



Initiation Coverage

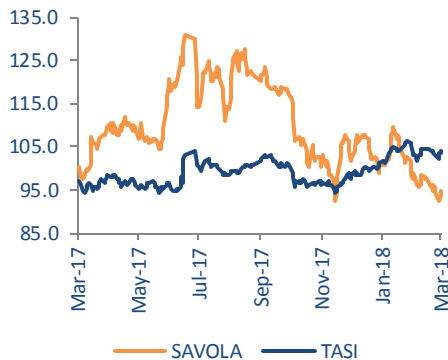
March 08, 2018

Recommendation	Overweight
Current Price (SAR)	36.2
Target Price (SAR)	40.5
Upside/Downside (%)	11.8%

As of March 8th, 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	19.3
52 Wk High (SAR)	51.0
52 Wk Low (SAR)	35.2
Total Outstanding shares (in mn)	534
Free Float (%)	74.5%

SAVOLA Vs TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	(3.1)%	(4.2)%
6m	(21.9)%	(23.5)%
12m	(5.3)%	(12.6)%

Major Shareholders (%)	
Assilah Investment Co.	11.2%
General Org For Social Insurance	10.3%
Abdul Qadir & Sons Co.	8.2%

Quarterly Sales (SAR mn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 8th March 2018

In 2017, Savola Group (Savola) reported SAR23.8bn sales, a 9.5% YOY decline. The year 2017 has been a challenging year with deflation, overall decline in retail market, expat migration and pressure on disposable incomes. For the quarter, sales declined 14.7% Y-o-Y to SAR5.6 bn. Net income for Q4 2017 for food was SAR 198mn; versus a loss of SAR 221mn last year due to lower forex and impairment charges, while retail segment recorded a net loss of SAR 408mn versus a loss of SAR 543 last year.

Saudi Arabia's food market is quite fragmented, while Savola's strong brand value makes it better positioned to cater the rising competition. We believe the process of retail revamp could help revive retail sales, while 100% devaluation of Egyptian Pound and unlikely significant impairments in short term should lower net income volatility. Savola is trading at an 11% discount with TASI, and 23% discount to sector median 12-month forward EV/EBITDA. The stock has declined by 9% over the past 3-months, while we foresee recovery from current levels and recommend 'Overweight' rating on the stock.

Strong brand name and a scalable business model makes the retailer competitive

Panda has been ranked the 244th most powerful retailer in the world. The feat comes after Savola undertook strategic customer-centric initiatives to improve profitability. Panda emerged as a dominant retailer, accounting for 11.5% of total grocery retail in KSA, more than double its nearest competitor. Also, being a large scale organised player, Panda is insulated from the margin pressures occurring from government's austere reforms, which might drive unorganised retailers to consolidate. Savola's management appears more committed about closure of non-performing Panda stores, which should support retail EBITDA breakeven. We have lowered our S&A expenses as a % of sales by 180 bps in 2018.

Favourable demographics; wider reach in food markets

Savola operates in defensive sectors with leading market shares across growth markets which are well positioned to benefit from a younger and growing population. Saudi Arabia's population could reach 33.0mn by 2021, presenting a favourable demand scenario. Besides, Savola Group accounts for one-third of the domestic market demand in food segment, and also has strong presence in GCC and Africa. Savola's subsidiary Afia International Company holds 62% edible oil market share in the UK, enabling the company to increase revenues within premium segments, in the face of currency devaluations.

Net income volatility to lower in 2018

We expect margins to improve in 2018 and easier comps to prevail especially in Egypt following currency devaluation impact absorbed in 2017. Besides, post goodwill markdowns in Egypt operations of Savola foods, store closure and project write-offs (net impact SAR 302mn in 2017), we believe further significant impairments are unlikely in short term. Excluding one-off impairment losses in 2017, the operating margins should improve by 220 bps in 2018 (profits move up from SAR 1.0bn to SAR 1.6bn).

Savola exploring in-organic growth opportunities

Earlier in October 2017, Reuters reported that Savola is in talks to acquire sweets and confectionary maker Sanabel Al Salam in a deal worth USD 300mn, which if materialize could fetch significant synergies for its supermarket chain Panda. The confectioner has 104 branches across KSA and a catering unit.

Valuation: We valued Savola using the DCF Approach to arrive at a fair value of SAR40.5 per share. We considered WACC at 9.3%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Revenues (SAR bn)	23.8	24.7	25.4	26.3
Operating Profit (SAR bn)	0.8	1.6	1.8	2.1
EPS (SAR)	2.1	2.2	2.4	3.0
Operating Margin (%)	3.4%	6.5%	6.9%	7.8%
D/E (x)	0.8	0.7	0.6	0.5
RoE (%)	11.5%	10.6%	10.7%	11.5%
P/E (x)	18.8	16.8	14.8	12.2
Price/BV (x)	2.2	1.8	1.6	1.4
EV/EBITDA (x)	15.4	10.3	9.1	7.5

Source: Company Financials, FALCOM Research



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Valuation Summary**Explanation of valuation methodology and assumptions**

We valued Savola using the DCF Approach to arrive at a fair value of SAR40.5 per share. We considered WACC at 9.3% with a terminal growth rate of 2.0%. In relative terms, Savola is trading at one-year forward P/E of 16.8x (at a discount of 20%) to its sector peers and at a premium of 21% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
EBIT	800	1,606	1,758	2,055	2,514	
Taxes	-77	-80	-90	-110	-141	
Depreciation, amortization and impairment	1,016	815	880	948	1,018	
Changes in working capital	149	409	-41	69	132	
Net capital expenditure	-550	-1,109	-1,144	-1,184	-1,230	
Free Cash Flow to firm	1,339	1,641	1,363	1,778	2,293	
Discount Factor		0.9	0.9	0.8	0.7	
PV of free cash flow to firm		1,526	1,160	1,385	1,634	
Net Present Value (A)					5,705	
Terminal Value					32,045	
PV Terminal Value (B)					22,834	
Assumed Terminal Growth Rate					2.0%	
Discount Rate					9.3%	
Enterprise Value (A+B)	28,539	WACC Assumptions				
Total Cash	1,344	Risk free rate				2.6%
Total Debt	7,403	Equity Risk Premium				8.9%
Minority Interest	879	Beta				1.1x
Equity Value in SAR mn	21,601	Cost of equity				12.7%
Number of shares in mn	534	Post tax cost of debt				4.8%
Target Price in SAR per share	40.5	Weight of equity in capital structure				56.7%
CMP in SAR as on March 8th, 2018	36.2	Weight of debt in capital structure				43.3%
Upside/(Downside) to current market price	11.8%	WACC				9.3%

Source: Company Financials, FALCOM Research Estimates

Risks**Upside Risks:**

- Faster-than-expected progress towards retail restructuring leading to margin recovery of Panda retail stores.
- Favourable foreign exchange movements within the food operations will lead to a better pricing power.

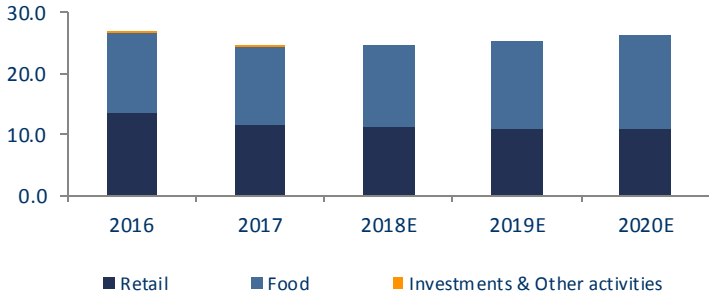
Downside Risks:

- The implementation of VAT and hike in fuel prices increased inflation in KSA, with prices in January rising 3.0% Y-o-Y. The F&B sector saw a significant impact, with prices of goods rising 6.8% Y-o-Y in January. Any further increase in inflation may impact the consumer spending.
- Continued foreign exchange volatility shall negatively affect Savola's food segment margin.

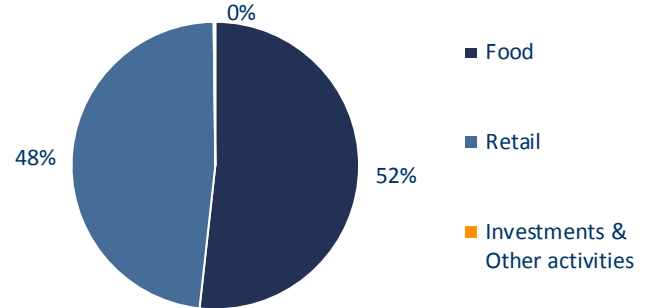


Key Charts

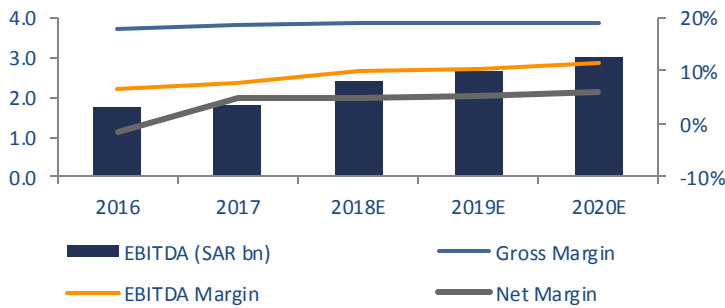
Revenue (SAR bn)



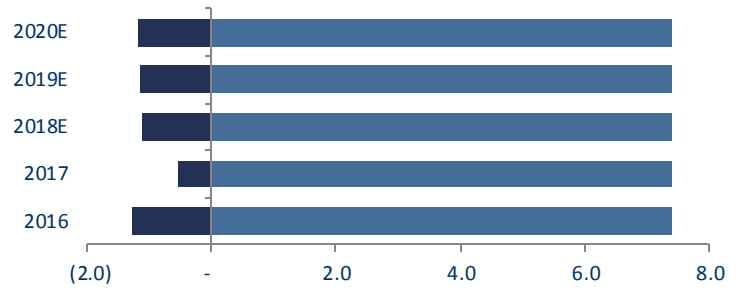
Revenue Split (2017)



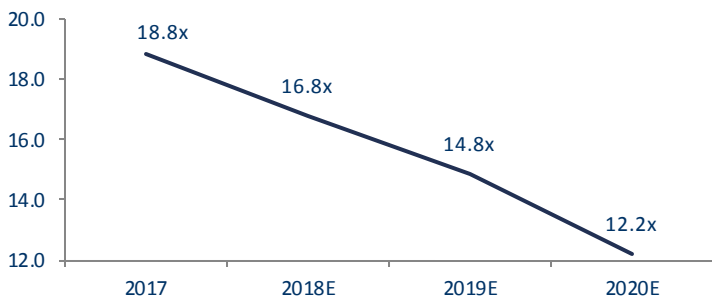
EBITDA & Margins



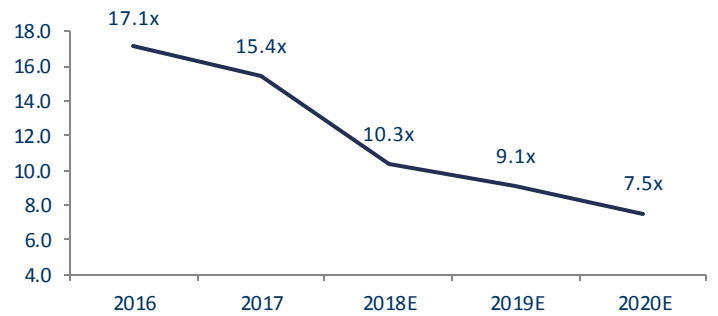
CAPEX and Debt



Price to Earnings



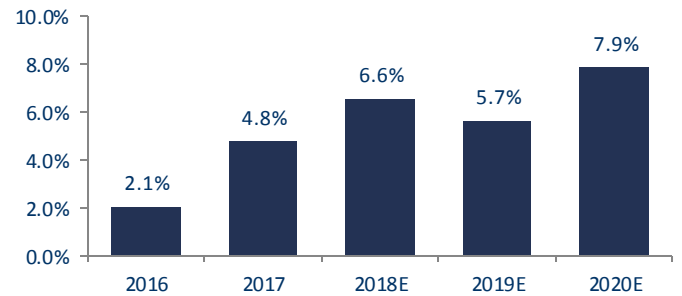
EV/EBITDA



Debt/Equity (x)



Free Cash Flow Yield



Source: FALCOM Research Estimates



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Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Sales	23,832	24,652	25,421	26,309
Gross Profit	4,386	4,635	4,779	4,946
Earnings from Associates	752	792	792	792
EBITDA	1,817	2,421	2,638	3,003
EBIT	800	1,606	1,758	2,055
Net Interest	(381)	(374)	(366)	(359)
Other	778	-	-	-
PBT	1,197	1,232	1,392	1,696
Minorities	-	-	-	-
Zakat	(77)	(80)	(90)	(110)
Net Income	1,120	1,152	1,302	1,586
EPS	2.1	2.2	2.4	3.0
DPS	0.0	-	-	-

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	1,344	2,611	3,607	5,026
Current Assets	6,549	7,556	8,671	10,227
Fixed Assets	7,560	7,929	8,267	8,578
Intangibles	450	376	301	227
Investments in associates and JVs	7,924	7,924	7,924	7,924
Total Assets	23,098	24,400	25,778	27,570
Current Liabilities	8,403	8,552	8,629	8,835
Short Term Debt	3,873	3,873	3,873	3,873
Long Term Debt	3,530	3,530	3,530	3,530
Shareholders Equities	9,708	10,860	12,162	13,748
Total Liabilities	23,098	24,400	25,778	27,570

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	1,176	1,967	2,182	2,534
Working Capital Changes	149	409	(41)	69
Cash Flow from Operating Activities	1,325	2,376	2,140	2,603
Capex	550	1,109	1,144	1,184
Cash Flow from Investing Activities	812	(1,109)	(1,144)	(1,184)
Changes in Debt	(1,666)	-	-	-
Dividends	(8)	-	-	-
Cash Flow from Financing Activities	(2,007)	-	-	-

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue	-9.5%	3.4%	3.1%	3.5%
EBITDA	3.2%	33.2%	9.0%	13.8%
Operating profit	69.4%	100.6%	9.5%	16.9%
PBT	-556.4%	3.0%	13.0%	21.8%
Net Income	-369.7%	2.9%	13.0%	21.8%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	18.4%	18.8%	18.8%	18.8%
EBITDA Margin	7.6%	9.8%	10.4%	11.4%
EBIT Margin	3.4%	6.5%	6.9%	7.8%
Net Margin	4.7%	4.7%	5.1%	6.0%
ROE	11.5%	10.6%	10.7%	11.5%
ROCE	5.4%	10.1%	10.3%	11.0%
ROA	4.8%	4.7%	5.0%	5.8%
Debt/Equity	0.76	0.68	0.61	0.54
Net Debt/EBITDA	3.34	1.98	1.44	0.79
FCF Yield	4.8%	6.6%	5.7%	7.9%
Dividend Yield	0.0%	0.0%	0.0%	0.0%

Valuation	2017	2018E	2019E	2020E
PE	18.8	16.8	14.8	12.2
PB	2.2	1.8	1.6	1.4
EV/EBITDA	15.4	10.3	9.1	7.5
EV/EBIT	35.0	15.6	13.6	11.0
EV/Sales	1.2	1.0	0.9	0.9

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Al marai Co. JSC	22.4x	14.8x
Saudi Dairy and Foodstuff Co.	14.1x	9.2x
Halwani Brothers	20.7x	12.5x
Abdullah Al Othaim Markets	21.2x	14.3x
Savola Group	16.8x	10.3x
Sector Median	20.9x	13.4x
TASI	13.8x	11.6x



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 $\geq 10\%$.

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 $\geq 10\%$.

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.

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