

Delta Sugar [SUGR]

Market Price
EGP11.01
at close of 7 Jun 2022

12MPT
EGP22.2 (+101%)
set on 8 Jun 2022

Impact

POSITIVE

Degree

STRONG

Sweet and Sour

Higher sugar prices and thin inventory to drive profitability

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Stock performance lagging global sugar prices ytd: So far in 2022, Delta Sugar [SUGR] has been lagging global sugar prices by a 30% spread (ytd: SUGR -28%, sugar: +2%). We think this divergence in performance is unjustified in view of soaring global commodity prices, warranting a re-rating of SUGR. We set SUGR's 12MPT at EGP22.2/share (+101%).

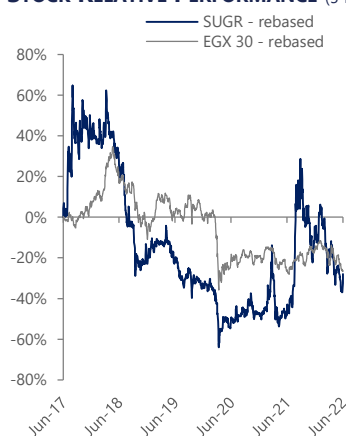
Figure 1: SUGR has underperformed global sugar prices ytd



* As of 7 June 2022.

Source: Koyfin.com, Prime Research.

STOCK RELATIVE PERFORMANCE (5 YR)



Source: Prime Research.

More sweet profits to come: The year 2020 was a one-off for SUGR when it recorded huge losses of EGP254mn before turning this around in 2021 with net earnings of EGP385mn. SUGR had record sales in 2020, selling as much as 428,000 tons, nearly depleting its entire inventory. Starting 2021 with thin inventory, SUGR managed to sell all sugar produced during the year at 17% higher selling prices. With sales volume falling 24% off its 2020 peak, SUGR's revenues were flat in 2021 with gross margin improving from -3.6% in 2020 to +15.3% in 2021.

Higher prices and thin inventory to drive 2022 performance:

Throughout 2021, sugar prices soared globally as supply shortages hit hardest. Sugar prices usually correlate with oil prices, as the majority of global sugar capacity is sugar cane-based. This makes both sugar and ethanol production compete for the same main input. When oil prices surge, sugar cane gets more directed towards ethanol production, thus limiting sugar global supply. In 2022, global sugar prices continued to trend upward, reaching their best levels since 2017. Prices are expected to remain in a bullish mode this year supported by both input costs and supply levels. On one hand, higher natural gas prices in Europe intensify supply shortages and support selling prices. On the other hand, higher oil prices kept adding fuel to the rally in other energy-related products, including ethanol. As a result, Brazil, the world's largest sugar producer, is using more sugar cane as feedstock for ethanol production, putting a lid on global sugar supply levels. Indeed, higher global sugar prices are a good omen for SUGR, supporting its average selling prices. To maintain its profitability levels, SUGR needs to see both selling prices increase and inventories to remain relatively thin.

KEY STOCK STATISTICS

Shares outstanding (mn)	142.2
Free float	20%
Market cap (EGPmn)	1,565
Market cap (USDmn)	83
52w range (EGP/share)	7.85-20.28
EGP100 invested 5y ago	72
TTM EPS (EGP)	2.71
TTM P/E	4.0x
2022e EPS (EGP)	2.28
2022e P/E	4.8x
TTM P/B	1.3x
Last fiscal year's DPS (EGP)	0.50
Dividend yield	4.5%
5Yr beta	1.0

Source: Prime Research.



Recent government action further supports profitability: In December 2021, the Egyptian government raised subsidized sugar prices by 24% to EGP10,500/ton. The decision was attributed to higher global prices in general, as raw sugar prices jumped c.70% since H1 2020. We believe SUGR is set to benefit off this decision, given its strong contribution to the local market in general and the subsidized sugar segment in particular. So far, the hike proved to be persistent, further supporting SUGR's selling prices. We note that SUGR sells a huge chunk of its output to the Holding Co. for Food Industries through contracts.

Our 2022 forecasts: We conservatively project SUGR's sales volumes to reach 230,000 tons in 2022, a 29% drop y/y, having hit above-average levels in 2020 and 2021. Also, we expect white sugar selling prices to average EGP9,000/ton in 2022 in light of the government's latest decision to hike subsidized sugar prices up to EGP10,500/ton. Meanwhile, we expect average price per ton for beet to reach EGP777/ton (include an EGP75 premium to 2021 prices). Hence, we conservatively expect revenues to weaken by 16% to EGP2.7bn but GPM to improve to 18% vs. 15% in 2021. We expect pretax income to grow by 9% to EGP418mn on lower borrowing costs, yet we expect net earnings to drop 16% y/y to EGP324mn on the back of tax expenses.

Valuation: We valued SUGR using two valuation methods: multiples and replacement cost.

- (1) Multiples:** We applied a 5x EV/EBITDA multiple to a long-term median USD-denominated EBITDA (2014a-2022e), adjusted for FX impact, which came out to be USD26mn (incidentally our estimated EBITDA for 2022). Valuing SUGR's investments at c. EGP300mn, we reached **an equity value of EGP2.9bn** (EGP20.5/share).
- (2) Replacement cost:** We conservatively applied USD480/ton to an estimated sales volume of 230,000 tons for 2022. This is a 20% discount to an EV/ton of USD600 derived from **Canal Sugar's** inauguration costs of USD450mn for its 0.75mtpa sugar facility. SUGR's investments included, we reached **an equity value of EGP2.5bn** (EGP17.7/share).

On average, both valuation methods yielded a fair value of EGP19.1/share, which implies **a 12MPT of EGP22.2/share**, offering an upside of 101%. We note that more recently SUGR's shareholders approved a cash dividend distribution of EGP0.5/share, a 4.5% yield, with eligibility/payment dates of 20/23 June 2022.

Figure 2: SUGR's summary valuation & sensitivities

Valuation Method 1: Multiples	
Market price	11.01
FX rate (USD/EGP)	18.50
Historical median EBITDA adjusted for FX (USDmn)	26
EV/EBITDA multiple (x)	5.0x
EV (EGPmn)	2,447
Debt (EGPmn)	159
Cash (EGPmn)	337
Investments (EGPmn)	297
Equity value (EGPmn)	2,922
FV per share	20.5
vs. last price	87%

Valuation Method 2: Replacement Cost	
EV/ton (USD) (20% discount to Al Ghurair Group's investment)	480
FX rate (USD/EGP)	18.5
EV per ton (EGP)	8,880
Total white sugar sales to be sold 2022e (tons)	230
EV based on tons sold(EGPmn)	2,042
Debt (EGPmn)	159
Cash (EGPmn)	337
Investments (EGPmn)	297
Equity value (EGPmn)	2,517
FV per share	17.7
vs. last price	61%

Valuation & 12-Month Price Target	
Average equity value (EGPmn)	2,720
FV per share	19.1
12MPT	22.2
Last price	11.01
Upside	101%

Source: Prime Research.

2022e white sugar average price vs. sales volume

12MPT (EGP/share)

		2022e white sugar average price (EGP/ton)				
22.2		8,000	8,500	9,000	9,500	10,000
2022e white sugar sold (000 tons)	180	16.4	17.8	20.6	22.2	22.2
	205	17.3	18.6	21.4	23.1	23.1
	230	18.2	19.4	22.2	24.0	24.0
	255	19.1	20.2	23.0	24.9	24.9
	280	20.0	21.0	23.8	25.8	25.8

2022e net income (EGPmn)

		2022e white sugar average price (EGP/ton)				
324		8,000	8,500	9,000	9,500	10,000
2022e white sugar sold (000 tons)	180	104	209	314	419	524
	205	109	214	319	424	530
	230	113	219	324	430	535
	255	117	223	329	429	525
	280	122	228	334	440	546

2022e EV/EBITDA multiple vs. EV/ton (USD)

12MPT (EGP/share)

		2022e EV/EBITDA				
22.2		4.0x	4.5x	5.0x	5.5x	6.0x
EV/ton (USD)	280	16.7	17.7	18.7	19.7	20.7
	380	18.5	19.5	20.4	21.4	22.4
	480	20.2	21.2	22.2	23.2	24.2
	580	21.9	22.9	23.9	24.9	25.9
	680	23.7	24.7	25.7	26.7	27.7

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