Herfy Food Services
Food/Dairy Products – Industrial
HERFY AB: Saudi Arabia
05 November 2019

الراجحي المالية
Al Rajhi Capital

US$0.828bn	51%	US$1.091mn
Market cap	Free float	Avg. daily volume

Target price	62.00	26.00% over current
Current price	49.20	as at 4/11/2019

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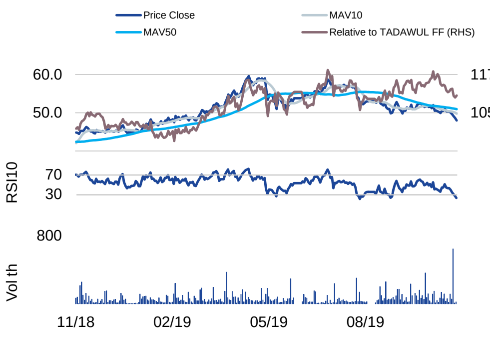
Existing rating

Underweight	Neutral	Overweight

Performance



Source: Bloomberg

Earnings

Period End (SAR)	12/18A	12/19E	12/20E	12/21E
Revenue (mn)	1227	1312	1429	1528
Revenue growth	6.0%	6.9%	8.9%	6.9%
EBITDA (mn)	288	305	333	361
EBITDA growth	5.1%	6.2%	9.0%	8.4%
Net Profit	204	230	257	286
Net Profit Margin	16.6%	17.5%	18.0%	18.7%
EPS	3.16	3.55	4	4.42
EPS growth	3.2%	12.4%	12.0%	11.1%
DPS	1.00	2.38	2.78	3.09
Payout Ratio	31.6%	67.0%	70.0%	70.0%
ROE	21.89%	22.76%	23.68%	24.38%

Source: Company data, Al Rajhi Capital

Herfy Foods

Remain Overweight; Revise TP to SAR62/sh

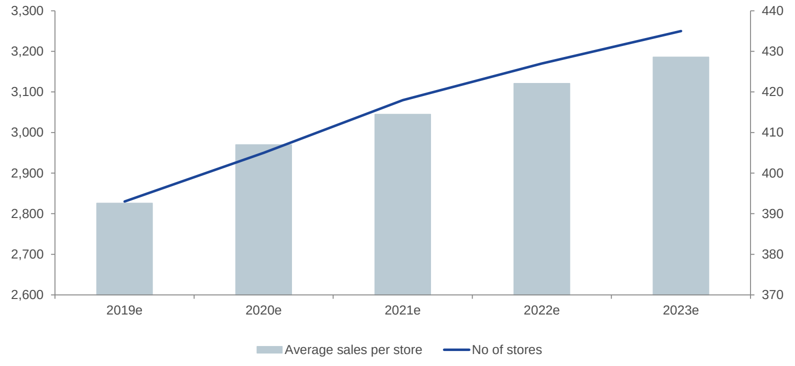
Herfy foods bottom-line came in at SAR58mn (-1% y-o-y) broadly in-line with our estimate of SAR57mn. The top-line grew modestly by 3% y-o-y to SAR339mn missing our estimate of SAR369mn by 6%. The gross margins improved by 400bps y-o-y likely due to IFRS16 adjustment where higher lease rentals have been replaced by lower depreciation expenses. The operating margin improved slightly due to higher gross margin while net margin dropped by 100bps mainly due to higher interest cost arising due to implementation of IFRS16 and lower sales. Going forward we expect the rate of store expansion to slow down and believe the top-line growth to come from online sales as well as improving LFL growth. Company is focusing on digitalizing its stores which in future should lead to cost reduction. We expect the company to open 20 stores and accordingly the store count to reach to 393 by 2019e and the yield per store to gradually increase as the new stores mature. Accordingly we revise our target price to SAR62/Sh (earlier SAR68/Sh) which implies 26% upside from CMP.

New product launches to increase consumer footfall:Herfy recently launched fried chicken in its menu and there are further product launches in pipeline. Company is pro-active in launching new products according to the changing taste and preferences of the customer. In past they launched grilled chicken burger a healthy variant to attract calorie conscious crowd. Thus new launches should help the company in attracting new segment of customers.

Yield per stores to increase as the new stores matures: It takes anywhere between 6-12 months for a new stores to normalize operations. Though the increasing number of restaurants will have a negative impact on SG&A initially but once these new stores matures yield per store will increase gradually. As per our analysis we expect revenue per store to increase from SAR2.8mn in 2018 to SAR3.2mn in 2023e and average profit per store to increase from SAR358,000 per store to SAR478,000 per store in 2023e.

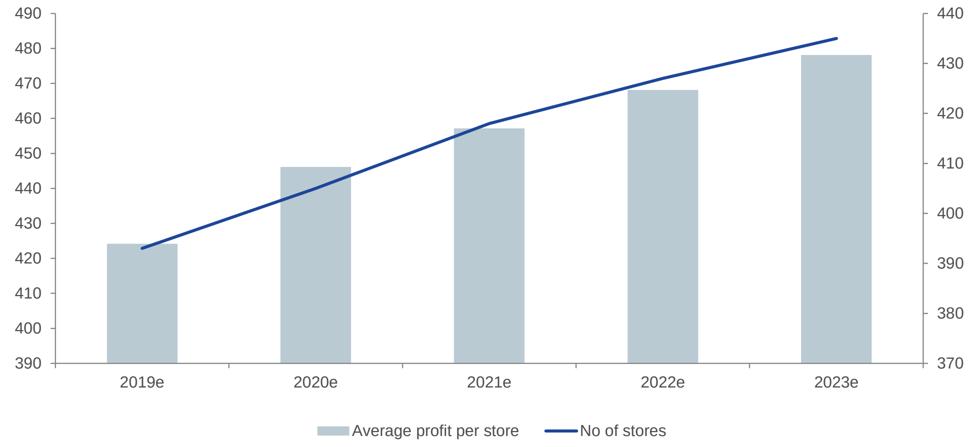
Increasing demand for online food orders to support top-line: As per Statista, the value of total food delivered online in Saudi Arabia is worth USD1.1bn and this number is expected to increase by ~26% as mobile phone and internet penetration increases in the Kingdom. Therefore we believe that the penetration of online food delivery will have a positive impact on the overall QSR industry. Herfy is one of the oldest players in hamburger meals and they roll out promotions strategically to capture these online sales. We believe this is expected to create an extra demand for Herfy's apart from store expansion.

Fig 1: Average sales per store



Source: Company data, Al Rajhi Capital

Fig 2: Average profit per store to increase as the old stores mature and capex reduces



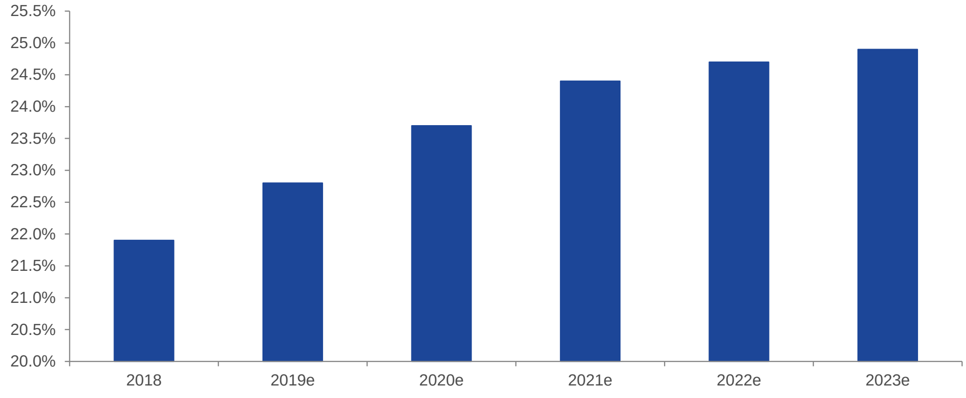
Source: Company data, Al Rajhi Capital

Fig 2: Key Assumptions

(SAR 000's)	2019e	2020e	2021e	2022e	2023e
Total sales from restaurants	1,110,650	1,202,965	1,272,613	1,332,670	1,385,837
No of stores	393	405	418	427	435
Average sales per store	2,826	2,970	3,045	3,121	3,186
Average profit per store	424	446	457	468	478

Source: Company data, Al Rajhi Capital

Fig 4: Improving ROE above 20% over 2018-2023e



Source: Company data, Al Rajhi Capital

Valuation: Herfy has a solid payout history, a dividend payout of ~70% over the previous four years (except 2018), thereby implying a dividend yield of ~5 for FY19E. We continue to value Herfy based on equal weights for DCF and P/E based relative valuation. Our DCF based target price is SAR 60 per share, assuming 9% WACC (25% debt in capital structure) and 3% terminal growth. The P/E based relative valuation at 20x FY20 EPS yields a target price of SAR63 per share. The equal weighted target price stands at SAR62 per share, implying 26% upside from current price. We remain "Overweight" on Herfy.

Key Risks:

- As per our calculations the average sales per store after declining in 2017 has again improved in 2018, but the trend is still erratic. So if the stores do not mature as per our expectations then it will have a negative impact on margins
- The company's fixed cost are increasing due to store expansion and hence if the like for like growth doesn't improve as per our expectations then the average revenue per store might further go down having a negative impact on the margins.
- Slower than expected consumer spending and any increase in government levies will have a negative impact on the growth.

(SAR mn)	Q3 2019	Q2 2019	Q3 2018	% chg y-o-y	% chg q-o-q	ARC est
Revenue	339.0	309.0	329.0	3.0%	9.7%	369.0
Gross profit	111.0	88.0	97.0	14.4%	26.1%	108.0
Gross margin	33.0%	28.0%	29.0%	13.8%	17.9%	29.3%
Operating profit	69.0	51.0	62.0	11.3%	35.3%	61.0
Net profit	58.0	41.0	58.0	0.0%	41.5%	56.0

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

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