Savola Group Company
Agriculture & Food Sector
SAVOLA AB: Saudi Arabia
2 October 2010

الراجحي المالية
Al Rajhi Capital

US$4.600bn	60.1%	US$2.900mn
Market cap	Free float	Avg. daily volume

Target price	39.50	15.5% over current
Consensus price	40.00	17.0% over current
Current price	34.20	as at 29/9/2010

Research Department
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Underweight | Neutral | **Overweight**

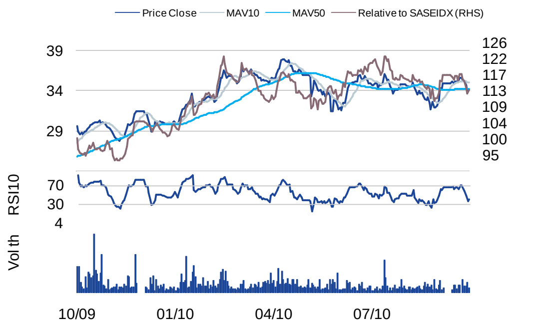
Key themes

Driven by rising population and improving education, we expect the food sector in Saudi Arabia to continue growing. Rising shopping in supermarkets and hypermarkets should support food sales and benefit Savola with its presence in retailing as well as food.

Implications

Savola is one of our top picks in the food sector. It has attractive financial ratios that reflect its improvement. It is performing well operationally and offers growth in the near term at a reasonable valuation.

Performance

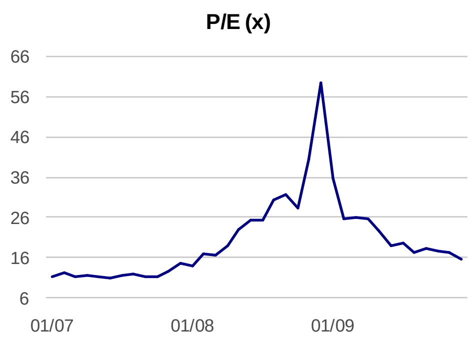


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	17,917	21,031	23,793	26,886
Revenue Growth	29.9%	17.4%	13.1%	13.0%
EBITDA (SARmn)	1,306	1,355	1,551	1,738
EBITDA Growth	61.5%	3.7%	14.4%	12.1%
EPS	1.90	2.42	2.60	2.66
EPS Growth	370.2%	26.9%	7.7%	2.3%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Savola Group
Slightly disappointing

Savola announced its initial Q2 results two months ago. We are disappointed not only because they were below expectations, but also because the company has not yet disclosed the full revenue and net income breakdown by segments which is vital to investors. More recently, Savola has announced that it will acquire minority interests in both Panda and Savola Food Company in exchange for issued shares in the group. We think that this could be dilutive to shareholders in the short run, but that it will be balanced by the expected increase in net income. Moreover, we expect Q3 results to be better than Q2 as Q3 coincides with Ramadan, which is a food shopping season. Therefore, we retain our Overweight rating on the company, but we have lowered our target price to SAR39.5, implying upside potential of 15.5%.

Q2 revenues and profits were below expectations: Savola announced initial Q2 results in late July. Q2 revenues grew by about 12% from the same period in 2009. This was far below Q1 growth of 31% and well below our estimate of 17%. We have waited for two months for Savola to publish its normal full breakdown of results, but this has not yet appeared. We believe that sales of the core products in the food segment, sugar and edible oil, did not grow as strongly as in Q1; we attribute this to declines in commodity foodstuff prices. We estimate that retail and plastics sales grew by 10% and 16% respectively in Q2. The Q2 gross margin, in contrast, declined from 18.0% in Q2 2009 to 14.6% in Q2 2010; the figure was also well below the Q1 2010 gross margin of 16.6%. We still find this sharp decrease in the gross margin – which was the main cause of the 6.3% decline in net profit in Q2 – hard to explain.

Acquiring minority interests could be dilutive: Savola recently announced that it will acquire the minority interests in Panda and Savola Food Company. The group will issue 46.5mn new shares, which represents 8.5% of the group capital, to the Alhokair and Al Muhaidib companies in exchange for their minority stakes, plus paying SAR20mn in cash to Alhokair. As a result, the group ownership will increase in Panda and Savola Food Company from 74.4% to 100%, and 90% to 100% respectively. From one perspective, we see this acquisition as a positive one as it shows Savola's confidence in its core business. Nevertheless, considering that the price paid is not cheap, based on the companies' net income and the sector average PE of 17x, and that a large portion of this transaction is directed at Panda which is currently not very profitable, we believe that this transaction could be dilutive to shareholders in the short term. However, the reduction in minority interests should outweigh dilution and results in earnings accretion over the long term.

Valuation: Savola is a respected group that has a strong position in both the food and retail industries. It also owns invaluable stakes in strong companies such as Almarai and Herfy. Although the group showed strong revenue growth in Q1, it failed to achieve similar growth in Q2. More importantly, it has struggled to maintain last year's margins in both Q1 and Q2, and hence has reported rather weak net profits. We are now waiting for the Q3 results, which will be crucial in determining the company's ability to manage its costs. We retain our Overweight rating on the company, but have lowered our target price from SAR40.9 to SAR39.5 as a result of cutting our forecasts for revenues and the gross margin in 2010 by 7.0% and 0.6% respectively.

Corporate summary

Savola, one of the leading companies in food and retail industries, is a group that holds several companies that operate in different industries. According to Savola's website, the Group operates its businesses through four Core Sectors, these are "Savola Foods Sector", including Edible Oils, Foods, and Sugar, "Savola Retail Sector", including Retail (Panda - and Hyper Panda), Real Estate Sector (Kinan International) and Savola Plastics Sector. Furthermore, Savola has a major investment in the leading dairy company in the GCC(Almarai) and in Herfy Foods Company with stakes of 29.9% and 49% respectively.

Share information

Market cap (SAR/US$)	17.10bn / 4.600bn
52-week range	27.80 - 38.00
Daily avg volume (US$)	2.900mn
Shares outstanding	500.0mn
Free float (est)	60.1%

Performance:	1M	3M	12M
Absolute	7.2%	-2.3%	21.7%
Relative to index	2.2%	-6.5%	19.9%

Major Shareholder:	
Mohammed Ibramim Alisa	11.9%
General Oraganistion for Social Insurance	10.9%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	17,917	21,031	23,793	26,886
EBITDA (SARmn)	1,306	1,355	1,551	1,738
Net Profit (SARmn)	1,183	1,341	1,418	1,517
EPS (SAR)	1.90	2.42	2.60	2.66
DPS (SAR)	1.00	1.25	1.05	1.21
EPS Growth	370.2%	26.9%	7.7%	2.3%
EV/EBITDA (x)	12.3	10.4	8.8	8.2
P/E (x)	18.0	14.2	13.2	12.9
P/B (x)	2.5	2.3	2.1	2.0
Dividend Yield	2.9%	3.7%	3.1%	3.5%

Source: Company data, Al Rajhi Capital

Savola: estimated Q3 results potential growth

We expect solid revenue growth of 15% in Q3

Although we still lack details of the breakdown of revenues in Q2, we expect that the results for Q3 2010 will be stronger than those of Q2 2010 and Q3 2009. We base our assumption on the fact that Q3 includes Ramadan, which is a major grocery shopping season, and that Q3 has historically been strong for Savola. Moreover, Savola has completed several acquisitions in retail and food plus the international food production start-ups. Therefore, we assume that Q3 revenues reached around SAR5.1bn, 15.0% higher than revenues for the same period last year. We assume that the sugar and edible oil divisions achieved the highest revenue growth, of 22% and 21% respectively. We further assume that retail revenues grew by 12%, and plastics revenues by 16%. In terms of profitability, we estimate that Savola recorded a gross margin of 17.0%, higher than 14.6% in Q2, but lower than last year's Q3 of 17.9%. We estimate that Savola achieved net income of SAR319mn in Q3 2010.

Figure 1. Savola: 2009Q3A vs. 2010Q2A vs. 2010Q3E

(SAR) mn	2009Q3A	2010Q2A	2010Q3E	YOY % chg.
Sugar	1,007	N/A	1,229	22%
Edible oil	1,812	N/A	2,193	21%
Retail	1,961	N/A	2,196	12%
Plastics	206	N/A	239	16%
Other	117	N/A	13	-89%
Total Revenues	**5,104**	**4,868**	**5,870**	**15%**
Gross Profit	915	710	998	9%
	17.9%	14.6%	17.0%	
EBITDA	**442.4**	**257.0**	**447.0**	**1%**
EBITDA margin (%)	8.7%	5.3%	7.6%	
Net Income	**289.9**	**207.7**	**319.9**	**10%**

Source: Company data, Al Rajhi Capital

We expect revenues to reach SAR21bn this year

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	**13,795**	**17,917**	**21,031**	**23,793**	**26,886**
Cost of Goods Sold	(12,007)	(14,810)	(17,615)	(19,794)	(22,343)
Gross Profit	**1,788**	**3,107**	**3,416**	**4,000**	**4,544**
Government Charges					
S.G. & A. Costs	(1,587)	(2,162)	(2,569)	(2,964)	(3,388)
Operating EBIT	**201**	**945**	**847**	**1,036**	**1,156**
Cash Operating Costs	(12,987)	(16,611)	(19,676)	(22,243)	(25,148)
EBITDA	809	1,306	1,355	1,551	1,738
Depreciation and Amortisation	(607)	(361)	(508)	(514)	(582)
Operating Profit	**201**	**945**	**847**	**1,036**	**1,156**
Net financing income/(costs)	324	444	422	257	238
Forex and Related Gains	-	-	-	-	-
Provisions	(437)	-	-	-	-
Other Income	134	80	189	160	160
Other Expenses	-	(222)	-	-	-
Net Profit Before Taxes	**223**	**1,247**	**1,457**	**1,453**	**1,554**
Taxes	(52)	(63)	(117)	(35)	(37)
Minority Interests	32	(232)	(133)	(56)	(60)
Net profit available to shareholders	**202**	**952**	**1,208**	**1,362**	**1,456**
Dividends	(500)	(500)	(625)	(575)	(661)
Transfer to Capital Reserve	-	-	-	-	-

	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	500.0	500.0	500.0	547.5	547.5
CFPS (SAR)	1.556	3.089	3.698	3.690	3.834
EPS (SAR)	0.405	1.903	2.415	2.600	2.660
DPS (SAR)	1.000	1.000	1.250	1.050	1.208

We still expect strong revenue growth of 17.4% in 2010

Growth	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue Growth	32.5%	29.9%	17.4%	13.1%	13.0%
Gross Profit Growth	5.5%	73.7%	9.9%	17.1%	13.6%
EBITDA Growth	-7.9%	61.5%	3.7%	14.4%	12.1%
Operating Profit Growth	-54.4%	369.4%	-10.4%	22.4%	11.6%
Net Profit Growth	-83.5%	370.2%	26.9%	12.8%	6.9%
EPS Growth	-83.2%	370.2%	26.9%	7.7%	2.3%

We assume a weaker gross margin this year

Margins	12/08A	12/09A	12/10E	12/11E	12/12E
Gross profit margin	13.0%	17.3%	16.2%	16.8%	16.9%
EBITDA margin	5.9%	7.3%	6.4%	6.5%	6.5%
Operating Margin	1.5%	5.3%	4.0%	4.4%	4.3%
Pretax profit margin	1.6%	7.0%	6.9%	6.1%	5.8%
Net profit margin	1.5%	5.3%	5.7%	5.7%	5.4%

Other Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
ROCE	2.4%	8.9%	6.8%	7.8%	8.2%
ROIC	1.6%	7.7%	5.7%	7.0%	7.4%
ROE	3.0%	14.3%	16.7%	16.8%	15.9%
Effective Tax Rate	23.3%	5.1%	8.0%	2.4%	2.4%
Capex/Sales	6.8%	5.3%	4.1%	5.0%	5.0%
Dividend Payout Ratio	247.1%	52.5%	51.8%	42.2%	45.4%

EV/EBITDA is still reasonable compared to other food companies

Valuation Measures	12/08A	12/09A	12/10E	12/11E	12/12E
P/E (x)	84.5	18.0	14.2	13.2	12.9
P/CF (x)	22.0	11.1	9.2	9.3	8.9
P/B (x)	2.7	2.5	2.3	2.1	2.0
EV/Sales (x)	1.1	0.9	0.7	0.6	0.5
EV/EBITDA (x)	18.9	12.3	10.4	8.8	8.2
EV/EBIT (x)	76.0	17.1	16.7	13.2	12.4
EV/IC (x)	1.3	1.2	1.0	0.9	0.9
Dividend Yield	2.9%	2.9%	3.7%	3.1%	3.5%

Source: Company data, Al Rajhi Capital

Savola's balance sheet is expanding as a result of recent acquisitions

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	605	1,091	588	1,061	1,150
Current Receivables	1,209	1,417	1,769	2,261	2,420
Inventories	2,039	2,297	2,521	2,512	2,689
Other current assets	1,179	746	1,228	1,228	1,228
Total Current Assets	**4,729**	**5,634**	**6,106**	**7,062**	**7,486**
Fixed Assets	4,251	5,537	5,349	6,024	6,786
Investments	4,771	5,056	5,942	5,942	5,942
Goodwill	654	918	1,108	1,108	1,108
Other Intangible Assets	140	112	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**9,817**	**11,623**	**12,399**	**13,074**	**13,836**
Total Assets	**14,546**	**17,257**	**18,504**	**20,136**	**21,322**
Short Term Debt	3,433	3,022	2,202	2,202	2,202
Trade Payables					
Dividends Payable	160	-	-	-	-
Other Current Liabilities					
Total Current Liabilities	**6,001**	**6,313**	**5,828**	**6,598**	**6,907**
Long-Term Debt	1,117	1,996	3,246	3,246	3,246
Other LT Payables	74	61	156	156	156
Provisions	217	358	269	269	269
Total Non-current Liabilities	**1,408**	**2,415**	**3,671**	**3,671**	**3,671**
Minority interests	748	1,567	1,532	1,114	1,174
Paid-up share capital	5,000	5,000	5,000	5,475	5,475
Total Reserves	1,389	1,961	2,473	3,279	4,095
Total Shareholders' Equity	**6,389**	**6,961**	**7,473**	**8,754**	**9,570**
Total Equity	**7,137**	**8,528**	**9,005**	**9,867**	**10,744**
Total Liabilities & Shareholders' Equity	**14,546**	**17,257**	**18,504**	**20,136**	**21,322**

Savola's net debt is relatively high, reflecting recent acquisitions

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	3,798	3,927	4,860	4,386	4,298
Net Debt/EBITDA (x)	4.70	3.01	3.59	2.83	2.47
Net Debt to Equity	53.2%	46.1%	54.0%	44.5%	40.0%
EBITDA Interest Cover (x)	(2.5)	(2.9)	(3.2)	(6.0)	(7.3)
BVPS (SAR)	12.78	13.92	14.95	15.99	17.48

Savola enjoys strong cash flows

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	**223**	**1,247**	**1,457**	**1,453**	**1,554**
Depreciation & Amortisation	607	361	508	514	582
Decrease in Working Capital	(573)	534	(659)	287	(26)
Other Operating Cashflow	513	381	(69)	(35)	(37)
Cashflow from Operations	**770**	**2,523**	**1,238**	**2,219**	**2,072**
Capital Expenditure	(937)	(945)	(873)	(1,190)	(1,344)
New Investments	(907)	(129)	(457)	-	-
Others	(507)	(427)	(27)	-	-
Cashflow from investing activities	**(2,351)**	**(1,500)**	**(1,357)**	**(1,190)**	**(1,344)**
Net Operating Cashflow	**(1,581)**	**1,023**	**(119)**	**1,030**	**728**
Dividends paid to ordinary shareholders	(495)	(513)	(626)	(556)	(640)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	162	(316)	(24)	-	-
Cashflow from financing activities	**2,153**	**(444)**	**(297)**	**(556)**	**(640)**
Total cash generated	572	579	(416)	473	88
Cash at beginning of period	335	605	1,091	588	1,061
Implied cash at end of year	**907**	**1,184**	**675**	**1,061**	**1,150**

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	6.8%	5.3%	4.1%	5.0%	5.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair 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.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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