



US\$4.29bn Market cap
73.9% Free float
US\$4.600mn Avg. daily volume

Target price **40.90** 26.9% over current
Consensus price **40.00** 24.2% over current
Current price **32.20** as at 31/5/2010

Research Department
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Underweight

Neutral

Overweight

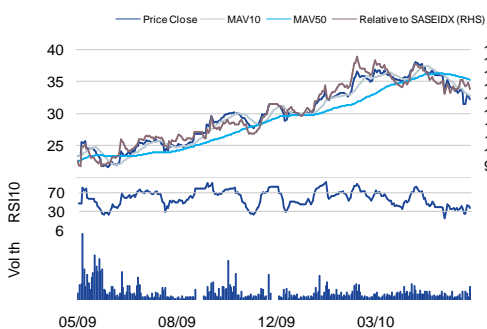
Key themes

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

Performance

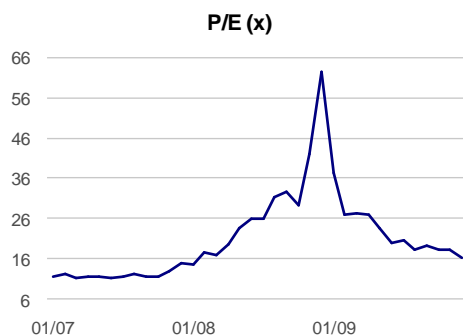


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	17,917	22,354	25,483	28,796
Revenue Growth	29.9%	24.8%	14.0%	13.0%
EBITDA (SARmn)	1,331	1,291	1,518	1,715
EBITDA Growth	64.7%	-3.1%	17.6%	13.0%
EPS	1.82	2.32	2.44	2.66
EPS Growth	370.2%	27.7%	4.9%	9.0%

Source: Company data, Al Rajhi Capital

Valuation



EFAChartCorpVal

Source: Company data, Al Rajhi Capital

Savola Attractive at current level

After the recent drop in the Saudi market, Savola's share price has fallen from about SAR37 to under SAR33. Savola's recently released full Q1 results showed robust sales growth driven by Savola's food operations. While gross margin and operating profit were below our forecasts, strong sales growth supports our long-run valuation, and so our target price is little changed at SAR40.9. This implies 27% upside potential and so we retain our Overweight rating.

Impact of recent price decline: Savola's share price has fallen from a high of SAR38.3 on 11th April, 2010 to a low of SAR31.5 on 26th May, 2010; it has since rallied to SAR32.2. This represents a fall of 15.9%. Savola has outperformed the index by 1.1% over the past month. At the current price, Savola trades on a 2010 PE ratio of 13.2x and a 2010 EV/EBITDA multiple of 10.2x. While this valuation is higher than for certain other high-quality Saudi stocks (e.g. Mobily), it is lower than the typical range for food companies. Moreover, we retain our view that high transparency and likely popularity with international investors should drive further share price appreciation. Finally, our target price remains barely changed at SAR40.9 (see below), implying 27% upside potential.

Impressive top line growth in Q1: Savola's full results for Q1 2010, published recently, show that the company achieved outstanding revenue growth of 31% in Q1 2010 from the same period last year. All segments grew strongly; to our surprise, the food segment (edible oils and sugar) was the biggest winner with sales growth of above 60%. This strong growth was driven largely by start-up food operations, which now contribute about 20% of total food sales. Retail and plastics revenues grew by 9% and 21% respectively. We believe that edible oil and sugar will continue to drive growth this year; however, we expect retail, new food categories and plastics to drive Savola's growth over the long run.

Q1 gross and net margin lower than we had expected: Savola's gross margin shrank from 17% in Q1 2009 to 16.6% in Q1 2010. We explain this drop chiefly by a decline in the gross margin in the sugar and plastics operations. The decline in the gross margin coupled with the noticeable increase in administrative costs is the main reason why Savola's net profit of SAR394mn was below our forecast of SAR423mn (including the capital gain of SAR196mn recorded on the IPO of Herfy in Q1 in both figures). Looking forward, we believe that Savola can improve its gross margin slightly over the next few quarters and maintain it at close to the 17% level over 2010 and the next few years.

Stock rating and conclusion: We think that the food market is promising and offers growth potential considering the GCC region's favourable demographic profile. Savola reported impressive revenue growth for Q1 2010, and we think it will maintain this growth over the remaining months. We also see potential for Savola to improve the efficiency of its retail segment, especially its recently acquired stores. In our view, improving gross margins will be key to driving net earnings. Despite the shortfall in profits in Q1, we have therefore lowered our estimate of long-run DEP fair value only marginally, from SAR43.2 to SAR43.0. Our new target price of SAR40.9 (previously SAR41.1) is a weighted average of long-run fair value and fair value of SAR36.1 on the basis of comparative multiples analysis, with a 70% weight given to the long-run method. Our new target implies 27% upside potential and so we retain our Overweight rating.



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\$) 16.1bn / 4.3bn
52-week range 21.65 - 38.00
Daily avg volume (US\$) 4.600mn
Shares outstanding 500.0mn
Free float (est) 73.9%

Performance:	1M	3M	12M
Absolute	-10.6%	-8%	37.3%
Relative to index	0.3%	-3.1%	33.4%

Major Shareholder:

Mohammed Ibramim Alisa	11.9%
GOSI	10.9%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	17,917	22,354	25,483	28,796
EBITDA (SARmn)	1,331	1,291	1,518	1,715
Net Profit (SARmn)	952	1,215	1,275	1,390
EPS (SAR)	1.82	2.32	2.44	2.66
DPS (SAR)	0.96	1.67	1.92	2.21
EPS Growth	370.2%	27.7%	4.9%	9.0%
EV/EBITDA (x)	11.3	10.8	9.2	8.4
P/E (x)	17.7	13.9	13.2	12.1
P/B (x)	2.4	2.2	2.2	2.1
Dividend Yield	3.0%	5.2%	6.0%	6.9%

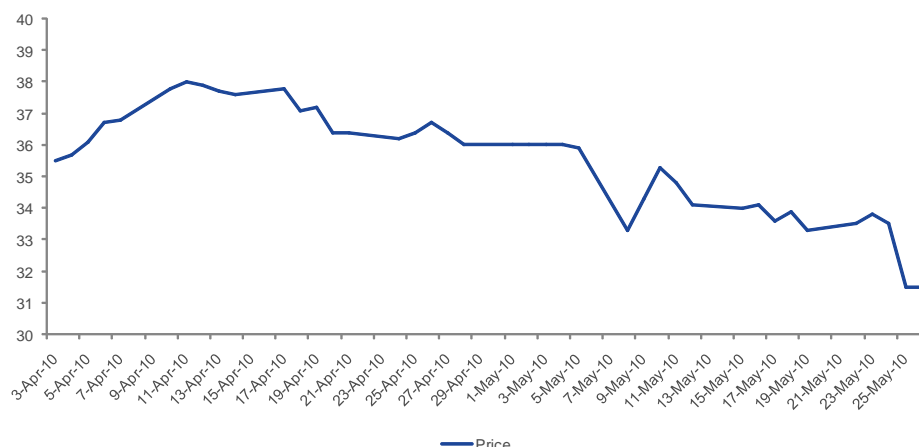
Source: Company data, Al Rajhi Capital

Savola's stock price has fallen 15.9% from its recent high

Savola: attractive after recent fall

Savola's share price has fallen from a high of SAR38.3 on 11th April, 2010 to a low of SAR31.5 on 26th May, 2010; it has since rallied slightly to SAR32.8. This represents a decline of 15.9%. We think that the biggest reason for this decline is the drop in the Saudi stock market overall, which Savola has outperformed by 1.1% over the past month.

Figure 1. Savola's share price



Source: Tadawul, Al Rajhi Capital

At the current price, Savola trades on a 2010 PE ratio of 13.2x and a 2010 EV/EBITDA multiple of 10.2x. While this valuation is higher than for certain other high-quality Saudi stocks (e.g. Mobily), it is lower than the typical range for food companies. For example, Nestle trades on a PE ratio of 19.9x and an EV/EBITDA multiple of 13.3x (based on consensus figures as reported on Bloomberg). Moreover, we retain our view that high transparency and likely popularity with international investors should drive further share price appreciation. Finally, our target price remains barely changed at SAR40.9 (see below), implying 27% upside potential.

Strong sales growth in Q1 outweighs drop in margins

Q1 2010: impressive revenue growth

Savola's full results for Q1 2010, published recently, show that the company achieved outstanding revenue growth of 31% in Q1 2010 from the same period last year. All segments grew strongly; to our surprise, the food segment (edible oils and sugar) was the biggest winner with sales growth of above 60%. This strong growth was driven largely by start-up food operations, which now contribute about 20% of total food sales. Retail and plastics revenues grew by 9% and 21% respectively. We believe that edible oil and sugar will continue

All segments grew strongly in 2010 Q1



to drive growth this year; however, we expect retail, new food categories and plastics to drive Savola's growth over the long run.

We show details of Savola's full Q1 results in the table below.

Figure 2. Savola: Q1 2010 vs Q1 2009

(SAR) mn	2009Q1A	2010Q1E	2010Q1A	% chg.	Comments
Sugar	698	840	1,142	64%	Impressive growth driven by start-ups
Edible oil	967	1,085	1,602	66%	Impressive growth driven by start-ups
Retail	1,703	1,856	1,849	9%	Actual results is aligned with our estimates
Plastics	158	173	192	22%	Plastics segment achieved strong growth as a result of increasing market share and export
Other	109	7	(21)	-119%	
Total Revenues	3,635	3,962	4,764	31%	
Gross Profit	616	685	790	28%	Gross margin declined as a result of the margin decline in sugar and plastics segments
	17.0%	17.3%	16.6%		
EBITDA	224.1	331.7	261.3	17%	EBITDA was below our estimates as a result of lower margin
EBITDA margin (%)	6.2%	8.4%	5.5%		
Net Income	192.6	423.9	394.0	105%	though it seems strong, the underlying growth excluding Herfy IPO capital gain is below our estimates
Capex	110.5	156.5	131.2	19%	Capex was slightly lower than our estimates
Capex/Sales	3%	4%	3%		

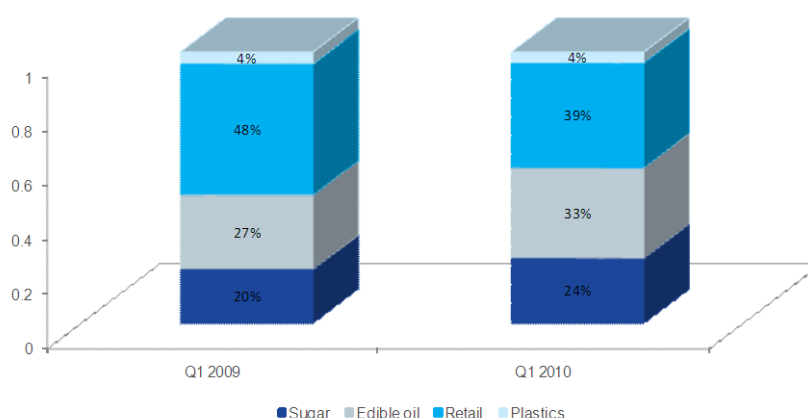
Source: Company data, Al Rajhi Capital

The rapid sales growth in food segment in Q1 has changed revenues breakdown

Revenue breakdown has changed

It is probably better to wait for the full year results to formulate a proper idea of the new breakdown of Savola's revenues, given different seasonal impacts over the various quarters. Nevertheless, it is important to highlight the major change in the company's revenue breakdown in Q1 2010. Sales growth of 64% and 66% in the sugar and edible oil divisions respectively was far above our forecasts and resulted in, respectively, a 4 percentage point and 7 percentage point increase in these two divisions' share of aggregate turnover. This change in turn resulted in a 9 percentage point decline in the contribution of retailing to aggregate turnover.

Figure 3. Savola: breakdown of revenues by division



Source: Company data, Al Rajhi Capital

The gross margin in the sugar and plastics segment declined noticeably

Gross margin below our estimates

Savola's gross margin shrank from 17% in Q1 2009 to 16.6% in Q1 2010. We explain this drop chiefly by a decline in the gross margin in the sugar and plastics operations. According to Savola, the gross margin in sugar went down from 12% in Q1 2009 to a more normal level of 6%. (In 2009, the margin in sugar was higher as the company was enjoying the benefits of raw sugar that it had bought at low prices in 2008.) Meanwhile, the gross margin in plastics



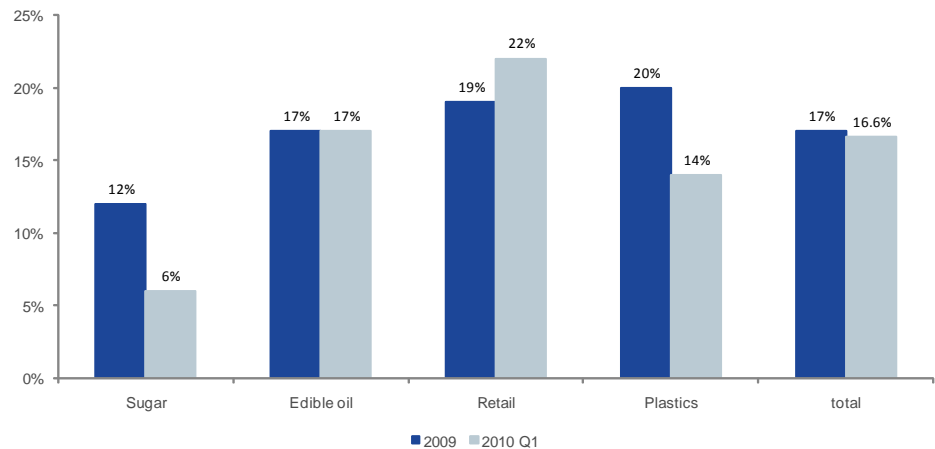
Weakness in the gross margin explains why Savola's net profit fell below our forecasts

was affected by the increase in raw materials costs, primarily petrochemicals; this in turn reflected the strong recovery in oil prices from the weak levels of H2 2008 and early 2009.

Another factor that negatively impacted the gross margin was higher administrative costs. These climbed from 12.0% of sales in Q1 2009 to 13.2% in Q1 2010. According to Savola, this partly reflected the consolidation of new operations in Iran. The company assumes that administrative costs will remain at around a level of 13% of sales.

The decline in the gross margin coupled with the noticeable increase in administrative costs is the main reason why Savola's net profit of SAR394mn was below our forecast of SAR423mn (including the capital gain of SAR196mn recorded on the IPO of Herfy in Q1 in both figures). Looking forward, we believe that Savola can improve its gross margin slightly over the next few quarters and maintain it around the 17% level over 2010 and the next few years.

Figure 4. Savola's gross margin



Source: Company data, Al Rajhi Capital

Long-run fair value and target price little changed

In our view, strong revenue growth in the food operations and improving gross margins will be key to driving net earnings. Despite the shortfall in profits in Q1, we have therefore lowered our estimate of long-run discounted economic profit (DEP) fair value per share for Savola only marginally, from SAR43.2 to SAR43.0. Our new target price of SAR40.9 (previously SAR41.1) is a weighted average of long-run fair value and fair value of SAR36.1 on the basis of comparative multiples analysis, with a 70% weight given to the long-run method.

CEO's resignation should not be a great concern

Savola's CEO, Dr Sami Baroum, resigned a few months ago. Although Savola is a group that has different divisions with decentralised management, we consider this resignation as a loss knowing that he has led Savola in the last three years and achieved impressive results last year which showed his strategic thinking. However, the important question now is: who will lead Savola from now on? The board announced on 4th May, 2010 that Dr Abdulraouf Manna would be the new CEO to lead the group. Dr. Manna had led the group for three years already from 2004 to 2007; besides that he had worked in the group for 15 years. This news is reassuring; we believe that Dr Manna should be able to continue what Dr Baroum started.



Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	13,795	17,917	22,354	25,483	28,796
Cost of Goods Sold	(12,007)	(14,801)	(18,597)	(21,200)	(23,957)
Gross Profit	1,788	3,116	3,757	4,283	4,839
Government Charges					
S.G. & A. Costs	(1,587)	(2,145)	(2,914)	(3,322)	(3,754)
Operating EBIT	201	971	843	961	1,086
Cash Operating Costs	(12,987)	(16,586)	(21,063)	(23,965)	(27,081)
EBITDA	809	1,331	1,291	1,518	1,715
Depreciation and Amortisation	(607)	(360)	(448)	(557)	(629)
Operating Profit	201	971	843	961	1,086
Net financing income/(costs)	324	246	352	226	235
Forex and Related Gains	-	-	-	-	-
Provisions	(437)	-	-	-	-
Other Income	134	107	297	297	297
Other Expenses	-	(74)	-	-	-
Minority Interests	32	(236)	(177)	(176)	(192)
Net Profit Before Taxes	254	1,014	1,315	1,307	1,426
Taxes	(52)	(63)	(100)	(33)	(36)
Net Profit	202	952	1,215	1,275	1,390
Dividends	(500)	(500)	(875)	(1,006)	(1,157)
Transfer to Capital Reserve	-	-	-	-	-
	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	523.0	523.0	523.0	523.0	523.0
CFPS (SAR)	1.548	2.508	3.180	3.502	3.861
EPS (SAR)	0.387	1.819	2.323	2.437	2.658
DPS (SAR)	0.956	0.956	1.673	1.924	2.213
Growth	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue Growth	32.5%	29.9%	24.8%	14.0%	13.0%
Gross Profit Growth	5.5%	74.3%	20.5%	14.0%	13.0%
EBITDA Growth	-7.9%	64.7%	-3.1%	17.6%	13.0%
Operating Profit Growth	-54.4%	382.3%	-13.2%	14.0%	13.0%
Net Profit Growth	-83.5%	370.2%	27.7%	4.9%	9.0%
EPS Growth	-83.5%	370.2%	27.7%	4.9%	9.0%
Margins	12/08A	12/09A	12/10E	12/11E	12/12E
Gross profit margin	13.0%	17.4%	16.8%	16.8%	16.8%
EBITDA margin	5.9%	7.4%	5.8%	6.0%	6.0%
Operating Margin	1.5%	5.4%	3.8%	3.8%	3.8%
Pretax profit margin	1.8%	5.7%	5.9%	5.1%	5.0%
Net profit margin	1.5%	5.3%	5.4%	5.0%	4.8%
Other Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
ROCE	2.4%	9.2%	6.9%	7.6%	8.3%
ROIC	1.7%	7.8%	5.7%	6.4%	7.1%
ROE	3.0%	14.3%	16.8%	16.6%	17.5%
Effective Tax Rate	20.4%	6.2%	7.6%	2.5%	2.5%
Capex/Sales	6.8%	5.7%	4.5%	5.0%	5.0%
Dividend Payout Ratio	247.1%	52.5%	72.0%	78.9%	83.2%
Valuation Measures	12/08A	12/09A	12/10E	12/11E	12/12E
P/E (x)	83.2	17.7	13.9	13.2	12.1
P/CF (x)	20.8	12.8	10.1	9.2	8.3
P/B (x)	2.6	2.4	2.2	2.2	2.1
EV/Sales (x)	1.1	0.8	0.6	0.5	0.5
EV/EBITDA (x)	18.3	11.3	10.8	9.2	8.4
EV/EBIT (x)	73.3	15.5	16.5	14.5	13.3
EV/IC (x)	1.3	1.1	1.0	0.9	0.9
Dividend Yield	3.0%	3.0%	5.2%	6.0%	6.9%

Source: Company data, Al Rajhi Capital

We expect strong revenue growth of 25% in 2010

We expect the full year gross margin to be 16.8%

EV/EBITDA is on the low side compared to other food companies



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	1,131	572	758	500
Current Receivables	1,209	1,447	1,900	2,293	2,592
Inventories	2,039	2,354	2,711	2,548	2,880
Other current assets	1,179	746	937	937	937
Total Current Assets	4,729	5,679	6,121	6,537	6,909
Fixed Assets	4,251	5,068	5,599	6,316	7,127
Investments	4,771	5,028	6,031	6,031	6,031
Goodwill	654	1,398	1,104	1,104	1,104
Other Intangible Assets	140	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	9,817	11,494	12,733	13,451	14,261
Total Assets	14,546	17,172	18,854	19,988	21,170
Short Term Debt	3,433	3,027	2,533	2,533	2,533
Trade Payables					
Dividends Payable	160	-	-	131	282
Other Current Liabilities					
Total Current Liabilities	6,001	6,310	6,435	7,123	7,854
Long-Term Debt	1,117	2,012	2,755	2,755	2,781
Other LT Payables	74	67	152	152	152
Provisions	217	265	250	250	250
Total Non-current Liabilities	1,408	2,344	3,157	3,157	3,183
Minority interests	748	1,576	1,698	1,875	2,067
Paid-up share capital	5,000	5,000	5,000	5,000	5,000
Total Reserves	1,389	1,942	2,564	2,833	3,065
Total Shareholders' Equity	6,389	6,942	7,564	7,833	8,065
Total Equity	7,137	8,518	9,262	9,707	10,132
Total Liabilities & Shareholders' Equity	14,546	17,172	18,854	19,988	21,170

Savola's financial ratios are healthy

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	3,798	3,908	4,715	4,529	4,814
Net Debt/EBITDA (x)	4.70	2.93	3.65	2.98	2.81
Net Debt to Equity	53.2%	45.9%	50.9%	46.7%	47.5%
EBITDA Interest Cover (x)	(2.5)	(5.4)	(3.7)	(6.7)	(7.3)
BVPS (SAR)	12.22	13.27	14.46	14.98	15.42

Savola has strong cash flow

Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	223	1,250	1,492	1,484	1,618
Depreciation & Amortisation	607	360	448	557	629
Decrease in Working Capital	(573)	598	(357)	327	(50)
Other Operating Cashflow	513	218	(71)	(33)	(36)
Cashflow from Operations	770	2,427	1,512	2,335	2,162
Capital Expenditure	(937)	(1,029)	(1,011)	(1,274)	(1,440)
New Investments	(907)	(62)	(618)	-	-
Others	(507)	(362)	(13)	-	-
Cashflow from investing activities	(2,351)	(1,453)	(1,642)	(1,274)	(1,440)
Net Operating Cashflow	(1,581)	974	(130)	1,061	722
Dividends paid to ordinary shareholders	(370)	(507)	(626)	(875)	(1,006)
Proceeds from issue of shares	-	-	-	-	-
Increase in Loans	2,486	(238)	239	-	26
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	162	446	93	-	-
Cashflow from financing activities	2,278	(299)	(293)	(875)	(980)
Total cash generated	697	675	(423)	186	(258)
Cash at beginning of period	335	605	1,131	752	758
Implied cash at end of year	1,031	1,279	709	758	500

Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	6.8%	5.7%	4.5%	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.

Contact us

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