Savola Group Company

Food-Diversified – Industrial
SAVOLA AB: Saudi Arabia
11 November 2019

الراجحي المالية
Al Rajhi Capital

US$4.435bn	60%	US$7.43mn
Market cap	Free float	Avg. daily volume

Target price	30.00	-3.22% over current
Current price	31.00	as at 11/11/2019

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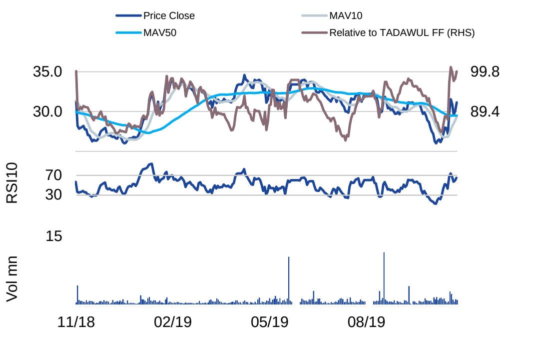
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

(SARmn)	2018	2019e	2020e
Revenue	21,815	21,101	21,147
Revenue growth	-8.5%	-3.3%	0.2%
Gross profit	3,898	3,806	3,765
Gross margin	17.9%	18.0%	17.8%
EBITDA	664	1,055	1,100
EBITDA margin	3.0%	5.0%	5.2%
Net profit	(458)	634	677
Net margin	-2.1%	3.0%	3.2%
EPS	-1.0	1.19	1.27
DPS	0.0	0.0	0.0
Payout ratio	NA	NA	NA
EV/EBITDA	34.0x	21.4x	20.51
P/E	NA	26.4x	24.8x
RoE	NA	7.23%	6.78%

Source: Company data, Al Rajhi Capital

Savola Group

Beat estimates but low visibility on future growth; Remain Neutral

Savola reported a net profit of SAR222mn (+71% y-o-y) beating our and consensus estimates of SAR130mn and SAR89mn respectively. The main reason for the growth was reduction in opex especially selling and distribution expenses to the tune of SAR102mn led by reduced promotions and lower general overheads due to store closure. Top-line grew 2% y-o-y to SAR5.3bn in-line with our estimates. Gross margins improved 240bps mainly due to IFRS 16 adjustment where lease rentals are reported below COGS while operating margins increased 500bps. The retail business growth was backed by improving LFL and basket size growth which led to 3.8% y-o-y increment in revenue. Net loss for retail segment has reduced to SAR48mn compared to SAR198mn against Q3 18. In food segment the volume growth remained negative for all the three categories (edible oil, sugar and pasta) but still the gross margins improved due to higher contribution of pasta in revenue mix which has a better margin compared to oil and sugar. Going forward the visibility of revenue growth is not convincing as the company is not planning to open any new stores. In food segment edible oil volume growth is declining over the last few quarters and production of sugar in central Asia is impacted due to shortage of fuel. Further imposition of taxes on sugary drinks in Saudi Arabia will reduce sugar demand in B2B segment where the sugar prices were normally hedged against volatility in prices. Moreover we feel that there is very less room for cost savings in future as there will be limited store closure in future. Thus we keep our target price unchanged at SAR30/sh which implies a downside of 3.22% from CMP given the limited growth opportunities in near future.

Retail Business: The company's store rationalization strategy adopted few years back played well as the retail business EBIDTA grew this quarter due to lower SG&A arising due to closure of loss making stores, the top-line for the retail business increased 3.8% y-o-y to SAR2.7bn mainly due to improving LFL growth and increasing basket size, the gross profit improved 13% y-o-y while the gross margins increased by 180bps. The adjusted EBIDTA improved to SAR49mn against a negative SAR74mn in Q3 2018. Consequently the net loss decreased from SAR198mn in Q3 2018 to SAR48mn in Q3 2019. The selling space reduced 6.2% from 690k sqm in Q3 2018 to 647k sqm in Q3 2019. Going forward we expect the company to shut 2-3 more stores for the remaining part of the year and the net profit to improve on the back of lower selling and general overheads. However with lower number of stores and no further plans of expansion the sustainability of top-line growth remains uncertain.

Food Business: The revenue for the food segment declined 5% y-o-y to SAR2.2bn from SAR2.3bn in Q3 2018 mainly due to lower volume growth across all the categories. The contribution of revenue from food segment has reduced from 45% in 9M of 2018 to 41% in 9M of 2019 indicating a weak overall demand especially for the edible oil segment in international market. Apart from weaker demand the overseas investment also faces headwinds due to currency devaluation. The gross profit for the food business increased 8% y-o-y while the gross margins improved 180bps partly due to higher sale of pasta which have a higher margin compared to oil and sugar. The EBIDTA increased 20% y-o-y to SAR167mn while the EBIDTA margin improved by 160bps. The net profit turned positive to SAR75mn as compared to net loss of SAR44mn.

Other Business: The share of income from Herfy foods reduced to SAR57.5mn from SAR58.1mn (-1% y-o-y) in Q3 2018. The frozen food business is doing good as it contributed SAR11.6mn to the company's bottom-line while the income from associate investment in Almarai fell 8.4% y-o-y to SAR200.7mn in Q3 2019.

Valuation and Risks: We keep our target price unchanged. We use SoTP to value Savola. The value of Almarai stake is based on our target price of SAR51.0 per share and includes 20% hold-co discount, while other investments are valued at book. The standalone business (including Herfy) is valued based on EV/EBIDTA at 9x (average market multiple). Based on our estimates, our target price stands at SAR30 per share which implies 3.22% downside from the current market price . We remain "neutral" on the stock.

Figure 1 Savola: Summary of Q3 2019 results

(SAR mn)	3Q18	2Q19	3Q19	y-o-y	q-o-q	ARC est.
Revenue	5212	6024	5336	2%	-11%	5225
Gross Profit	932	1163	1084	16%	-7%	967
G. margin	18%	19%	20%			19%
Op. profit	169.9	363.7	427.1	151%	17%	296
Op. margin	3%	6%	8%			6%
Net profit	-50.7	110.2	221.8	-537%	101%	130
Net margin	-1%	2%	4%			2%

Source: Company data, Al Rajhi Capital

Upside Risks: Better than expected recovery in retail business due to new store openings and higher LFL growth will improve the EBIDTA for the company and pose upward risk to our target price.

Downside Risks: Volatility in the global commodity prices and weaker demand in food segment specially oil and sugar might create pressure in the top-line growth. Further, currency devaluation is another risk which might badly impact the overall top-line growth of the company in international market. Any increase in SAIBOR in future will have a negative impact on our valuations .These structural issues along with any impairment pose a downside risk to our target price.

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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.

"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.

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