SHUAA CAPITAL PSC

Savola (2050.SE)

Equity Research — Analyst Comment

February 3rd, 2009

Sector Coverage Team

Laurent-Patrick Gally
+9714 4283 544
lgally@shuaacapital.com

Fully detailed FY 08 financials provide more color on company performance; Q4 08 ongoing EBIT better than our initial thoughts: following its Q4 08 results highlights publication on January 18th, Savola recently disclosed full-year unaudited 2008 financials. The company reported a SAR 464 mn net loss in Q4 08, on the back of several non-cash charges totaling a combined SAR 715 mn and consisting of (1) a SAR 434 mn impairment of financial assets, (2) a SAR 242 mn net inventory write-down (vs. SAR 282 mn booked against gross profit, the SAR 40 mn difference being due to consolidation effects) within both the edible oil and sugar division, (3) a SAR 35 mn loss on disposal of investments, and (4) a SAR 3 mn write-off of project costs. FY 08 reported net income reached SAR 202 mn, or SAR 734 mn on an ongoing basis when performing the same adjustments. Reported Q4 08 EBIT was a SAR 46 mn loss, or a SAR 236 mn profit when excluding the SAR 282 mn inventory write-down booked against gross profit, coming 5.8% above our SAR 223 mn forecast.

Savola quarterly results, as per reported:

In SAR mn	Q4 07	Q1 08	Q2 08	Q3 08	Q4 08
Revenues	2,630	2,996	3,313	3,919	3,567
COGS	(2,178)	(2,515)	(2,763)	(3,408)	(3,321)
Gross Profit	**452**	**482**	**549**	**511**	**246**
Share of Associates/JVs	47	96	93	101	45
Other Income	29	10	25	23	78
S G & A	(331)	(386)	(392)	(394)	(415)
EBIT	**197**	**202**	**275**	**242**	**(46)**
Capital gain (loss)	18	114	57	12	(35)
Impairment	(7)	0	0	0	(437)
Fin. Charges	(7)	(26)	(32)	(50)	(53)
Zakat	(8)	(30)	(20)	(17)	14
Min. Interests	(15)	(10)	(23)	(29)	94
Net Income	**177**	**250**	**258**	**158**	**(464)**

Source: Company Data

Savola retreated results, as per SHUAA Capital analysis:

In SAR mn	Q4 07	Q1 08	Q2 08	Q3 08	Q4 08A	FY 08	Management FY 09 guidance
Revenues	2,630	2,996	3,313	3,919	3,567	13,795	
COGS, ongoing	(2,178)	(2,515)	(2,763)	(3,408)	(3,039)	(11,725)	
Gross Profit, ongoing	**452**	**482**	**549**	**511**	**528**	**2,070**	
SG&A	(331)	(386)	(392)	(394)	(415)	(1,587)	
EBIT, ongoing	**121**	**96**	**157**	**117**	**113 ***	**483**	
Depreciation & Amortization	79	85	80	79	107	351	
EBITDA, ongoing	200	181	238	197	220	835	
Other Income	29	10	25	23	78	136	
Associates/JVs	47	96	93	101	45	335	
Fin charges	(7)	(26)	(32)	(50)	(53)	(161)	
Zakat	(8)	(30)	(20)	(17)	14	(52)	
Min. Interests	(15)	(10)	(23)	(29)	54	(8)	
Net Income, ongoing	**166**	**137**	**200**	**146**	**251**	**734**	**800**
Cap gain (loss)	18	114	57	12	(35)	148	
Impairment & Projects costs written-off	(7)	0	0	0	(437)	(437)	
Inventory Write down	0	0	0	0	(242)	(242)	
Total Net Income	**177**	**250**	**258**	**158**	**(464)**	**202**	

** Q4 08 ongoing EBIT + Other Income + Associates/JVs total of SAR 236 mn vs. our SAR 223 mn forecast*
Source: Company Data, SHUAA Capital calculations

As suspected, retail was the bright spot as the Panda-Giant merger was effective; 2009 earnings upside expected: as suspected when Savola released Q4 08 results highlights, the bright light in Q4 08 came from retail operations (Panda Azizia) which included for the first time the consolidation of Giant super/hypermarkets (a merger effective in Q4 08). Retail (Panda and Giant) operations achieved a 17.9% gross margin in Q4 08, (a 190 bp QoQ increase from 16.0% in Q3 08) on the back of SAR 1.80 bn in revenues. The division net margin came out at 2.3% in Q4 08 (SAR 42 mn net earnings generated), a pleasing improvement vs. 1.8% in Q3 08 and 1.2% in Q2 08. We view these results positively in light of (1) Panda poor 0.6% net margin in FY 07, and (2) an implied Q4 08 net margin of 2.7% for Panda operations (our calculation point to about SAR 250 mn of revenues stemming from Giant in Q4 08, with limited net income contribution). For 2009, we believe the combined Panda-Giant operations can generate (before any integration costs) about SAR 150 mn of net earnings (vs. SAR 98 mn in 2008), even after factoring reduced Savola ownership within the retail division (Panda was previously fully owned by Savola, but under the merger terms, Savola only owns a majority stake in the new Panda-Giant entity).

Savola ongoing Gross Profit, 2008

In SAR mn	Q1 08	Q2 08	Q3 08	Q4 08A	FY08A
Oil	172	203	133	25	532
Sugar	38	45	62	59	204
Retail	193	225	237	323	979
Oil + Sugar + Retail Gross Profit (ongoing)	403	473	432	407	1,715
Other activities	*78*	*77*	*79*	*121*	*355*
Group Gross Profit, ongoing	**482**	**549**	**511**	**528**	**2,070**

Source: Company data, SHUAA Capital calculations

Savola ongoing Gross Profit margin, 2008

	Q1 08	Q2 08	Q3 08	Q4 08A	FY08A
Oil	14.6%	17.3%	9.5%	3.1%	11.7%
Sugar	8.2%	7.2%	9.0%	8.7%	8.3%
Retail	17.6%	18.8%	16.0%	17.9%	17.5%
Group	**16.1%**	**16.6%**	**13.0%**	**14.8%**	**15.0%**

Source: Company data, SHUAA Capital calculations

Edible Oil, sugar gross margin down on lower commodities prices… Q1 09 pick-up expected on the back of material inventory write-down: both edible oil and sugar recorded a gross loss in Q4 08 (SAR 124 mn loss for oil, SAR 75 mn loss for sugar) on the back of inventory write-downs of respectively SAR 149 mn and SAR 134 mn. Excluding the write-down effect, Q4 08 edible oil gross profit stood at SAR 25 mn, down from SAR 133 mn in Q3 08, for a corresponding gross margin of 3.1%, just about a third of the 9.5% recorded in Q3 08 and down even further from the 17.3% recorded in Q2 08 when commodity prices peaked. As far as sugar is concerned, Q4 08 ongoing gross profit was SAR 59 mn, corresponding to a 8.7% gross margin, down from 9.0% in Q3 08. We note that ongoing gross margins within both the edible oil and sugar businesses reflect pressure resulting from commodities price decline. However, we believe that the material inventory write-down within both divisions pave the way for a pick-up in 2009 margins starting in Q1 09, assuming no further decline in commodity prices occur (no evidence of which has so far materialized).

Investment portfolio still sizeable despite SAR 434 mn Q4 08 impairment; net gearing still reasonable albeit up YoY: Savola took a SAR 434 mn impairment charge in Q4 08 against the value of its available for sale investments, which totaled SAR 0.76 bn at FY 08-end vs. SAR 2.00 bn at FY 07-end and were part of total investments of SAR 4.90 bn at FY 08-end vs. SAR 5.00 bn at FY 07-end. We note Savola investment portfolio included at December 08-end (1) SAR 0.15 bn worth of investments in marketable securities and locally listed companies (AFS held for short-term), down substantially from SAR 0.95 bn at FY 07-end, (2) SAR 0.94 bn of land (located in KSA, and recorded at cost), (3) SAR 3.19 bn of investment in associates and JVs (vs. SAR 2.12 bn at FY 07-end), almost half of which corresponds to the 28% stake in Almarai (recorded at its SAR 1.47 bn cost vs. a current market value of SAR 4.24 bn). Savola ended 2008 with gross cash (including short-term AFS investments) of SAR 0.69 bn, gross debt of SAR 4.71 bn, and Shareholder Equity of SAR 6.55 bn vs. corresponding values of SAR 1.28 bn, SAR 1.90 bn, and SAR 7.16 bn at the end of 2007. The corresponding net gearing was 61% at Q4 08-end, up from 9% at Q4 07-end. While we view Savola's current net gearing as still reasonable, we believe investors will increasingly focus on how the company manages its capital structure in light of (1) its stated expansion plans (mostly within sugar, retail, edible oil), (2) rising cost of financing, (3) margin pressure on some of its core business… all of these elements in the context of slowing global economics.

Savola Investments breakdown, 2008-end

In SAR mn	2008	2007	Comment
Investment in associates and JVs, net	3,187	2,119	Of which 28% in Almarai for SAR 1.47bn
AFS investments	764	2,006	Was subject to a SAR 434 mn impairment in Q4 08
of which AFS held for ST period	148	947	Decline in value mostly due to 2008 regional stock market declines
Investment in unconsolidated subsidiary	9	9	
Other investment, at cost	945	861	Landbank located in KSA
Total	4,905	4,995	

Source: Company Data

Guidance for 2009 net earnings of SAR 800 mn implies no earnings upside when excluding Almarai contribution: Savola management is guiding for Q1 09 and FY 09 net earnings of respectively SAR 160 mn and SAR 800 mn. Those targets (1) correspond to net income from core operations (i.e. without the contribution from any capital gain), (2) assume price stabilization for some of the company's input costs (such as edible oil) and (3) do not include any future acquisition-related earnings contribution. When compared to the SAR 734 mn of ongoing net income achieved in 2008, Savola guidance suggests 8.9% year-on-year improvement. However, we note Almarai profits' contribution to Savola FY 08 net income was SAR 231 mn, suggesting Savola ongoing net income, excluding Almarai contribution was SAR 503 mn. Assuming Almarai generates 2009 net earnings of SAR 1,094 mn (our current estimate), Savola would record a SAR 306 mn profit from its 28% Almarai ownership. This, in turn, suggests that Savola FY 09 SAR 800 mn net income guidance implies SAR 494 mn excluding Almarai contribution… in other words 1.7% less than the corresponding SAR 503 mn figure in FY 08. Our view at that stage is that Savola might not be forecasting flat YoY earnings in 2009 before Almarai earnings' contribution but rather might have wished to deliver a slightly conservative guidance to the market.

Savola 2009 guidance in perspective

in SAR mn	2008	2009 guidance	YoY (%) implied
Net Income reported	202	-	
Net income, ongoing	734	800	9.1%
of which, Almarai contribution	231	306 *	
Ongoing net income, excl. Almarai contribution	502	494	-1.7%

** Based on SHUAA Capital latest Almarai estimate of 2009 total net earnings of SAR 1,094 mn and a 28% ownership stake by Savola.*
Source: SHUAA Capital calculations

2009 dividend expectations supportive to the shares at current price levels… Valuation not expensive yet not cheap either: In our view, one of the supporting factors of Savola shares below the SAR 20 level following the market's disappointment in relation to both Q3 08 and Q4 08 results has been the quarterly payment of a SAR 0.25/share dividend (SAR 1.00 / year, a SAR 500 mn cash outflow for the company). Savola management declared after Q4 08 results its SAR 0.25/share quarterly dividend payments are not at risk in 2009… suggesting a pleasing FY 09 dividend yield of 5.2% at the current share price of SAR 19.05. On a P/E basis, the company is trading at 11.9x Savola Management 2009 SAR 800 mn earnings guidance, which is not, per se, cheap.

Strategic refocus, margin expansion in core businesses keys to the investment upside case: following Q4 08 net loss of SAR 464 mn (on the back of unusual non-cash expenses), we believe retail investors will wait for Savola to post again earnings in the SAR 150 mn plus range before putting money back into the stock. Having said that, the perspective of a 5.2% dividend yield might already be appealing to some of them. We also believe institutional investors will be looking for (1) signs of margin improvement within Savola's core food and retail operations, (2) successful integration and business momentum following the Panda-Giant merger (with limited integration costs), (3) investment of capital within the core business of the company, (4) a strategic refocus on Savola's core food and retail business, with less diversification. We view (a) the current finalization of the 80% acquisition of Pakistan's 3rd largest edible oil processor (Agri-Processors) and (b) Savola's intended move into rice trading alongside Saudi's Al Muhaidib Group (former owner of Giant) as positive steps. However, what will remain a paramount for investors in the medium-term is the company's capability to generate adequate returns on those investments in relation with the amount of capital committed, and with limited integration costs to the rest of the group's activities. We believe Q1 09 results could act as a short-term catalyst for the share price, and view Savola as an interesting GCC retail play for long-term investors.

Recommendation:	NOT RATED
Current Price (SAR)	19.10
52-week high (SAR)	40.75
52-week low (SAR)	16.90
Number of shares (mn)	500
Free Float (%)	44.8%
Market Cap (SAR mn)	9,550
Market Cap (USD mn)	2,546
Est. Dividend Yield '09 (%)	5.2 %