Savola Group Company

Food-Diversified –Industrial

SAVOLA AB: Saudi Arabia

14 August 2011

US$3.413bn	60.1%	US$2.885mn
Market cap	Free float	Avg. daily volume

Target price	**32.86**	28.30% over current
Consensus price	**37.00**	44.5% over current
Current price	**25.60**	as at 13/8/2011

Research Department

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Underweight | Neutral | **Overweight**

Savola
Eye-catching at current level

Driven by strong overseas operations in food segment and remarkable growth in retail segment, Savola released Q2 results with robust y-o-y growth in revenues and net income of 30% and 11% respectively. Revenues from Iran and Egypt showed the highest y-o-y growth of 56% and 35%. Stimulated by the two month salary bonus, revenues from local market also grew remarkably by 22%. In our view, Q2 results were strong and exceeded our estimates; we've revised our near term forecasts accordingly. However, due to recent global economic concerns and the company's relatively high exposure to international markets, we have raised our WACC assumption to 11%. Therefore, we set a new target price of SAR32.9. This implies around 28% upside potential as the share price recently fell, we remain overweight.

Revenues up 30%, supported by overseas business: Savola reported impressive top line y-o-y growth of 30%, driven by robust growth in international operations. Revenues from Iran (edible oil) saw an outstanding y-o-y rise of 56% mainly on: i) strong position in the Iranian market (current market share around 45%), ii) lack of international competitors, and iii) changes in market dynamics. On the other hand, revenues from Egypt (sugar) rose by 35% compared to a 5% decline last quarter. In our view, this is an indication that operations in Egypt are getting back on track. Finally, revenues from local market showed robust y-o-y growth of 22% driven by strong sales in both food and retail segments. We believe the two month salary bonus stimulated consumers' spending and hence contributed to this growth.

Stable Gross but lower net margins: Savola managed to maintain its Q1 gross margin of 15.3%. This was higher than Q2 2010 gross margin of 14.6%. In addition, SG&A costs as a proportion of sales declined to 10.8% from 11.8% for the same period last year. As a result, EBITDA margin rose to almost 6.7% compared to 6.4% in Q2 2010. Savola's net income increased 11% y-o-y and 39.7% q-o-q, reaching SR230.7mn (vs. our estimate of SAR222mn). It's worth noting that interest charges impacted bottom line as it doubled in Q2 reaching SAR108mn although gross debt has not significantly increased.

Softness in raw sugar & edible oil prices set to improve margins: With the recent global issues (US downgrade and European sovereign debt crises), commodities including sugar and edible oil prices have plunged. During last week sessions, raw sugar and palm oil prices fell noticeably (figure 1.1 & 1.2). Savola normally benefit from softening commodities; however, sharp fluctuations could harm its margins. Furthermore, growing retail business (Panda), which carries low margins, is likely to put pressure on margins.

Conclusion: We believe Savola showed respectable growth for this half of the year. We like Q2 results and believe that the easing in edible oil and sugar prices will be a big catalyst going foreword. We have revised our near term forecasts and WACC assumption on the back of recent economic developments and Q2 results. Therefore, we retain our overweight rating and set a new target price of SAR32.9 (old target SAR33.7). Savola's share price currently trades on a 2011 PE ratio of 12.5x and an EV/EBITDA multiple of 5.7x. The stock offers 3.9% dividend yield at current price.

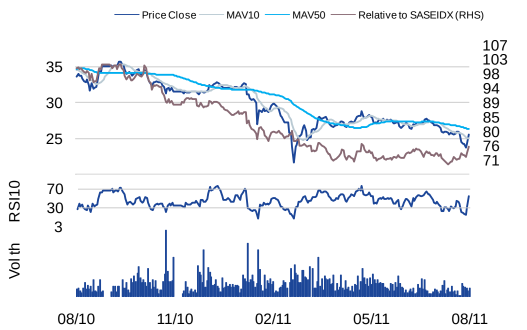
Key themes

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

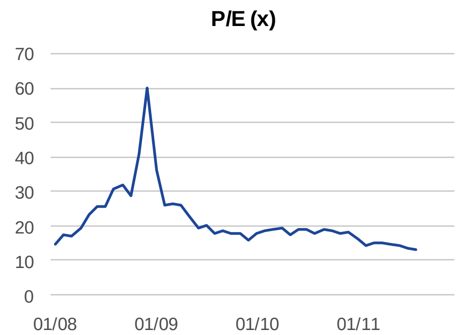


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	21,070	25,245	27,557	30,064
Revenue Growth	17.6%	19.8%	9.2%	9.1%
EBITDA (mn)	1,698	1,770	1,966	2,012
EBITDA Growth	19.6%	4.3%	11.1%	2.4%
EPS	1.77	2.06	2.23	2.41
EPS Growth	-6.8%	15.9%	8.3%	8.4%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

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. 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$)	12.80bn / 3.413bn
52-week range	21.65 - 35.70
Daily avg volume (US$)	2.885mn
Shares outstanding	500.0mn
Free float (est)	60.1%

Performance:	1M	3M	12M
Absolute	-4.8%	-9.6%	-24.9%
Relative to index	0.6%	-1.2%	-24.4%

Major Shareholder:	
Mohammed Ibrahim Alisa	11.9%
General Organisation for Social Insurance	10.9%

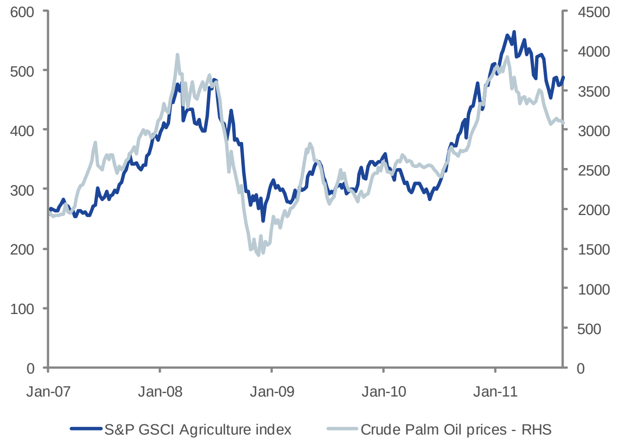
Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	21,070	25,245	27,557	30,064
EBITDA (SARmn)	1,698	1,770	1,966	2,012
Net Profit (SARmn)	887	1,028	1,113	1,206
EPS (SAR)	1.77	2.06	2.23	2.41
DPS (SAR)	1.25	1.00	1.00	1.01
EPS Growth	-6.8%	15.9%	8.3%	8.4%
EV/EBITDA (x)	6.1	5.7	5.3	5.1
P/E (x)	14.4	12.5	11.5	10.6
P/B (x)	1.8	1.7	1.6	1.4
Dividend Yield	4.9%	3.9%	3.9%	4.0%

Source: Company data, Al Rajhi Capital

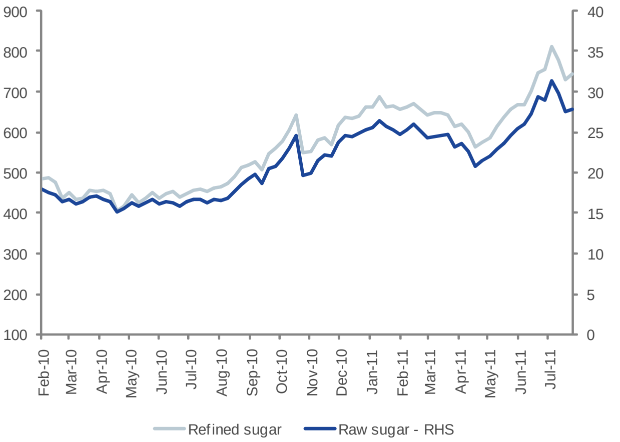
Figure 1.1 Crude Palm Oil prices vs. GSCI Agriculture index



*Malaysian Palm Oil Board Crude Palm Oil fob spot prices

Source: Bloomberg, Al Rajhi Capital

Figure 1.2 Raw vs. Refined sugar prices



*Raw sugar: Sugar No. 11 contract (USd/lb); Refined sugar: White sugar No. 5 contract (USD/MT)

Source: Bloomberg, Al Rajhi Capital

Valuation: Still attractive

We use two valuation methods to arrive at our target price for Savola: long-run discounted economic profit (DEP), also known as discounted long-run EVA (economic value added) and multiples analysis. We have increased our revenue and profit forecasts, which if all other factors had been equal would have pushed our target price substantially. However, we have also increased our WACC from 10.3% to 11.0% to reflect our assumptions of recent economic developments. Consequently, we have lowered our target price from SAR33.7 to SAR32.9. This still implies 28% upside from current share price. We further note that Savola is now trading on a 2011 PE of 12.5x and EV/EBITDA of 5.7x, with a 2011 dividend yield of 3.9%. We remain overweight.

Figure 2. Savola: 2010Q2A vs. 2011Q2E vs. 2011Q2A & 2010Q3A vs. 2011Q3E

(SAR) mn	2010Q2A	2011Q2E	2011Q2A	YOY% chg	2010Q3A	2011Q3E	YOY% chg
Revenues	4,868	5,516	6,313	29.7%	5,613	6,519	16.2%
Gross Profit	710	872	963	35.7%	710	1,030	45.1%
Gross margin	14.6%	15.8%	15.3%		12.6%	15.8%	
Operating profit	136	210	281	107.0%	241	319	32.5%
Net income	208	222	231	11.1%	283	306	8.2%

Source: Company data, Al Rajhi Capital

We expect net profit to exceed SAR1bn this year

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**17,917**	**21,070**	**25,245**	**27,557**	**30,064**
Cost of Goods Sold	(14,810)	(17,723)	(21,237)	(23,135)	(25,254)
Gross Profit	**3,107**	**3,346**	**4,007**	**4,422**	**4,810**
Government Charges					
S.G. & A. Costs	(2,162)	(2,494)	(2,835)	(3,113)	(3,518)
Operating EBIT	**945**	**852**	**1,172**	**1,309**	**1,293**
Cash Operating Costs	(16,497)	(19,372)	(23,475)	(25,591)	(28,052)
EBITDA	1,420	1,698	1,770	1,966	2,012
Depreciation and Amortisation	(475)	(846)	(597)	(656)	(719)
Operating Profit	**945**	**852**	**1,172**	**1,309**	**1,293**
Net financing income/(costs)	(227)	(210)	(271)	(223)	(223)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	751	728	515	435	435
Other Expenses	(222)	(217)	-	-	-
Net Profit Before Taxes	**1,247**	**1,152**	**1,416**	**1,521**	**1,505**
Taxes	(63)	(128)	(134)	(138)	(31)
Minority Interests	(232)	(137)	(254)	(271)	(268)
Net profit available to shareholders	**952**	**887**	**1,028**	**1,113**	**1,206**
Dividends	(500)	(625)	(500)	(500)	(507)
Transfer to Capital Reserve	-	-	-	-	-

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	500.0	500.0	500.0	500.0	500.0
CFPS (SAR)	3.317	3.739	3.758	4.080	4.386
EPS (SAR)	1.903	1.773	2.056	2.226	2.412
DPS (SAR)	1.000	1.250	1.000	1.000	1.015

Revenue growth set to remain above 8% over the next three years

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	29.9%	17.6%	19.8%	9.2%	9.1%
Gross Profit Growth	73.7%	7.7%	19.7%	10.3%	8.8%
EBITDA Growth	167.6%	19.6%	4.3%	11.1%	2.4%
Operating Profit Growth	369.4%	-9.8%	37.6%	11.7%	-1.3%
Net Profit Growth	370.2%	-6.8%	15.9%	8.3%	8.4%
EPS Growth	370.2%	-6.8%	15.9%	8.3%	8.4%

We expect gross margin to remain the same as last year

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	17.3%	15.9%	15.9%	16.0%	16.0%
EBITDA margin	7.9%	8.1%	7.0%	7.1%	6.7%
Operating Margin	5.3%	4.0%	4.6%	4.8%	4.3%
Pretax profit margin	7.0%	5.5%	5.6%	5.5%	5.0%
Net profit margin	5.3%	4.2%	4.1%	4.0%	4.0%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	8.9%	7.9%	10.4%	10.8%	9.9%
ROIC	14.6%	10.2%	16.1%	17.4%	16.1%
ROE	14.3%	12.7%	14.1%	14.2%	14.2%
Effective Tax Rate	5.1%	11.1%	9.5%	9.0%	2.1%
Capex/Sales	5.3%	3.0%	3.4%	3.8%	4.7%
Dividend Payout Ratio	52.5%	70.5%	48.6%	44.9%	42.1%

EV/EBITDA of 5.7x is attractive

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	13.5	14.4	12.5	11.5	10.6
P/CF (x)	7.7	6.8	6.8	6.3	5.8
P/B (x)	1.8	1.8	1.7	1.6	1.4
EV/Sales (x)	0.6	0.5	0.4	0.4	0.3
EV/EBITDA (x)	7.1	6.1	5.7	5.3	5.1
EV/EBIT (x)	10.7	12.1	8.5	8.0	7.9
EV/IC (x)	1.4	1.6	1.5	1.3	1.2
Dividend Yield	3.9%	4.9%	3.9%	3.9%	4.0%

Source: Company data, Al Rajhi Capital

Balance sheet is expanding due to retail and international expansion

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	1,001	660	1,502	1,333	1,747
Current Receivables	1,507	1,518	2,167	2,365	2,706
Inventories	2,297	2,513	2,708	2,956	3,006
Other current assets	836	1,166	1,362	1,362	1,362
Total Current Assets	**5,634**	**5,858**	**7,738**	**8,016**	**8,821**
Fixed Assets	5,537	4,719	5,002	5,397	6,090
Investments	5,056	6,123	6,137	6,137	6,137
Goodwill	918	1,020	1,001	1,001	1,001
Other Intangible Assets	112	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**11,623**	**11,862**	**12,140**	**12,534**	**13,228**
Total Assets	**17,257**	**17,720**	**19,878**	**20,550**	**22,049**
Short Term Debt	3,022	2,783	3,426	3,426	3,426
Accounts Payable	1,830	2,003	2,844	2,838	3,157
Accrued Expenses	503	1,689	1,896	1,892	2,105
Dividends Payable	-	-	-	-	-
Other Current Liabilities	564	186	203	-	-
Total Current Liabilities	**6,313**	**6,662**	**8,368**	**8,156**	**8,687**
Long-Term Debt	1,996	2,393	2,142	2,142	2,142
Other LT Payables	61	171	173	173	173
Provisions	358	276	291	291	291
Total Non-current Liabilities	**2,415**	**2,840**	**2,605**	**2,605**	**2,605**
Minority interests	1,567	1,188	1,380	1,650	1,918
Paid-up share capital	5,000	5,000	5,000	5,000	5,000
Total Reserves	1,961	2,031	2,525	3,138	3,838
Total Shareholders' Equity	**6,961**	**7,031**	**7,525**	**8,138**	**8,838**
Total Equity	**8,528**	**8,218**	**8,904**	**9,788**	**10,756**
Total Liabilities & Shareholders' Equity	**17,257**	**17,720**	**19,878**	**20,550**	**22,049**

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	3,927	4,516	4,066	4,235	3,821
Net Debt/EBITDA (x)	2.77	2.66	2.30	2.15	1.90
Net Debt to Equity	46.1%	54.9%	45.7%	43.3%	35.5%
EBITDA Interest Cover (x)	6.2	8.1	6.5	8.8	9.0
BVPS (SAR)	13.92	14.06	15.05	16.28	17.68

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	**1,247**	**1,152**	**1,416**	**1,521**	**1,505**
Depreciation & Amortisation	475	846	597	656	719
Decrease in Working Capital	534	(86)	39	(658)	140
Other Operating Cashflow	201	222	196	(138)	(31)
Cashflow from Operations	**2,456**	**2,133**	**2,248**	**1,381**	**2,333**
Capital Expenditure	(945)	(634)	(850)	(1,051)	(1,413)
New Investments	(129)	(601)	(26)	-	-
Others	(427)	(20)	(21)	-	-
Cashflow from investing activities	**(1,500)**	**(1,255)**	**(897)**	**(1,051)**	**(1,413)**
Net Operating Cashflow	**956**	**878**	**1,351**	**331**	**920**
Dividends paid to ordinary shareholders	(513)	(627)	(502)	(500)	(506)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(316)	(669)	(6)	-	-
Cashflow from financing activities	**(444)**	**(979)**	**(292)**	**(500)**	**(506)**
Total cash generated	512	(102)	1,059	(169)	415
Cash at beginning of period	604	1,001	660	1,502	1,333
Implied cash at end of year	**1,116**	**899**	**1,720**	**1,333**	**1,747**

We expect capex to increase due to expansion in retail segment

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	5.3%	3.0%	3.4%	3.8%	4.7%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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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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