

Saudia Dairy and Foodstuff Co (SADAFCO)

Flat Margins during Q3 2021, Further Pressure on Margins in 2021e

26 January 2021

Competitive prices and increased promotions in the milk segment cost SADAFCO a drop of 8% in milk sales during Q3 2021, however, the company was able to pull through with 18% increase in ice-cream sales. Future challenges ahead due to expat exodus, VAT and higher expected raw material prices.

SADAFCO faced a number of challenges during Q3 2021, resulting in a relatively flat margins Y-o-Y. During the period, SADAFCO posted revenues of SAR482mn, representing a Y-o-Y drop of 1.3% compared to SAR488mn in Q32020. The reason for the drop was mainly due to the lower milk sales during the period, due to intense promotions provided by the company's competitors. SADAFCO is known for its premium-priced brands, while consumers tend to favor lower priced long-life brands. Consequently, consumer milk sales dropped by 8.1% Y-o-Y. On the other hands, the company enjoyed a Y-o-Y increase of 4.1% in tomato paste sales and a significant 17.9% increase in ice-cream sales Y-o-Y.

COGS slightly increased during the quarter by 2.8% Y-o-Y, resulting in a drop in gross profit from SAR176mn in Q3 2020 to SAR161mn in Q32021, representing a decrease of 8.7% Y-o-Y. Similarly, gross margin dropped from 36.1% in Q3 2020 to only 33.4% in Q3 2021.

During the period, SG&A dropped by 6.6% Y-o-Y, from SAR106mn in Q3 2020 to SAR97mn in Q3 2021. The drop in SG&A it to be attributed to the drop in sales during the quarter. Nevertheless, operating profit dropped by 8.9% Y-o-Y, resulting in a drop in operating profit margin of 110bps, from 14.4% in Q3 2020 to 13.3% in Q3 2021.

Finally the company reported a net income of SAR64mn in Q3 2021, representing a total drop of 5.7% compared to SAR68mn in Q3 2020. Net income margin dropped slightly reaching 13.3% Q3 2021 compared to 13.9% in Q3 2020.

It is worth mentioning that the company announced that the new ice-cream factory process is going well, with expected trial production in May 2021. Moreover, on January 4th, 2021 the company's board of directors approved a distribution of interim dividend of SAR3 per share, representing an increase of 20% over previous year.

SADFCO is able to provide high dividend yield, despite the current pressures on the company's margins including expected increase in raw material prices. The current fresh-milk oversupply, lead to increasing conversion of excess fresh milk to skim milk powder (SMP), resuming the long-life milk price discount wave. Moreover, the projected 11% higher SMP prices in 2021 based on future contracts is likely to add further pressure on the company's margins. Furthermore, the current rate of expat exodus (over 257,000 expat workers exited) is expected to significantly impact the current demand, negatively impacting SADAFCO's profitability.

Going forward, we do not expect the company to fully pass on the increase in raw materials to consumers, provided the tripling in VAT that resulted in weak purchasing power, which would certainly limit profitability during 2021e. However, it remains reassuring that SADAFCO remains in strong position in key market segments, providing the company with enough defensiveness to push through the current economic climate.

We update our 52 weeks target price SAR178.0/share with a Neutral recommendation.

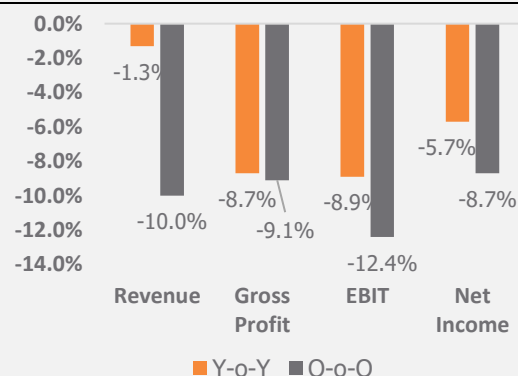
Recommendation **Neutral**

| | |
|--------------------------------|-----------------|
| Previous Recommendation | Neutral |
| Current Price (25-01-2021) | SAR164.4 |
| Target Price (52 Weeks) | SAR178.0 |
| Upside/ (Downside) | 8.3% |
| Shariah Compliance | Pass |

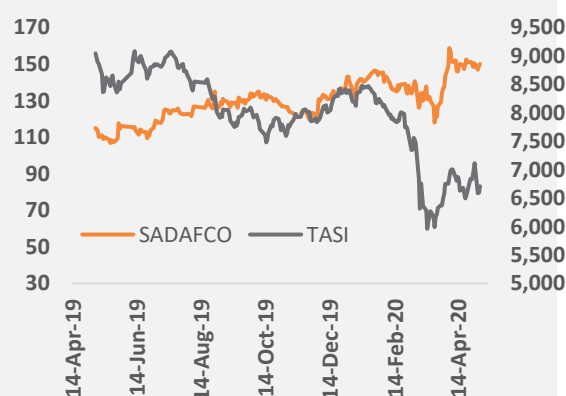
Key Financial Ratios

| Ratio | Q3 2021 | Q2 2021 | Q3 2020 |
|----------------|---------|---------|---------|
| Revenue Growth | -10.0 % | -5.4% | -6.3% |
| Gross Margin | 33.4% | 33.0% | 36.1% |
| EBIT Margin | 13.3% | 13.6% | 14.4% |
| Net Margin | 13.3% | 13.1% | 13.9% |

Key Financial Results (Q3 2021)



Share Price Performance



Guide to Ratings and Disclaimer

Guide to Ratings

| | |
|--------------------|--|
| Buy | An upside potential of more than 20% in 52-week period |
| Overweight | An upside Potential of more than 10% in 52-week period |
| Neutral | Will stay in the range of it value (up/down 10%) in a 52-week period |
| Underweight | A downside potential of more than 10% in 52-week period |
| Sell | A downside potential of more than 20% in 52-week period |

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