Development Works Food

Restaurants – Industrial
DWF AB: Saudi Arabia
01 December 2020

الراجحي المالية
Al Rajhi Capital

US$0.123bn	27%	US$5.203mn
Market cap	Free float	Avg. daily volume

Target price	170.00	-2% over current
Current price	174.00	**as at 30/11/2020**

Existing rating

Underweight	**Neutral**	Overweight

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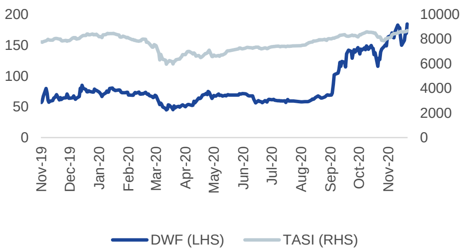
Key themes

DWF is in the early stages of growth and the strategy to focus on core juice business which have higher margins should improve the overall return metrics in near term. Company's product offering aligns well with the food preferences of the youth who dominates the population mix in KSA. Rising disposable income, increasing tourism and increasing entertainment avenues are other growth drivers which should support DWF's growth.

Price Performance



Source: Company data, Al Rajhi Capital

Earnings

Period End (SAR '000)	FY18	FY19	FY20E	FY21E
Revenue	108,660	138,433	93,894	101,875
Revenue Growth	45%	27%	-32%	9%
Gross Profit	14,940	19,520	7,350	16,300
Gross Margin %	14%	14%	8%	16%
EBITDA	11,942	14,780	(1,454)	17,256
EBITDA Margin %	11%	11%	-2%	17%
Net Profit	7,742	8,304	(7,133)	5,245
Net Margin %	7%	6%	-8%	5%
EPS	3.10	3.32	(2.85)	2.10
Return on Equity % (ROE)	30%	24%	-20%	16%

Source: Company data, Al Rajhi Capital

Valuation

	FY18	FY19	FY20E	FY21E
EV/Sales	0.6x	0.5x	0.7x	0.6x
EV/EBITDA	5.1x	8.2x	NM	5.6x
P/E	10.7x	23.8x	NM	82.9x
P/B	2.7x	5.1x	13.8x	12.2x

Source: Company data, Al Rajhi Capital

Development Works Food

Initiating coverage with a TP of SAR170/sh

Development food work (DWF) operates ~43 quick service restaurants (QSR) under three brands "Juice Time, "Quiznos Sub"(franchisee) and "Meshwar Pizza". The company recently sold "Bait- a- katakit" and "Mahboob" shawarma brand and has shut down some stores due to COVID 19 induced business disruptions. The majority of the revenue comes from "Juice time" brand and the company aim to expand this brand further in existing cities as well as new regions by opening new stores and by partnering through online food aggregators. The company is still in the early stages of growth and the entire QSR industry in which the company operates is well poised to grow at a faster pace compared to the other segments of the F&B industry. The key growth drivers of the industry are young demographic mix, rising disposable income and increasing tourism in the country while the key upside risks include acquisition of new brands and faster than expected store expansion in the kingdom. The company's gross margins and ROE off late have been in a falling trajectory however we believe it is expected to improve after the disposal of low performing brands and expansion of new juice stores. We assume 45 net store additions from 2021- 2023e and a positive LFL growth of existing stores from 2021e and as such forecast company's revenue to reach ~SAR166mn by 2023e. We initiate coverage on DWF with a target price of SAR170/sh. arrived with equal mix of DCF and EV/EBITDA based relative valuation which indicates a "Neutral" rating at CMP of SAR174/sh. The company has recently filed request with CMA to list in the main market.

Strategy to focus on expansion of juice time brand should improve gross margins and overall return metrics: DWF's revenue grew at a CAGR of 41% in between 2015-2019 however the business was impacted in 2020 due to covid as a result the company shut down many stores and is currently focusing on maximizing value from "Juice Time" brand. This is a good strategy as juice is a high margin business (in FY2015, 2016 the gross margin was ~45%) and is perceived as a healthy beverage among the masses. Thus, company's product offering aligns well with the food preferences of the youth crowd. The majority of the stores are concentrated in Riyadh and Jeddah and this provides a significant expansion opportunity across KSA especially in underpenetrated tier 2 cities. The lower level of lease rentals due to COVID and lower interest rates also provides conducive environment for any capital expenditures. The only challenge while expansion in near term could be the hiring of expat workers which should be possible by H1 2021E once the flights resume.

Valuation: We value DWF using 50:50 weights given to DCF and EV/EBITDA based relative valuation. Our DCF based price based on 2% terminal growth and 7.92% WACC is ~SAR182 while relative valuation-based price on applying a target EV/EBITDA multiple of 16.8x to FY2023e EBITDA is SAR158. Thus, equal weighted target price stands at ~SAR170/sh which implies a 2% downside from CMP of SAR174/sh. We initiate coverage on DWF with a "Neutral" rating.

Key Financials

Figure 1 Income Statement Summary

SAR ('000)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	108,660	138,433	93,894	101,875	122,688
Cost of Revenue	(93,720)	(118,913)	(86,544)	(85,575)	(100,604)
Gross Profit	14,940	19,520	7,350	16,300	22,084
Operating Expenses	(9,251)	(12,871)	(17,101)	(8,150)	(7,361)
Operating Income or (Losses)	5,689	6,649	(9,752)	8,150	14,723
Depreciation & Amortization	6,253	8,131	8,297	9,106	10,401
EBITDA	11,942	14,780	(1,454)	17,256	25,123
Interest expense, net	2,262	1,923	2,718	2,629	2,693
Pretax Income	7,951	8,572	(7,034)	5,521	12,030
Income Tax (Expense)/Benefit	(209)	(268)	(99)	(276)	(601)
Net Income/Net Profit (Losses)	7,742	8,304	(7,133)	5,245	11,428
EPS	3.10	3.32	(2.85)	2.10	4.57
DPS	0.00	0.00	0.00	0.42	1.14

Source: Company data, Al Rajhi Capital

Figure 2 Cash flow Statement Summary

(SARmn)	FY18	FY19	FY20E	FY21E	FY22E	FY22E
Cash flow from operations	9,496	20,695	4,084	15,927	23,738	33,673
Capex	(24,196)	(82,077)	(7,384)	(11,329)	(16,902)	(18,635)
Free cash flow	(14,700)	(61,382)	(3,300)	4,598	6,836	15,038
Cash flow from financing activities	14,888	53,482	9,368	(3,603)	(4,396)	(9,392)
Change in cash	197	(1,207)	8,700	549	1,979	5,168

Source: Company data, Al Rajhi Capital

Figure 3 Balance Sheet Summary

SAR ('000)	FY18	FY19	FY20E	FY21E	FY22E
Current Assets	27,607	27,717	27,794	28,330	30,515
Non-Current Assets	46,490	113,750	87,209	89,878	96,840
Total Assets	74,097	141,467	115,003	118,208	127,355
Current Liabilities	10,558	31,678	19,003	21,485	23,438
Non-Current Liabilities	33,248	71,190	64,534	61,061	59,684
Total Non-Current Liabilities	43,806	102,868	83,537	82,546	83,122
Shareholders' Equity	30,291	38,595	31,462	35,658	44,229
Total Liabilities & Shareholder Equity	74,097	141,463	114,999	118,204	127,351

Source: Company data, Al Rajhi Capital

Figure 4 DCF Valuation

(SAR'000)	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E
Free Cash Flow to Firm	(2,154)	8,685	11,097	19,441	26,924	38,570
Sum of present values of FCFs	76,586					
Present value of terminal value	451,181					
EV	527,767					
Less: Net debt	(24,102)					
Less: Minority	0					
Equity value	454,605					
Fair value per share (SAR)	182					
Shares O/s ('000)	2,500					

Source: Company data, Al Rajhi Capital

Figure 5 DCF-based target Price sensitivity to Terminal growth rate and WACC assumptions

Sensitivity Analysis

		Terminal Growth Rate					
		1.50%	**1.75%**	**2.00%**	**2.25%**	**2.50%**	**2.75%**
WACC	**7.4%**	186	194	204	214	225	238
	7.7%	176	184	192	202	212	223
	7.9%	167	174	**182**	190	199	210
	8.2%	159	165	172	180	188	197
	8.4%	151	157	163	170	178	186

Source: Al Rajhi Capital

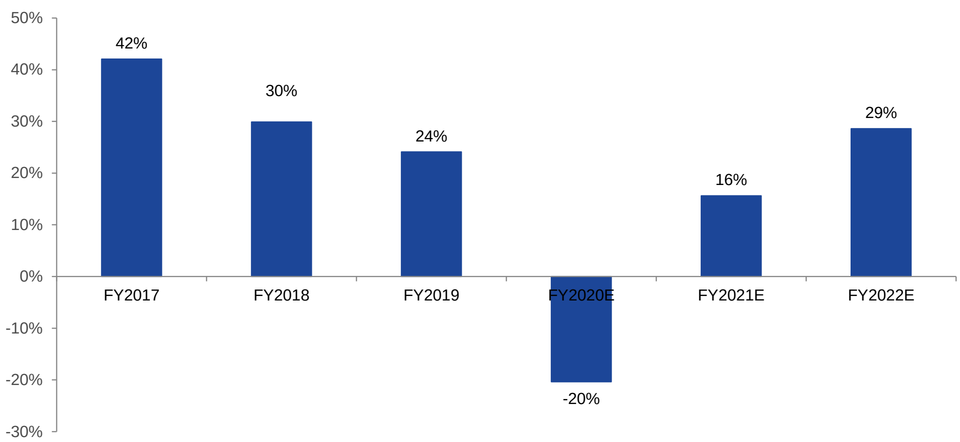
Figure 6 Target Price sensitivity to no. of stores added and terminal year GPM% assumptions

Sensitivity Analysis

		No. of stores added each year					
		10	**20**	**30**	**40**	**50**	**60**
GPM %	**26.0%**	155	193	232	270	309	347
	24.0%	146	181	217	252	287	322
	22.0%	138	**170**	201	233	265	297
	20.0%	129	158	186	215	243	272
	18.0%	121	146	171	196	221	247

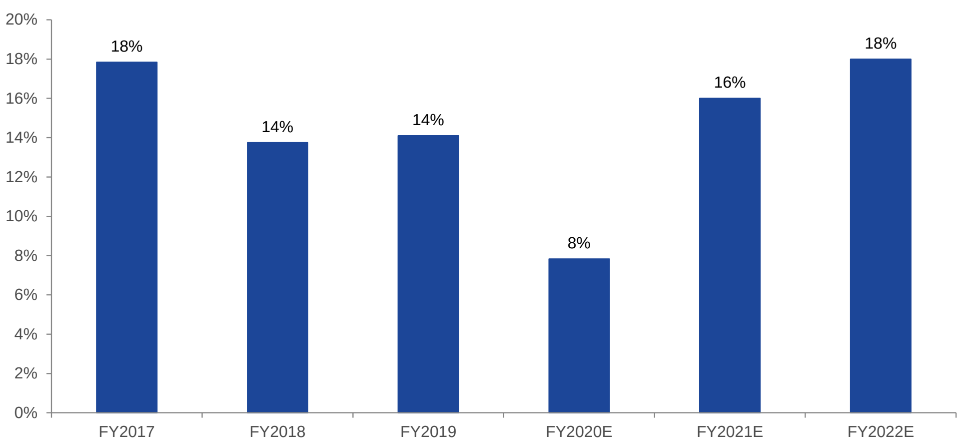
Source: Al Rajhi Capital

Figure 7 Return on Equity



Source: Company data, Al Rajhi Capital

Figure 8 Gross Profit Margin



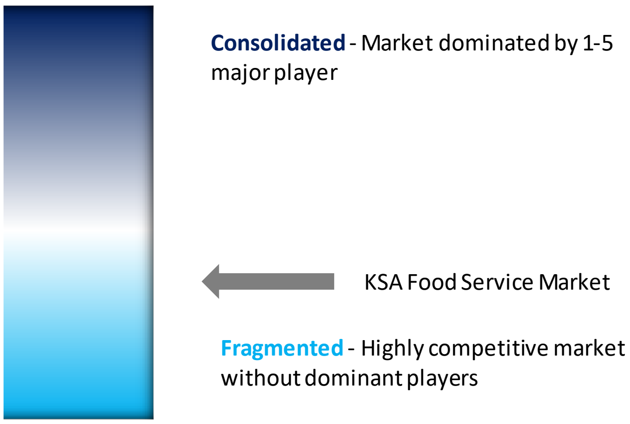
Source: Company data, Al Rajhi Capital

Company Overview: Development works food operates "Juice Time' brand and runs a franchise of "Quiznos Sub" in KSA. The company has ~40 stores (after disposal of Mahboob shawarma and Bait Al kata-kit) predominantly in Riyadh and Jeddah. The 'Juice time' brand serves fresh fruit juice, mocktails, milk shakes, etc. while Quiznos sub serves subway sandwiches, selective range of pizzas and beverages. The company commenced its operations in 2012 with an annual turnover of SAR3mn which increased to SAR138mn in FY 2019 driven by store expansion as well as LFL growth of established stores. Covid 19 disrupted the entire QSR industry and therefore company had to shut down many stores permanently but has plans to expand their "Juice time" brand to other regions as well as further penetrate in the kingdom. The change in the business strategy to focus on "Juice time" brand should expect the gross margins as juice is a higher margin business compared to other brands. We expect the gross margins of juice to reach 22% by 2025e.

Industry Overview:

The food and beverage industry in Saudi Arabia is worth USD45bn as per JLL and is expected to grow at a CAGR of 6% over the next five years (2020 growth to remain impacted due to COVID 19 related crisis). Currently the industry is highly fragmented with many regional and international players operating in the kingdom. Covid 19 disrupted the industry in 2020e but a strong rebound is expected in 2021e as KSA plans to vaccinate ~70% of its population by 2021e. The top five players in the industry are McDonalds, Herfy, Yum Brands, Kudu and Dunkin Donuts. In terms of pure beverage players Starbucks, Tim Horton's and Dunkin donuts dominates the market. The major growth driver for F&B industry is large young population with increasing disposable income and rapid social changes such as introducing tourist visa and rising entertainment avenues.

Figure 9 Market concentration



Source: Mordor Intelligence, Al Rajhi Capital

Approximately 2/3rd of the total population is below the age of 35. This age group generally has a higher propensity to consume. Moreover, there is a shift towards healthy food options among the youth to enhance their lifestyle. This creates a good opportunity for healthy food chains to improvise on their product offering and create a strong brand image which would drive their growth in future.

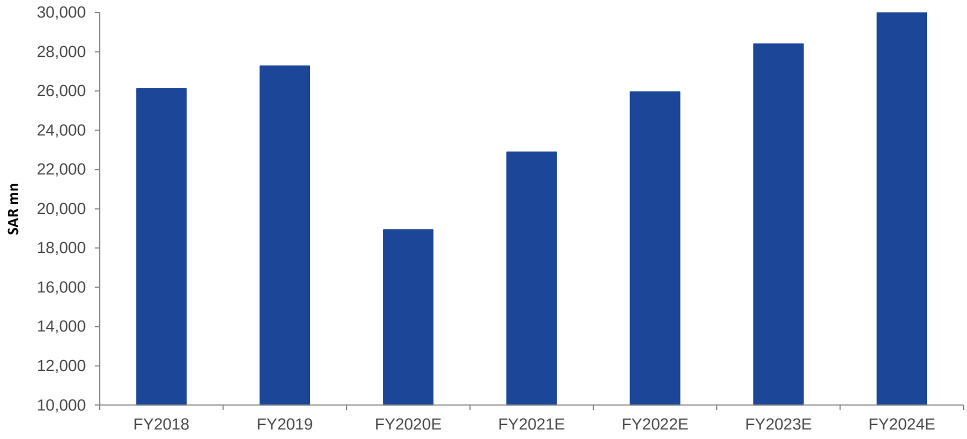
The tourism industry is taking a new shape in KSA with many private players putting in significant investments backed by Saudi government's 2030 vision where one of the key focuses is to increase the number of tourists in the kingdom. In the longer term this bodes well for F&B industry as it will have a major impact on the quality and diversity of F&B concepts.

Apart from these there are many entertainment options available to people such as cinemas, increasing sports activities, Riyadh season, Jeddah season etc. which creates growth opportunities for food service industry especially QSR's. We believe that despite a sizeable number of restaurants and QSR's there is still enormous opportunities to further expand in the mega cities as well as tier 2 cities.

Healthy and sustainable eating is the trend now worldwide among youths and as such customers in Saudi Arabia are also preferring healthy food options. As a result, many food brands are starting to incorporate healthy food options in their menu, for example grilled patty burger, fresh juices, low carb keto options, vegan food etc. Thus we believe, brands being perceived as diet friendly or healthy have a strong opportunity to create a brand image among the youths and tap a significant portion of young population in the future.

The QSR industry nosedived in 2020e due to covid 19 related disruptions however a strong rebound is expected in H2 2020 and 2021 onwards. The overall market is expected to increase to ~SAR28bn as shown in fig 14.

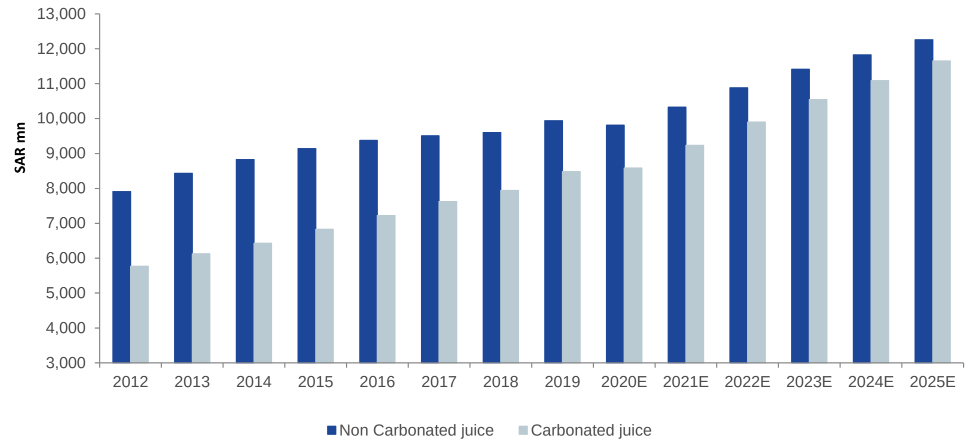
Figure 10 Quick Service Restaurants revenue trend and forecast



Source: Euromonitor, Al Rajhi Capital

The juice market size of KSA as on 2019 was close to SAR10bn and is expected to cross over SAR12bn by 2025e driven by rising preference of Saudi youths for a healthy lifestyle, thus providing significant opportunities for brands like "Juice time".

Figure 11 Juice market size trend and forecast



Source: Statista, Al Rajhi Capital

Increasing consumer spending on restaurants to drive the growth of overall QSR market

The consumer spending on restaurants and eating out is increasing at a rapid pace over the last few years driven by rising disposable income and availability of multiple regional and international food chains in the kingdom. There is a significant presence of US based fast food chains such as McDonald's, Burger king, Domino's Pizza, Pizza hut, Starbucks etc. Among the local players Herfy and Albaik food systems are among the top 5 QSR's in the kingdom. The QSR industry is expected to grow to USD8bn by 2024e from USD7.2bn in 2019 and USD5bn in 2020e (due to covid19 the market shrank in 2020e) as per market reports which indicate huge potential for companies like DWF to tap these opportunities by expanding their store network across the kingdom.

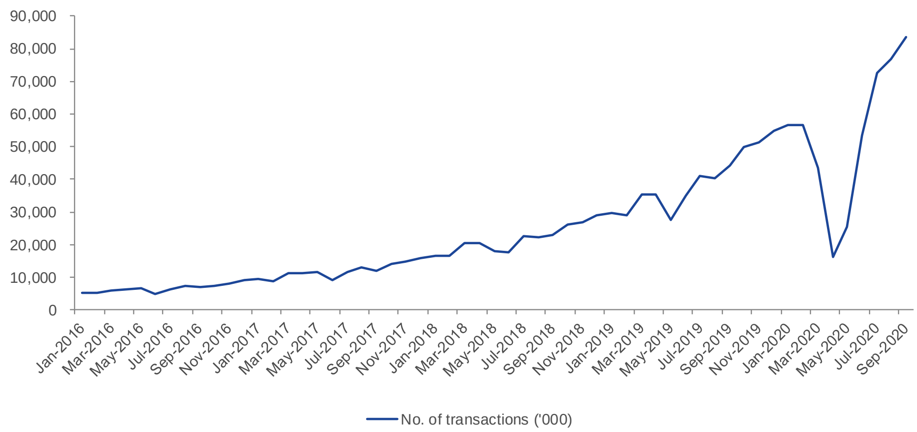
Figure 12 Average household monthly spending by spending group and nationality of the household head

Major Expenditure Group (SAR)	Saudi	% of Total	Total	% of Total
Food And Beverages	2,621	16%	2,202	17%
Tobacco	50	0%	70	1%
Fabric, Apparel and Footwear	599	4%	492	4%
Housing, Water, Electricity, Gas, and other Fuels	3,616	22%	2,989	23%
Furniture and Furnishings	1,048	6%	789	6%
Health	225	1%	167	1%
Transport	1,992	12%	1,532	12%
Communications	827	5%	658	5%
Recreation and Culture	460	3%	359	3%
Education	358	2%	336	3%
Restaurants and Hotels	726	4%	657	5%
Miscellaneous Personal Goods and Services	3,605	22%	2,567	20%
Total	**16,125**	**100%**	**12,818**	**100%**

Source: Gastat, Al Rajhi Capital

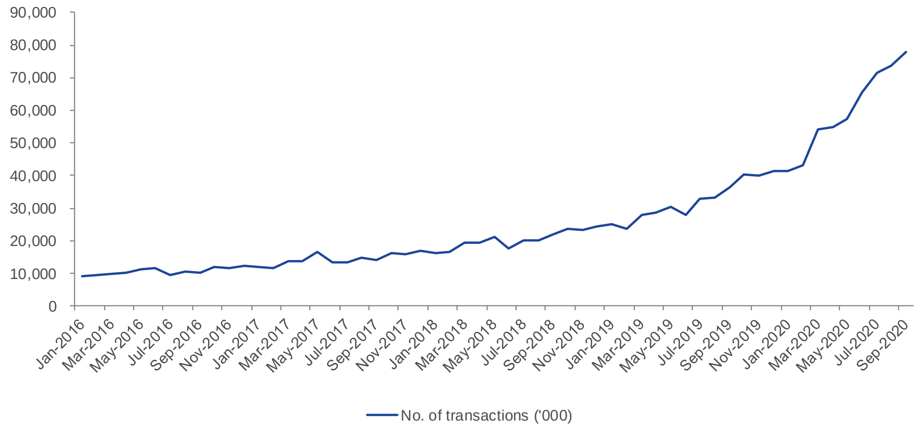
Rising POS transaction data at restaurants and café indicates increasing consumer spending towards eating out.

Figure 13 POS transaction trend at Restaurants & Café



Source: SAMA monthly report, Al Rajhi Capital

Figure 14 POS transaction trend at Beverage and Food

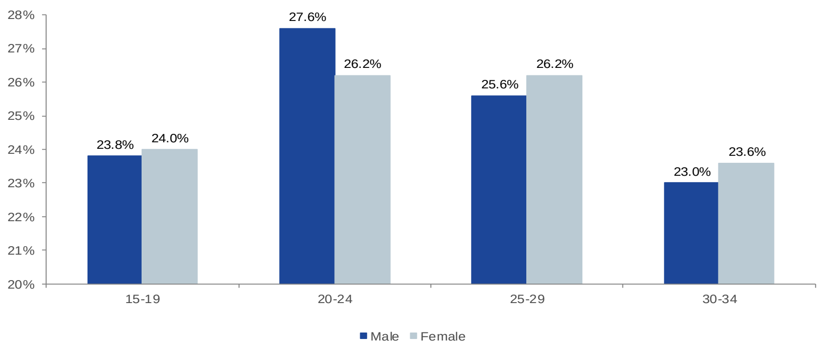


Source: SAMA monthly report, Al Rajhi Capital

Favourable demographics provides significant opportunities for QSRs

The major growth of the QSR industry in KSA is expected to be driven by the young population of Saudi Arabia who have higher propensity to spend and whose eating habits are influenced by western culture. Approximately 67% of the total population in Saudi Arabia is currently below the age of 35 and young generation prefers eating out at leading international and local brands. The changing social landscape especially with increasing entertainment avenues and rising leisure tourism also provides long term sustainable growth potential for the overall QSR industry.

Figure 15 Percentage distribution of Saudi Youth by age group and gender, 2020



Source: Gastat, Al Rajhi Capital

Figure 16 Population by Age Groups ,and Gender mid-year 2019

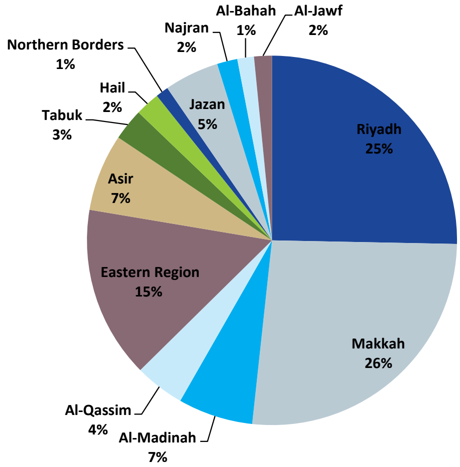
	Total Population					
Age group	MALE	% of Total	FEMALE	% of Total	TOTAL	% of Total
4 - 0	1,449,705	7%	1,394,796	10%	2,844,501	8%
9 - 5	1,506,148	8%	1,450,289	10%	2,956,437	9%
14 - 10	1,317,077	7%	1,271,948	9%	2,589,025	8%
19 - 15	1,205,027	6%	1,154,954	8%	2,359,981	7%
24 - 20	1,401,128	7%	1,226,566	8%	2,627,694	8%
29 - 25	1,806,124	9%	1,460,587	10%	3,266,711	10%
34 - 30	1,950,461	10%	1,362,914	9%	3,313,375	10%
39 - 35	2,326,154	12%	1,381,077	10%	3,707,231	11%
44 - 40	2,118,142	11%	1,198,365	8%	3,316,507	10%
49 - 45	1,628,848	8%	831,711	6%	2,460,559	7%
54 - 50	1,175,456	6%	539,183	4%	1,714,639	5%
59 - 55	786,126	4%	397,103	3%	1,183,229	3%
64 - 60	487,714	2%	291,415	2%	779,129	2%
69 - 65	236,215	1%	197,537	1%	433,752	1%
74 - 70	150,559	1%	137,517	1%	288,076	1%
79 - 75	91,832	0%	81,006	1%	172,838	1%
+ 80	102,340	1%	102,145	1%	204,485	1%
Total	**19,739,056**	**100%**	**14,479,113**	**100%**	**34,218,169**	**100%**

Source: Company data, Al Rajhi Capital

Significant expansion opportunities across kingdom

Currently DWF has ~40 juice time brand outlets mainly in Riyadh and Jeddah. The company closed many stores recently due to COVID19 and sold off two brands named Bait-a-katakit and Mahboob shawarma. The company's strategy is to increase the presence of "juice time" brand across the kingdom. We believe that the company has a scope for further penetration in Riyadh and Jeddah cities and good potential to enter into other cities in the western and eastern region. There are very few brands currently competing directly in fresh juice segment with "Juice time" and therefore DWF can target regions with relatively higher population such as Makkah, Qassim and Madinah as shown in fig 7.

Figure 17 Population break up region wise as on 2019



Source: Gastat, Al Rajhi Capital

Rising disposable income due to female employment bodes well for spending in food and beverages sector:

The female participation rate in labour force is increasing at a rapid pace in KSA. It has grown from 17.7% in Q2 2016 to 31.4% in Q2 2020 and has led to an increasing disposable income in the hands of families which in turn supports higher spending towards food and beverages. The increasing government focus towards female employment, which is expected to continue, should drive the growth of restaurants and quick service restaurants in KSA.

Increasing preference towards healthy diet:

As per the recent youth survey released by GASTAT ~60% of the youth population takes their health seriously and practice sports for improving their health. This indicates an increasing preference by the younger generation for a healthy diet. DWF operates “Juice time” and “Quiznos Sub” brand which sells fresh fruit juices and sandwiches respectively. This is perceived as a healthy option and thereby company’s strategy to expand their network of “Juice time” brand aligns well with the current market environment.

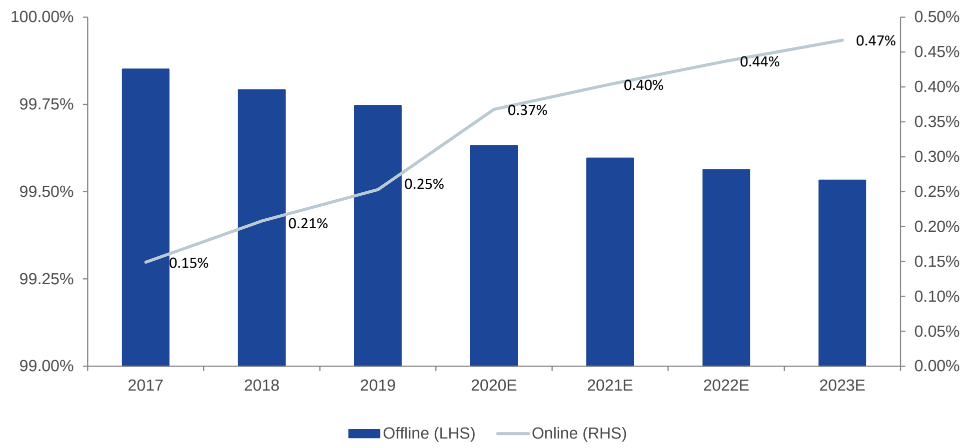
Increase in tax on sugar based drinks makes healthy juice more attractive:

Given the hot and dry weather in Saudi Arabia beverages are part of a staple diet. There are many FMCG companies which sells packaged juice, dairy based drinks such as laban, milk shakes, flavoured sodas, etc. However, with the increasing tax on sugar based drinks and rising preference towards fresh juice the market size of packaged juices has reduced recently. In terms of pricing, with an increase in tax on sugar based drinks, the price gap between fresh juice and packaged juice has reduced thus making customers inclined towards buying fresh juices which is a healthier option.

Food delivery applications provide further avenues to expand:

Online food delivery is gaining a rising presence especially after COVID 19 which has led to a rapid adoption of e-commerce among people globally. One advantage of food aggregators is that they cover a wide area which helps the restaurants and QSR’s to reach out to a wider audience. Food delivery app provides a great Omni-channel strategy for the food service industry to leverage on. Though sales through food aggregators come at a cost in the form of commission yet it increases the turnover without the need for significant capex and other overhead cost. QSR’s can also adopt a cloud kitchen concept with very low initial investment and increasing focus on promotions and marketing.

Figure 18 F&B Sales Channel trend and forecast



Source: Statista, Al Rajhi Capital

Valuation: The company is currently trading at 38.1x FY2022e EPS of SAR4.57 which is expensive in our view. We value DWF using 50:50 weights given to DCF and EV/EBITDA based relative valuation. Our DCF based price based on 2% terminal growth and 7.92% WACC is ~SAR182 while relative valuation-based price on applying a target EV/EBITDA multiple of 16.8x to FY2023e EBITDA is SAR158. Thus, equal weighted target price stands at ~SAR170/sh which implies a 2% downside from CMP of SAR174/sh. We initiate coverage on DWF with "Neutral" rating.

Key Risks:

Key Upside risks to our valuations include:

1) If the company operates more than 20 stores each year in between 2021-2025e then it will have a positive impact on company's revenue and our valuation.

2) If the gross margins improve and go back to historical levels then it will have a significant upside risk on our valuation.

3) Higher than expected consumer spending and government spending augers well for the company's business and will have a positive risk to our valuation.

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