SORIANA

Quarterly Report

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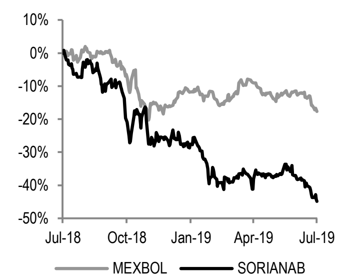
Commercial aggressiveness pressured margins

- **Soriana reported 2Q19 figures that stood in line with our expectations at operating level. However, the company had to forego profitability in order to remain competitive**
- **On the positive side, as expected, SSS are back on the growth track, increasing 2.4% yoy, supported by a solid response from the Julio Regalado summer campaign, while leverage dropped**
- **We lowered our PT2019 to MXN$26.00 (6.5x 2019E FV/EBITDA below the 3-year average of 7.0x). Given a lack of clarity regarding the inflexion point on the results, we reiterate HOLD**

A report in line with estimates. We rate Soriana's 2Q19 report as neutral, alluding to a performance that matched expectations. Sales grew 2.0% yoy to MXN$39.0 billion (+1.7% vs BNTe), boosted mainly by a 2.4% increase in SSS (vs +3.6%e), which offset the impact of a 3.5% sales floor contraction on account of the closing of 13 units in adherence to the store base efficiency program. Meanwhile, higher investments in prices, with the purpose of streamlining LfL sales, as well as the effect of the "Julio Regalado" campaign, pressured the gross margin by 30bps to 21.8%, translating into a gross profit growth of only 0.6%. Expenses, in turn, fell 2.3%, due to the IFRS 16 effect- yet rose 1.6% on an adjusted basis (below the pace for revenue), reflecting a strict expense control -. Thus, EBITDA grew 9.5% yoy to MXN$3.0 billion (-1.2% vs BNTe) with the corresponding margin expanding 50bps to 7.7%, although, without considering the accounting changes, it would have declined 40bps from pressures at gross level (-3.3% yoy). Finally, net income tumbled 11.1% to MXN$796 million, hit by a 57.1% increase in the net interest expense and sharper losses in Soriban and Sodimac (+61.4%).

HOLD	
Current Price	MXN$20.00
PT 2019	**MXN$26.00**
Dividend 2019	
Dividend Yield (%)	
Upside Potential	30.0%
Max – Min LTM (MXN$)	37.00 – 19.90
Market Cap (US$m)	1,886.5
Shares Outstanding (m)	1,800
Float	13.8%
Daily Turnover (MXN$ m)	1.3
Valuation metrics TTM	
FV/EBITDA	6.0x
P/E	10.5x

Relative performance to Mexbol
LTM



Financial Statements

MXN, million	2017	2018	2019E	2020E
Revenues	153,632	153,475	155,944	163,760
Operating Income	9,164	8,068	8,967	10,319
EBITDA	12,415	10,884	12,167	13,512
EBITDA Margin	8.1%	7.1%	7.8%	8.3%
Net Income	4,588	3,605	3,375	3,708
Net Margin	3.0%	2.3%	2.2%	2.3%
Total Assets	129,317	132,967	148,467	153,563
Cash	3,666	2,231	2,276	2,690
Total Liabilities	70,442	71,024	83,459	86,729
Debt	22,940	22,663	34,283	34,326
Common Equity	58,875	61,944	65,008	66,834

Source: Banorte with data from MSE

Valuation and financial metrics

	2017	2018	2019E	2020E
FV/EBITDA	4.5x	5.2x	5.6x	5.0x
P/E	7.8x	10.0x	10.7x	9.7x
P/Book	0.6x	0.6x	0.6x	0.5x
ROE	8.1%	6.0%	5.3%	5.6%
ROA	3.5%	2.7%	2.3%	2.4%
EBITDA/ Interest exp	6.9x	6.9x	6.9x	6.9x
Net Debt/EBITDA	1.6x	1.9x	2.6x	2.3x
Debt/Equity	0.4x	0.4x	0.5x	0.5x

SORIANA – Results 2Q19

MXN, million

Concept	2Q18	2Q19	Var %	2Q19e	Diff% vs Estim.
Revenue	38,346	39,096	2.0%	38,438	1.7%
Operating Income	1,990	2,199	10.5%	2,260	-2.7%
Ebitda	2,748	3,010	9.5%	3,045	-1.2%
Net Income	895	796	-11.1%	873	-8.9%
Margins					
Operating Margin	5.2%	5.6%	0.4pp	5.9%	-0.3pp
Ebitda Margin	7.2%	7.7%	0.5pp	7.9%	-0.2pp
Net Margin	2.3%	2.0%	-0.3pp	2.3%	-0.2pp
EPS	$0.50	$0.44	-11.1%	$0.49	-8.9%

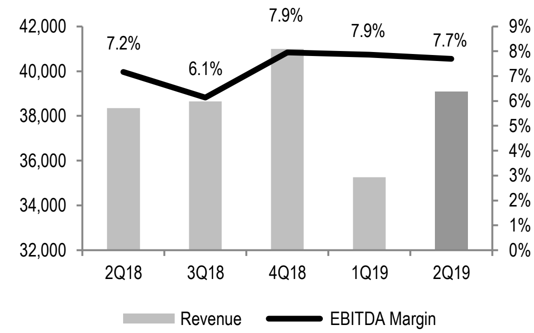
Source: Banorte

Income Statement (Million pesos)					
Year	**2018**	**2019**	**2019**	**Change**	**Change**
Quarter	**2**	**1**	**2**	**% YoY**	**% QoQ**
Net Revenue	**38,345.6**	**35,255.4**	**39,095.9**	**2.0%**	**10.9%**
Costs of goods sold	29,884.4	27,081.4	30,587.7	2.4%	12.9%
Gross profit	8,461.2	8,174.1	8,508.2	0.6%	4.1%
General expenses	6,491.1	6,266.2	6,340.4	-2.3%	1.2%
Operating Income	**1,990.0**	**1,994.0**	**2,198.9**	**10.5%**	**10.3%**
Operating Margin	**5.2%**	**5.7%**	**5.6%**	**0.4pp**	**(0.0pp)**
Depreciation	757.6	777.4	810.9	7.0%	4.3%
EBITDA	**2,747.6**	**2,771.4**	**3,009.8**	**9.5%**	**8.6%**
EBITDA Margin	**7.2%**	**7.9%**	**7.7%**	**0.5pp**	**(0.2pp)**
Interest Income (Expense) net	**(548.4)**	**(782.4)**	**(861.7)**	**57.1%**	**10.1%**
Interest expense	599.0	845.2	933.3	55.8%	10.4%
Interest income	51.4	58.5	64.0	24.5%	9.6%
Other income (expense)				N.A.	N.A.
Foreign exchange gain (loss)	(0.8)	4.3	7.5	N.A.	73.5%
Unconsolidated subsidiaries	(82.3)	(104.5)	(132.9)	61.4%	27.1%
Income before taxes	**1,359.3**	**1,107.0**	**1,204.3**	**-11.4%**	**8.8%**
Income taxes	457.0	358.5	398.9	-12.7%	11.3%
Discontinued operations					
Consolidated Net Income	**902.3**	**748.5**	**805.4**	**-10.7%**	**7.6%**
Non-controlling interest	7.2	10.6	9.4	31.1%	-11.3%
Net Income	**895.1**	**737.9**	**796.0**	**-11.1%**	**7.9%**
Net Margin	**2.3%**	**2.1%**	**2.0%**	**(0.3pp)**	**(0.1pp)**
EPS	**0.497**	**0.410**	**0.442**	**-11.1%**	**7.9%**
Balance Sheet (Million pesos)					
Total Current Assets	**41,678.6**	**42,987.2**	**48,589.0**	16.6%	13.0%
Cash & Short Term Investments	3,008.7	2,634.1	2,794.6	-7.1%	6.1%
Long Term Assets	**91,010.3**	**98,918.0**	**99,374.3**	9.2%	0.5%
Property, Plant & Equipment (Net)	69,883.4	68,367.7	68,089.6	-2.6%	-0.4%
Intangible Assets (Net)	20,012.7	20,340.1	20,338.0	1.6%	0.0%
Total Assets	**132,688.8**	**141,905.2**	**147,963.3**	**11.5%**	**4.3%**
Current Liabilities	**39,142.5**	**42,435.3**	**44,044.8**	**12.5%**	**3.8%**
Short Term Debt	5,184.7	14,269.8	6,673.6	28.7%	-53.2%
Accounts Payable	32,247.3	26,630.6	35,844.7	11.2%	34.6%
Long Term Liabilities	**32,932.2**	**37,003.2**	**40,677.5**	**23.5%**	**9.9%**
Long Term Debt	18,055.5	24,693.2	28,363.0	57.1%	14.9%
Total Liabilities	**72,074.7**	**79,438.5**	**84,722.3**	**17.5%**	**6.7%**
Common Stock	60,614.1	62,466.7	63,241.0	4.3%	1.2%
Non-controlling interest	247.8	131.4	128.9	-48.0%	-1.9%
Total Equity	**60,366.3**	**62,335.4**	**63,112.1**	**4.5%**	**1.2%**
Liabilities & Equity	**132,688.8**	**141,905.2**	**147,963.3**	**11.5%**	**4.3%**
Net Debt	**20,231.5**	**36,328.8**	**32,242.0**	**59.4%**	**-11.2%**
Cash Flow					
FX difference in cash & equivalents	3,522.4	(4,444.3)	5,535.3		
CF from Operating Activities	(478.7)	(674.9)	(450.0)		
CF from Investing Activities	(3,654.6)	5,524.2	(4,924.8)		
CF from Financing Activities					
Change in Cash Balance	**(611.0)**	**405.0**	**160.5**		

Source: Banorte, MSE.

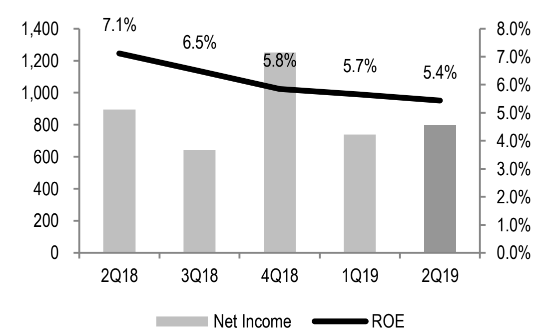
Revenue & EBITDA Margin

MXN, million



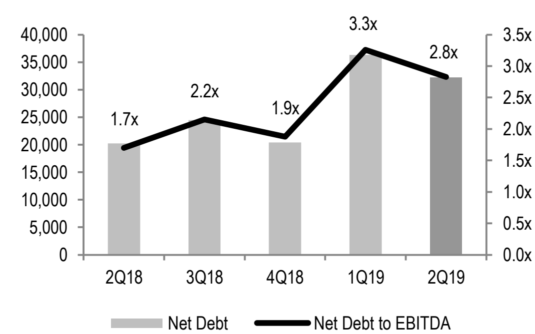
Net Income & ROE

MXN, million



Net Debt & Net debt to EBITDA ratio

MXN, million



Growth in SSS is back on track. 2Q19 revenue for Soriana grew 2.0% year-on-year to MXN$39.0 billion (+1.7% vs BNTe), due to a 2.4% increase in SSS (vs +3.6%e) -given greater commercial aggressiveness- offsetting a 3.5% sales floor contraction on account of the closing of 13 units in the LTM, in adherence to the company's store base efficiency program and some renovations. Without a doubt, it is very positive to see LfL sales growth is back on track, and even more so that the "Julio Regalado" summer campaign has played a part in its doing, outweighing thus the weakness reported in stores that had previously belonged to Comercial Mexicana.

Investments in prices erode the gross margin. In 2Q19, the company reported a 30bps contraction in gross margin to 21.8%, leading gross profit to grow just 0.6% yoy, below the performance seen in revenue. Such performance is attributed to a greater commercial aggressiveness with the purpose of streamlining LfL sales, as well as to the effect of the "Julio Regalado" campaign. Thus, although contrary to our expectation that an improvement in product shrinkage would provide an opportunity to both invest in prices and also boost gross profitability, it undoubtedly contributed to motivate the return of customer traffic towards its stores and allowed SSS to resume growth, which should ultimately pay off through improved operating leverage.

EBITDA grew 9.5% yoy, in line with our estimates. The company's EBITDA reached MXN$3.0 billion in 2Q19, up 9.5% year-on-year, in line with our expectations (-1.2% vs BNTe). It should be noted that such increase is attributed to the effect of IFRS 16, reducing expenses by 2.3% yoy on that account. However, on an adjusted basis from accounting changes, these rose 1.6%, reflecting a strict control on expenses which was offset by lower gross profitability. Therefore, without accounting changes, EBITDA dropped 3.3% yoy, while the corresponding margin eroded 40bps, confirming our thesis that the company would have to forego margins to remain competitive.

Net interest expense growth and sharper losses at Soriban and Sodimac impacted net profit. Soriana's net income fell 11.1% to MXN$796 million, 8.9% below our estimate. Such performance is explained by pressures in net interest expense (+57.1% yoy), derived from the adoption of the new accounting standard, as well as from 61.4% greater losses in non-consolidated subsidiaries (Soriban and Sodimac).

Leverage fell. The company's ND/EBITDA ratio fell to 2.8x from 3.3x in 1Q19, resulting from a MXN$3.9 billion qoq decline in interest-bearing debt (short term), a higher LTM EBITDA generation and a sequential MXN$160 million increase in cash.

Valuation parameters lowered following the report. After incorporating 2Q19 figures SORIANA's multiples cheapened. On one hand, FV/EBITDA fell to 6.0x from a previous 6.5x, due to both EBITDA growth and leverage reduction, while P/E rose to 10.5x from 10.2x.

We have revised our estimates. We have adjusted our projections model reflecting the effects of IFRS 16. In addition, we have incorporated **the new economic growth forecasts estimated by our Economic Analysis department**, as well as **recent FX rate projections from our Strategy department** into our model.

Estimates						
	2019 (current)	2019 (previous)	Δ%	2020 (current)	2020 (previous)	Δ%
SSS*	2.9%	2.3%	+0.6%	4.6%	5.3%	-0.7%
Revenue+	155,944	156,193	-0.2%	163,760	164,528	-0.5%
EBITDA+	12,167	11,558	+5.3%	13,512	12,998	+4.0%
EBITDA Margin*	7.8%	7.4%	+0.4%	8.3%	7.9%	+0.4%
Net Income+	3,375	3,625	-6.9%	3,708	5,187	-28.5%

We have lowered our PT2019. We have adopted a more conservative stance in our valuation model for Soriana's shares. In view of local uncertainty and lower confidence among investors towards the Mexican equity market in general, and after including the effect of IFRS 16, by using a relative valuation model, we lowered our PT2019 to MXN$26.00 from MXN$33.00, which implies a 6.5x 2019E FV/EBITDA multiple, above the current level (6.0 x), but below the 3-year average forward multiple (7.0x) considering the growth outlook ahead seems to improve a bit vs what the historical average implies. Despite the attractive potential return, and the fact that the current 6.0x valuation reflects an excessive discount on the company, being the most attractive within the retail sector in Mexico, we considered that the lack of clarity in relation to a inflexion point on the results and the extent of the amount of investment on prices that may be needed to stimulate growth, we reiterate our HOLD recommendation.

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, and Leslie Thalía 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	*When the share expected performance is similar to the MEXBOL estimated performance.*
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History of PT and Ratings

Stock	Date	Rating	PT
SORIANA	30/07/19	Hold	P$26.00
SORIANA	08/01/19	Hold	P$33.00
SORIANA	15/08/18	Sell	P$35.50
SORIANA	30/04/18	Hold	P$40.00

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