



CAIRO CAPITAL SECURITIES

A High Conviction Call

Obour Land for Food Industries

A 6 billion Egyptian Pound company

24 Dec 2023

Investment thesis: A rare laggard in a bull market

Within a bull equity market led by net exporters and commodity plays in 2023, OLFI materially lagged the EGX30 given its negative exposure to EGP weakness and limited growth in volumes sold. During 2023YTD, the stock underperformed the EGX30 by 33%.

However, similar to most sector peers, history shows that OLFI has consistently managed to pass on cost shocks to end consumers and maintain GPM within a tight range of 20-22% over the commodity and FX cycles. Moreover, OLFI has consistently maintained a cash dividend payout ratio in of 40-80%.

In 2024, OLFI is expected to post record top and bottom lines of EGP8.2 billion and EGP0.7 billion, respectively. By 2026, OLFI is expected to double its bottom line versus 2023 to circa EGP1.0 billion.

We use four theoretically-consistent valuation models to estimate the FV of equity. The estimated simple average FV per share EGP15.2 as of end 2023 and EGP21.3 as of end 2024.

FV/Share: EGP15.2

BUY

Key metrics

Outstanding common shares, in million	400
Free float, %	38.8%
Closing price/share, EGP	10.98
MCAP, EGP m	4,392
Target price/share, EGP/share, end 2023	15.2
Target price/share, EGP/share, end 2024	21.3
YTD share price performance in EGP terms	40.0%
3M MDTV, EGP million	5.5
P/Ex (TTM net attributable income)	9.8
P/Ex (FY2024P net attributable income)	6.4
Latest DPS, EGP	0.95
Latest payout ratio	82.2%

FV estimate using four valuation models

Estimated equity value per share as of end Dec 2023, in EGP million

Model 1: Discounted FCFE	6,006.8
Model 2: Dividend discount model	5,970.3
Model 3: Fundamental P/E	6,356.5
Model 4: Adjusted IPO forward earnings multiple	5,985.1

Simple average equity value **6,079.7**

Number of shares outstanding, in million 400

Fair equity value per share, in EGP, end 2023 **15.2**

Fair equity value per share, in EGP, end 2024 **21.3**

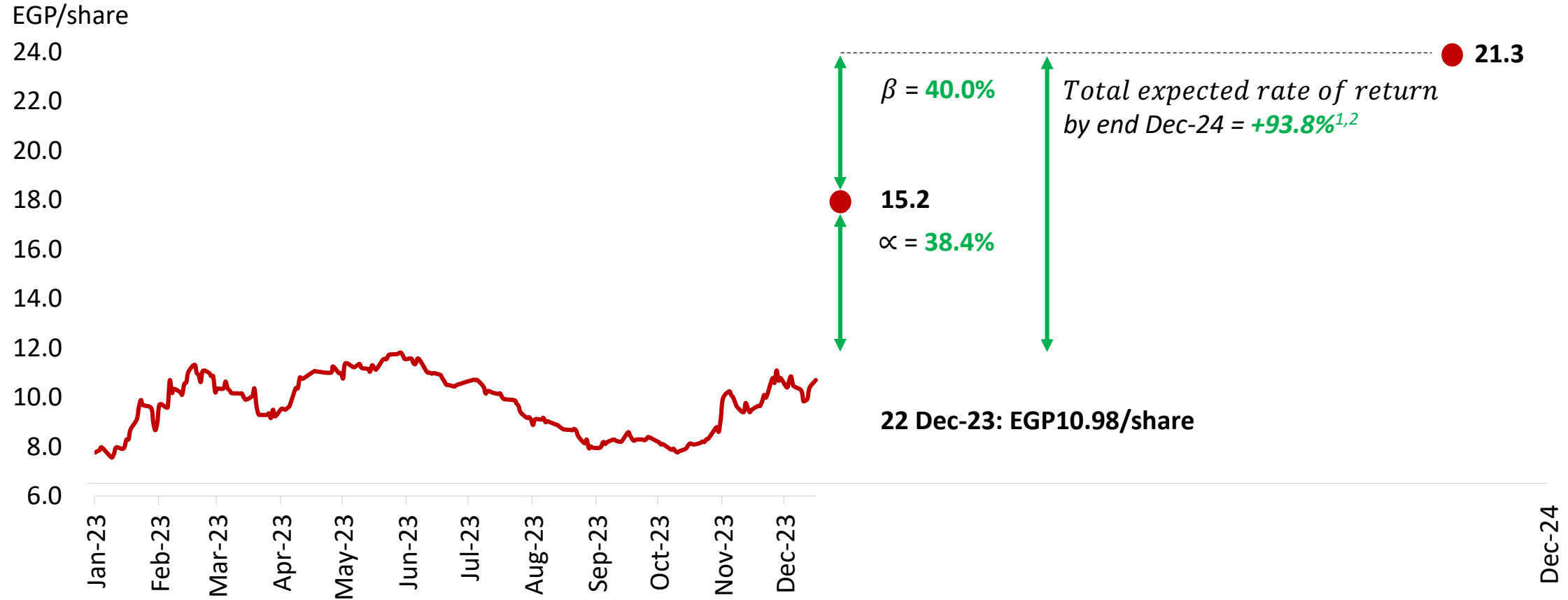
We use four models to estimate the FV of equity, namely;

1. Discounted FCFE
2. Dividend discount model
3. Fundamental P/E
4. Adjusted IPO forward earnings multiple

We use a terminal growth rate of 12.35% and a terminal COE of 20.0%.

Our terminal growth rate assumption is consistent with our estimate of the long-term nominal GDP growth rate in Egypt, which is decomposed into a long-term real GDP growth rate of 5.0% and long-term GDP deflator of 7.0%. It is also consistent with OLF long-term ROAE and retention rate of circa 40% and 30%, respectively.

Expected rate of return based on our FV estimate



1. Total expected rate of return by end 2024 = $(1 + \alpha) \times (1 + \beta) - 1$

2. Total return is composed of capital appreciation and cash dividends

A quick refresher of OLFI business model

Obour Land for Food Industries (hereinafter Obour Land) is a leading producer of packaged feta cheese in Egypt. The nameplate feta cheese production capacity is 275,000 tons per annum. The firm also produces limited volumes of three additional products, namely; 1) processed cheese, 2) UHT milk and 3) pasteurized juice. Aside from limited exports of processed cheese, the firm is Egypt-centric.

The four main raw materials used in the production process are 1) Skimmed Milk Powder (SMP), 2) palm oil, 3) butter and 4) Glucono Delta Lactone (GDL). Combined, these four raw materials plus packaging cost accounted for 69% of COGS in 2022. The bulk of these components are imported, which explains the firm's negative exposure to EGP weakness.

A distinguishing feature of Obour Land is its limited investment in both long and short-term assets (mainly receivables) due to the presence of 1) sizable excess feta cheese capacity and 2) a short cash conversion cycle. The firm is finalizing an investment in a medium-scale dairy farm and may expand the processed cheese capacity by 2025/26 to increase export revenue.

Obour Land value chain, 2022 actual figures

Step 1: Sourcing of SMP, palm oil, butter, GDL and packaging material from abroad and occasionally from domestic substitutes.

→ **Step 2:** Production of white cheese, processed cheese, UHT milk and pasteurized juice. In 2022, total revenue stood at EGP4.5 billion.

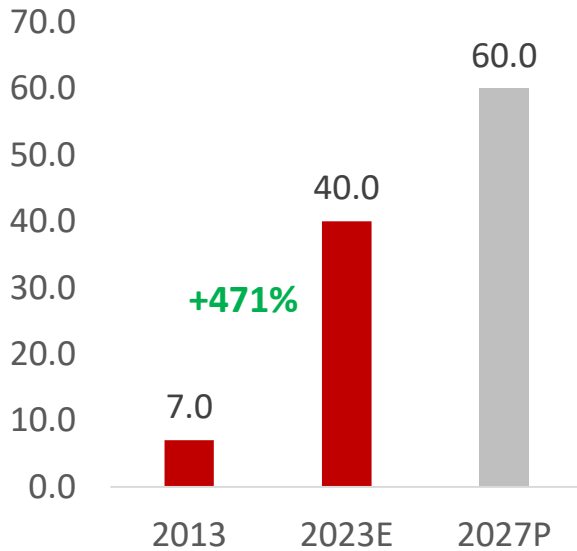
2022 revenue breakdown by segment

White cheese:	93.4%
UHT milk:	4.5%
Pasteurized juice:	1.4%
Processed cheese:	0.6%

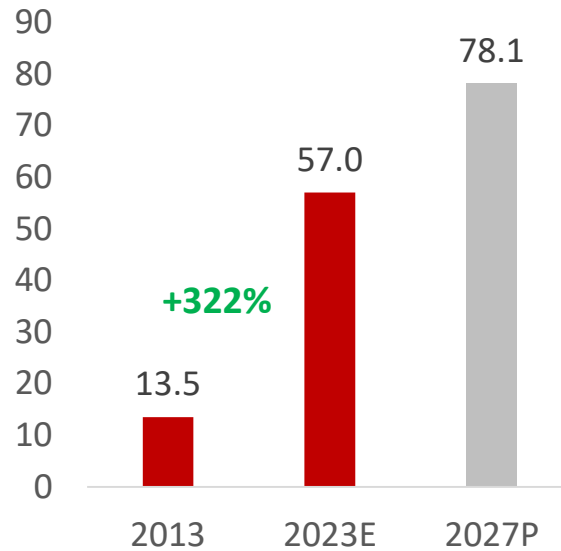
Step 3: Products are distributed indirectly (via wholesalers) and directly to groceries. Distribution via wholesalers accounts for around 70-75% of total sales.

OLFI hedges its negative exposure to EGP weakness via price adjustments

Average USD/EGP



Feta cheese, P/kg, in EGP



Given that most 1) domestic peers rely on imported SMP to produce feta cheese, 2) the relatively inelastic nature of the product and 3) its leading market share (circa 40%), the firm has consistently succeeded in passing on higher costs to end consumers.

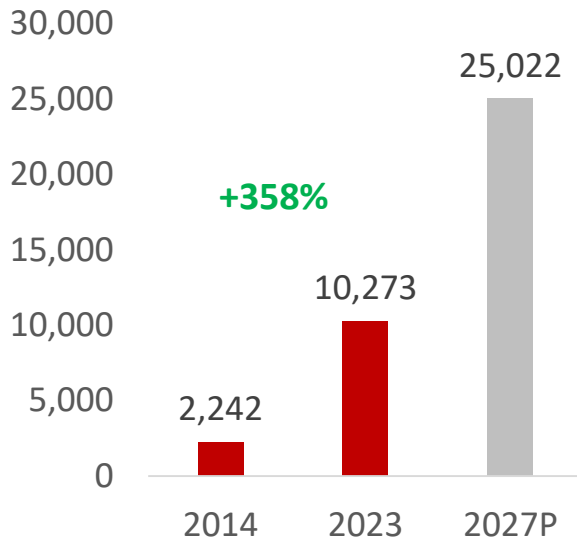
From 2013 until 2023, the EGP value per USD jumped by 471%. Over the same period, OLFI managed to raise the average EGP price per kg of feta cheese by 322%.

The percentage increase in feta cheese price is roughly 70% of the increase in the USD exchange rate, which roughly corresponds to the weight of USD-denominated components in total COGS.

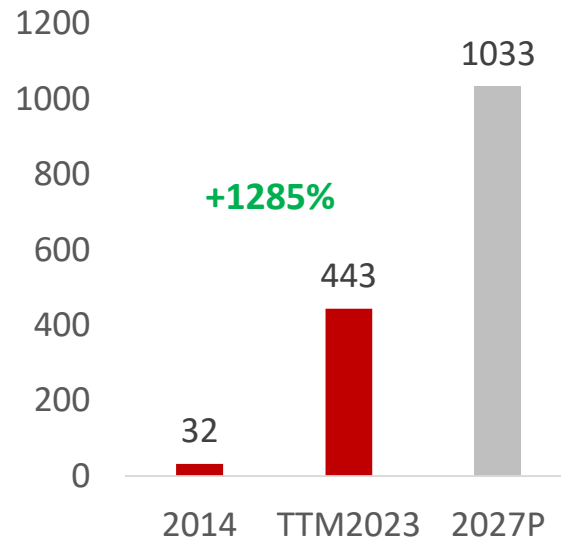
Over the coming 4 years, we project the EGP price per kg to increase by 37.1% to EGP78.1. The persistence of double-digit inflation rates suggest that our projections are fairly conservative.

In fact, historic net income expansion by far exceeded the expansion in nominal GDP

Nominal GDP, in EGP billion



OLFI net income, in EGP million



From 2014 to TTM-2023, OLFI net income mushroomed by 1,285% from EGP32 million to EGP443.4 million due to both volume and price effects. Over the same period, nominal GDP expanded by 358% only.

From TTM-2023 to 2027, we conservatively project net income to grow by a cumulative 133%, which is materially less than the projected growth rate in nominal GDP over the same period (219%).

The primary reason behind our subdued medium-term growth projections is our ultra conservative volume assumptions. We expect feta cheese volume sold in 2027 to remain at the same level of 2023 to account for 1) competitive pressures and 2) partial diversion towards loose cheese.

Core model assumptions

	Actual		Estimate		Projected			
	2020A	2021A	2022A	2023E	2024P	2025P	2026P	2027P
Feta cheese volume sold, thousand tons/annum	105.5	108.1	123.2	118.8	116.5	116.5	117.6	118.8
Average feta cheese ex-factory price /kg, in EGP	24.0	25.5	34.6	57.0	65.0	69.5	73.7	78.1
Average SMP price, in USD per ton	4,140	4,060	4,250	3,900	3,800	3,800	3,600	3,600
Average USD/EGP	15.75	15.75	20.00	40.00	50.00	50.00	55.00	60.00
SG&A/revenue	-8.5%	-7.6%	-5.9%	-4.2%	-4.7%	-5.0%	-5.2%	-5.6%
GPM	23.4%	22.3%	20.6%	19.6%	19.4%	19.6%	20.2%	19.9%
Cash conversion cycle, in days	99	63	36	55	58	62	67	70
Cash dividends payout ratio	77.3%	74.1%	82.2%	82.2%	65%	75%	75%	75%

Source: Management guidance and our projections

COGS structure

	Actual		Estimate		Projected			
	2020A	2021A	2022A	2023E	2024P	2025P	2026P	2027P
Raw materials	70.0%	72.7%	72.8%	74.8%	70.8%	70.3%	71.1%	72.3%
Packaging	16.1%	12.8%	12.9%	11.3%	12.9%	12.9%	12.5%	12.0%
Industrial expenses	5.6%	6.8%	5.7%	5.7%	6.7%	6.9%	6.7%	6.4%
Others	6.7%	6.0%	7.6%	7.6%	8.9%	9.2%	8.9%	8.6%
Direct depreciation expense	1.6%	1.6%	1.1%	0.7%	0.7%	0.7%	0.7%	0.7%

Source: Management guidance and our projections

Abridged statement and profitability ratios

Figures are in EGP million	Actual			Estimate		Projected		
	2020A	2021A	2022A	2023E	2024P	2025P	2026P	2027P
Revenue, net of discounts	2,739.1	3,006.6	4,560.3	7,252.2	8,128.0	8,721.9	9,350.5	10,037.9
<i>o/w feta cheese revenue</i>	2,536.8	2,756.0	4,260.6	6,774.0	7,567.9	8,097.7	8,669.4	9,281.4
<i>o/w other</i>	202	251	300	478	560	624	681	756
Gross profit	642.0	671.2	940.1	1,423.5	1,574.1	1,706.8	1,888.8	1,992.6
SG&A	(232.8)	(229.1)	(270.4)	(304.7)	(380.9)	(438.0)	(490.6)	(564.2)
Core operating income	409.1	442.0	669.7	1,118.8	1,193.2	1,268.8	1,398.2	1,428.4
Net attributable income	310.4	350.7	462.4	554.1	683.5	870.2	992.8	1,033.4
GPM	23.4%	22.3%	20.6%	19.6%	19.4%	19.6%	20.2%	19.9%
NPM	11.3%	11.7%	10.1%	7.6%	8.4%	10.0%	10.6%	10.3%
ROAE	66.5%	36.2%	44.0%	47.7%	50.2%	52.9%	51.7%	48.1%

Source: Management guidance and our projections

Abridged statement of financial position and liquidity ratios

Figures are in EGP million	Actual			Estimate		Projected		
	2020A	2021A	2022A	2023E	2024P	2025P	2026P	2027P
Total assets	1,356.1	1,548.3	2,566.8	2,888.6	2,953.2	3,085.1	3,268.6	3,496.5
Total liabilities	422.8	542.9	1,471.7	1,662.5	1,455.5	1,293.9	1,218.5	1,250.5
Total equity	933.3	1,005.4	1,095.0	1,226.1	1,497.6	1,791.3	2,050.1	2,246.0
Cash/sales ratio	0.6%	11.2%	15.9%	9.6%	7.4%	7.6%	8.1%	7.9%
Gross debt (cash)/equity	17%	23%	47%	72%	46%	33%	29%	26%
Net debt (cash)/equity	16%	-10%	-19%	15%	6%	-4%	-8%	-9%

Source: Management guidance and our projections

Model 1: Discounted FCFE

Figures are in EGP million

Projected

	2023	2024P	2025P	2026P	2027P	2028P	
Net Income		683.5	870.2	992.8	1,033.4		
Depreciation expense		70.3	74.2	83.0	92.4		
Capital expenditure		(104.4)	(88.9)	(67.6)	(72.5)		
Change in non-cash working capital		(158.6)	(148.4)	(181.6)	(180.7)		
Net borrowing (repayment)		(100.0)	(100.0)	-	-		
Employee and board profit share		(51.8)	(63.9)	(81.4)	(92.8)		
FCFE		338.9	543.2	745.3	779.8	876.1	Terminal g = 12.35%
COE		40.0%	25.0%	22.7%	20.0%	20.0%	Terminal COE = 20.00%
PV of FCFE plus excess cash balance (50% of 2023 profit)	6,006.8						
FV/share, in EGP	15.0						

Model 2: Dividend discount model

Figures are in EGP million, unless o/w stated	Actual					Average/CAGR
	2018	2019	2020	2021	2022	2018 – 2022
Net attributable income	238.0	295.3	310.4	350.7	462.4	
ROAE	39.2%	38.4%	34.7%	36.2%	44.0%	Average 38.5%
Cash dividends	100	200	240	260	380	CAGR 44.8%
Cash dividends payout ratio	42.0%	67.7%	77.3%	74.1%	82.2%	Average 68.7%
FV of equity Dec 2023 =	$\frac{\text{Div}_{2023} \times (1 + 12.35\%)}{20\% - 12.35\%} + \text{excess cash}$					
FV of equity Dec 2023 =	$\frac{\text{EGP}382 \text{ m} \times (1 + 12.35\%)}{20\% - 12.35\%} + \text{EGP}360.2 \text{ m} = \text{EGP}5,970.3 \text{ m}$					
FV of equity per share Dec 2023 =	$\frac{\text{EGP}5,970.3 \text{ million}}{400} = \textbf{EGP14.9/share}$					

Model 3: Fundamental P/E ratio

Figures are in EGP million, unless o/w stated

Figures are in EGP million, unless o/w stated	Actual					Average/CAGR
	2018	2019	2020	2021	2022	2018 – 2022
Net attributable income	238.0	295.3	310.4	350.7	462.4	
ROAE	39.2%	38.4%	34.7%	36.2%	44.0%	Average 38.5%
Cash dividends	100	200	240	260	380	CAGR 44.8%
Cash dividends payout ratio	42.0%	67.7%	77.3%	74.1%	82.2%	Average 68.7%
FV of equity _{Dec 2023}	$= \frac{1}{\text{COE}} + \frac{\text{RR} \times (\text{ROE} - \text{COE})}{\text{COE} \times (\text{COE} - g)}$					
FV of equity _{Dec 2023}	$= \frac{1}{20\%} + \frac{28.7\% \times (43\% - 20\%)}{20\% \times (20\% - 12\%)} = 9.3x$					
FV of equity _{Dec 2023}	$= 9.3 \times \text{EGP}683.5 \text{ million} = \text{EGP}6,356.5 \text{ million}$					
FV of equity _{Dec 2023}	$= \text{EGP}6,356.5 \text{ m} \div 400 \text{ m shares} = \textbf{EGP15.9/share}$					

Model 4: Adjusted IPO 1Y forward earnings multiple

Obour Land for Food Industries, IPO valuation, 15 Dec 2016

IPO price:	EGP9.68/share
Adjusted IPO price (IPO price x 1.1)	EGP10.65
Number of shares (in Dec 2016):	200 million
Adjusted market capitalization:	EGP2,129.6 million
2017 net income:	EGP243.2 million
1Y adjusted forward earnings multiple:	8.75x
Fair equity value, as of end Dec 23	EGP5,985.3 million
Fair equity value per share, EGP	EGP15.0

Finally, we look at OLFI forward multiple as indicated by its public offering price.

OLFI started to trade on the EGX on 15 December 2016 at an opening price of EGP9.68/share number of shares. At the time, the outstanding number of shares was 200 million shares. Accordingly, OLFI equity was valued at EGP1,936 million.

Given the conventional discount embedded in IPOs, we adjust the offering price upwards by 10% to EGP10.65/share.

In 2017, the firm reported a net attributable income of EGP243.2 million.

Based on the above information, OLFI equity was valued at a forward earnings multiple of 8.0x and an adjusted multiple (excluding a 10% discount) of 8.8x. It is important to note that OLFI was offered few weeks after Egypt floated the EGP on 3 November 2016 and hiked the policy rate 3.0%.

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