3Q 2018 Results Update

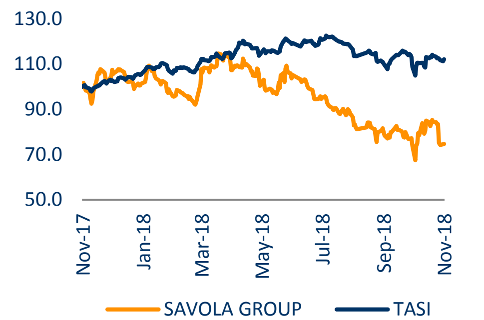
November 15, 2018

Recommendation	Neutral
Previous Recommendation	Overweight
Current Price (SAR)	27.8
Target Price (SAR)	30.0
Upside/Downside (%)	8.2%

As of 14th Nov 2018

Key Data (Source: Bloomberg)	
Market Cap (SAR bn)	14.8
52 Wk High (SAR)	44.9
52 Wk Low (SAR)	25.1
Total Outstanding shares (in mn)	534
Free Float (%)	74.8%

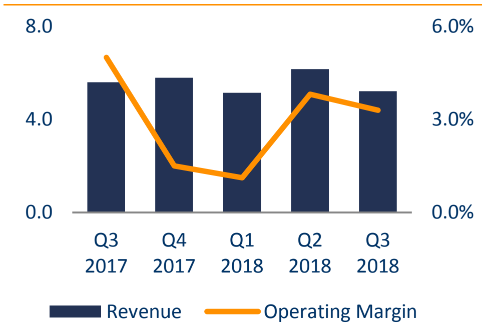
SAVOLA GROUP vs. TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	1.3%	(2.0%)
6m	(25.6%)	(23.8%)
12m	(25.3%)	(37.4%)

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 14th Nov 2018

Weak quarter on lower revenues and higher finance costs

Savola Group reported a net loss of SAR 50.7mn vis-à-vis net profit of SAR 829.0mn and SAR 140.7mn recorded in 3Q17 and 2Q18, respectively. Weaker revenue, lower share of profit from Almarai, higher net finance expenses, due to currency devaluation resulted in losses. Revenue was impacted by lower segmental sales across retail and foods, which offset higher sales in the Herfy segment. An increase in basket size, partially offset by a decline in customer count, affected revenue in the retail segment. Additionally, total retail selling space declined 3.9% in 3Q18 from 2017, as the group closed one Hyper and seven Pandati stores during the quarter. The decline in food revenue was ascribed to lower commodity prices, the impact of overseas currency devaluation, and end price controls in international markets that offset the increase in pasta revenue. Profitability across Savola's food segments was hit by lower gains in edible oils due to currency exchange losses of SAR 73mn, following the devaluation of the Iranian rial and unfavorable market dynamics that impacted the sugar segment.

Going forward, we expect the company's top line to be pressurized as the food segment faces headwinds in the form of volatile commodity prices, currency devaluation and hyperinflationary trends witnessed in Sudan and Iran. However, Savola's plans to acquire a 51% stake in the Al-Kabeer Group by 4Q18 would expand its portfolio in the food sector. Also, retail margins are expected to improve as the company is committed to restructuring its retail operations in efforts to break even by 2019.

- Revenue declined 6.9% YoY and 15.4% QoQ to SAR 5.2bn due to lower sales in the retail and food segments. Retail sales decreased 0.3% YoY and 18.1% QoQ to SAR 2.6bn as selling space reduced by 12,603 sqm on a quarterly basis, following the closure of eight stores in 3Q18. Food revenue fell 14.4% YoY and 14.2% QoQ to SAR 2.3bn impacted by lower commodity prices, while volumes remained relatively stable.
- Gross profit declined 11.6% YoY and 12.6% QoQ to SAR 932mn, despite a decrease in cost of sales. Cost of sales declined 5.8% YoY and 16.0% QoQ to SAR 4.3bn. Consequently, gross margins contracted 95bps YoY to 17.9% during the quarter.
- Operating profit declined 39.4% YoY to SAR 169.9mn due to a lower share of profit from associates (Almarai), which offset a 5.7% YoY decrease in SG&A expenses. Sequentially, operating profit declined 27.6% due to lower revenue. Consequently, operating margins declined to 3.3% in 3Q18 from 5.0% in 3Q17 and 3.8% in 2Q18.
- The company reported a net loss for 3Q18, which came in at SAR 50.7mn. Higher finance expense stemming from foreign exchange losses and a lower share of minority interest contributed to the losses.
- Retail segment continued to drag with a net loss of SAR 198.3mn in 3Q18. Savola's Foods segment recorded a net loss of SAR 43.7mn during the quarter vis-à-vis a net profit of SAR 105.7mn and SAR 134.6mn in 3Q17 and 2Q18, respectively. Herfy recorded a 3.7% YoY increase in net income amounting to SAR 58.1mn in 3Q18.

Valuation: We revised our target price down to SAR 30.0 per share and downgraded the stock to 'Neutral', after factoring in the disappointing 3Q18 performance. However, we believe that improvement in retail margins and inorganic expansion would be the key long-term drivers for the stock.

	3Q'18	3Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR bn)	5.2	5.6	-6.9%	22.0	23.8	-7.7%
Gross Profit (SAR bn)	0.9	1.1	-11.6%	4.0	4.4	-9.4%
EBITDA (SAR bn)	0.4	0.5	-31.6%	1.5	1.8	-19.5%
Net Profit (SAR bn)	-0.1	0.8	NM	0.2	1.0	-83.8%
EPS basic (SAR)	-0.09	1.55	NM	0.3	1.9	-83.8%
Gross Margin (%)	17.9%	18.8%	-1.0%	18.1%	18.4%	-0.3%
EBITDA Margin (%)	6.7%	9.2%	-2.4%	6.6%	7.6%	-1.0%
Net Profit Margin (%)	-1.0%	14.8%	NM	0.8%	4.3%	-3.6%

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.

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