Gil Dattner
Analyst
☏ 972-3-753 2038
gil.dattner@xnes.co.il

29 October 2009

Shufersal (TASE: SAE)

Sector: Food Retailers **Outperform**

Review of earnings: 3Q09 **Target Price NIS 21.80 (▲)**

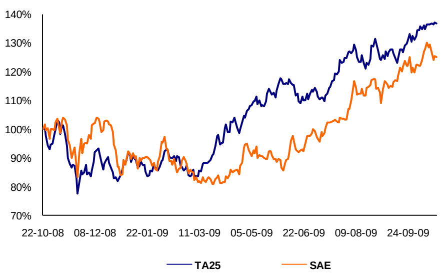
Raising target price on a more positive outlook

- Shufersal reported third quarter results that were slightly above our expectations as a result of a better-than-forecasted gross margin and financial income.
- Same store sales fell 1.6% as a result of a 2%-3% decline in prices year-on-year. This was partially offset by 10 new stores, and overall food retail sales fell 0.5% year-on-year. Operating profit fell 14.3% year-on-year, however at 4.4% the operating margin was in-line with 1H09, and is at a decent level considering the business environment. Operating costs fell 1.6% year-on-year.
- Results for the first three quarters of the year show that Shufersal has coped well with the recessionary environment, maintaining both market share and managing an orderly retreat in margins.
- Though market conditions remain difficult, and the trajectory of the recovery uncertain, the worse seems to be behind us and our investment thesis is shifting away from the worst-case scenario towards the positive developments in the near and medium term.
- Beginning 2010 the company is initiating an accelerated expansion of retail space, including a rapid expansion of the Shufersal Express neighbourhood format. It will also put back into action steps to increase profitability.
- **Valuation**: Based on a combination of our DCF and comparative model, we increase our target price to NIS 21.80, and reiterate our outperform recommendation.

Stock Data

TASE		SAE
Bloomberg		SAE.IT
Reuters		SAE.TA
Price (NIS)		17.55
Shares O/S (m)		215.7
Market Cap (NISm)		3,784
Free Float (%)		32.0%
12 Mo. Range (NIS)	11.25	18.10
12 Mo. Average Volume (NISm)		8.0

SAE Versus TA25 Relative Strength



Summary Earning Estimates

Year-end Dec (NISm)	2006	2007	2008	2009E	2010E
Sales	9,153	9,935	10,962	11,035	11,501
Operating Income	318	457	570	476	518
EBITDA	527	671	801	693	748
Adjusted Net Income	121	244	236	303	291
EPS	0.57	1.15	1.15	1.45	1.35
DPS	0.50	1.64	2.79	1.16	1.08

Key Valuation Ratios

Year-end Dec	2006	2007	2008	2009E	2010E
P/E (x)	30.5	15.1	15.1	12.0	12.9
EV/EBITDA (x)	9.9	7.8	6.5	7.5	7.0
FCF Yield	2.9%	9.5%	13.8%	6.7%	6.2%
Dividend Yield	-0.6%	12.2%	10.7%	17.0%	6.8%

Shufersal reported third quarter results slightly above our expectations. The results contained no major surprises; the market was looking for continued resilience consistent with 1H09 results, and that is what the company delivered.

Actual vs. Estimates

	3Q09A	3Q09E	Δ
Revenues	2,880	2,860	20
Op Income	126	117	9
Net Income	63	56	7
EPS	0.30	0.26	0.04

Shufersal
3Q09 Results

NISm (except EPS)	3Q09	3Q08	Delta %
Sales	**2,880**	**2,892**	***-0.4%***
Cost of Sales	2,138	2,119	*0.9%*
Gross Profit on Sales	**742**	**773**	***-4.0%***
Gross Margin on Sales	*25.8%*	*26.7%*	
SG&A	616	626	*-1.6%*
SG&A as % of sales	*21.4%*	*21.6%*	
Operating Income	**126**	**147**	***-14.3%***
Operating margin	*4.4%*	*5.1%*	
Other operating income/expenses	(1)	-	
Total operating income	125	147	
EBITDA	**180**	**203**	***-11.3%***
EBITDA margin	*6.3%*	*7.0%*	
Financial Expenses, net	(38)	(58)	
Other Income/Expenses, net	-	-	
Share in profit (loss) of affiliates	(1)	(5)	
Profit before tax	**86**	**84**	*2.4%*
Income taxes	23	25	*-8.0%*
Tax Rate	26.7%	29.8%	
Net profit	**63**	**59**	***6.8%***
Net Margin	*2.2%*	*2.0%*	
EPS (fully diluted)	**0.30**	**0.28**	***7.1%***

Key Operating Data:	3Q09	3Q08	Delta %
Same Store Sales	-1.6%	12.4%	n/a
Sales per sqm	5,710	5,770	*-1.0%*
Number of Stores	241	231	*4.3%*
Total Sqm	518,000	514,000	*0.8%*
Average Store Size	2,149	2,225	*-3.4%*

Revenue: fell 0.4% year-on-year, or -0.5% looking at the food retail segment alone. Same store sales were down 1.6%. According to management the decline in revenues was a result of a 2%-3% decline in prices compared to 3Q08. This was a result of increased in-store offers and a different product mix, both measures taken to adapt to the more difficult economic conditions.

Market share: the company reported stability in its market share, which was 37.0% in the quarter, similar to the first half of the year, and compared to 36.7% in 2008. The company's ability to hang on to market share reflects positively on the marketing strategy, particularly given that it has over the last year expanded its retail space at a slower pace than in the rest of the market. According to the financial press, the smaller chains have added between 60,000m^2-70,000m^2 in new retail space, compared to only 4,000m^2 new retail space at Shufersal over the past year.

Gross profit margin for food retail segment came to 25.7% in 3Q09, down one percentage point compared to 3Q08. Again this was a result of lower prices given the economic environment. In the first three quarters of the year the food retail segment posted a gross margin of 25.8%, compared to 26.7% in the first three quarters of 2008. While a loss of 90bp in gross margins is no small thing in the food retail industry, it is far less than some had feared or what could be inferred from never-ending media reports on supermarket price wars. Looking ahead, the gradual recovery of economic activity and the likely return of price inflation should see a recovery in gross margins.

Operating profit from regular operations was down 14.3% year-on-year, better than the 17.2% year-on-year decline in 1H09. The operating margin in the food retail segment for the quarter totalled 4.2%, compared to 4.9% in 3Q08. The decline in gross margin and sales was partially offset by a NIS 10m decline in operating costs.

Net income in the quarter totalled NIS 63m up 6.8% year-on-year and NIS 7m better than our forecast. Net income was boosted by lower financial costs as a result of financial income from the higher value of financial derivatives, particularly forwards on inflation.

Cash flow- Operating cash flow for the quarter totalled NIS 242m, compared to NIS 191m in 3Q08. However adjusted for seasonal effects the company reported an operating cashflow of NIS 160m versus NIS 172m in 3Q08. The decline was due to the lower operating profit.

Outlook

Third quarter earnings showed continued signs of the economic slowdown, although the recession in Israel was less traumatic to the Israeli consumer. Looking ahead we can begin to say that the worst is behind us, even though the trajectory of the recovery is debatable. However the fears of reckless competition and a decline into losses are now outweighed by optimism on positive developments at the company, and we see a few of these.

- The company is planning an accelerated expansion of new retail space beginning 2010, at a rate of about 20,000m^2 a year. This includes putting the Shufersal Express neighbourhood format in higher gear. The company has been assessing the viability of the Express format over the past two years. It currently has eight stores, five of which are franchised. According to management the company will initiate a nationwide expansion of the format under the franchise model; 25-40 stores are expected to be opened in 2010, at an investment of NIS 1m-1.5m per store.
- Recent labour legislation aims to standardise payment terms for workers across the industry, bringing them in line with what Shufersal must already offer today. If effective this will reduce the competitive advantage of the smaller chains.
- Supply chain efficiencies- last year the company froze plans intended to increase operating profitability due to the uncertain economic environment. Today the company is taking these plans out of the draw again. Management announced that beginning next year it will gradually takeover the task of arranging its shelves, a process which is currently carried out by the food suppliers at a cost. This will entail the addition of about 1,000 extra workers, but the company expects that in the medium term the transition will increase both profitability (greater availability of products) and reduce costs. The company is also planning on examining its supply chain in detail, including the installation of a new supply management system. These steps should help profitability return to a positive trajectory towards (and perhaps beyond) the 5% level.

Risks

Aside from on-going risks of a spike in competitive pressures, the main wildcard is the threat of an anti-trust indictment. Shufersal is still awaiting the decision of the anti-trust regulator whether to issue an indictment against the company, and two of its senior managers, including the CEO, for an alleged breach of the terms of the Clubmarket acquisition. There is a risk that the regulator will issue a criminal indictment against the CEO, forcing him to step down.

Valuation

We value Shufersal using both a DCF model and a comparative peer model, applying an 80/20 weighting in favour of the DCF model. Our updated DCF model provides a target price of NIS 22.8. Looking at the peer model, food retailers are trading at an average 2010 P/E of about 13.0x earnings. Shufersal is trading roughly in-line with at a 2010 P/E of 12.9x earnings. However the company offers a more attractive expected dividend yield of 6.2% for 2010, compared to an average of 2.8% for the peer group. We therefore maintain our Outperform recommendation, and raise our target price from NIS 18.80 to NIS 21.80, giving a 25.8% upside to the current share price.

EXCELLENCE
Excellence Nessuah Brokerage Services

Shufersal

Profit & Loss

NIS millions	2006	2007	2008	2009E	2010E
Sales	**9,153**	**9,935**	**10,962**	**11,035**	**11,501**
Cost of Sales	6,719	7,292	8,007	8,173	8,453
Gross Profit	**2,434**	**2,643**	**2,955**	**2,862**	**3,048**
Gross margin	*26.6%*	*26.6%*	*27.0%*	*25.9%*	*26.5%*
SG&A	2,116	2,186	2,386	2,386	2,530
SG&A as % of sales	*23.1%*	*22.0%*	*21.8%*	*21.6%*	*22.0%*
EBIT	**318**	**457**	**570**	**476**	**518**
EBIT margin	*3.5%*	*4.6%*	*5.2%*	*4.3%*	*4.5%*
Other Operating Income, Net	-	-1	-57	-1	-
Total operating income	318	456	513	475	518
EBITDA	**527**	**671**	**801**	**693**	**748**
EBITDA margin	*5.8%*	*6.8%*	*7.3%*	*6.3%*	*6.5%*
Financial Income (expenses), net	-101	-95	-204	-63	-128
Equity in Affiliates	-	-	-7	-2	-2
Profit before Tax	**214**	**358**	**300**	**410**	**388**
Income Taxes (Benefit)	33	108	18	106	97
Income tax rate	*15.4%*	*30.2%*	*6.0%*	*104.1%*	*25.0%*
Net Income after tax	141	250	282	303	291
Net Income	**121**	**244**	**282**	**303**	**291**
Net margin	*1.3%*	*2.5%*	*2.6%*	*11.0%*	*2.5%*
EPS	**0.59**	**1.18**	**1.38**	**1.45**	**1.35**
Adjusted net income	**121**	**244**	**236**	**303**	**291**
Adjusted net margin	*1.3%*	*2.5%*	*2.2%*	*11.0%*	*2.5%*
Adjusted EPS	**0.57**	**1.15**	**1.15**	**1.45**	**1.35**
Number of Shares	213	213	213	216	216
Sales growth YoY	*38.4%*	*8.5%*	*10.3%*	*0.7%*	*4.2%*
EBIT growth	*88.2%*	*43.7%*	*24.7%*	*-16.6%*	*8.8%*
Net Income Growth YoY	*49.4%*	*101.7%*	*15.6%*	*7.5%*	*-4.1%*
Adjusted Net Income Growth	*49.4%*	*101.7%*	*-3.1%*	*28.2%*	*-4.1%*
Adjusted EPS Growth YoY	*49.0%*	*101.7%*	*0.2%*	*26.2%*	*-7.0%*

Ratings Key

1. **Outperform**: Expected to outperform the relevant broader market index over the next 12-18 months.
2. **Market perform**: Expected to perform in-line with the relevant broader market index over the next 6-12 months.
3. **Underperform**: Expected to underperform the relevant broader market index over the next 6-12 months.

Disclaimer and Disclosures

- **Analyst Information**

Name	Gil Dattner
License type	Investment advisory
License number	8185
Address	7 Jabotinsky Street Ramat Gan 52520 Israel

Education
Master in International Business Administration (2006), Tel Aviv University
B.A Modern History (1998), Queen Mary & Westfield College, London

Experience
Gil Dattner has been working as an analyst at Excellence Nessuah Brokerage Services since 2007

Licensed broker:
Excellence Nessuah Brokerage Services Ltd.
7 Jabotinsky Street
Ramat Gan
52520
Israel

Conflict of interest - Analyst

At date of preparation of this report, the analyst is not aware of any conflict of interest with respect to the company that is covered in this report.

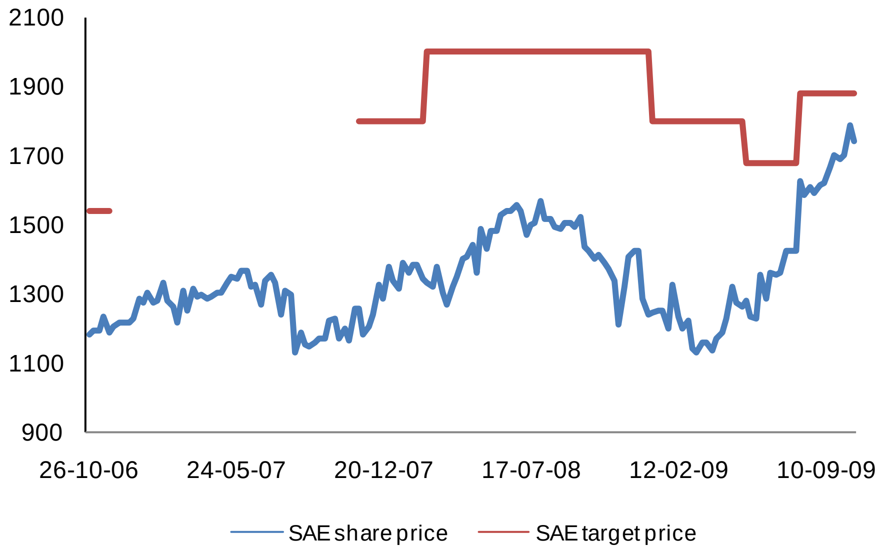
- **Information regarding analysis**

Valuation methodology

Using our earnings forecasts and historical data as a base, we apply a DCF model, in conjunction with peer group comparison and multiple analysis.

Risks

1. The anti-trust regulator is currently considering issuing an indictment against the firm and senior management (including the CEO) for a breach of anti-trust regulation. If the CEO is faced with a criminal indictment, he will have to resign his position, creating significant uncertainty in the company's leadership.
2. Given the harsh competitive environment and slim profit margins in the food retail industry, any spike in price competition could significantly affect the company's results.



Recommendations History	Change	Rating	Target Price
02-Aug-09	Target price upgrade	Outperform	NIS 18.80
27-Jul-09	Recommendation structure	Outperform	NIS 16.80
17-May-09	Target price downgrade	Buy	NIS 16.80
26-Dec-08	Target price downgrade	Buy	NIS 18.00
21-Feb-08	Target price upgrade	Buy	NIS 20.00
11-Nov-07	Rating upgrade	Buy	NIS 18.00
30-Nov-06	Downgrade	Neutral	-

- **Analyst Certification**

I, Gil Dattner, certify that views expressed in this report accurately reflect my personal views about the subject securities and issuer. I also certify that I have not and will not receive any compensation for providing specific recommendations or views expressed in this report.

▪ **Disclosure – Excellence Nessuah Brokerage Services Ltd (the 'Company')**

Conflicts of interest

1. This report was published as a preview of earnings note.
2. At the time of publishing this report, or in the 30 days previous to this report, the company or companies associated with it, held in its Nostro or managed accounts, significant holdings in the securities of the company analysed, or companies associated with it.

Disclaimer

The analysis included in this report is for informational purposes only and is offered for the knowledge of investment advisors solely as background information that may be used as one of a number of tools that are available to help such persons formulate recommendations to their clients, with whom they have signed consulting agreements, as required under the law. This report and/or the information contained herein and/or the analysis provided herein should not be considered as an offer and/or advice to purchase and/or sell and/or hold the securities and/or the financial assets described herein or any other securities and/or financial assets.

This document is presented solely for the use of professional and experienced investors as defined in the First Schedule of the Israel Securities Law (1968), who make their investment decisions without relying on this document, or on any documentation related to it. Companies within the Excellence Nessuah Group, its directors, managers and workers, take no responsibility for any direct or circumstantial loss that may arise from use of this document or any documents related to it.

The analysis presented herein was performed on the basis of information that was published and/or that was made available to the entire public, including information that was collected and prepared by the Company and information that originates from other sources that the Company assumes to be reliable, although no independent investigation as to the credibility of such was made by the Company. This report does not constitute a written proof and/or approval as to the credibility of such information.

The information presented in this report does not claim to include all the information that an investor would require, and does not claim to constitute a complete analysis of all of the facts and details that appear in the report, and the opinions presented herein may change without prior notice. Accordingly, this report does not constitute in any way a substitute for investment advising that would take into consideration the figures and special needs of each person.

Anyone who relies upon the information presented in this report does so at he's own risk and the Company, companies controlled by the Company and their shareholders, managers and employees, shall not bear any liability whatsoever for any damage and/or loss that may be caused as a result of using this report, and shall not guarantee or bear any responsibility whatsoever for the reliability of the information presented in this report.

It should be noted that the *Excellence* Nessuah Brokerage (the Company) Services Ltd is part of the Excellence Group, which is part of the Delek Group. Excellences Group businesses include, *inter alia*, the management of investment portfolios, securities trade, stock market transactions, and investment banking. Furthermore, companies controlled by the Company and it's shareholders, or other related parties hold or may hold, from time to time, either directly or indirectly, securities or financial instruments that are the subject of this report, either before they are published, at the time they are published or after they are published. In addition, by virtue of the fact that the Company, companies held by the Company, the Company's shareholders, or other related parties are entities that serve as underwriters or in the area of investment advising, portfolio management, or investment marketing, such entities may act as underwriters for the securities of the Company that is the subject of this report, and may be related to the Company by virtue of commercial ties.

In addition, the Company serves as a market maker with regard to the securities of various companies, pursuant to the approval granted by the Tel Aviv Securities Exchange Ltd., and may use at any date as market maker with regard to the securities of the Company that is the subject of this report.

EXCELLENCE
Excellence Nessuah Brokerage Services

Excellence Nessuah Securities Contact Page

CEO	**Eran Fuchs**
Telephone	++972 3 753 2079
Email	eran.fuchs@xnes.co.il
Deputy CEO	**Eytan Ben David**
Telephone	++972 3 753 6590
Email	eytan.bendavid@xnes.co.il

Research Department

Head of Research	**Terence Klingman**
Telephone	++972 3 753 6940
Mobile	++972 54 900 1047
Email	terencek@xnes.co.il
Analyst	**Gilad Alper**
Telephone	++972 3 753 2035
Mobile	++972 54 245 0342
Email	gilad.alper@xnes.co.il
Analyst	**Gil Dattner**
Telephone	++ 972 3 753 2038
Mobile	++ 972 54 900 1004
Email	gilda@xnes.co.il
Chief Macro Economist	**Shlomo Maoz**
Telephone	++ 972 3 753 2068
Mobile	++ 972 50 727 6772
Email	shlomom@xnes.co.il

Sales & Trading Department

International Sales	**Dan Farhi**
Telephone	++ 972 3 753 2058
Mobile	++ 972 54 521 1353
Email	danf@xnes.co.il
Head Trader, International Desk	**Daniel Rapoport**
Telephone	++ 972 3 753 2072
Mobile	++ 972 54 770 630
Email	daniel.rapoport@xnes.co.il
Trader	**Oren Ossad**
Telephone	++ 972 3 753 2075
Mobile	++ 972 54 521 1369
Email	oren.ossad@xnes.co.il