Savola Group Company

Food-Diversified – Industrial

SAVOLA AB: Saudi Arabia

27 April 2016

الراجحي المالية
Al Rajhi Capital

Rating	OVERWEIGHT
Target price	SAR48.9 (21.7% upside)
Current price	SAR40.2

Research Department

ARC Research Team

Tel 966 1 211 9370, devassyp@alrajhi-capital.com

Key themes & implications

Savola net profit declined by 45% in Q1 2016, impacted by weakness in retail segment due to subdued demand environment. We believe these implications will continue to impact Savola's top line and margin in 2016. However, we expect earnings to bottom in 2016 and recover from next year. Based on our revised estimates, we arrive at target price of SAR48.9 per share and rate the stock as Overweight.

Share information

Market cap (SAR/US$)	21.20bn / 5.65bn
52-week range	29.88 - 78.00
Daily avg volume (US$)	mn
Shares outstanding	534.0mn
Free float (est)	60%

Performance	1M	3M	12M
Absolute	-4.0%	10.2%	-49.4%
Relative to index	-12.1%	-11.6%	-20.0%

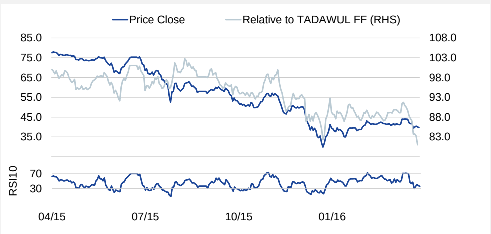
Major Shareholder:	
Mohammed Ibrahim Alisa	11.9%
General Oraganistion for Social Insurance	10.9%

Valuation

	12/14A	12/15A	12/16E	12/17E
P/E (x)	11.3	11.8	14.1	11.5
P/B (x)	2.1	2.0	1.9	1.8
EV/EBITDA (x)	6.7	8.7	8.1	7.2
Dividend Yield	5.4%	4.9%	4.3%	5.2%

Source: Company data, Al Rajhi Capital

Performance



Source: Bloomberg, Company data, Al Rajhi Capital

Company summary

Savola is a conglomerate with leading position in Saudi food and retail industries. The group operates its businesses through three broad sectors – 'Savola Foods Sector' comprising edible oil, sugar and pasta; 'Savola Retail Sector' comprising retail (Panda and Hyper Panda); and 'Savola Plastics Sector'. Furthermore, Savola has made substantial investments in Almarai (the leading dairy company in the GCC region) and Herfy with 36.5% and 47.6% stake respectively.

Savola Group

Bottoming out

Post yesterday's analyst conference call with Savola, we revise our outlook on the stock. Savola's top line was impacted in Q1, led by weakness in food segment (-8.6% y-o-y), while retail segment also posted relatively weak growth of 2.5% y-o-y. In the retail segment (54% of revenue), Savola closed 51 Pandati stores in Q1 due to lesser traffic and unfavourable locations, which impacted growth. Also, we believe the retail segment will continue to face margin pressure in 2016 due to higher operating expenses, even as new store roll-outs will aid revenue growth. However, over the medium to long term, Savola's retail segment is well positioned to benefit from continued shift towards modern retail (hyper and super market formats). In the food segment (46% of revenue), we believe increased competition and currency devaluation in key international markets will continue to impact this year, but should stabilize in 2017. The decline in value of investments in Almarai and Herfy has also impacted the stock price. We expect earnings to bottom this year and stage a recovery from 2017. We rate the stock as Overweight with revised target price of SAR48.9 per share.

Savola is going through a rough phase where volatile currency movements (especially the Egyptian Pound) and its strategy to aggressively expand smaller retail stores (Pandati) is impacting financial performance and hurting margins. The company's plan to expand the convenience store format is not working as per expectations, with 51 stores being closed down in Q1 2016, from the 282 stores they had at the end of 2015.

Management Inputs:

- Revenue was primarily impacted by subdued demand environment in operating economies, resulting in lower consumption and unfavourable foreign exchange impact (Egyptian pound and Turkish lira).
- Savola has closed 51 Pandati stores in Q1 2016, attributable to unfavourable location and traffic related issues. The company is working on changing the format of this business.
- Savola is changing the business model for Sugar (USCE), to an export oriented operation, comprising of 80% export and 20% domestic sales.
- The company expects higher competition in Iran with the opening of the economy (~35% market share in oil). Savola intends to start a new line on soft oil, consumption of which is increasing at a healthy rate.

Period End (SAR)	12/13A	12/14A	12/15A	12/16E	12/17E
Revenue (mn)	25,281	26,588	26,425	27,387	28,767
Revenue Growth	-7.7%	5.2%	-0.6%	3.6%	5.0%
Gross profit margin	18.9%	18.3%	19.3%	19.8%	19.9%
EBITDA margin	9.4%	8.2%	6.3%	6.7%	7.4%
Net profit margin	5.9%	7.1%	6.8%	5.5%	6.4%
EPS	2.91	3.52	3.36	2.81	3.45
EPS Growth	3.7%	21.0%	-4.7%	-16.2%	22.6%
ROE	16.8%	19.0%	17.4%	14.0%	16.1%
ROCE	11.4%	9.3%	6.4%	7.2%	8.7%
Capex/Sales	4.0%	6.3%	7.3%	2.5%	2.3%

Source: Company data, Al Rajhi Capital

- The company has forayed into seafood business with John West as JV.
- Plans to add approximately 20-25 super and hypermarkets in 2016.
- Has access to bank line of $800mn, which is currently unutilized.
- The implementation of ERP and higher operating expenses will weigh on retail segment margin.
- Capex of Panda stores is expected to be SAR0.8–1.0 bn for 2016.

Segmental analysis

Food: The Food segment revenue was down 8.6% y-o-y to SAR2,819mn, mainly impacted by lower commodity prices and currency devaluation (Egyptian pound and Turkish lira). The decline was primarily led by the edible oil business, which declined by 15% y-o-y to SAR1,948mn. This decline is attributable to lower volumes, down from 425 tonnes to 395 tonnes (7% y-o-y) and lower margin (0.4%). Sugar revenue grew 8% to SAR733mn, driven by higher volume (+16% y-o-y), partially offset by negative currency impact. However, the sugar market remains oversupplied due to which prices are likely to remain under pressure. The Pasta business continued to grow significantly by +14% y-o-y to SAR138mn, supported by volume increase of +23% y-o-y. The business did well despite the impact of negative foreign exchange movement. The net profit of the food segment declined 41.1% y-o-y to SAR56mn, primarily due to loss in sugar business (SAR67mn).

Retail: The retail segment grew by 2.5% y-o-y to SAR3,271mn, led by store expansion and benefits from the DC in Jeddah. The Saudi retail revenue increased 2.3% to SAR3,191m and the international revenue grew 6.7% to SAR80mn. The segment posted net loss of SAR21mn in Q1 2016, compared to net profit of SAR18mn in Q1 2015. During the quarter, Savola opened 5 new stores and closed 53 stores (51 Pandati). The closure of Pandati stores was primarily due to the unfavourable location and lesser traffic. The Pandati stores are finding it difficult to keep up with the existing convenient stores, which provide home delivery and credit options. Moreover, Savola will have to open 500 Pandati stores to reach breakeven, which may be difficult to achieve in near future. The company will open 20-25 super and hypermarket stores in 2016, which will drive top line. Overall, being the leader in the Kingdom, we believe Savola's retail segment is well placed to benefit from continued shift towards modern retail (hyper and super market formats) over the medium to long term.

Valuation: In addition to the performance of Savola's standalone business, the valuation of its investments in Almarai and Herfy has also taken a hit recently. The stock is currently trading at SAR40.2, which translates to a 2016E PE of 14.1x. Based on our new estimates post the earnings call, we arrive at a target price of SAR48.9 per share with Overweight rating.

IMPORTANT DISCLOSURES FOR U.S. PERSONS

This research report was prepared by Al Rajhi Capital (Al Rajhi), a company authorized to engage in securities activities in Saudi Arabia. Al Rajhi is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act").

Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through Rosenblatt Securities Inc, 20 Broad Street 26th Floor, New York NY 10005, a registered broker dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through Al Rajhi. Rosenblatt Securities Inc. accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to a U.S. person other than a major U.S. institutional investor.

The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of Rosenblatt Securities Inc. and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Ownership and Material Conflicts of Interest

Rosenblatt Securities Inc. or its affiliates does not 'beneficially own,' as determined in accordance with Section 13(d) of the Exchange Act, 1% or more of any of the equity securities mentioned in the report. Rosenblatt Securities Inc, its affiliates and/or their respective officers, directors or employees may have interests, or long or short positions, and may at any time make purchases or sales as a principal or agent of the securities referred to herein. Rosenblatt Securities Inc. is not aware of any material conflict of interest as of the date of this publication.

Compensation and Investment Banking Activities

Rosenblatt Securities Inc. or any affiliate has not managed or co-managed a public offering of securities for the subject company in the past 12 months, nor received compensation for investment banking services from the subject company in the past 12 months, neither does it or any affiliate expect to receive, or intends to seek compensation for investment banking services from the subject company in the next 3 months.

Additional Disclosures

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither Al Rajhi nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research report's preparation or publication, or any losses or damages which may arise from the use of this research report.

Al Rajhi may rely on information barriers, such as "Chinese Walls" to control the flow of information within the areas, units, divisions, groups, or affiliates of Al Rajhi.

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this research report may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States.

The value of any investment or income from any securities or related financial instruments discussed in this research report denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments.

Past performance is not necessarily a guide to future performance and no representation or warranty, express or implied, is made by Al Rajhi with respect to future performance. Income from investments may fluctuate. The price or value of the investments to which this research report relates, either directly or indirectly, may fall or rise against the interest of investors. Any recommendation or opinion contained in this research report may become outdated as a consequence of changes in the environment in which the issuer of the securities under analysis operates, in addition to changes in the estimates and forecasts, assumptions and valuation methodology used herein.

No part of the content of this research report may be copied, forwarded or duplicated in any form or by any means without the prior consent of Al Rajhi and Al Rajhi accepts no liability whatsoever for the actions of third parties in this respect. This research document has been prepared by Al Rajhi Capital Company ("Al Rajhi Capital") of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

Disclaimer and additional disclosures for Equity Research

Disclaimer

This research document has been prepared by Al Rajhi Capital Company (“Al Rajhi Capital”) of Riyadh, Saudi Arabia. It has been prepared for the general use of Al Rajhi Capital’s clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Al Rajhi Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Al Rajhi Capital. The information contained was obtained from various public sources believed to be reliable but we do not guarantee its accuracy. Al Rajhi Capital makes no representations or warranties (express or implied) regarding the data and information provided and Al Rajhi Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document.

Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Al Rajhi Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Al Rajhi Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Al Rajhi Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document.

This research document and any recommendations contained are subject to change without prior notice. Al Rajhi Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Al Rajhi Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

Explanation of Al Rajhi Capital’s rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company’s profits or operating performance exceed or fall short of our expectations.

Contact us

Al Rajhi Capital
Research Department
Head Office, King Fahad Road
P.O. Box 5561, Riyadh 11432
Kingdom of Saudi Arabia
Email: research@alrajhi-capital.com

Al Rajhi Capital is licensed by the Saudi Arabian Capital Market Authority, License No. 37/07068.