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SAVOLA

الأهلي كابيتال
NCB Capital

EVENT FLASH

First loss on weakness in Retail and impairments

Savola reported a weak set of 4Q16 results with a net loss of SR964mn vs. profits of SR515mn in 4Q15. Excluding one-offs in 4Q16 and 4Q15, Savola reported a net profit of SR74mn against a profit of SR350mn in 4Q15. We believe the YoY weakness in adj. net income is mainly attributable to 1) gross margin weakness due to the Retail segment, 2) weak Retail segment sales, 3) higher financing charges and 4) weakening performance of USCE.

- **NCBC view on the results:** Savola reported a weak set of 4Q16 results with a net loss of SR964mn as against a profit of SR515mn in 4Q15. Adjusting for one-off costs, currency losses, extraordinary inventory impact and other one-off items in 4Q16 and 4Q15, adjusted profits stand at SR74mn against a profit of SR350mn last year. This compares to the NCBC estimates of profits of SR46mn. We believe the YoY decline is largely due to 1) weak gross margins from the Retail segment's margin investment, 2) weak sales of the retail segment despite the aggressive promotional campaigns, 3) increased financing charges and 4) weaker performance of USCE.
- Savola's sales remained flat YoY at SR6.25bn, broadly in-line with our estimates of SR6.65bn. We believe the food revenue continued to perform in line with our expectations, while retail sales declined c.6% YoY to SR3.2bn. The weak retail sales came despite the huge inventory clearance sale event held as of 29 November 2016.
- The total inventory reduction cost incurred by Panda amounted to SR377mn, with Savola's share amounting to SR343mn. We believe this move came to return inventory to normal levels and improving overall working capital. However, it signals further weaknesses in the Retail segment beyond Pandati and the relatively lower margins compared to peers due to Opex inefficiencies.
- Gross margins contracted 827bps YoY to a record low of 12.1%, below our estimates of 17.8%. We believe this weakness is largely due to the Retail segment's inventory reduction campaign, which led to overall Retail gross margins to decline to 19.6% in 2016 vs. 24% in 2015.

4Q16 Results Summary

SR mn	4Q16A	4Q15A	% YoY	4Q16E	% Var^
Sales	6,250	6,260	(0.2)	6,652	(6.0)
Gross income	755	1,274	(40.7)	1,185	(36.3)
Gross margin (%)	12.1%	20.4%	(8.27)	17.8%	(5.74)
Operating income	(176)	378	NM	289	NM
Operating margin (%)	(2.8)%	6.0%	(8.86)	4.3%	(7.16)
Net income	(964)	515	NM	46	NM
Net margin (%)	(15.4)%	8.2%	(23.66)	0.7%	(16.12)
EPS	(1.81)	0.97	NM	0.09	NM
Adj. Net Income	74	350	(78.9)	56	32.1
Adj. margin	1.2%	5.6%	(4.42)	0.8%	0.43
Adj. EPS	0.14	0.66	(78.9)	0.11	32.1

Source: Company, NCBC Research ^ % Var indicates variance from NCBC estimates

OVERWEIGHT

Target price (SR)	**47.0**
Current price (SR)	**35.8**

STOCK DETAILS

M52-week range H/L (SR)	44/29
Market cap ($mn)	5,105
Shares outstanding (mn)	534
Listed on exchanges	TADAWUL

Price perform (%)	1M	3M	12M
Absolute	(6.0)	23.1	0.8
Rel. to market	(3.1)	(1.4)	(18.8)

Avg. daily turnover (mn)	SR	US$
3M	26.4	7.1
12M	22.6	6.0

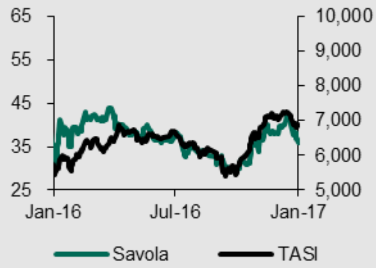
Reuters code	2050.SE
Bloomberg code	SAVOLA AB
	www.savola.com

VALUATION MULTIPLES

	15A	16E	17E
P/E (x)	10.7	40.3	19.0
P/B (x)	1.7	1.7	1.6
EV/EBITDA (x)	10.9	14.7	11.8
Div Yield (%)	5.6	2.8	2.8

Source: NCBC Research estimates

SHARE PRICE PERFORMANCE



Source: Tadawul

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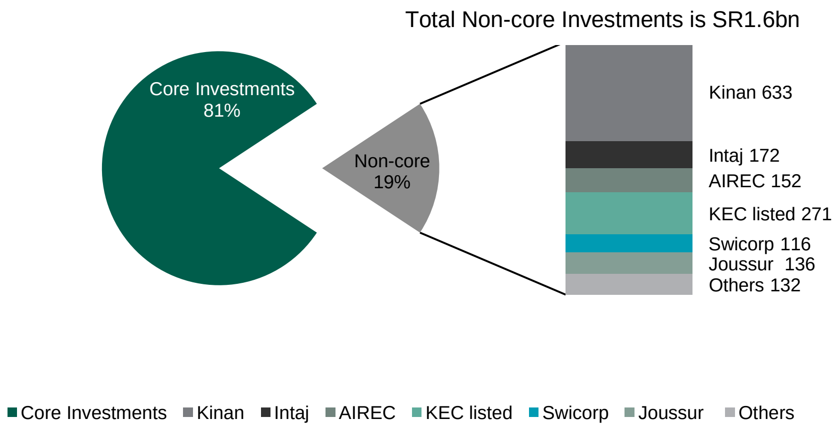
- Opex increased 3.9% YoY to SR931mn in 4Q16, higher than our expectations of SR896mn. We believe is due to new store openings, store closure costs and marketing campaigns. This led to an EBIT loss of SR176mn vs. a profit of SR378mn in 4Q15 and NCBC estimates of SR289mn. Store space for Savola increased by around 1% in 2016, as the company recorded a net opening of 18 new stores during the year.
- Savola's operations in Egypt continue to be impacted by the volatility in the Egyptian Pound. Following the flotation in November 2016, the exchange rate of one Saudi Arabian Riyal changed to 5.0 Egyptian pounds from 2.4 Egyptian pounds previously. Savola operates in the Egyptian food business through Afia International (Egypt), United Sugar Company of Egypt (USCE) and Alexandria Sugar Company, Al-Maleka and Al-Farasha Companies. As a result of the floatation, Savola's management expected a negative impact of SR171mn on the 4Q16 results. We believe the actual impact of the floatation was around SR178mn. Moreover, Savola incurred an additional impairment cost of SR245mn on the assets and goodwill of Savola Foods Company in Egypt.
- Savola incurred other expenses of SR788mn as against an income of SR137mn in 4Q15. We believe this was due to financing charges of c.SR204mn. Moreover, we believe higher than expected zakat and losses from USCE added to the net loss.
- An additional impairment cost of SR272mn was incurred by Savola on its non-core investments. We believe this impairment was on investments in Joussour Holding Company, Intaj Capital Limited and Swicorp Company. Savola intends to sell its investment in Intaj Capital Limited (SR172mn as of 3Q16) in the coming 12 months and has classified it as held for sale. Investments account for c.1.3% of its enterprise value. Core investments in Almarai and Herfy dominate its investment portfolio (81.4%), while the remaining is from the non-core investments.

Exhibit 1: Savola's Investment break-up (3Q16)



Source: Company Financials

- We are Overweight on Savola with a revised PT of SR47.0. The continuous weakness in the Retail segment along with negative impact of FX volatility remains a concern. Management's initiatives to turnaround retail operations are critical to the overall earnings outlook. Moreover, the management has announced no quarterly dividends will be distributed in 2017.

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NCBC Investment Ratings

OVERWEIGHT: Target price represents an increase in the share price in excess of 15% in the next 12 months

NEUTRAL: Target price represents a change in the share price between -10% and +15% in the next 12 months

UNDERWEIGHT: Target price represents a fall in share price exceeding 10% in the next 12 months

PRICE TARGET: Analysts set share price targets for individual companies based on a 12 month horizon. These share price targets are subject to a range of company specific and market risks. Target prices are based on a methodology chosen by the analyst as the best predictor of the share price over the 12 month horizon

Other Definitions

NR: Not Rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or in circumstances when NCB Capital is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

CS: Coverage Suspended. NCBC has suspended coverage of this company

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