**1,072**	**1,781**	**2,550**

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	31.3%	20.9%	12.0%	10.0%	10.0%

Source: Company data, Al Rajhi Capital

Savola Group

Agriculture & Food Sector

Saudi Arabia

03 April 2010

الراجحي المالية
Al Rajhi Capital

US$4.6bn	60.1%	US$4.9mn
Market cap	Free float	Avg. daily volume

Target price	41.11	17.4% over current
Consensus price	40.00	14.3% over current
Current price	35.00	as at 29/3/2010

Equity Research Department
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Underweight | Neutral | **Overweight**

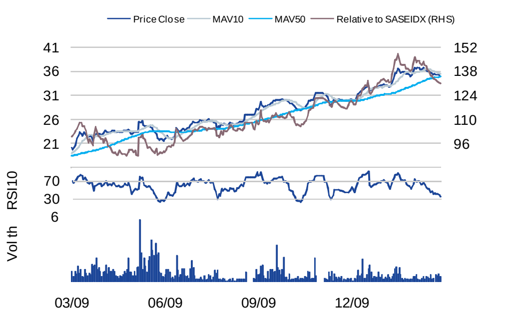
Key themes

Driven by rising population and improving education, we expect the food sector in Saudi Arabia to continue growing. Rising shopping in supermarkets and hypermarkets should support food sales and benefit Savola with its presence in retailing as well as food.

Implications

Savola is our second pick in the food sector. It has attractive financial ratios that reflect its improvement. It is performing operationally well and offers growth in the near term at reasonable valuation.

Performance

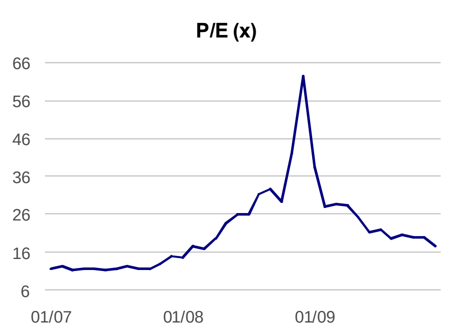


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	17,917	19,288	20,927	22,602
Revenue Growth	29.9%	7.7%	8.5%	8.0%
EBITDA (SARmn)	1,331	1,540	1,704	1,841
EBITDA Growth	64.7%	15.7%	10.7%	8.0%
EPS	1.82	2.00	2.17	2.37
EPS Growth	370.2%	10.1%	8.1%	9.3%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Savola

It's back on track

Savola, the second biggest company in the food sector, seems to be back on track after struggling in 2008. We believe that the company's focus on its core businesses, food and retail, will achieve the intended results and pay off in the long run. The company has dramatically decreased its reliance on capital gains, which made up only 10% of 2009 net profit. We expect that recent acquisitions and expansion in food and retail will pay off in the coming years. Our expectation of stable food commodities prices should help the company maintain its strong position in this segment.

Market: We believe that the young (50% below 20) and rapidly growing population play a vital role in stimulating the food market. The GCC has a young population with annual growth of 2.5%; Saudi Arabia is the largest market with a population of about 25mn and per capita GDP of about $19,000. Moreover, given both the low proportion of retail sales in supermarkets and hypermarkets and people's desire to enjoy a more modern lifestyle, the retail market is set to grow considerably and set to grow from US$76bn in 2008 to US$97bn according to Business Monitor International (BMI). Note that retailing composes around 44% of Savola's top line.

New opportunities: In spite of its recent acquisitions and new plants, Savola still has the potential to continue this trend considering its strong operating cash flow. The company can diversify its food category by producing other foods; it has already started a pasta factory. In addition, we see retailing and the plastics segment as the main drivers of growth over the next few years. Savola should be able to improve its top and bottom retail line by rationalising its recently acquired Geant business and other Savola start-up stores. The plastics segment, similarly, has the potential to grow considering its current size and the fact that it has its own customer base; internal sales to other Savola subsidiaries are less than 10% of the total.

Strategic investments: Savola holds a valuable stake of in Almarai, and has recently increased it from 26.5% to 29.9%. While it is not essential for Savola to hold this stake, we applaud it because 1) Savola has held the stake since 1991 as a long-term investment, and we see no reason for the status quo to change, and 2) we see Almarai as one of the best food companies in the world. Savola also holds another major stake in Herfy which went public recently. On the other hand, Savola has some real estate investments which we question considering not only that these investments are not aligned with the company's core business, but also that they seem ambiguous.

Valuation: Savola still offers value: Using long-run discounted economic profit valuation, we estimate fair value per share for Savola at SAR43.2. On a comparative multiples analysis basis, we estimate fair value at SAR36.2. Our target price for Savola of SAR41.1 is a weighted average of the two estimates with a weight of 70% to the long run DEP method and 30% to the multiples. Our target implies 17.4% upside potential. Note that in our EVA valuation we include Savola's stake in Almarai at market value, not our estimate of fair value. If we were to include the stake in Almarai at our estimate of fair value, our estimate of fair value per share would be SAR47.0. Savola is trading on a 2010 EV/EBITDA multiple of 9.6x, a 2010 PE ratio of 16.7x, and offers a yield of 2.7%.

Corporate summary

Savola, one of the leading companies in food and retail industries, is a group that holds several companies that operate in different industries. According to Savola's website, the Group operates its businesses through four Core Sectors, these are "Savola Foods Sector", including Edible Oils, Foods, and Sugar, "Savola Retail Sector", including Retail (Panda - and Hyper Panda), Real Estate Sector (Kinan International) and Savola Plastics Sector. Furthermore, Savola has a major investment in the leading dairy company in GCC(Almarai), Herfy Foods Company, and Jordanian Tameer Company with a stake of 28%, 70%, and 5% respectively.

Share information

Market cap (SAR/US$)	17.9bn / 4.8bn
52-week range	19.80 - 36.80
Daily avg volume (US$)	4.700mn
Shares outstanding	500.0mn
Free float (est)	60.1%

Performance:	1M	3M	12M
Absolute	0%	16.7%	74.1%
Relative to index	-5.2%	6.1%	30.9%

Major Shareholder:	
Mohammed Ibramim Alisa	11.9%
GOSI	10.9%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	17,917	19,288	20,927	22,602
EBITDA (SARmn)	1,331	1,540	1,704	1,841
Net Profit (SARmn)	952	1,048	1,134	1,239
EPS (SAR)	1.82	2.00	2.17	2.37
DPS (SAR)	0.96	0.96	1.15	1.38
EPS Growth	370.2%	10.1%	8.1%	9.3%
EV/EBITDA (x)	12.8	10.3	9.2	8.5
P/E (x)	19.6	17.8	16.5	15.1
P/B (x)	2.7	2.5	2.3	2.2
Dividend Yield	2.7%	2.7%	3.2%	3.9%

Source: Company data, Al Rajhi Capital

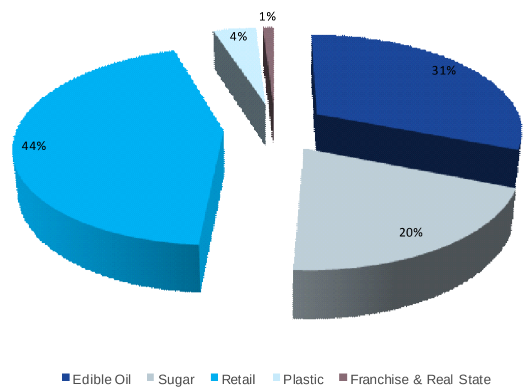
Savola is back on track

Diversified revenues

Savola has four core sectors

Savola, one of the leading companies in the food and retail sector, is a group that holds several companies that operate in different industries. According to Savola's website, the group operates its businesses through four core sectors. These are the "Savola Foods Sector", including edible oils, foods, and sugar, the "Savola Retail Sector", including Retail (Panda - and Hyper Panda), the Franchise & Real Estate Sector (Kinan International), and the Savola Plastics Sector. Furthermore, Savola has a major investment in the leading dairy company in the GCC (Almarai), Herfy Foods Company, and Jordanian Tameer Company with stakes of 29.9%, 49%, and 5% respectively.

Figure 34. Revenue breakdown by segments



Source: Company data, ARC Research

We believe that Savola's strategy creates synergies by capitalising on two adjacent segments, food and retail. Plastic is parallel to Savola's core business as it is supplying plastic packaging for FMCG. Strategic investment not only contributes to Savola's revenues, but also diversifies its business considering it has the biggest investment in the best dairy company, Almarai.

Savola has the potential to expand both food and retail revenues

Savola has the potential to expand its food segment by entering new food categories such as pasta. It also has a good opportunity to expand its revenues and bottom line from retail by improving efficiency in current stores, and opening or acquiring new stores in new geographic regions. The low proportion of total retail sales from supermarkets and hypermarkets (30-35%) ought to improve, and this will be reflected in Savola's retail segment revenues.

Strategic investment

Although we are somewhat sceptical about Savola's investments in real estate, we see its stake of 29.9% in Almarai as a highly valuable investment that comprises about 20% of Savola's fair equity value. Savola has been a major shareholder of Almarai since 1991 and has maintained a strong relationship since then. We should note that, while Almarai is a customer of Savola's Plastics division, it does not purchase any food products from Savola. The two companies thus have a close and strong relationship, but the relationship is entirely at arm's length; Savola exercises no management control over Almarai, and its investment in Almarai is not necessary for the two companies to have their commercial relationship. One might ask, therefore, why Savola holds the stake.

Frankly speaking, it is probably not strategically essential for Savola to hold the stake. Nevertheless, we approve of the holding because:

1. It is as a highly valuable investment that comprises about 20% of Savola's fair equity value;

2. Savola has held the stake since 1991 as a long-term investment, and we see no reason for the status quo to change;

3. We see Almarai as one of the best food companies in the world, which helps explain why the investment has been highly successful for Savola

Herfy, recently listed in TASI, is another precious investment that brings liquidity to Savola. Savola made a capital gain of around SR200 million (30% of its share) when Herfy went public in February 2010.

Savola has been increasing its stake in Almarai until this moment in which it has reached 29.9%. We believe that the reasons behind this step are as follows. Firstly, Savola's stake in Almarai has declined after the latter acquisition of HADCO. Secondly, Savola's capital gains from Herfy IPO and selling warehouses to Alrajhi Capital. Finally, we believe that combining these reasons with Savola's strong belief in Almarai has resulted in this move.

However, we are dubious about Savola's investment in real estate. The company has several investments in real estate companies and major infrastructure projects in Saudi Arabia such as Kinan, King Abdullah Economic City, and Knowledge City. Our concern stems from the ambiguity of this step and the risks associated with such megaprojects. We would also argue that Savola has no particular expertise in the real estate business. However, Savola's real estate investments may prove to be valuable over the long run considering the booming real estate in the Kingdom.

Savola is getting better
SWOT Analysis

Strengths

- Leading company in edible oil and sugar markets with a market shares of 62% and 68% respectively.
- Strong cash flows.
- Well diversified businesses.
- Owns a stake of 29.9% in one of the best and promising companies in the region, Almarai.

Opportunities

- Saudi lifestyle is changing as many people prefer shopping in comfortable stores, i.e. supermarket & hypermarkets, to shopping in old traditional markets. This is stimulated by the young population of the Kingdom.
- Opportunity to boost retail sales in large outlets from current low level.
- Expand in other food segments (rice, pasta).
- Utilising capital gain from Herfy in other strategic investments.
- Although we are sceptical about Savola's real estate investments, the booming real estate in Saudi Arabia might make those investments worthwhile.

Weaknesses

- Weak new product development (organic growth through innovation).
- Low retail geographic diversification (99% Saudi Arabia).
  Slightly higher cost of capital than for peers.

Threats

- People's increasing consciousness towards health, which may affect Savola's food sector business. This is fuelled by the educational revolution in Saudi Arabia.
- The increasing price of soda may hurt demand for the product, and hence sugar demand.
- Exposure to global food prices. Edible oil fluctuates in price as it does not have a liquid market; as a result, Savola is not 100% hedged as it is against the sugar price.
- Questionable investments in real estate.

Valuation

We selected two food multinational companies and one retail company as benchmarks

We use two valuation methods to arrive at our target price for Savola: long-run EVA and comparative multiples analysis. For the multiples analysis, we use EV/EBITDA and PE ratios. We have been selective and conservative in our benchmarking. Since Savola operates mainly in the commodity food (sugar and edible oil) and retail markets which contribute about 52% and 40% of its top line respectively, we have selected three multinational companies in which two are food producers (sugar & pasta) and one in retail. We believe that this is the most appropriate benchmark to compare Savola's diversified business. Those three companies are: Suedzucker AG (food), Tate & Lyle PLC (food), and Carrefour (retail). Those companies have similar market capitalisation to Savola's except Carrefour which has much larger market capitalisation; nevertheless, we believe that they all provide good comparables considering their combined business nature compared to Savola's.

Figure 35. Savola: comparative multiples analysis

Coompany	Market	Sector	MKT Cap	P/E	EV/ EBITDA	EPS	Bloomberg Code
Suedzucker AG	Xetra (Germany)	Food (Sugar)	4232.6	16.1	11.4	1.4	SZU GY
Tate & Lyle PLC	London	Food	2884	10.8	11.7	0.6	TATE LN
Carrefour	EN Paris	Retail - Food	33657	17.8	7.7	3.2	CA FP
Savola	Tadawul	Food & Agriculture	4466.7	16.7	9.6	0.6	Savola AB

Source: Bloomberg, ARC Research

Using the average of the benchmark companies' PE and EV/EBITDA ratios, we calculate the price of Savola's share at SAR36.2. It is important to note that we have given 30% weight to this method. We utilise long-run EVA, on the other hand, to calculate Savola's fair price using a WACC of 9.1%. In the long-run EVA method, it is essential to highlight that when calculating Savola's enterprise value, we use the market value of its stakes in Almarai and Herfy. Using our core assumption of a period of competitive advantage of 30 years, we estimate fair value per share for Savola at SAR43.2.

We set our target price per share for Savola at SAR41.1. We have arrived at this target price by giving a weight of 70% to the long-run EVA method (SAR43.2 fair value per share), and 30% to the multiples method (36.2 fair value per share). If we included the stake in Almarai at our estimate of fair value, our estimate of fair value per share for Savola would be SAR47.0. Combining this with our estimate of multiples-based fair value of SAR36.2 and using the same weights, our target price for Savola would be SAR41.1.

Risks associated with our assumptions

It is important to highlight that our valuation relies heavily on future forecasts which are uncertain. We have come up with several assumptions including growth, competition, cost of capital, and market trend to predict future performance. We have tried to arrive to the most accurate assumptions; however, reality may deviate from our forecasts depending on new micro or macro factors. Furthermore, although Savola is hedging against changes in the prices of sugar and edible oil, sharp price changes, especially in edible oil price which doesn't have a very liquid market, may affect the company, and hence, our assumptions.

Operating profit has increased to its normal level after the 2008 drop

We expect growth to remain above 7%

Improving retail margin will help maintain 2009 strong gross margin

EV/EBITDA is very strong compared to other food companies

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	**13,795**	**17,917**	**19,288**	**20,927**	**22,602**
Cost of Goods Sold	(12,007)	(14,801)	(15,939)	(17,293)	(18,677)
Gross Profit	**1,788**	**3,116**	**3,349**	**3,634**	**3,925**
Government Charges					
S.G. & A. Costs	(1,587)	(2,145)	(2,185)	(2,370)	(2,560)
Operating EBIT	**201**	**971**	**1,165**	**1,264**	**1,365**
Cash Operating Costs	(12,987)	(16,586)	(17,748)	(19,223)	(20,761)
EBITDA	809	1,331	1,540	1,704	1,841
Depreciation and Amortisation	(607)	(360)	(376)	(441)	(476)
Operating Profit	**201**	**971**	**1,165**	**1,264**	**1,365**
Net financing income/(costs)	324	246	114	119	147
Forex and Related Gains	-	-	-	-	-
Provisions	(437)	-	-	-	-
Other Income	134	107	4	4	4
Other Expenses	-	(74)	-	-	-
Minority Interests	32	(236)	(208)	(224)	(245)
Net Profit Before Taxes	**254**	**1,014**	**1,075**	**1,163**	**1,270**
Taxes	(52)	(63)	(27)	(29)	(32)
Net Profit	**202**	**952**	**1,048**	**1,134**	**1,239**
Dividends	(500)	(500)	(500)	(600)	(720)
Transfer to Capital Reserve	-	-	-	-	-

	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	523.0	523.0	523.0	523.0	523.0
CFPS (SAR)	1.548	2.508	2.722	3.010	3.278
EPS (SAR)	0.387	1.819	2.004	2.167	2.368
DPS (SAR)	0.956	0.956	0.956	1.147	1.377

Growth	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue Growth	32.5%	29.9%	7.7%	8.5%	8.0%
Gross Profit Growth	5.5%	74.3%	7.5%	8.5%	8.0%
EBITDA Growth	-7.9%	64.7%	15.7%	10.7%	8.0%
Operating Profit Growth	-54.4%	382.3%	19.9%	8.5%	8.0%
Net Profit Growth	-83.5%	370.2%	10.1%	8.1%	9.3%
EPS Growth	-83.5%	370.2%	10.1%	8.1%	9.3%

Margins	12/08A	12/09A	12/10E	12/11E	12/12E
Gross profit margin	13.0%	17.4%	17.4%	17.4%	17.4%
EBITDA margin	5.9%	7.4%	8.0%	8.1%	8.1%
Operating Margin	1.5%	5.4%	6.0%	6.0%	6.0%
Pretax profit margin	1.8%	5.7%	5.6%	5.6%	5.6%
Net profit margin	1.5%	5.3%	5.4%	5.4%	5.5%

Other Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
ROCE	2.4%	9.2%	10.3%	10.4%	10.6%
ROIC	1.7%	7.8%	8.4%	8.6%	8.8%
ROE	3.0%	14.3%	14.5%	14.6%	15.0%
Effective Tax Rate	20.4%	6.2%	2.5%	2.5%	2.5%
Capex/Sales	6.8%	5.7%	4.0%	5.0%	5.0%
Dividend Payout Ratio	247.1%	52.5%	47.7%	52.9%	58.1%

Valuation Measures	12/08A	12/09A	12/10E	12/11E	12/12E
P/E (x)	92.3	19.6	17.8	16.5	15.1
P/CF (x)	23.1	14.2	13.1	11.9	10.9
P/B (x)	2.9	2.7	2.5	2.3	2.2
EV/Sales (x)	1.2	1.0	0.8	0.7	0.7
EV/EBITDA (x)	20.7	12.8	10.3	9.2	8.5
EV/EBIT (x)	83.0	17.6	13.7	12.4	11.5
EV/IC (x)	1.4	1.3	1.1	1.0	1.0
Dividend Yield	2.7%	2.7%	2.7%	3.2%	3.9%

Source: Company data, Al Rajhi Capital

Savolaôs Balance sheet is expanding as a result of recent acquisitions

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	605	1,131	1,398	1,948	2,152
Current Receivables	1,209	1,447	1,672	1,883	2,034
Inventories	2,039	2,354	2,551	2,093	2,260
Other current assets	1,179	746	746	746	746
Total Current Assets	**4,729**	**5,679**	**6,367**	**6,670**	**7,193**
Fixed Assets	4,251	5,068	5,464	6,070	6,724
Investments	4,771	5,028	5,028	5,028	5,028
Goodwill	654	1,398	1,398	1,398	1,398
Other Intangible Assets	140	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**9,817**	**11,494**	**11,890**	**12,495**	**13,149**
Total Assets	**14,546**	**17,172**	**18,256**	**19,165**	**20,342**
Short Term Debt	3,433	3,027	3,027	3,027	3,027
Trade Payables	1,704	3,283	3,611	3,662	3,955
Dividends Payable	160	-	-	100	220
Other Current Liabilities	704	0	-	(0)	-
Total Current Liabilities	**6,001**	**6,310**	**6,638**	**6,789**	**7,202**
Long-Term Debt	1,117	2,012	2,012	2,012	2,012
Other LT Payables	74	67	67	67	67
Provisions	217	265	265	265	265
Total Non-current Liabilities	**1,408**	**2,344**	**2,344**	**2,344**	**2,344**
Minority interests	748	1,576	1,784	2,008	2,253
Paid-up share capital	5,000	5,000	5,000	5,000	5,000
Total Reserves	1,389	1,942	2,490	3,023	3,542
Total Shareholders' Equity	**6,389**	**6,942**	**7,490**	**8,023**	**8,542**
Total Equity	**7,137**	**8,518**	**9,274**	**10,032**	**10,796**
Total Liabilities & Shareholders' Equity	**14,546**	**17,172**	**18,256**	**19,165**	**20,342**

Savolaôs financial ratios are promising

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	3,798	3,908	3,641	3,091	2,887
Net Debt/EBITDA (x)	4.70	2.93	2.36	1.81	1.57
Net Debt to Equity	53.2%	45.9%	39.3%	30.8%	26.7%
EBITDA Interest Cover (x)	(2.5)	(5.4)	(13.6)	(14.3)	(12.6)
BVPS (SAR)	12.22	13.27	14.32	15.34	16.33

Savola has strong cash flow

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	223	1,250	1,283	1,387	1,516
Depreciation & Amortisation	607	360	376	441	476
Decrease in Working Capital	(573)	598	(93)	297	(25)
Other Operating Cashflow	513	218	(27)	(29)	(32)
Cashflow from Operations	**770**	**2,427**	**1,538**	**2,096**	**1,935**
Capital Expenditure	(937)	(1,029)	(772)	(1,046)	(1,130)
New Investments	(907)	(62)	-	-	-
Others	(507)	(362)	-	-	-
Cashflow from investing activities	**(2,351)**	**(1,453)**	**(772)**	**(1,046)**	**(1,130)**
Net Operating Cashflow	**(1,581)**	**974**	**767**	**1,050**	**805**
Dividends paid to ordinary shareholders	(370)	(507)	(500)	(500)	(600)
Proceeds from issue of shares	-	-	-	-	-
Increase in Loans	2,486	(238)	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	162	446	-	-	-
Cashflow from financing activities	**2,278**	**(299)**	**(500)**	**(500)**	**(600)**
Total cash generated	697	675	267	550	205
Cash at beginning of period	335	605	1,131	1,398	1,948
Implied cash at end of year	**1,031**	**1,279**	**1,398**	**1,948**	**2,152**

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	6.8%	5.7%	4.0%	5.0%	5.0%

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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