1Q 2018 Results Update

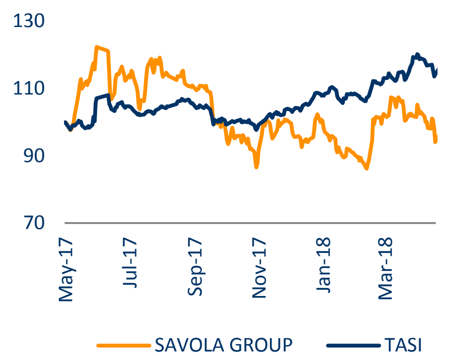
May 25, 2018

Recommendation	Overweight
Previous Recommendation	Overweight
Current Price (SAR)	37.7
Target Price (SAR)	42.6
Upside/Downside (%)	13.1%

As of May 24th 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	20.1
52 Wk High (SAR)	51.0
52 Wk Low (SAR)	35.2
Total Outstanding shares (in mn)	534
Free Float (%)	74.5%

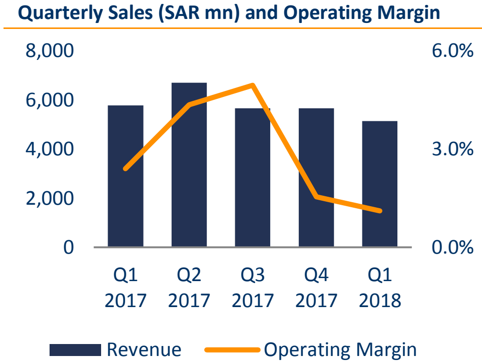
SAVOLA GROUP vs. TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	(13.5%)	(9.9%)
6m	(0.7%)	(17.6%)
12m	(9.0%)	(24.9%)

Major Shareholders (%)	
Assilah Investment Co.	11.2
General Org For Social Insurance	10.3
Abdulqader Al Muhaidib & Sons Co.	8.2

Quarterly Sales (SAR mn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 24th May 2018

Another weak quarter on feeble sales and higher finance costs, taking street by surprise

Savola Group reported a net loss of SAR84mn in 1Q 2018 versus consensus expectations of net profit during the quarter, and against a net profit of SAR5mn in the same period last year. Profitability declined due to weak sales, higher losses from associates and higher interest costs. The company reported a drop in sales due to weak performance from retail and food processing segments. 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, weak results in the food processing segment were due to higher competition and duties imposed on the Iranian market to lower the consumption of ghee.

Although, gross margins of the retail segment expanded by 245bps Y/Y on continuous cost optimisation efforts, as the company had shut down 49 stores in 2017. The group margins largely remained flat due to contraction in margins of food processing (154 bps Y/Y) and food services (392 bps Y/Y) on weak purchasing power and intense competition.

- Savola's revenue fell 11.1% Y/Y and 9.2% Q/Q to SAR 5,145mn in Q1 2018. On a segmental basis, food processing (-13% Y/Y) and retail (-10% Y/Y) segments reported a decline, while food services reported a growth of 4%.
- Gross profits dropped 9.1% Y/Y to SAR 945mn, mainly due to decline in profitability of the food processing (-22% Y/Y to SAR 330mn) and food services (-9% Y/Y to SAR 79mn) segments. However, the core retail segment reported strong growth in gross profits despite declining sales (margins moved up to 22.2% in 1Q18 from 19.8% in 1Q17) At a group level, the gross margins remained almost flat Y/Y, as expansion in retail margins offset by the contraction in food services and processing segments.
- The company reported a net loss of SAR 84mn on weak performance from all operating segments. Retail continue to drag with a net loss of more than SAR 200mn, food processing's net income drop by 90% to SAR 8mn and food services profits fell by 9% to SAR 48mn. Additionally, net finance cost grew to SAR 126mn from SAR 89mn Y/Y. Income from associates and dividends declined by 5% Y/Y to SAR 114mn on higher losses from associates, while the income for investments remained flat over same period in last year.
- Savola signed a binding agreement to acquire 51% of the shares of Dubai based Al Kabeer Group in all cash deal of SAR 565.5mn. The deal would be financed through a mix of cash on books, debt proceeds and sale proceeds from investment portfolio. Al Kabeer Group is a leading player in frozen foods industry of Middle East. It has presence over 15 countries and offers more than 300 products and runs 20,000+ retail outlets. Acquisition of Al Kabeer group is in line with the group's strategy to focus on core assets and scale back non-core assets like real estate and plastics.
- Like for like sales, store expansion and weak disposable income are near-term risk for the retail business, we expect retail margins to improve as the company is committed to restructure its retail operations by shutting stores which are not generating meaningful returns.

Valuation: We have revised our target price slightly upwards with a fair value of SAR 42.6 per share. Despite short-term pressures, we believe that the expansion through inorganic mode and retail margin improvement will be the key long-term catalysts for the stock. We maintain our 'overweight' rating on the stock.

	1Q'18	1Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR bn)	5.1	5.7	-11.1%	23.9	23.8	0.2%
Gross Profit (SAR bn)	0.9	1.0	-9.1%	4.5	4.4	2.3%
EBITDA (SAR bn)	0.2	0.3	-26.7	2.1	1.8	14.5%
Net Profit (SAR bn)	-0.08	0.01	NM	0.7	1.0	-29.6%
EPS basic (SAR)	-0.16	0.01	NM	1.4	1.9	-29.6%
Gross Margin (%)	18.4%	18.0%	0.4%	18.8%	18.4%	0.4%
EBITDA Margin (%)	4.7%	5.7%	-1.0%	8.8%	7.6%	1.1%
Net Profit Margin (%)	-1.6%	0.2%	-1.8%	3.4%	4.6%	-1.2%

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

Contact us on the below phone numbers:
Customer Services: 8004298888
Brokerage Services: 920004711

Fax or Email us at the below number:
Fax: +966 11 2032546
Email: addingvalue@falcom.com.sa

Mail us at the following address:
P.O. Box 884
Riyadh 11421
Kingdom of Saudi Arabia

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