

Herfy Food Services Co.

Quarterly Recovery, Despite Higher Provisions, yet Pressure on Margins Remain

12 November 2020

Herfy was able to significantly recover from Q2 2020, on the back of the easing of COVID-19 restrictions and the reopening of commercial centers, with 83% Q-o-Q increase in Sales. Meanwhile, the company still hasn't reached pre-COVID numbers as net income dropped by 28% Y-o-Y due to lower sales, higher costs and higher provisions. Going forward, recovery is expected to be slow with high pressure on yield-per-store due to heavy reliance on aggregators.

In line with our previous expectations, Herfy was able to significantly recover during Q3 2020 both in terms of top-line and bottom-line numbers compared to the previous quarter, where it was significantly impacted by COVID-19 restrictions. During Q3 2020, the company reported sales of SAR311mn. While sales recovered on quarterly bases (+83% Q-o-Q), sales dropped by 8% Y-o-Y from SAR339mn in Q3 2019. The Q-o-Q recovery is mainly attributed to the reopening of commercial centers (11% of Herfy stores are in commercial centers) and the overall easing in movement restrictions, which significantly improved sales across all segments. Meanwhile, the company sales are still impacted with the current market conditions during the COVID-19 pandemic, hence the drop in sales on yearly basis.

COGS remained flat Y-o-Y, sitting at around SAR227mn in Q3 2020, however, gross profit dropped by 24% from SAR111mn in Q3 2019 to SAR84mn in Q3 2020. Similarly, gross profit margin dropped by 370bps during the quarter from 32.7% in Q3 2019 to 27% in Q3 2020.

During the quarter the company endured an increase in the provision for slow moving inventory reaching SAR8.4mn in Q3 2020 and the provision for doubtful debts by SAR6.5mn in the same quarter. That being said, SG&A were at an all-time high reaching SAR51mn, representing a 39% increase Y-o-Y compared to SAR43mn in Q3 2019. Moreover, the company reported other income of SAR17mn in Q3 2020, including a nonrecurring value of SAR11mn in rent concession as a COVID-19-related accounting amendment. That being said, operating income dropped by 27% Y-o-Y, while operating profit margin dropped 430bps, reaching 16% in Q3 2020.

While the company witnessed a drop in financing cost during the quarter 27% Y-o-Y, Herfy's net income still dropped by 28% Y-o-Y from SAR58mn in Q3 2019 to SAR41mn in Q3 2020. Net income margin also dropped from 17% in Q3 2019 to 13% in Q3 2020. The Y-o-Y drop in net income is a combination of drop in sales, relatively higher costs and the provisions endured during Q3 2020.

Herfy's has not announced any dividend distribution yet, and is not expected to until the end of FY2020e.

It is a fact that the Quick Service Restaurant (QSR) sector is among the hardest hit sectors during the pandemic, especially during the COVID-19 movement restriction measures. Despite the easing in said restrictions, the recovery for the QSR sector will not be smooth as people's hygienic concerns will drive them away of the eating-in experience. Coupled with the heavy reliance on aggregators, the company's yield-per store is expected to be at its lowest levels until the end of 2021e. Furthermore, the extra cost on the back of the hygiene measures that must be taken to ensure the safety of in-house customers, are bound to further pressure Herfy's recovery.

We expect that the company will not be able to reach pre-COVID levels until 2022e, however, the company will maintain competitiveness due to its home delivery application.

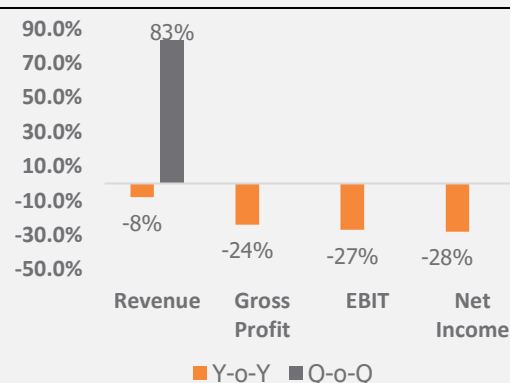
We update our 52 weeks target price SAR51.3/share while maintaining our **Neutral recommendation**

Recommendation	Neutral
Previous Recommendation	Underweight
Current Price (12-12-2020)	SAR55.2
Target Price (52 Weeks)	SAR51.3
Upside/ (Downside)	-7.12%
Shariah Compliance	Pass

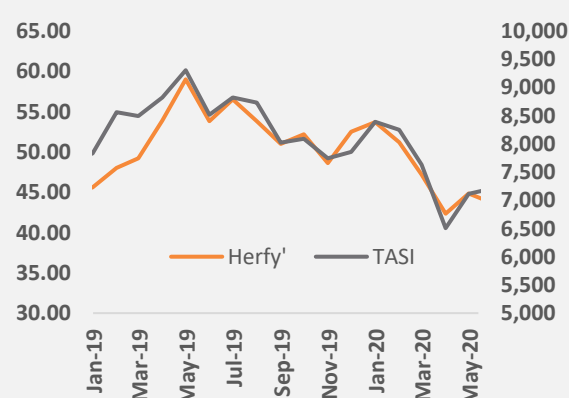
Key Financial Ratios

Ratio	Q3 2020	Q3 2019	Q2 2020
Revenue Growth	82.9%	9.6%	42.7%
Gross Margin	27.0%	32.7%	6.3%
EBIT Margin	16.2%	20.5%	N/A
Net Margin	13.3%	17.0%	N/A

Key Financial Results (Q2 2020)



Share Price Performance





Herfy Food Services Co.

DCF Valuation

	2020 E	2021 F	2022 F	2023 F	2024 F
EBITDA	147	231	264	297	326
Operating CF	100	227	264	297	315
Capex	(86)	(87)	(106)	(99)	(91)
FCFF	15	141	158	198	224
Stub Period (FCF to be discounted)	4	141	158	198	224
PV (FCFF)	4	127	132	152	158
WACC	8.02%				
Perpetuity Growth	3.00%				
PV-FCFF	573				
PV-TV	2,873				
Net Debt	(131)				
Less: End of services benefits	(70)				
Less: NCI	73				
Intrinsic Values	3,316				
Shares Outstanding	65				
Equity value per share	51.3				
CMP (12-11-2020)	55.2				
Upside / (Downside%)	-7.12%				

We have valued Herfy using DCF approach, considering a WACC is equal to 8.0% (based on a risk-free rate of 3.3%, market risk premium 7.3%, Beta of 0.88) Based on the DCF valuation, the fair price of Herfy share price is SAR51.3, which is lower than the traded value by 7.1%.

All values are in SARmn



Herfy Food Services Co.

Financial Ratios	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Return on Average Assets (%)	11.3%	3.1%	6.6%	8.3%	9.8%	11.0%
Return on Average Equity (%)	20.3%	6.3%	12.7%	15.1%	17.0%	18.3%
Earnings Before Zakat Margin (%)	15.6%	6.4%	11.7%	13.5%	14.8%	16.0%
Net Income Margin (%)	15.2%	6.0%	11.4%	13.1%	14.5%	15.6%
Revenue Growth (%)	5.0%	-15.3%	12.4%	10.9%	8.9%	6.7%
EPS	3.0	1.0	2.2	2.8	3.3	3.8

Income Statement	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Revenues	1,288	1,091	1,227	1,360	1,481	1,581
Cost of revenues	(746)	(775)	(837)	(920)	(995)	(1,054)
Gross Profit	393	255	331	383	431	473
SG&A	(156)	(169)	(159)	(175)	(190)	(201)
Zakat	(5)	(5)	(4)	(5)	(5)	(6)
Net Income	196	65	140	178	214	247

Balance Sheet	2019 A	2020 E	2021 F	2022 F	2023 F	2024 F
Current Assets	351	485	570	641	714	831
Non-Current Assets	1,683	1,623	1,567	1,534	1,497	1,457
Total Assets	2,033	2,107	2,137	2,175	2,211	2,287
Current Liabilities	408	433	419	407	394	384
Non-Current Liabilities	627	611	579	548	518	493
Total Equity	998	1,063	1,139	1,220	1,298	1,410
Total Liabilities and Equity	2,033	2,107	2,137	2,175	2,211	2,287

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

Itqan Capital

Al Zahraa District, Al Zahraa Commercial Center,
PO Box 8021, Jeddah 21482,
Kingdom of Saudi Arabia

Tel: 966 12 263 8787

Fax: 966 12 263 8789

info@itqancapital.com

www.itqancapital.com

Disclaimer

This research document has been prepared by Itqan Capital Company ("Itqan Capital"), Saudi Arabia. It has been prepared for the general use of Itqan Capital's clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Itqan Capital. Receipt and review of this research document constitute your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this document prior to public disclosure of such information by Itqan Capital. The information contained was obtained from various public sources believed to be reliable, but we do not guarantee its accuracy. Itqan Capital makes no representations or warranties (express or implied) regarding the data and information provided and Itqan Capital does not represent that the information content of this document is complete, or free from any error, not misleading, or fit for any particular purpose. This research document provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other investment products related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this document. Investors should seek financial, legal or tax advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this document and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities or other investments, if any, may fluctuate and that the price or value of such securities and investments may rise or fall. Fluctuations in exchange rates could have adverse effects on the value of or price of, or income derived from, certain investments. Accordingly, investors may receive back less than originally invested. Itqan Capital or its officers or one or more of its affiliates (including research analysts) may have a financial interest in securities of the issuer(s) or related investments, including long or short positions in securities, warrants, futures, options, derivatives, or other financial instruments. Itqan Capital or its affiliates may from time to time perform investment banking or other services for, solicit investment banking or other business from, any company mentioned in this research document. Itqan Capital, together with its affiliates and employees, shall not be liable for any direct, indirect or consequential loss or damages that may arise, directly or indirectly, from any use of the information contained in this research document. This research document and any recommendations contained are subject to change without prior notice. Itqan Capital assumes no responsibility to update the information in this research document. Neither the whole nor any part of this research document may be altered, duplicated, transmitted or distributed in any form or by any means. This research document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or which would subject Itqan Capital or any of its affiliates to any registration or licensing requirement within such jurisdiction.

Itqan Capital is licensed by the Saudi Arabian Capital Market Authority, License No.07058-37 and CR No.4030167335