

The Egyptian Milling Industry

Impact

POSITIVE

Degree

MODERATE

Separating the Wheat from the Chaff

Our top stock picks in this high-dividend-yield industry

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Figure 1: Our top picks

Middle & West Delta Flour Mills	WCDF
Price target (EGP)	170.8
Closing price (EGP)	103.69
Upside potential	65%
Dividend Yield (FY21a)	12.5%
East Delta Flour Mills	EDFM
Price target (EGP)	131.4
Closing price (EGP)	85.08
Upside potential	54%
Dividend Yield (FY21e)	11.8%
Upper Egypt Flour Mills	UEFM
Price target (EGP)	131.4
Closing price (EGP)	102.16
Upside potential	29%
Dividend Yield (FY21e)	9.8%
Central Egypt Flour Mills	CEFM
Price target (EGP)	42.7
Closing price (EGP)	33.45
Upside potential	28%
Dividend Yield (FY21e)	9.7%

* As of 31 October 2021.

Source: Prime Research.

Look for high dividend plays: Egypt's milling industry is one of the few industries that include high dividend plays, along with the pharmaceutical industry. The fact that the seven milling stocks listed on the EGX are all state-owned mills means that it is dividend season. State-owned mills end their fiscal year in June with annual cash dividends usually paid in November/December. This is one reason we think milling stocks should perform well over the coming period. Another reason, dividends aside, is that four of these seven names are worth owning on a valuation basis, specifically for income investors. Our top picks are Middle & West Delta Flour Mills [WCDF] (PT EGP170.8/share, +65%), East Delta Flour Mills [EDFM] (PT EGP131.4/ share, +54%), Upper Egypt Flour Mills [UEFM] (PT EGP131.4/share, +29%), and Central Egypt Flour Mills [CEFM] (PT EGP42.7/share, +28%). While POSITIVE, we see the dividend story a MODERATE impact due to the low trading liquidity of all milling stocks.

The competitive landscape: The competition state-owned mills have long been facing has stiffened lately since private-sector mills producing 82%-extraction flour started to enter the market. Slashing the flour allocation to state-owned mills in major governorates and reducing their capacity utilization rates, this competition proved cutthroat. Private-sector mills have switched to the production of 82%-extraction flour only after it became more profitable than 72%-extraction flour in the new status quo which will be explained later in this note. Today, total milled wheat in Egypt amounts to c.8mn tons (down from c.9mn tons earlier) due to the decline of production state-owned mills to 5.17mn tons (down from c.6mn earlier). Private-sector mills currently mill c.3mn tons of wheat annually, capturing 35% of the 82%-extraction flour market, up from 30% few years ago. Nearly three years ago, licenses for new mills were suspended due to the current high production capacity in the industry. Prior to 2019, there were 153 mills in Egypt, split between 81 state-owned mills and 72 private-sector mills. In 2019, total number of mills in Egypt increased to 159.

Winners and losers: Nonetheless, the sky for four of the seven EGX-listed mills is blue, unclouded by such competition, which allowed them to achieve sizable profit from milling the 82%-extraction flour. Unrivaled by private-sector mills in their coverage areas, these state-owned mills are the ones mentioned above, namely CEFM, EDFM, WCDF, and UEFM. Meanwhile, the remaining companies rivaled by private-sector mills are South Cairo & Giza Flour Mills [SCFM], followed by North Cairo Flour Mills [MILS] then Alexandria Flour Mills [AFMC]. Indeed, SCFM became the biggest loser in this zero-sum game, as it vies against 18 private-sector mills, shrinking its flour allocation versus years ago. This left SCFM's capacity utilization rate at 39.3% in FY21. This led SCFM's total milling cost to rise to EGP854.5/ton (+20% y/y) in FY21 compared to MILS's EGP750/ton (+12% y/y), UEFM's EGP355-498/ton and CEFM's EGP410.1/ton compared to a standardized cost⁽¹⁾ of EGP438.5/ton.

⁽¹⁾ Standardized cost is calculated by the Ministry of Supply & Internal Trade (MOSIT).



Private sector- vs. state-owned mills: The refinement rate⁽²⁾ in private-sector mills is 157 kg of flour and bran per ardeb⁽³⁾ of wheat compared to a standard rate of 153.5 kg for private-sector and state-owned mills since 1 February 2020 and 152.5 kg earlier. In reality, this only applies to state-owned mills, being subject to government inspection – unlike their private-sector competitors. This dynamic ultimately left private-sector mills gushing in profits and state-owned mills either swamping in losses (like **SCFM**) or clambering for the crumbs (like **MILS** and **AFMC**). The new status quo rendered all state-owned mills so helpless that two years ago they had to ask the **Cabinet**, the **Ministry of Supply & Internal Trade (MOSIT)**, and the **Holding Co. for Food Industries (HCFI)** for two things: **(1)** to raise the milling fees from a current EGP500/ton to EGP700/ton due to higher operating costs, led by wages and **(2)** to double the commission for coarse bran to 20%.

Profitability in question: For the most part, having fixed milling fees is what stifles state-owned mills' profitability even it should revise upward to accommodate the increase in operating costs. The bran pricing mechanism itself does not produce an even match to the market price (e.g. the MOSIT price is currently set at EGP3,500/ton vs. a current market price of EGP3,700-3,750/ton), forcing state-owned mills to either **(a)** sell their bran cheaper at the MOSIT price of EGP3,500/ton and lose part of their commission or **(b)** stockpile their bran. We note that the market price of bran only increased to EGP4,700/ton by end of June 2021 post Ramadan and towards Eid Al-Adha due to its use in fattening livestock. Meanwhile, the decline in produced volume of milled wheat (as per the current framework) only rubs salt in the wound.

Background: The Egyptian milling industry passed through three critical stages over the previous ten years following a government plan that was announced back in 2009 to liberalize flour trade, allowing state-owned - and private-sector mills to compete for the supply of 82%-extraction flour to:

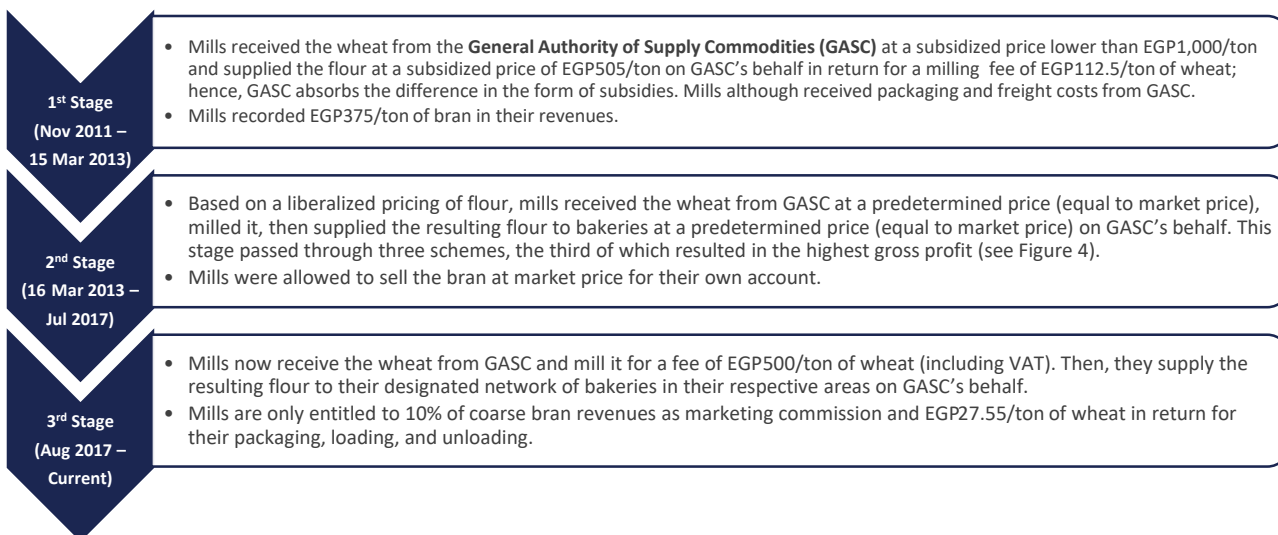
- (1) enhance the quality of subsidized bread,
- (2) reduce wheat leakage, and
- (3) prevent illegal trade in the black market.

In each stage, a different milling framework governed the milling industry with strikingly different implications on its fundamentals, as depicted in Figure 2. We note that after liberalization of flour prices in 2nd Stage, the bakeries objected as they did not want to pay for the flour. Thus, in April 2015, bakeries started purchasing flour in installments, but with the introduction of 3rd Stage in August 2017, they started paying three-day insurance. We note that state-owned mills obtain the wheat required for the 82%-extraction flour from GASC. As for the 72%-extraction flour, they used to obtain the required wheat from GASC before 2002/03, but afterwards they had to obtain it from their own sources. Other than bran, state-owned mills used to and continue to retain all other milling residuals (used in fish farms) across all stages.

⁽²⁾ Refinement rate includes 820 kg of 82%-extraction flour, 190 kg of coarse bran, and 13 kg of soft bran.

⁽³⁾ Ardeb of wheat is equal to 150 kg.

Figure 2: Development of the Egyptian milling industry frameworks over the past ten years



Source: Prime Research.

Figure 3: The main differences between the three stages over the past ten years

	1st Stage (Nov 2011 – 15 Mar 2013)	2nd Stage (16 Mar 2013 – Jul 2017)	3rd Stage (Aug 2017 – Current)
Subsidy mechanism	Wheat, flour, and bread	Bread only	Bread only
Wheat & Flour prices	Subsidized	Liberalized	Liberalized
Wheat milling fees	EGP112.5/ton	None	EGP500/ton (including VAT)
Bran	State-owned mills received EGP375/ton of bran	Retained by mills	Returned to GASC, but mills retain 10% of coarse bran
Mills' revenues from coarse bran *	Applicable	None	EGP27.55/ton of wheat (EGP145/ton of wheat x 190 kg)
Supply service fee (for mills)/revenue (for GASC)	A "Service Improvement Fee" of EGP5.0/ton of flour	EGP9.12/ton of wheat (EGP48/ton of bran x 190 kg)	EGP14.25/ton of wheat (EGP75/ton of bran x 190 kg)
Transportation freight paid to mills	Applicable	None	None

Note: Each ton of wheat results in 190 kg of coarse bran for 82%-extraction flour.

* Packaging, loading, and unloading.

Source: Prime Research.

Figure 4: Profitability per ton of 82%-extraction flour under the three schemes of 2nd Stage

	Scheme I Liberalized pricing scheme (16 Mar 2013 – Jun 2014)	Scheme II (Jul 2014 – Nov 2014)	Scheme III (Dec 2014 – Jul 2017)
Milling revenues	EGP2,826	EGP3,100	EGP2,600
Milling cost	EGP2,860.2 EGP2,275 / (97% x 82%) *	EGP3,205.9 EGP2,550 / (97% x 82%) *	EGP2,577.3 EGP2,050 / (97% x 82%) *
Gross profit/(loss)	(EGP34.2)	(EGP105.9)	EGP22.7

* Per ton of wheat. Wholegrain flour (at 97%) includes 82%-extraction flour in addition to coarse bran.

Source: Prime Research.

Figure 5: Mills revenues and costs under 3rd Stage currently in force

Mills' revenues per ton of wheat	Mills' standardized total milling costs per ton of wheat
EGP500 (including VAT), EGP438.5 (net of VAT) Milling fees	All operating costs (including, wages, electricity, spare parts, maintenance, fuel, property taxes etc.)
+ EGP62.3 10% marketing & storing commission (coarse bran), calculated based on a price of EGP3,280/ton of bran (MOSIT selling price of EGP3,500/ton of bran, net of EGP145/ton of bran for packaging, loading, & unloading and EGP75/ton of bran for supply services charges) x 10% x 190 kg	
+ EGP27.6 Packaging, loading, & unloading (coarse bran), EGP145/ton of bran x 190 kg	
= EGP528.4 Total, EGP589.9/ton – EGP61.5/ton (VAT taxes)	= EGP438.5/ton Total
Gross profit = EGP528.4/ton – EGP438.5/ton = EGP89.9/ton	

Note: Each ton of wheat results in 190 kg of coarse bran and 13 kg of soft bran for 82%-extraction flour.

Source: Company's reports, Prime Research.

A new framework in place: On 1 August 2017, MOSIT applied a new framework for milling wheat, which harmed almost all state-owned mills. Today, as shown in Figure 5, mills receive their wheat from GASC then mill it for a fee of EGP500/ton (including VAT) or EGP438.5/ton (net of VAT). Later, they deliver the resulting flour to their designated network of bakeries in their respective areas before returning the milling residuals (i.e. bran) as well as sales revenue to GASC. In return, the mills capture 10% of coarse bran revenues as marketing commission. They also make EGP27.55/ton of wheat in revenue in return for their paper packaging, loading, and unloading. The main purpose of the current framework was for the government to save on annual subsidies amounting to EGP1bn through reorganizing the bran market – a key feedstock in animal and poultry production. Indeed, the bran market had been unsaturated over the few months before the current framework began to take effect, with prices exceeding EGP4,000/ton of bran.

Figure 6: State-owned mills' market shares in 82%-extraction flour in FY21

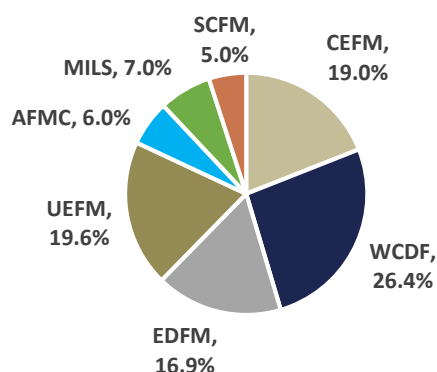
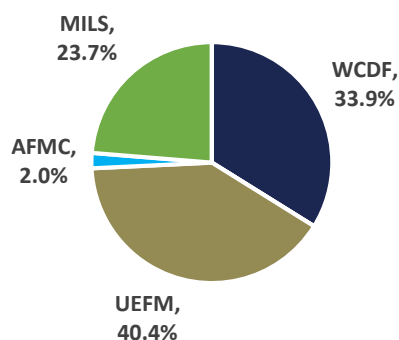


Figure 7: State-owned mills' market shares in 72%-extraction flour in FY21



Source: Company's reports, Prime Research.

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Top players in the market: The four stocks we picked represent the top players in the 82%-extraction flour market, namely **WCDF** (with a market share of 26.4% in FY21), followed by **UEFM** (19.6%), **CEFM** (19.0%), and **EDFM** (16.9%). Meanwhile, in the 72%-extraction flour, **UEFM** dominates the mills' market (with a market share of 40.4% in FY21), followed by **WCDF** (33.9%).

Clean balance sheets: Save for **EDFM**, the top players in the 82%-extraction flour (namely **WCDF**, **UEFM**, and **CEFM**) have clean balance sheets with strong cash positions with an average high net cash/market cap ratio of 88% in FY21. This is compared to only 12% for the remaining mills. Thus, **WCDF**, **UEFM**, and **CEFM** are able to pay out dividends even when generating inadequate profits.

Mounting costs pressure profit: State-owned mills bear operating costs that are increasing by the year, especially wages, while private-sector mills have less workers and pay lower wages, hence netting them higher profits. Furthermore, state-owned mills incur increasing costs of electricity, packing materials, spare parts, and fuel which weigh on their earnings.

Diversifying the revenue base: Almost all mills listed on the EGX added real estate investment to their list of activities to diversify their revenue streams in an effort to offset any revenue decline stemming from the latest milling framework (3rd Stage) and the COVID-19 outbreak.

Our top picks valuation: In our back-of-the-envelope valuation exercise, we used the Gordon Growth Model, assuming an average growth rate of 5% for all mills. We reached a cost of equity (COE) of 13.6% for all the stocks in the milling industry, resting on (1) an average beta of 0.7 to account for their thin trading activity and (2) expected dividend per share as per each company's proposal for FY21, except for **WCDF** which was approved by the company's GM. We note that the weighted dividend yield for the sector is currently at 8.7% in FY21. On these bases, we concluded with the following valuation for our four top picks in the Egyptian milling industry:

- **WCDF:** PT of **EGP170.8/share** (upside +65%, including a dividend yield of 12.5% for FY21).
- **EDFM:** PT of **EGP131.4/share** (upside +54%, including a dividend yield of 11.8% for FY21).
- **UEFM:** PT of **EGP131.4/share** (upside +29%, including a dividend yield of 9.8% for FY21).
- **CEFM:** PT of **EGP42.7/share** (upside +28%, including a dividend yield of 9.7% for FY21).

Figure 8: The Egyptian milling industry's KPIs and our back-of-the-envelope valuation

Per-Share Data & Market Cap	Unit	CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	Sector
Close Price as of 31 Oct 2021	EGP	33.45	103.69	85.08	102.16	11.82	23.07	20.41	
No. of Shares	mn shares	14.7	7.5	6.0	7.0	32.9	10.7	6.0	
Market Cap.	EGP	492	778	510	715	389	247	122	3,254
Debt	EGP mn	8	-	-	-	-	-	4	13
Cash	EGP mn	438	812	18	512	147	9	7	1,943
Enterprise value	EGP mn	63	(34)	492	203	242	238	120	1,323
EPS FY20	EGP	6.70	24.10	20.21	20.52	0.25	1.63	(5.73)	
EPS FY21	EGP	7.02	25.47	21.20	21.02	0.55	0.11	(9.91)	
DPS FY20	EGP	3.25	12.00	11.00	10.00	0.18	0.50	2.30	
DPS FY21e *	EGP	3.25	13.00	10.00	10.00	0.20	-	-	
Financial KPIs		CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	Sector
Revenues FY20	EGP mn	550	1,121	510	1,185	190	639	202	4,397
Revenues FY21	EGP mn	541	1,137	510	1,178	185	552	148	4,251
% Change	%	-1.8%	1.4%	0.1%	-0.6%	-2.1%	-13.6%	-26.9%	-3.3%
Gross Profit FY20	EGP mn	221	243	175	239	23	98	52	1,051
Gross Profit FY21	EGP mn	250	289	184	244	37	71	34	1,108
% Change	%	13.2%	19.0%	5.0%	2.1%	61.3%	-27.4%	-35.5%	5.5%
Net Income FY20	EGP mn	99	181	121	144	8	17	(34)	535
Net Income FY21	EGP mn	103	191	127	147	18	1	(59)	529
% Change	%	4.9%	5.7%	4.9%	2.4%	124.2%	-93.3%	nm	-1.3%
Total Equity FY20	EGP mn	428	451	260	479	229	186	7	2,040
Total Equity FY21	EGP mn	434	620	372	601	233	193	(53)	2,401
% Change	%	1.5%	37.3%	43.4%	25.5%	1.8%	3.5%	na	17.7%
Total Dividends FY21e	EGP mn	47.8	97.5	60.0	70.0	6.6	0.0	0.0	282
Operational KPIs		CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	Sector
Ground Wheat 82%-Ext. Volume FY20	k tons	1,004	1,425	922	1,096	327	463	390	5,627
Ground Wheat 82%-Ext. Volume FY21	k tons	984	1,364	876	1,014	312	362	258	5,171
% Change	%	-2.1%	-4.3%	-5.0%	-7.5%	-4.4%	-21.7%	-33.8%	-8.1%
Flour 82%-Ext. Volume FY20	k tons	824	1,170	757	900	268	380	320	4,620
Flour 82%-Ext. Volume FY21	k tons	808	1,120	719	833	256	298	212	4,245
% Change	%	-2.1%	-4.3%	-5.0%	-7.5%	-4.4%	-21.7%	-33.8%	-8.1%
Margins & Ratios		CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	Sector
GPM FY20	%	40.1%	21.6%	34.4%	20.2%	12.0%	15.3%	25.8%	23.9%
GPM FY21	%	46.3%	25.4%	36.1%	20.7%	19.9%	12.8%	22.7%	26.1%
Net Profit Margin FY20	%	17.9%	16.1%	23.8%	12.1%	4.3%	2.7%	-17.0%	12.2%
Net Profit Margin FY21	%	19.1%	16.8%	24.9%	12.5%	9.8%	0.2%	-40.2%	12.4%
ROE FY20	%	23.0%	40.0%	46.7%	30.0%	3.5%	9.4%	nm	26.2%
ROE FY21	%	23.8%	30.8%	34.2%	24.5%	7.8%	0.6%	nm	22.0%
Multiples (FY21)		CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	Sector
P/E	x	4.8	4.1	4.0	4.9	21.5	211.7	nm	6.2
PEG	x	1.0	0.7	0.8	2.0	0.2	nm	nm	0.9
P/B	x	1.1	1.3	1.4	1.2	1.7	1.3	nm	1.4
Dividend Yield	%	9.7%	12.5%	11.8%	9.8%	1.7%	0.0%	0.0%	8.7%
EV/Sales	x	2.1	-0.2	8.1	1.4	167.0	15.5	23.0	0.1
Earnings Yield	%	21.0%	24.6%	24.9%	20.6%	4.7%	0.5%	-48.5%	16.2%
Net Cash/Market Cap	%	87.3%	104.4%	3.6%	71.6%	37.9%	3.6%	2.1%	59.3%
EV/ton (82%-Ext. Volume)	EGP	77	(30)	684	244	942	800	566	311.7
Other Data		CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	
Event Date		1-Nov-21	17-Oct-21	2-Nov-21	4-Nov-21	7-Nov-21	27-Oct-21	25-Oct-21	
Event Type		OGM	OGM / EGM	OGM / EGM	OGM / EGM	OGM	OGM	OGM / EGM	
Valuation		CEFM	WCDF	EDFM	UEFM	AFMC	MILS	SCFM	
Gordon Growth Model valuation	EGP	42.7	170.8	131.4	131.4	2.6	na	na	
COE	%	13.6%	13.6%	13.6%	13.6%	13.6%	13.6%	13.6%	
Beta		0.78	0.72	0.56	0.58	1.08	0.81	0.41	0.71
Upside	%	28%	65%	54%	29%	-78%	na	na	

* FY21 dividends for WCDF, MILS, and SCFM are as approved by each company's GM.

Source: Prime Research.

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