Savola Group Company
Food Diversified – Industrial
SAVOLA AB: Saudi Arabia
16 November 2022

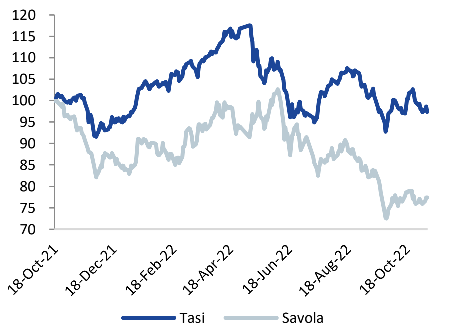
US$4.01bn	66%	US$3.97mn
Market cap	Free float	Avg. daily volume

Target price	**34.00**	+20.4% over current
Current price	**28.25**	as at 15/11/2022

Existing rating

Underweight | Neutral | **Overweight**

Performance



Earnings

Period End (SARmn)	2021	2022E	2023E
Revenue	24,660	28,794	29,349
Revenue Growth %	13.6%	16.8%	1.9%
EBITDA	2,506	2,810	2,934
EBITDA Margin %	10.2%	9.8%	10.0%
Net Profit	222	681	673
Net Profit Margin	0.9%	0.9%	2.4%
EPS	0.42	1.28	1.26
EPS Growth %	-75.7%	207.1%	-1.2%
DPS	0.20	0.57	0.57
Payout Ratio	48%	45%	45%
ROE	2.7%	8.2%	7.8%

Source: Company data, Al Rajhi Capital

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Savola Group

Unfavourable environment, lower our target price to SAR34/sh with an overweight rating.

The current environment of high interest rates and the exposure to deteriorating currency will most likely hit the performance of Savola in the coming period. Savola is exposed to many depreciating currencies, which will affect the company's performance. Moreover, depreciating currencies will affect the purchasing power of consumers, which will limit Savola's ability to pass on further cost increases (the Egyptian pound alone declined around 35% YTD, and the country accounted for 15% of sales as of Q322). On the other hand, the rising interest rates will also affect the company's earnings, as rates are expected to be high in the coming period. The group has around SAR9.4bn of debt outstanding as of Q322 and if we assume an interest rate of 6.5%, finance cost will be around SAR611mn, up from around SAR350mn in 2021.

Recent Performance trend:

The strong revenue growth the company witnessed recently was mostly due to the inflationary pressure in commodities. The food processing segment (which produces edible oil, sugar, pasta and, others) sales jumped to SAR12.7bn in the 9 months ending 2022 vs SAR8.6bn in 2021 and SAR6.4bn in 2020, which reflects what we mentioned earlier regarding the inflation of food prices. At the same time, gross profit reached SAR3.68bn in 9M22 vs SAR3.35bn in 9M21 and SAR3.57bn in 9M20. Although revenue doubled from 2020, earnings declined by 21%, which shows the inability of the company to completely pass on increasing commodities prices. We do not believe that there will be a significant decline in margins going forward, as Q3 margins are reflecting the high cost of raw materials bought during the peak in the March-April period. Since then, raw material prices have declined; however, the company still carries high-cost inventory.

Panda CXR:

The Panda CXR program delivered good results. The company now has around 29 stores that were already revamped and the feedback we saw from these stores was great. Currently, there are around 18 stores that are going through the refurbishment process, with a target of reaching 75 revamped stores by 1Q23. We believe that the Capex for these stores will be financed mostly from debt, which will increase the level of debt for the company and result in higher interest costs in the coming year. We expect Capex to be between SAR1bn to SAR1.3bn in 2022 due to the Panda Capex.

Q3 Performance:

In Q3, the company witnessed a slight decline in the level of prices for its products across different segments. The average price of oil did not fall much and was around 7,000/ton, a slight decline from 7,053/ton in 2Q22. However, margins in the oil segment stood at 11.3% in Q3 vs 14.6% in Q2 (330bps decline), and in absolute terms, it reported a gross profit of SAR347mn in Q3 vs SAR386mn in Q2. We believe that higher inventory affected costs this quarter, reflecting the peak commodity prices in March-April. Also, margins in the sugar segment fell to 10.6% from the previous quarter's levels of 13.3%. The frozen segment (Alkabeer) also took a hit in margins (higher raw material prices due to government restrictions on suppliers), reaching 29% in Q3 vs 31.3% in Q2 vs 36% in Q1 and vs average of 35.7% in 2021.

Figure 1: Segments Margins

Segments	1Q 2021	2Q 2021	3Q 2021	4Q 2021	1Q 2022	2Q 2022	3Q 2022
Food							
Oil-Mature Markets	20.4%	15.1%	13.1%	15.7%	14.5%	14.6%	12.3%
Oil-Start-up Markets*	10.6%	6.2%	6.2%	5.6%	8.6%	9.4%	5.9%
Total Oil	**18.3%**	**13.3%**	**11.5%**	**12.2%**	**13.5%**	**13.7%**	**11.3%**
Oil GP/ton	**708.0**	**676.0**	**632.0**	**676.0**	**734.0**	**832.0**	**820.0**
Sugar	11.2%	14.6%	3.4%	4.3%	6.4%	13.3%	10.6%
Sugar GP/ton	**215**	**230**	**175**	**154**	**146**	**228**	**241**
Pasta	16.3%	12.2%	12.9%	14.7%	18.7%	13.7%	14.5%
Total Non-Oil	**12.8%**	**14.7%**	**4.9%**	**8.9%**	**12.1%**	**16.2%**	**12.5%**
Retail							
KSA	22.3%	22.2%	22.7%	22.2%	21.1%	23.4%	23.3%
Gulf	21.9%	22.9%	18.9%	22.2%	19.0%	22.2%	18.6%
Other							
Herfy	26.5%	25.5%	32.6%	32.2%	25.3%	22.3%	22.0%
Frozen food	34.9%	35.8%	36.2%	36.3%	35.9%	31.3%	28.8%

Source: Company data, Al Rajhi Capital

Despite the fall in gross margins, profit per ton has trended upward from 3Q21 until 2Q22 and has since fallen in 3Q22. The company is trying to maintain its earnings in this inflationary period, with SAIBOR reaching high levels. Taking what we said earlier into account, we have arrived at a TP of SAR34/sh down from SAR35/sh and 20.4% up from the current market price of SAR28.25/sh. Our valuation is conservative, and we believe the downside of the stock is limited and the upside is much more promising.

Figure 2: Q3 Performance

(SAR mn)	3Q 2022	3Q 2021	*Y-o-Y*	2Q 2022	*Q-o-Q*	ARC est	*vs ARC*
Revenue	7,072	6,049	17%	6,888	*3%*	*7,079*	*0%*
Gross profit	1,149	1,024	*12%*	1,248	*-8%*	1,296	*-11%*
Gross margin	16%	17%		18%		18%	
Operating profit	421	302	*39%*	504	*-16%*	552	*-24%*
Operating margin	6%	5%		7%		8%	
Net profit	164	122	*34%*	214	*-23%*	272	*-40%*
Net margin	2%	2%		3%		4%	

Source: Company data, Al Rajhi Capital

Valuation

We have arrived at our 12m forward-looking target price for the company using only the DCF approach. The DCF target price is based on a 2.5% terminal growth and a WACC of 10.4%, which gives us a price of SAR34/share. Overall, we change our target price to SAR34/sh and maintain an overweight rating. Due to the great subjectivity in the SoTP method, we preferred not to use it, since many of the inputs are missing. Although we have built it and the valuation of the SoTP is close to the valuation of the DCF.

Risks

Upside risks to our valuation are, better than expected improvement in earnings, lower than expected Capex spending, and faster than expected recovery of Panda stores. Downside risks are, higher than expected depreciation of the currency in the countries that the company operates in.

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"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.

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