Almarai Co.

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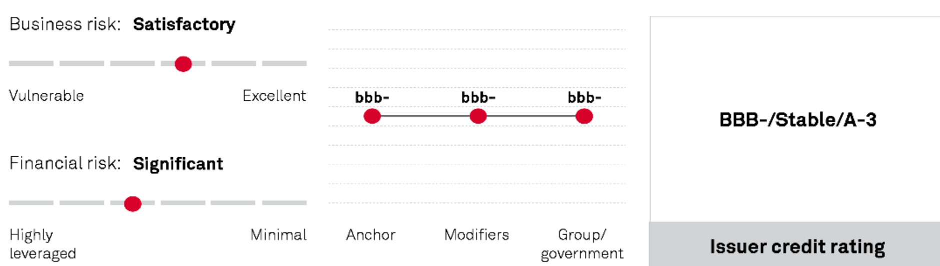
Ratings Score Snapshot



Credit Highlights

Overview

Key strengths	Key risks
Leading market positions in Saudi Arabia across all business segments, supported by an extensive distribution network generating Saudi riyal (SAR) 3.6 billion ($1 billion) of EBITDA in 2021.	Concentration in Saudi Arabia and dairy products.
Portfolio of well-known local brands and diversified products.	Revenue growth prospects appear limited over the next two years due to socio-demographic trends.
Declining, but still-higher-than-peer EBITDA margin of 22.6%, with positive free operating cash flow (FOCF).	Business model that has high working capital and capital expenditure (capex) needs.
Prudent financial policy regarding acquisitions and stable shareholder remuneration.	

Almarai Co. continues to benefit from its leading position in the domestic market. Almarai has a dominant position (No. 1 in most segments where it operates) in Saudi Arabia, where it generates about 65% of revenue. The company retained its market share in fresh and long-life dairy (46% of revenue) in 2021 but lost some ground in the poultry (15%) and food segments (14%) due to intense competition. Almarai's EBITDA margin of 22.6% in 2021 remains one of the strongest among its peers in the food and beverage industry, especially in dairy products. The company is also expanding its sales to Egypt and Jordan through its joint venture with PepsiCo, International Dairy & Juice (IDJ), which contributed 11% of revenue in 2021 compared with 9% in 2020. At year-end 2021, Almarai's funds from operation (FFO) to debt stood at 30.7% and its adjusted debt to EBITDA was about 2.9x, which is comfortably in line with the 'BBB-' rating on the company.

Despite improved product pricing, S&P Global Ratings expects a squeeze on profitability due to raw material inflation. EBITDA margin declined to 22.6% in 2021 versus 26.8% in 2020 due to higher commodity prices, particularly corn and soy, and lower subsidies. As a result, the company increased dairy prices twice last year, including most recently in December, which is expected to have a positive effect on absolute EBITDA in 2022-2023. We also note that as COVID-19 cases continue to decline and restrictions are removed, mobility will improve, resulting in increasing out-of-home consumption. However, as competition in the industry remains intense, we do not expect EBITDA margins to bounce back to historical levels of about 25%-26%. Instead, they should stabilize at about 18%-20% over the next 12-24 months.

Outlook

The stable outlook indicates that, over the next two years, we expect Almarai's operating performance to be broadly stable, despite negative external factors such as the declining population, increased inflation, and cost pressures. We expect that Almarai will offset revenue declines in some segments by increasing the earnings contribution from poultry and making changes to the product and channel mix, as well as through its cost-savings plan.

Over the next two years, we expect Almarai to maintain FFO to debt of 25%-30% and adjusted debt to EBITDA of 3.0x–3.5x, in line with the current rating. These ratios were 30.7% and 2.9x on Dec. 31, 2021.

Downside scenario

We could consider a downgrade if, over the next two years, we see continued revenue pressures and a sharp decline in Almarai's EBITDA margin, which would negatively affect FOCF and increase debt. This could stem from a continued loss of market share in key categories like dairy due to competitors' aggressive pricing, as well as an inability to control operating costs. We would also view negatively a more aggressive stance on large debt-financed acquisitions to offset potential low revenue growth. We would lower the rating if FFO to debt declines to 20% and adjusted debt to EBITDA rises to about 4.0x over the next two years.

Upside scenario

We would consider an upgrade if the company reduces leverage and maintains FFO to debt at 30%-45% and adjusted debt to EBITDA falls well below 3x.

This is possible if Almarai substantially increases its EBITDA and FOCF over time through a combination of solid earnings growth in its largest categories, successful geographical expansion into sizable new consumer markets, and successful working capital and capex management. We would also need to see a consistent financial policy toward mergers and acquisitions (M&A) and shareholder remuneration that is compatible with a higher rating.

Our Base-Case Scenario

Assumptions

- Saudi Arabia's real GDP increases 2.9% in 2022 and 2.4% in 2023, and consumer price inflation of 2.3% in 2022 and 2.1% in 2023.
- Mid-single-digit revenue growth in 2022-2023. This forecast stems from our assumption of moderate growth in the dairy, bakery, fruit juices, and poultry segments given recovery in consumption trends.
- EBITDA margin is expected to decline to 18%-20% in 2022-2023. This is mainly due to higher raw materials costs including feedstock costs driven by imported alfalfa, increased costs related to COVID-19, and higher trade support due to modern trade (increased credit periods compared with traditional trade, which was largely a cash business).
- Annual capex of SAR1.2 billion-SAR1.5 billion (about $320 million-$400 million) in 2022-2023.

- Expected annual dividends of SAR1 billion.
- Adjusted FOCF of SAR0.8 billion-SAR1.0 billion in 2022-2023.
- Negative working capital movements continue since the company has increased selling to regulated channels, leading to an increase in receivables, as well as seasonal working capital effects.
- We exclude discretionary spending on opportunistic M&A or capex such as under the Shareek program.

Key metrics

Almarai Co.--Key Metrics*

Mil. SAR	2019a	2020a	2021a	2022e	2023f
Revenue	14,351	15,357	15,850	16,600- 17,000	17,400-17,800
EBITDA	4,151	4,112	3,588	3,100-3,500	3,300-3,700
EBITDA margin (%)	28.9	26.8	22.6	18-20	18-20
Debt to EBITDA (x)	3.2	2.9	2.9	3.2-3.5	2.9-3.2
FFO to debt (%)	27.4	29.6	30.7	23-28	24-29
FOCF to debt (%)	13.7	16.6	22.8	5-10	8-13

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations. FOCF--Free operating cash flow. SAR--Saudi riyal.

Almarai's profitability is strong, but we expect EBITDA margins will likely decline in the near term. Almarai's EBITDA margin is among the strongest of peers in the food and beverages industry, especially in dairy products. This is notably due to premium pricing for its strong local and regional brands. However, we expect pressure on margins in the medium term as competition between the main branded players is increasing in Saudi Arabia and the Gulf Cooperation Council (GCC) region. In the near term, profitability pressure is also stemming from higher operating costs due to COVID-19, supply chain disruptions, and agriculture commodity prices.

We consider that Almarai has a stable financial policy that will result in credit metrics in line with our current rating. For many years, Almarai has invested its cash flows to increase production capacity outside dairy products. We exclude M&A or new capex under the Shareek program and expect the company will be selective regarding any deals, most likely keeping to bolt-on targets in nearby geographies and adjacent categories. That said, we believe that Almarai is committed to maintaining the current rating. Therefore, we expect a consistent shareholder remuneration policy with stable dividends and no share buybacks.

Company Description

Founded in 1977 and headquartered in Riyadh, Saudi Arabia, Almarai is a food and beverages manufacturer, with revenue of SAR15.8 billion ($4.2 billion) and reported EBITDA of SAR3.6 billion ($1 billion) in 2021.

The company operates mostly in Saudi Arabia (65% of revenue in 2021) and in the GCC region (20%). It also has a joint venture in Egypt and Jordan with PepsiCo (11%).

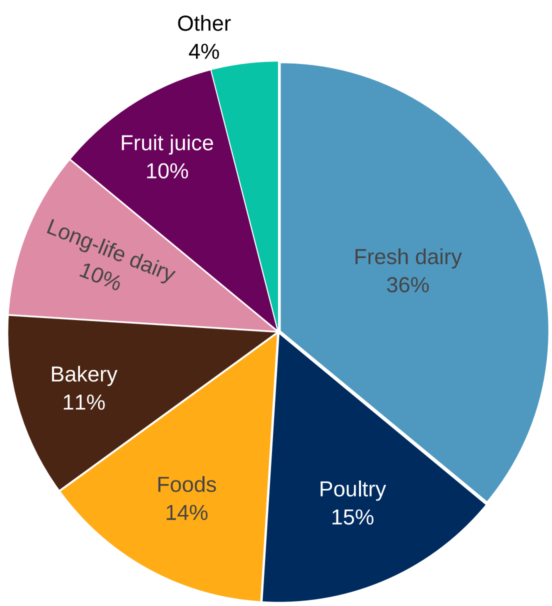
Almarai has been listed on Saudi stock market the Tadawul since 2005, and its biggest shareholders include SAVOLA Group Co. (34.52%), His Highness Prince Sultan bin Mohammed bin Saud Al Kabeer and related entity (23.59%), and more recently Saudi Agricultural and Livestock Investment Co. (SALIC, 16.32%) after the Public Investment Fund (PIF) transferred its shares to wholly owned SALIC. We understand the transfer aims to leverage synergies within the PIF's food and agriculture portfolio and enable SALIC to stimulate growth in the sector and will not affect Almarai's strategy.

Almarai's main product segments are:

- Dairy food and beverages (60% of revenue in 2021): Fresh dairy milk, long-life dairy, cheese, butter, and cream products. The main brand is Almarai.
- Poultry (15%): Fresh and frozen chicken. The main brand is Alyoum.
- Bakery (11%): Pastry, cakes, bread, and bars. The main brands are L'usine and 7Days.
- Fruit Juices (10%). The main brand is Almarai.
- Others (4%).

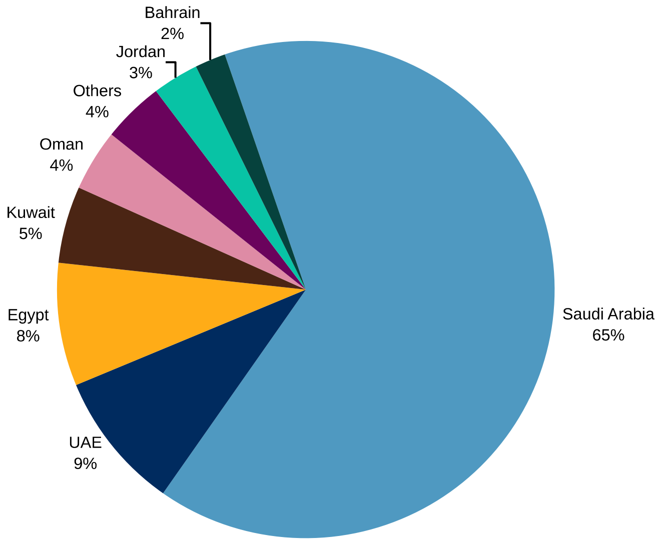
Other businesses include a joint venture in fruits and juices in Egypt and Jordan under the Teeba, Beyti, and Tropicana brands. Almarai also has a small infant nutrition business.

Almarai Revenue By Product For 2021



Source: Company reports.

Almarai Revenue By Country For 2021



Source: Company reports.

Peer Comparison

Almarai Company--Peer Comparisons

	Almarai Co.	Danone	China Mengniu Dairy Co. Ltd.	Nomad Foods Ltd.
Foreign currency issuer credit rating	BBB-/Stable/A-3	BBB+/Stable/A-2	BBB+/Stable/--	BB-/Stable/--
Local currency issuer credit rating	BBB-/Stable/A-3	BBB+/Stable/A-2	BBB+/Stable/--	BB-/Stable/--
Period	Annual	Annual	Annual	Annual
Period ending	2021-12-31	2020-12-31	2020-12-31	2020-12-31
Mil.	$	$	$	$
Revenue	4,222	28,894	11,812	3,078
EBITDA	956	5,255	1,283	533
Funds from operations (FFO)	852	4,080	1,030	370
Interest	106	479	136	84
Cash interest paid	95	254	138	61
Operating cash flow (OCF)	995	3,644	1,256	498

Almarai Company--Peer Comparisons

Capital expenditure	363	1,177	903	72
Free operating cash flow (FOCF)	632	2,467	353	427
Discretionary cash flow (DCF)	331	746	233	(341)
Cash and short-term investments	167	5,227	2,796	511
Gross available cash	167	5,227	2,796	511
Debt	2,775	17,241	1,529	1,959
Equity	4,427	19,171	5,908	2,601
EBITDA margin (%)	22.6	18.2	10.9	17.3
Return on capital (%)	5.3	10.6	15.4	9.5
EBITDA interest coverage (x)	9.1	11.0	9.4	6.3
FFO cash interest coverage (x)	10.0	17.0	8.5	7.0
Debt/EBITDA (x)	2.9	3.3	1.2	3.7
FFO/debt (%)	30.7	23.7	67.4	18.9
OCF/debt (%)	35.9	21.1	82.2	25.4
FOCF/debt (%)	22.8	14.3	23.1	21.8
DCF/debt (%)	11.9	4.3	15.2	(17.4)

Financial Risk

Debt maturities

- In the 12 months from Dec. 31, 2021: SAR2.7 billion
- Thereafter: SAR7.1 billion

Almarai Company--Financial Summary

Period ending	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021
Reporting period	2016a	2017a	2018a	2019a	2020a	2021a
Display currency (mil.)	SAR	SAR	SAR	SAR	SAR	SAR
Revenues	14,339	13,936	13,723	14,351	15,357	15,850
EBITDA	3,936	4,289	4,296	4,151	4,111	3,588
Funds from operations (FFO)	3,480	3,714	3,766	3,607	3,559	3,197
Interest expense	428	518	495	633	514	396
Cash interest paid	446	563	507	525	468	357
Operating cash flow (OCF)	3,502	3,567	2,496	3,578	3,091	3,736
Capital expenditure	4,533	2,850	1,959	1,775	1,089	1,364
Free operating cash flow (FOCF)	(1,030)	717	537	1,803	2,002	2,372
Discretionary cash flow (DCF)	(1,794)	(76)	(434)	638	904	1,244
Cash and short-term investments	730	1,892	1,183	1,148	504	628

Almarai Company--Financial Summary

Gross available cash	730	1,892	1,183	1,148	504	628
Debt	13,569	13,480	13,442	13,179	12,032	10,418
Common equity	11,778	13,181	14,516	15,259	16,234	16,618
Adjusted ratios						
EBITDA margin (%)	27.5	30.8	31.3	28.9	26.8	22.6
Return on capital (%)	8.4	8.7	7.7	7.0	7.1	5.3
EBITDA interest coverage (x)	9.2	8.3	8.7	6.6	8.0	9.1
FFO cash interest coverage (x)	8.8	7.6	8.4	7.9	8.6	10.0
Debt/EBITDA (x)	3.4	3.1	3.1	3.2	2.9	2.9
FFO/debt (%)	25.6	27.6	28.0	27.4	29.6	30.7
OCF/debt (%)	25.8	26.5	18.6	27.1	25.7	35.9
FOCF/debt (%)	(7.6)	5.3	4.0	13.7	16.6	22.8
DCF/debt (%)	(13.2)	(0.6)	(3.2)	4.8	7.5	11.9

Reconciliation Of Almarai Company Reported Amounts With S&P Global Adjusted Amounts (Mil. SAR)

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2021									
Company reported amounts	9,782	16,119	15,850	3,465	2,015	368	3,588	4,915	978	1,364
Cash taxes paid	-	-	-	-	-	-	(35)	-	-	-
Cash interest paid	-	-	-	-	-	-	(357)	-	-	-
Lease liabilities	441	-	-	-	-	-	-	-	-	-
Postretirement benefit obligations/ deferred compensation	761	-	-	16	16	16	-	-	-	-
Accessible cash and liquid investments	(567)	-	-	-	-	-	-	-	-	-
Capitalized interest	-	-	-	0	0	12	0	0	-	0
Share-based compensation expense	-	-	-	20	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	3	-	-	-	-	-

Reconciliation Of Almarai Company Reported Amounts With S&P Global Adjusted Amounts (Mil. SAR)

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(357)	-	-
Noncontrolling/ minority interest	-	499	-	-	-	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	128	128	-	-	-	-	-
EBITDA: Foreign exchange gain/(loss)	-	-	-	(42)	(42)	-	-	-	-	-
D&A: Asset valuation gains/(losses)	-	-	-	-	(688)	-	-	-	-	-
D&A: Impairment charges/ (reversals)	-	-	-	-	20	-	-	-	-	-
OCF: other	-	-	-	-	-	-	-	(822)	-	-
Total adjustments	636	499	0	123	(562)	28	(392)	(1,179)	0	0
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	10,418	16,618	15,850	3,588	1,453	396	3,197	3,736	978	1,364

Liquidity

We assess Almarai's liquidity as adequate. We forecast that liquidity sources will exceed uses by more than 1.2x over the next 12 months. Near-term debt maturities appear manageable and Almarai has large undrawn committed lines in case of volatility in capital markets. We view Almarai as benefiting from sound relationships with local and international banks, but with a track record of accessing mostly local capital markets.

Principal liquidity sources

- SAR628 million of cash and cash equivalents on Dec. 31, 2021;
- SAR3.2 billion of undrawn committed credit lines maturing in more than one year; and
- Our forecast of SAR2.2 billion-SAR2.7 billion of cash FFO for the next 12 months.

Principal liquidity uses

- SAR2.7 billion of debt due in the next 12 months as of Dec. 31, 2021;
- SAR600 million of estimated working capital movements;
- SAR1.0 billion-SAR1.2 billion of estimated maintenance capex; and
- SAR1.0 billion of cash dividends to be paid in 2022.

Covenant Analysis

Compliance expectations

We understand that Almarai had adequate (more than 15%) headroom under its maintenance financial covenants on its bank debt at Dec. 31, 2021.

Requirements

Almarai is subject to a minimum equity of SAR6.5 billion, leverage ratio (total liability to total equity) of less than 1.5x, interest coverage ratio of more than 4.0x, gearing ratio (net debt to tangible net worth) of less than 1.5x, and current ratio of more than 0.75x.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Environmental, social, and governance (ESG) factors have no material influence on our credit rating analysis of Almarai. We view ESG factors for Almarai as broadly in line with those of food and beverage industry peers. In our view, the main ESG risks include food health and safety, plastic packaging waste, water scarcity, and greenhouse gas emissions (GHG).

Large dairy milk activities in Saudi Arabia expose Almarai to environmental risks like CO2/GHG emissions and water scarcity. Its three main 2025 goals are to increase water efficiency by 15%, decrease energy consumption by 15%, and decrease waste to landfill by 50%. The company's main contributors to CO2 and GHG emissions are its large transportation fleet and herd of 80,000 dairy cows. Positively, we note that the group is investing in solar energy and expects to derive 10% of its electricity consumption in Saudi Arabia from this source (2.5% in 2020 for the GCC). Almarai also mitigates water usage in Saudi Arabia by importing 100% of its alfalfa supplies for its dairy cows from other countries.

In our view, social risks include food safety. Deficient product quality controls can have an immediate, high impact on consumer demand that can tarnish a brand in a country. Consumers and governments are also pushing for healthier product reformulations that lower intake of sugar or fat content. The move to healthier products is ongoing, and Almarai's products are already free of artificial colors or trans fats. Furthermore, governments could enforce more stringent recycling rules for packaging waste, which would mean higher operating costs if Almarai has to pay to collect and recycle waste.

We assess Almarai's management and governance as satisfactory, reflecting the consistency of the business strategy and its ability to adapt to changing market conditions. We also assess that the board maintains sufficient independence from management to provide effective oversight of its actions. That said, we note that only one-third of the board are independent directors.

Government Influence

We consider Almarai a government-related entity. We view the likelihood of timely and extraordinary support from the Saudi Arabian government as low.

Our assessment is based on two main considerations:

- The limited importance of its role to the government. Almarai is a profit-seeking company operating in a competitive environment. Its activity is relatively important for Saudi government policy, given it participates in the country's ability to secure a stable food and beverage supply for the local population, and in the economy's diversification as a national champion in the sector. That said, rather than support its financial position, we believe the Saudi government would likely support the takeover of Almarai's activities by another private-sector entity if it ceased to exist to ensure stability of food distribution in the country.

- Its limited link with the government. We understand the Saudi government has no direct influence in the management of Almarai. The government is a minority shareholder, holding 16% of common shares (through the PIF; now under SALIC) with two seats currently on the board of directors. We do not believe the Saudi government controls Almarai's cash flows, nor does it participate in the business strategy. Furthermore, we see no tangible evidence of a willingness to provide Almarai financial support on a timely basis.

Issue Ratings--Subordination Risk Analysis

Capital structure

Almarai's capital structure comprises mostly Islamic banking facilities (64% of total debt at Dec. 31, 2021) and sukuk (36%). We understand there is limited secured debt or debt held at operating subsidiaries (4%).

Analytical conclusions

The $2 billion sukuk program and the $500 million sukuk maturing in March 2024 are rated 'BBB-'.

This reflects that the transaction fulfils the five conditions of our criteria for rating sukuk (see "General Criteria: Methodology For Rating Sukuk," published Jan. 19, 2015, on RatingsDirect). Due to the lack of subordination risk, we equalize our rating on the trust certificates with our foreign currency long-term issuer credit rating on Almarai.

Rating Component Scores

Foreign currency issuer credit rating	**BBB-/Stable/A-3**
Local currency issuer credit rating	**BBB-/Stable/A-3**
Business risk	**Satisfactory**
Country risk	Moderately High
Industry risk	Low
Competitive position	Satisfactory
Financial risk	**Significant**
Cash flow/leverage	Significant
Anchor	**bbb-**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**bbb-**

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | Industrials: Key Credit Factors For The Branded Nondurables Industry, May 7, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Methodology For Rating Sukuk, Jan. 19, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Industry Top Trends 2022: Consumer Products, Jan. 25, 2022
- ESG Credit Indicator Report Card: Consumer Products, Dec. 17, 2021
- Saudi Arabia, Sept. 27, 2021