



October 28, 2009

Shufersal

Sector: Retail

Ticker: SAE

Exchange: TASE

Recommendation: Buy**Previous Recomm: Buy****Target price: NIS 20.5****Previous target price: NIS 20.5****Market price: NIS 17.7**

Q3/09 review – results in line with expectations – regulatory headwinds on the horizon

Shufersal – Income statement (NIS M)

Shufersal reported Q3/09 results that were broadly in line with our expectations. Revenue was slightly weaker, down 0.4% (reflecting a 1.6% decline in same-store-sales), while operating profit came in at NIS 125 million – a margin of 4.2%. We find this impressive given the current business environment – recession and tighter competition.

Net profit came in below our estimate at NIS 63 million, although it is still up on Q3/08.

	Q3/09A	Q3/09E	Q3/08A	Q2/09A	2008
Sales	2880	2,913	2,892	2,784	10,962
YoY	-0.4%	0.7%	12.9%	-0.1%	10.3%
Gross profit	742	750	773	719	2,955
%	25.8%	25.8%	26.7%	25.8%	27.0%
Operating profit	125	124	147	133	570
%	4.3%	4.3%	5.1%	4.8%	5.2%
YoY	-15.0%	-15.70%	20.5%	-16.4%	31.0%
Net income	63	77	59	96	283
%	2.2%	2.7%	2.0%	3.4%	2.6%
YoY	6.8%	31.0%	145.8%	-5.0%	19.0%

Revenue

Same-store sales declined 1.6% (broadly in line with our estimate of 1.5%). Sales per square meter were down 1%. Shufersal exited Q3/09 with 241 stores and a total of 518,000 square meters in commercial space, unchanged from Q2/09.

Shufersal notes in its report that the number of branded credit card holders rose to 300,000 in Q3/09 (224,000 at end-2008). Penetration of its "Shufersal" private brand, with its 1,000-strong product range, reached 10.8% in the quarter, while its discount brand "Yesh" now numbers 280 products.,

Gross margin

Gross margin was in line with our expectations at 25.8%. This is down on Q2/09 margin of 26.7%, but was no surprise to us given the decline in sales and tighter competition in 2009, compared with the price rises seen in 2008.

Operating margin

Q3/09 operating margin reached 4.3% (4.2% excluding real estate).

Again, we stress that we are in thick of a recession with a sector that is becoming increasingly competitive, although Shufersal appears to be holding its own with a margin that is relatively high considering current conditions. This, we feel, bodes well for the future, especially seeing as the recession is about to ease.

**Net profit**

Net profit came in below our estimate of NIS 77 million (2.7% margin) at NIS 63 million (2.2% margin).

Cash flow from current operations totaled NIS 242 million in Q3/09, with net cash increasing by NIS 515 million.

Regulatory oversight could cause near-term harm to margins but long-term prospects remain sound

The Antitrust Authority has imposed a series of changes to the relationship between retail chains and key suppliers. One of these, due to go into effect in February 2012, relates to the employment of shelf stackers at stores, a function that chains will now have to take in-house rather than allowing suppliers to send their own staff into stores. Shufersal is currently revising its practices and stipulated in its Q3/09 report that it would begin a gradual switch to a new format for this function from 2010. We feel this will give it more leverage in negotiations with suppliers, improve product availability and, leading on from this, sales per square meter, and reduce stock taking days at stores, as well as labor costs. There could be some harm to margins in the near-term however.

Shufersal also said it would continue to operate its "Shufersal Express" store format – a chain of convenience stores, most of which are operated by concession holders.

Valuation and assessment

This was a good report. The harm to revenue was tolerable and the operating margin points to a company that is holding up well, despite the current economic slowdown. Management is holding a conference call later today following which we will update if necessary. Reiterate Buy and NIS 20.5 price target.



Proper Disclosure

Analyst details

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Qualifications: **Michal Bar**: B.A. in Economics and Business Administration from Tel Aviv University. Holder of portfolio management license from the Israel Securities Authority.

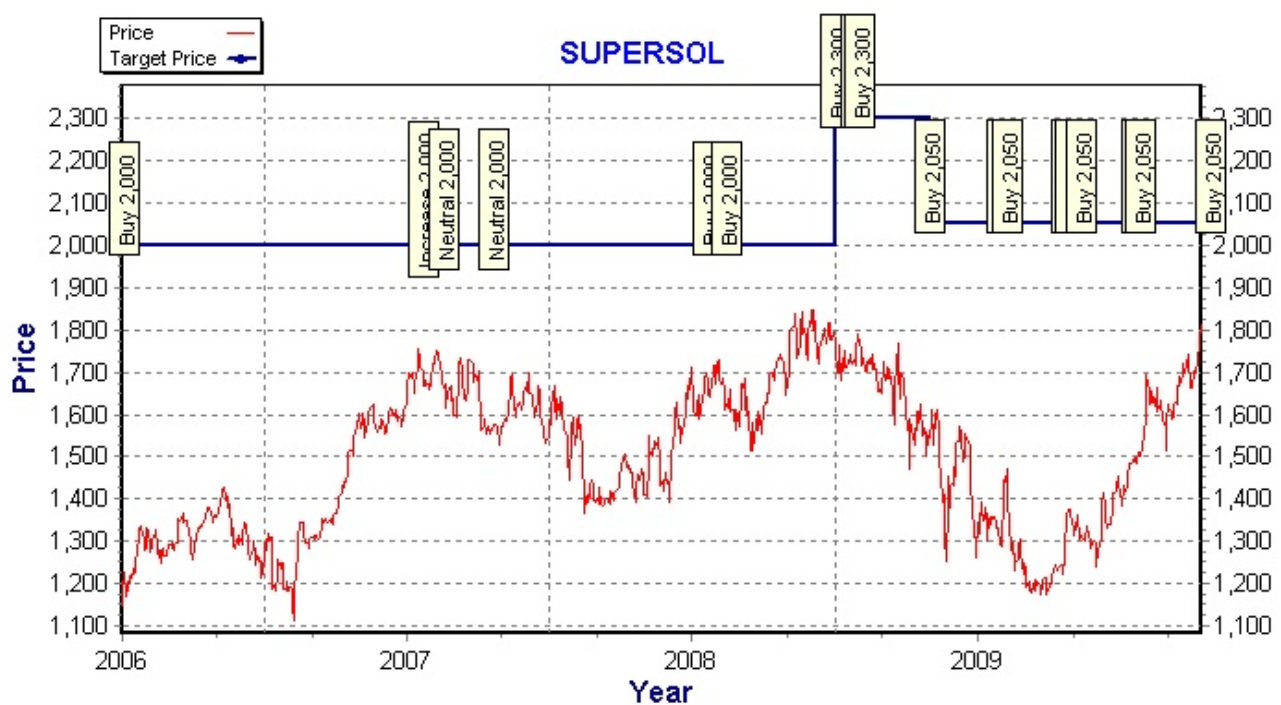
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Three-year rating and price target history :



**Valuation methodology and risks which could have a substantial impact on the recommendation**

Date of Report:	28/10/2009
Publication date:	28/10/2009
Valuation method:	DCF
Risk factors which could have a substantial impact on the recommendation	<ul style="list-style-type: none">• Intensifying competition in Israel's retail sector could result in lower margins and harm to chain sales.• Product quality issues could hurt the chain's reputation and sales.• A sharp rise in prices of raw materials could hurt profit potential.• Dependence on a number of key customers.

Proper disclosure by the analyst who prepared the report:

At the time of publication of this report, the analyst who prepared the report (see above) is not aware of any conflict of interest that could affect his judgment.

Proper disclosure by the authorized company for which report was prepared:

At the time of publication of this report, the authorized corporation (see above) is not aware of any conflict of interest that could affect the judgment of the analyst who prepared this report.

Analyst certification:

I, Michal Bar, bearer of license no. 8633, hereby certify that the opinions expressed in this report faithfully reflect my personal views about the securities and issuers covered in this report.

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