

SORIANA

Quarterly Report

October 29, 2019

Expense control offsets commercial aggressiveness

- Soriana reported 3Q19 figures above our expectations in terms of profitability, as reduced expenses offset a 60bps pressure on its gross margin
- SSS remained in positive territory by growing 2.2% yoy (-1.7% vs BNTe), supported mainly by an increase in the sales ticket, while traffic rose marginally
- We are introducing our PT2020 of MXN 31.00 which implies a 7.5x 2020E FV/EBITDA, similar to the current level and the 3-year average. In light of an improved outlook, we are upgrading our rating to BUY

Positive report. Soriana's 3Q19 figures outperformed our expectations and those of the consensus in terms of profitability, resulting from a tight control on expenses which offset pressures on the gross margin. Sales grew 2.1% yoy to MXN 39.4 billion, practically matching our estimate, supported by a 2.2% rally in SSS- mainly from an increase in the sales ticket-, which offset the 280bps sales floor contraction. Gross margin fell 60bps yoy to stand at 21.2%, due to price investments and a tough comparative basis given an extraordinary charge to store suppliers in 3Q18 for service level. Meanwhile, EBITDA grew 14.7% yoy to MXN 2.7 billion (+7.1% vs BNTe) leading the corresponding margin to expand 0.8pp to 6.9%. Although the latter is attributed to the IFRS 16 effect, on a comparable basis, profitability fell only 10bps, which would translate into a practically stable EBITDA (-0.1% yoy), resulting from strict expense which would practically compensate lower gross profitability. In terms of net profit, Soriana reported MXN 538 million, down 16% yoy, pressured by a 66.8% increase in the comprehensive financing result, from accounting changes, as well as from sharper losses in Soriban and Sodimac.

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BUY

Current Price	MXN\$25.80
PT 2020	MXN\$31.00
Dividend 2019	
Dividend Yield (%)	
Upside Potential	20.2%
Max – Min LTM (MXN\$)	30.69 – 18.28
Market Cap (US\$m)	2,407.9
Shares Outstanding (m)	1,800
Float	13.8%
Daily Turnover (MXN\$m)	3.5
Valuation metrics TTM	
FV/EBITDA	7.5x
P/E	14.0x

Relative performance to MEXBOL LTM



Financial Statements

MXN, million	2017	2018	2019E	2020E
Revenues	153,632	153,475	155,614	162,590
Operating Income	9,164	8,068	9,009	10,113
EBITDA	12,415	10,884	12,080	12,657
EBITDA Margin	8.1%	7.1%	7.8%	7.8%
Net Income	4,588	3,605	3,315	3,677
Net Margin	3.0%	2.3%	2.1%	2.3%
Total Assets	129,317	132,967	147,467	157,522
Cash	3,666	2,231	1,844	1,581
Total Liabilities	70,442	71,024	83,557	92,084
Debt	22,940	22,663	37,531	44,457
Common Equity	58,875	61,944	63,910	65,438

Source: Banorte with data from MSE

Valuation and financial metrics

	2017	2018	2019E	2020E
FV/EBITDA	5.3x	6.2x	6.8x	7.1x
P/E	10.1x	12.9x	14.0x	12.6x
P/Book	0.8x	0.8x	0.7x	0.7x
ROE	8.1%	6.0%	5.3%	5.7%
ROA	3.5%	2.7%	2.2%	2.3%
EBITDA/ Interest expen	6.9x	6.9x	6.9x	6.9x
Net Deb#EBITDA	1.6x	1.9x	3.0x	3.4x
Deb#Equity	0.4x	0.4x	0.6x	0.7x

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SORIANA – Results 3Q19

MXN, million

Concept	3Q18	3Q19	Var %	3Q19e	Diff% vs Estim.
Revenue	38,654	39,463	2.1%	39,461	0.0%
Operating Income	1,678	1,877	11.9%	1,734	8.3%
Ebitda	2,373	2,722	14.7%	2,542	7.1%
Net Income	640	538	-16.0%	519	3.7%
Margins					
Operating Margin	4.3%	4.8%	0.4pp	4.4%	0.4pp
Ebitda Margin	6.1%	6.9%	0.8pp	6.4%	0.5pp
Net Margin	1.7%	1.4%	-0.3pp	1.3%	0.0pp
EPS	\$0.36	\$0.30	-16.0%	\$0.29	3.7%

Source: Banorte

Income Statement (Million pesos)

Year	2018	2019	2019	Change	Change
Quarter	3	2	3	% YoY	% QoQ
Net Revenue	38,654	39,096	39,463	2.1%	0.9%
Costs of goods sold	30,214	30,588	31,092	2.9%	1.6%
Gross profit	8,440	8,508	8,371	-0.8%	-1.6%
General expenses	6,779	6,340	6,528	-3.7%	3.0%
Operating Income	1,678	2,199	1,877	11.9%	-14.6%
Operating Margin	4.3%	5.6%	4.8%	0.4pp	(0.9pp)
Depreciation	695	811	844	21.5%	4.1%
EBITDA	2,373	3,010	2,722	14.7%	-9.6%
EBITDA Margin	6.1%	7.7%	6.9%	0.8pp	(0.8pp)
Interest Income (Expense) net	(518)	(862)	(863)	66.8%	0.2%
Interest expense	573	933	905	58.0%	-3.0%
Interest income	66	64	62	-4.9%	-2.8%
Other income (expense)				N.A.	N.A.
Foreign exchange gain (loss)	(10)	7	(20)	105.6%	N.A.
Unconsolidated subsidiaries	(86)	(133)	(144)	68.5%	8.7%
Income before taxes	1,075	1,204	870	-19.1%	-27.8%
Income taxes	427	399	323	-24.3%	-19.1%
Discontinued operations					
Consolidated Net Income	648	805	547	-15.6%	-32.1%
Non-controlling interest	8	9	9	12.3%	-8.1%
Net Income	640	796	538	-16.0%	-32.4%
Net Margin	1.7%	2.0%	1.4%	(0.3pp)	(0.7pp)
EPS	0.356	0.442	0.299	-16.0%	-32.4%

Balance Sheet (Million pesos)

Total Current Assets	41,274	48,589	45,447	10.1%	-6.5%
Cash & Short Term Investments	2,839	2,795	1,251	-55.9%	-55.2%
Long Term Assets	90,929	99,374	99,561	9.5%	0.2%
Property, Plant & Equipment (Net)	69,815	68,090	68,157	-2.4%	0.1%
Intangible Assets (Net)	19,965	20,338	20,337	1.9%	0.0%
Total Assets	132,203	147,963	145,009	9.7%	-2.0%
Current Liabilities	38,018	44,045	41,442	9.0%	-5.9%
Short Term Debt	9,364	6,674	15,021	60.4%	125.1%
Accounts Payable	27,337	35,845	24,506	-10.4%	-31.6%
Long Term Liabilities	32,938	40,677	40,506	23.0%	-0.4%
Long Term Debt	17,970	28,363	28,164	56.7%	-0.7%
Total Liabilities	70,957	84,722	81,948	15.5%	-3.3%
Common Stock	61,246	63,241	63,060	3.0%	-0.3%
Non-controlling interest	255	129	138	-46.2%	6.7%
Total Equity	60,991	63,112	62,923	3.2%	-0.3%
Liabilities & Equity	132,203	147,963	145,009	9.7%	-2.0%
Net Debt	24,495	32,242	41,935	71.2%	30.1%

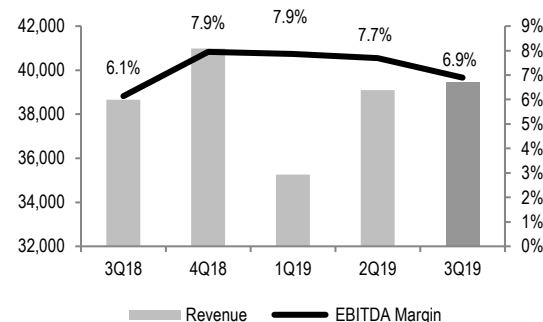
Cash Flow

FX difference in cash & equivalents	(2,899.7)	5,535.3	(7,032.0)		
CF from Operating Activities	(790.9)	(450.0)	(589.6)		
CF from Investing Activities	3,520.5	(4,924.8)	6,077.8		
CF from Financing Activities					
Change in Cash Balance	(170.1)	160.5	(1,543.7)		

Source: Banorte, MSE.

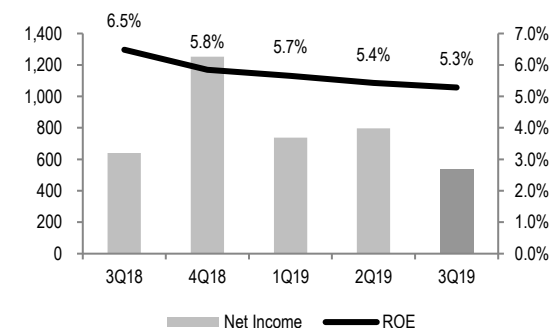
Revenue & EBITDA Margin

MXN, million



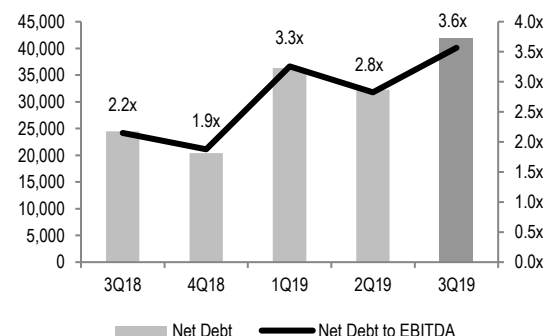
Net Income & ROE

MXN, million



Net Debt & Net debt to EBITDA ratio

MXN, million



SSS growth continued in 3Q19. Revenue for Soriana stood at MXN 39.5 billion during the third quarter of the year, equaling a 2.1% year-on-year surge. This result was practically similar to our estimate and is explained, mainly, by the 2.2% increase reported in SSS (-1.7% vs BNTe) on account of a higher sales ticket, as traffic rose only marginally. In addition, it must be noted that LfL growth offset the 2.8% decline in sales floor, after the net closing of 4 units in the L12M- even with the opening of 1 Soriana Super and 1 Soriana Hiper store during the quarter.

Gross margin contracts by 60bps. During the quarter, the company's gross profitability eroded 60bps yoy to 21.2%, due to a tough comparative basis from an extraordinary charge to suppliers for their level of service during 3Q18. Moreover, price investments resulting from greater commercial aggressiveness for the "Julio Regalado" summer sales campaign in an effort to recover store traffic, offset the positive effect of reduced product shrinkage. Accordingly, gross profit fell 0.8% year-on-year to MXN 8.3 billion.

EBITDA growth exceeded expectations. The company's EBITDA came in at MXN 2.7 billion, reporting a surprising 14.7% annual growth during 3Q19 (+7.1% vs BNTe), leading the corresponding margin to expand 0.8pp to 6.9%. Although this is attributed to an IFRS 16 effect, on an adjusted basis from accounting changes, profitability would have declined just 10bps yoy and thereby EBITDA would have remained practically flat (-0.1% yoy). This reflects a strict control on expenses (-1.7% yoy), which would have practically offset the lower gross profitability observed, which is, without a doubt, positive.

Growth in the comprehensive financing result and sharper losses in Soriban and Sodimac impacted net profit. Soriana's net income fell 16.0% to MXN 538 million (+3.7% vs BNTe). Such performance is explained by pressures in the comprehensive financing result (+66.8% yoy), derived from the adoption of the new accounting standard, as well as from 68.5% greater losses in non-consolidated subsidiaries (Soriban and Sodimac), which offset operating growth and the effect of a lower effective tax rate (37.1% vs. a previous 39.7%).

Higher leverage. The company's ND/EBITDA ratio rose to 3.6x from 2.8x in 2Q19, resulting from a MXN 1.5 billion qoq decline in cash and, especially, from an MXN 8.1 billion sequential increase in interest-bearing debt. It must be noted that this latter increase applies to short-term debt, as the company required working capital – on account of a sharp decline in the supplier account.

Higher leverage increased multiples. After incorporating this quarter's figures, SORIANA's multiples increased. On one hand, the FV/EBITDA rose to 7.5x from a prior 6.9x, from a higher leverage, and on the other, P/E was lifted to 14.0x from 13.6x.

2020 Estimates

We estimate Soriana could reach revenues worth MXN 162.6 billion in 2020. Such figure would represent a 4.5% yoy growth, higher than the 1.4% we expect the company report in 2019. This would be explained mainly by a 4.0% increase in SSS, while also projecting that the 0.7 sales floor increment, thanks to the opening of 9 new locations, would contribute with the rest. We consider that although the company will continue focused on recovering some of its clients that it lost during 2018 through commercial aggressiveness, improved inventory management should assume reduced product shrinkage that would allow a 20bps gross margin expansion. With this in mind, we project the company's gross margin would stand at 22.5%. Meanwhile, we consider that a higher operating leverage, related to a stronger growth of LfL sales, coupled with control on expenses, would outweigh some pressure relative to labor expenses, and translate into a 0.2pp EBITDA margin expansion to 7.8%, leading Soriana's EBITDA to reach MXN 12.7 billion in 2020, equaling a 4.8% year-on-year growth. In terms of net profit, we anticipate a 10.9% yoy increase to MXN 3.7 billion, as we expect operating growth and a lower effective tax rate to offset an 11.2% higher comprehensive financing result. Finally, we estimate capital investments to reach MXN 2.0 billion (vs MXN 1.5 billion 2019e) in 2020.

We have set our PT2020 at MXN 31.00 and upgraded the rating to BUY. To determine Soriana's theoretical value, we used a relative valuation method. After incorporating 3Q19's results, the share trades at 7.5x FV/EBITDA L12M. Assuming a 7.5x 2020E FV/EBITDA multiple, similar to the current level and that of the 3-year average, we set our PT2020E at MXN 31.00, offering a potential return of 20.2%. Although the implicit valuation could seem conservative, given an outlook of a [pick-up in economic growth](#) and [lower interest rates](#), like the one forecasted by our Economic Analysis department by 2020, the extent of a revaluation will depend on the development of global and local risks that prevail in the environment, as well as on whether the recovery of the results that we are estimating, actually materializes. Finally, upon considering an improved outlook for the company, we have upgraded our rating to BUY.

Certification of Analysts.

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato, and Leslie Thalia Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V. for the provision of our services.

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	Reference
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HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

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History of PT and Ratings

Stock	Date	Rating	PT
SORIANA	10/25/19	Buy	MXN\$31.00
SORIANA	07/26/19	Hold	MXN\$26.00
SORIANA	01/08/19	Hold	MXN\$33.00
SORIANA	08/15/18	Sell	MXN\$35.50

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