FALCOM

Savola Group

Consumer Staples| Savola Group|2050

INTELLIGENT INVESTMENT IDEAS

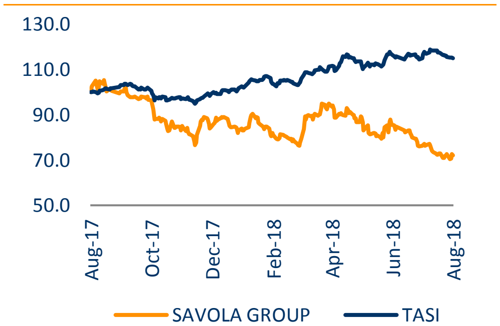
2Q 2018 Results Update **August 13, 2018**

Recommendation	**Overweight**
Previous Recommendation	Overweight
Current Price (SAR)	32.4
Target Price (SAR)	38.0
Upside/Downside (%)	17.2%

As of Aug 12th 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	17.3
52 Wk High (SAR)	49.6
52 Wk Low (SAR)	32.2
Total Outstanding shares (in mn)	534
Free Float (%)	74.5%

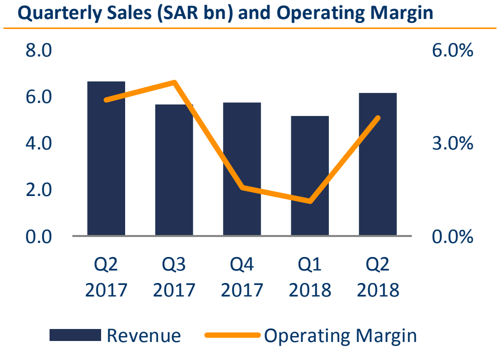
SAVOLA GROUP vs. TASI (Rebased)



Price Performance (%)	**Absolute**	**Relative**
1m	(5.5%)	(5.3%)
6m	(11.1%)	(22.0%)
12m	(28.0%)	(42.9%)

Major Shareholders (%)	
Assilah Investment Co.	11.23%
General Org. for Social Insurance	10.26%
Abdulqader Al Muhaidib & Sons Co.	8.23%
Abdullah M. A. Al Rabeia	8.21%
Al Muhaidib Holding Co.	6.36%

Quarterly Sales (SAR bn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 12th Aug 2018

Net income drops 39% YoY, however, beats street estimates

Savola Group's net profit declined 38.7% YoY to SAR 141mn in 2Q18, however, the results beat consensus estimates. Decline in profitability is ascribed to weak sales and the one-off impact of SAR 62mn gain on sale of lease rights in 2Q17. Revenues declined 7.4% YoY to SAR 6.2bn due to lower sales in the Retail and Food Processing segments, despite higher sales in the Food Services segment. We believe sluggishness in retail sales was due to drop in basket size and lower consumer spending on VAT implementation in KSA and UAE. Additionally, total retail selling space declined 3.8% YoY, as the group closed 7 supermarkets and 2 Pandati stores in 2Q18 as part of its ongoing space rationalization exercise. Decline in Food Processing revenues were ascribed to lower commodity (oil & sugar) prices and the impact of overseas currency devaluation.

Gross profit declined 6.4% YoY to SAR 1.1bn, due to lower revenues partially offset by 7.6% YoY drop in cost of sales in 2Q18. This decline in gross profit was mainly attributable to lower margins in the Food Processing segment, despite margin improvement in the Retail segment, which we believe, resulted from the company's ongoing retail space rationalization exercise.

- Revenues declined 7.4% YoY to SAR 6.2bn due to lower sales in the Retail and Food Processing segments, despite higher sales in Food services segment. However, revenue increased 19.7% QoQ as retail sales increased due to larger basket size and higher customer count coinciding with the month of Ramadan.
- Gross profit declined 6.4% YoY to SAR 1.1bn, while on a QoQ basis, gross profit rose by 12.8%. Cost of sales declined 7.6% YoY to SAR 5.1bn. Consequently, gross margin improved marginally by 18bps YoY to 17.3% in 2Q18.
- Operating profit declined 19.5% YoY to SAR 235mn, as SG&A expenses remained almost flat (up 0.1% YoY) despite lower revenue and gross profit. As are result, operating margins declined 57bps YoY to 3.8% in 2Q18. On QoQ basis, however, operating margins expanded by 269bps due to sales growth in the holy month of Ramadan.
- Savola's transformation plan for the retail segment is gaining momentum, as the company closed 9 stores during 2Q18, reducing total store count to 351, and total retailing space to 729,888 sqm (-3.8% YoY). Retail segment's net loss, however, increased 31% YoY to SAR 210.5mn in 2Q18, as compared to a net loss of SAR 160.2mn in 2Q17.
- In the Food Processing segment, Savola reported 33% YoY decline in net income of SAR 134.6mn. Revenue for the segment declined 14% YoY due to lower commodity prices and currency fluctuations.
- Net income for 2Q18 stood at SAR 141mn, decreasing 38.7% YoY. However, this was a notable improvement over net loss of SAR 84mn reported in 1Q18.
- Savola's General Assembly approved a cash dividend of SAR 1 per share for FY17, amounting to SAR 534mn.
- We expect retail margins to improve going forward as the company is committed to restructuring its retail operations by closing stores that are not generating meaningful returns.

Valuation: We have revised our target price down to SAR 38.0 per share, in light of the recent slide in stock prices. However, we maintain our "Overweight" rating on the stock, as we believe that inorganic expansion and improvement in retail margins would prove long-term catalysts for the stock.

	2Q'18	2Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	6,160	6,653	-7.4%	23,886	23,830	0.2%
Gross Profit (SAR mn)	1,067	1,140	-6.4%	4,490	4,391	2.3%
EBITDA (SAR mn)	437	438	-0.2%	2,080	1,816	14.5%
Net Profit (SAR mn)	141	229	-37.1%	722	1,026	-29.6%
EPS basic (SAR)	0.26	0.43	-38.7%	1.35	1.92	-29.6%
Gross Margin (%)	17.3%	17.1%	0.2%	18.8%	18.4%	0.4%
EBITDA Margin (%)	7.1%	6.6%	0.5%	8.7%	7.6%	1.1%
Net Profit Margin (%)	2.3%	3.4%	-1.2%	3.0%	4.3%	-1.3%

Source: Company Financials, FALCOM Research

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by ≥ 10%.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by ≥ 10%.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company`s performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

FALCOM Financial Services

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Disclaimer and Risks Warning:

FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.