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Research Update:

Saudi Arabia-Based Food And Beverage Company Almarai Affirmed At 'BBB-/A-3' On Solid Performance In 2022; Outlook Stable

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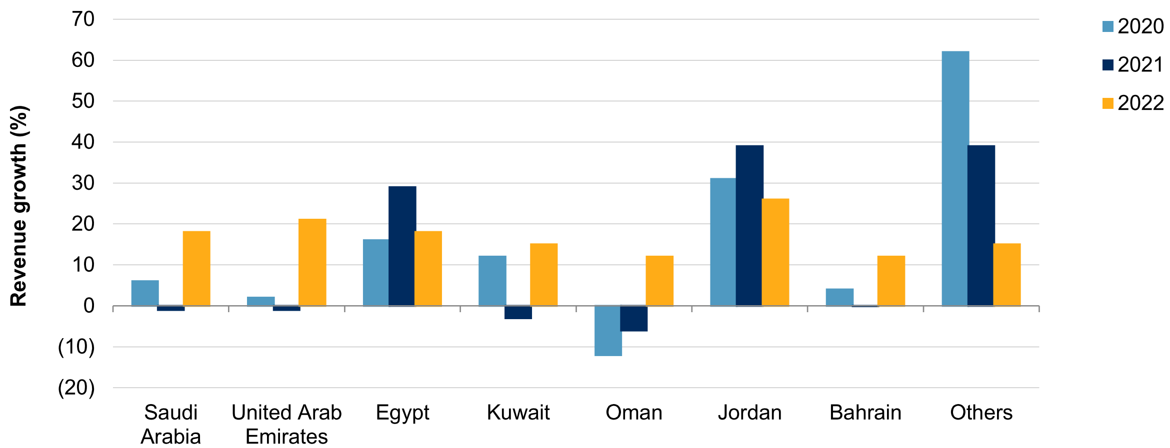
Rating Action Overview

- Almarai Co. reported significant revenue and EBITDA growth in 2022, alongside lower debt, with debt to EBITDA improving to 2.5x and funds from operations (FFO) to debt to 32.2%.
- The company's capital expenditure (capex) is projected to increase significantly in 2023-2024 on the back of its poultry capacity expansion, leading to negative to low free operating cash flow (FOCF) over that period.
- We are affirming our 'BBB-' long-term and 'A-3' short-term issuer credit ratings on Almarai and our 'BBB-' rating on the company's outstanding debt and sukuk.
- The stable outlook indicates that, over the next two years, we expect Almarai's operating performance to improve marginally, despite negative external factors, such as increased inflation, commodity cost pressures, and rising interest rates.

Rating Action Rationale

We expect revenue and EBITDA growth to continue in 2023-2024, owing to the company's ability to increase prices in a volatile macroeconomic environment. Despite macroeconomic challenges, for 2022, Almarai reported 18% revenue growth supported by a combination of volume (+3%) and price growth (+10%). Revenue increased in all segments, led by bakery (+36%) and poultry (+31%) after school re-openings (expansion of single-serve bakery product sales), expansion of the poultry business to 18 million-19 million birds in the fourth quarter, and higher demand from food service channels. The company also reported growth across all geographies and has a dominant position (No. 1 in most segments) in Saudi Arabia, where it generates about 64% of revenue. Our adjusted EBITDA margin of 22% was slightly lower than in 2021 (22.6%), due to higher agricultural commodity prices including for soya, corn, and alfalfa; and higher logistic costs. We expect the company's flexibility to increase prices and volume growth to continue resulting in annual revenue growth of 6%-10% in 2023-2024. We believe pressure from feedstock costs will remain but that Almarai can maintain EBITDA margins of 20%-22% thanks to cost-savings measures, premium pricing for its strong local and regional brands, and vertical integration. This should also enable Almarai to have one of the strongest, relatively resilient, EBITDA margins in the food and beverages industry, especially in the dairy products segment.

Almarai Revenue Growth By Geography



Source: Almarai investor presentations.

Rising interest rates and refinancing of large upcoming debt maturities will have a meaningful impact on Almarai's interest expense in 2023-2024. Almarai maintains a conservative interest-risk coverage policy, with about 60% of net debt fixed or hedged at all times. That said, we observe that local funding costs, as for most corporates in Saudi Arabia, are currently increasing, which could depress Almarai's operating cash flows somewhat. Debt maturities total Saudi Arabian riyal (SAR) 1.1 billion in the next 12 months and SAR3.9 billion in the next 24 months. We believe the company will be able to refinance, thanks to its strong banking relationships, should capital markets prove difficult to access in the coming months. However, the company in general maintains diversified debt sources: bank lines, sukuk, and government funding. We note that Almarai also has access to local capital markets as a listed company on the Saudi Stock Exchange (Tadawul) and has previously issued sukuk. As the company refinances maturing debt, we expect its average interest rates to increase from the current 5.5%.

Capex will increase in 2023-2024, mostly due to capacity expansion in poultry, and lead to negative to low FOCF. Almarai plans to spend about SAR6.6 billion on expansion over the next five years, in phases, to increase its poultry capacity to 450 million birds. In addition, it will undertake SAR1.3 billion of annual maintenance and replacement capex, in line with historical trends. We therefore believe FOCF in 2023 could be negative but quickly turn positive in 2024 as company generates solid cash flow. We exclude mergers and acquisitions from our base case and expect the company will be selective regarding such deals if any, most likely keeping to bolt-on targets in nearby geographies and adjacent product categories. We expect a consistent shareholder remuneration policy with stable dividends and no share buybacks. We project Almarai will maintain FFO to debt of 26%-32% and adjusted debt to EBITDA of 2.6x–3.1x in 2023-2024, which are commensurate with the ratings, despite potentially higher spending over that period.

Outlook

The stable outlook indicates that, over the next two years, we expect Almarai's operating performance to improve marginally, despite negative external factors, such as commodity cost pressures, rising interest rates, and lower consumer purchasing power. We believe Almarai's revenue will benefit from the company's ability to increase prices, generate higher earnings from poultry as capacity increases, make changes to the product and channel mix, and realize cost savings. We anticipate that Almarai can maintain FFO to debt of 26%-32% and adjusted debt to EBITDA of 2.6x–3.1x, in line with the rating, after 32.2% and 2.5x, respectively as of Dec. 31, 2022.

Downside scenario

We could consider a downgrade if, over the next two years:

- We see heightened cost pressures resulting in a sharper decline of Almarai's EBITDA margin than we currently expect, which would weigh on FOCF and increase debt. This could stem from a loss of market share in key categories like dairy due to competitors' aggressive pricing, as well as inability to control operating costs; or
- The company undertakes large debt-financed acquisitions to offset potential low revenue growth, with FFO to debt declining to 20% and adjusted debt to EBITDA rising to 4.0x or higher.

Upside scenario

We could take a positive rating action over the next 12-24 months if Almarai substantially increases its EBITDA and FOCF through a combination of solid earnings growth in its largest segments, successful expansion into sizable new geographic markets, and successful working capital and capex management such that:

- The company generates meaningfully positive FOCF with no expectation of significant future debt-funded acquisition;
- Reduces leverage and maintains FFO to adjusted debt at around 35%, while adjusted debt to EBITDA stays well below 3x; and
- Adheres to a consistent financial policy regarding mergers and acquisitions and shareholder remuneration that is compatible with a higher rating.

Company Description

Founded in 1977 and headquartered in Riyadh, Saudi Arabia, Almarai is a food and beverages manufacturer. It reported revenue of SAR18.7 billion ($4.9 billion) and EBITDA of SAR34.0 billion ($1.1 billion) in 2022. The company operates mainly in Saudi Arabia (64% of revenue in 2022) and in other Gulf Cooperation Council (GCC) countries (20%).

Almarai has been listed on the Tadawul since 2005, and its biggest shareholders include SAVOLA Group Co. (34.5%), His Highness Prince Sultan bin Mohammed bin Saud Al Kabeer and a related entity (23.7%), and more recently Saudi Agricultural and Livestock Investment Co. (SALIC, 16.3%)

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 (58% of revenue in 2022): Fresh dairy milk, long-life dairy, cheese, butter, and cream products. The main brand is Almarai.
- Poultry (16%): Fresh and frozen chicken. The main brand is Alyoum.
- Bakery (13%): Pastry, cakes, bread, and bars. The main brands are L'usine and 7Days.
- Fruit Juices (9%). The main brand is Almarai.
- Others (4%).

Other businesses include dairy and juices in Egypt and Jordan under the Teeba and Beyti brands. Almarai also has a small infant-nutrition business.

Our Base-Case Scenario

Assumptions

- Saudi Arabia's real GDP increasing 2.9% in 2023 and 2.7% in 2024 and consumer price inflation of 2.7% in 2023 and 1.8% in 2024. Population growth is expected to be 2% throughout.
- Annual revenue growth of 6%-10% in 2023-2024, assuming that Almarai can continue to pass through higher costs to customers and will have moderate volume growth and capacity expansion in the poultry segment.
- EBITDA margins of 20%-22% in 2023-2024. Margins to remain lower than in the past due to higher raw material costs, sustained inflation, and the gradual increase of the poultry capacity, which has structurally lower margins than dairy products.
- Negative working capital movements, owing to Alfalfa's high inventory, increased sales to regulated channels leading to higher receivables, and seasonal working capital effects.
- Capex of SAR2.8 billion-SAR3.2 billion in 2023 and SAR1.8 billion-SAR2.0 billion in 2024. This includes capex for maintenance and replacement of SAR1.3 billion or 6%-7% of the top line each year, and SAR6.6 billion over the next five years to increase poultry capacity to 450 million birds.
- Annual dividends of SAR1 billion.
- We exclude discretionary spending on opportunistic mergers and acquisitions due to unpredictability of timing.

Key metrics

Mil. SAR	2021a	2022a	2023e	2024f
Revenue	15,850	18,722	20,000-21,000	21,500-22,500
EBITDA	3,588	4,115	4,000-4,500	4,300-4,700

Mil. SAR	2021a	2022a	2023e	2024f
EBITDA margin (%)	22.6	22.0	20-22	20-22
Capital expenditure	1,364	1,161	2,800 – 3,200	1,800 - 2,000
Debt to EBITDA (x)	2.9	2.5	2.7-3.1	2.6-3.0
FFO to debt (%)	30.7	32.2	26-30	28-32
FOCF to debt (%)	22.8	11.2	(5)-5	5-10

*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 Arabian riyal.

Liquidity

We assess Almarai's liquidity as adequate. We estimate the company's liquidity sources will exceed uses by at least 1.2x over the 12 months started Jan. 1, 2023, and net sources will remain positive even if EBITDA declines 15%. We view Almarai as benefiting from sound relationships with local and international banks, and prudent risk management.

Principal liquidity sources

- SAR563 million of cash and cash equivalents on Dec. 31, 2022;
- SAR2.9 billion of undrawn committed credit lines maturing in more than one year; and
- Our forecast of SAR3.3 billion-SAR3.5 billion of cash FFO for the next 12 months.

Principal liquidity uses

- SAR1.1 billion of debt due in the 12 months from Dec. 31, 2022;
- SAR700 million-SAR800 million of estimated working capital movements;
- Capex of around SAR1.3 billion, including for maintenance and replacement capex. Expansionary capex is considered discretionary; and
- SAR1.0 billion of cash dividends.

Covenants

Requirements

Almarai is subject to minimum equity of SAR6.5 billion, a 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 a current ratio of 1:1.

Compliance expectations

We understand that Almarai had adequate (more than 15%) headroom under its maintenance financial covenants on its bank debt on Dec. 31, 2022.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

Environmental, social, and governance (ESG) factors have no material influence on our credit rating analysis of Almarai. We view ESG credit 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 activities in Saudi Arabia expose Almarai to environmental risks like carbon dioxide (CO_2) or 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% on 2018 intensity baseline. The company's main contributors to CO_2 and GHG emissions are its large transportation fleet and herd of about 172,012 dairy cows. Positively, we note that the group is investing in solar energy and expects to meet 10% of its electricity consumption in Saudi Arabia from this source (2.3% in 2021 for the GCC). Almarai also mitigates water use 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 reduce the intake of sugar or fat content. The move to healthier products is ongoing, and Almarai's products are already free of artificial colors and 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 its business strategy and 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 independent directors constitute only one-third of the board members.

Issue Ratings--Subordination Risk Analysis

Capital structure

Almarai's capital structure comprises mostly Islamic banking facilities and government funding institutions (80% of total debt as of Dec. 31, 2022) and sukuk (20%). We understand there is limited secured debt or debt held at operating subsidiaries (less than 3%).

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.

Ratings Score Snapshot

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-
Modifiers:	
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-
Likelihood of government support	Low (no impact)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate

Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Industry Top Trends 2023: Consumer Products, Jan. 23, 2023
- ESG Materiality Map: Consumer Products – Food, Oct. 27, 2022
- Research Update: Saudi Arabia 'A-/A-2' Ratings Affirmed; Outlook Remains Positive On Strong Fiscal And Economic Growth Dynamics, Sept. 16, 2022

Ratings List

Ratings Affirmed	
Almarai Co.	
Issuer Credit Rating	BBB-/Stable/A-3
Almarai Sukuk Ltd.	
Senior Unsecured	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914