



US\$0.607bn Market cap
51.1% Free float
US\$0.737mn Avg. daily volume

Target price **89.40** 6.17% over current
 Consensus price **88.00** 4.5% over current
 Current price **84.25** as at 24/1/2011

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Underweight

Neutral

Overweight

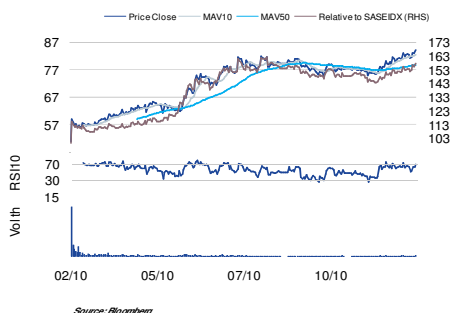
Key themes

We believe the fast food industry will continue to grow strongly. Herfy has a very strong position in the fast food market: it is currently the second just behind McDonalds. We think Herfy's strategy of opening 20 to 25 restaurants coupled with increasing production capacity in the bakery and meats divisions will allow the company to grow strongly.

Implications

Herfy is one of our preferred stocks in the agriculture & food sector. It is performing well operationally and offers growth in the near term at a reasonable valuation. We believe Herfy's handsome dividends coupled with decent transparency will continue to support Herfy's share price.

Performance

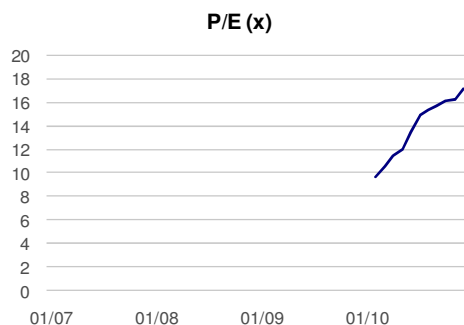


Earnings

Period End (SAR)	12/09A	12/10A	12/11E	12/12E
Revenue (mn)	518	580	649	724
Revenue Growth	11.0%	12.0%	11.9%	11.6%
EBITDA (mn)	145	160	181	203
EBITDA Growth	16.2%	9.9%	13.3%	12.0%
EPS	6.20	4.60	5.19	5.87
EPS Growth	-32.1%	-25.7%	12.8%	13.1%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Herfy

Q4: strong results with concerns

Herfy released Q4 results with robust year-on-year sales growth of 17% and net profit growth of 12%. Sales in two divisions, restaurants and meats, showed very strong growth of 20% and 50% respectively, with around 4% same store sales growth in the core restaurants division. The bakery and rusk divisions hinder sales growth, and we do not expect them to improve significantly in 2011. The gross margin improved in Q4, but was offset by increasing SG&A costs. Same store sales growth is decent but will require greater investment to accelerate. We expect 2011 to be good with slightly better margins. As the share price has recently rallied, we have lowered our rating to Neutral with a revised target price of SAR89.4.

Strong top line slightly above our estimates: Herfy reported sales growth of 16.5% from SAR129mn in Q4 2009 to SAR151mn in Q4 2010; this was above our forecast of 14.2% sales growth. The restaurants and meats divisions showed solid growth; bakery grew slightly while rusk sales continued to decline. As we had expected, the meats division showed the highest sales growth of 50%. Sales in the core restaurants division grew by 20%, better than our forecast of 17%. Although bakery sales grew by 2%, we are concerned that the company is losing market share to other rivals. We expect 2011 sales growth to be similar to that of 2010; however, the lower than expected sales in the rusk and bakery divisions may push Herfy's revenues below our forecast.

Decent same store sales growth: Herfy opened two new restaurants in Q4 to reach 172 restaurants by the end of 2010. On this basis, we estimate Herfy's same store sales (SSS) grew by 3.6% during Q4, higher than the level of about 3% in Q3. This acceleration in SSS growth can be mainly attributed to marketing activities despite their adverse impact on margins. We expect Herfy to open 20 stores during 2011 to reach 192 stores by the end of the year. Although the robust overall growth in the restaurants division, and the acceleration in SSS growth in particular, are encouraging, we believe that Herfy will have to improve the design of its stores to boost like-for-like sales further.

Strong gross margin but high SG&A costs: The gross margin improved considerably from 32.8% in Q4 2009 and the same level in Q3 2010 to 33.7% in Q4 2010. However, this improvement in gross margin was eroded by higher SG&A expenses. At this level, administrative and marketing costs comprise 12.3% of sales, higher than the level of 11.2% for the same period last year. Although we believe it will be difficult for Herfy to bring marketing costs back down to the 2009 level of 10.8%, we think the company will be able to reduce administrative costs as a proportion of sales during this year.

Valuation and conclusion: Herfy reported strong sales growth and respectable profits for Q4 2010. Net profit was depressed by higher marketing and administrative costs, but we expect it to improve in 2011. Although we like Q4 results, we are concerned about weak bakery sales. We have made slight changes to our forecasts, mainly on bakery sales. Therefore, we have set a new target price of SAR89.4 (old target price was SAR90.2). This implies 6% upside as the share price has recently rallied and so we rate the stock Neutral. Herfy stock is currently trading on a 2011 PE of 16.2x and an EV/EBITDA ratio of 12.6x.



Corporate summary

Herfy is a food services company that was founded in 1981 by Ahmed Alsaeed and Hamod Albrahim. The company's business includes four divisions: fast food chain, bakery, rusk (Shaborah), and meats. The fast food chain is the biggest division as it comprises about 77% of total revenues. Herfy has international business in the GCC and MENA regions through franchise and exports. The company was listed in February 2010.

Share information

Market cap (SAR/US\$) 2.275bn / 0.607bn
52-week range 51.00 - 84.25
Daily avg volume (US\$) 0.737mn
Shares outstanding 27.00mn
Free float (est) 51.1%

Performance:

	1M	3M	12M
Absolute	8%	8.4%	65.2%
Relative to index	6.3%	1.7%	58.5%

Major Shareholder:

Savola group	47.6%
Ahmed Hamad Mohammed Alsaeed	20.3%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/09A	12/10A	12/11E	12/12E
Revenue (SARmn)	518	580	649	724
EBITDA (SARmn)	145	160	181	203
Net Profit (SARmn)	115	124	140	159
EPS (SAR)	6.20	4.60	5.19	5.87
DPS (SAR)	2.97	2.98	2.98	3.28
EPS Growth	-32.1%	-25.7%	12.8%	13.1%
EV/EBITDA (x)	10.7	14.2	12.6	11.2
P/E (x)	13.6	18.3	16.2	14.3
P/B (x)	7.2	6.0	5.2	4.4
Dividend Yield	3.5%	3.5%	3.5%	3.9%

Source: Company data, Al Rajhi Capital

Herfy's Q4 results Slightly better than we had assumed

Q4 strong results offset Q3 weak results.

Herfy released Q4 results with strong year-on-year sales growth of 16.5% and good net profit growth of 11.8%. Sales in two divisions, restaurants and meats, showed robust growth of 20% and 50% respectively. The bakery division grew slightly, by 2.7%, while rusk sales continued to decline. Operating profit was marginally below our forecast as a result of higher SG&A costs; however, higher franchising income pushed net profit up slightly higher than we had expected.

Figure 1. Herfy: 2009Q4A vs. 2010Q4A vs. 2010Q4E & FY2009A vs. FY2010A

(SAR) mn	2009Q4A	2010Q4A	YOY % chg.	2010Q4E	FY2009A	FY2010A	YOY % chg.
Restaurants	99.2	119.6	20.6%	116.2	404.0	461.1	14.1%
Meats	3.7	5.6	50.0%	5.1	12.7	18.3	43.8%
Rusk	4.3	3.0	-30.0%	3.5	15.7	13.0	-17.0%
Bakery	22.5	23.0	2.3%	23.4	85.1	87.4	2.7%
Total Revenues	129.8	151.2	16.5%	148.2	517.6	579.9	12.0%
Gross Profit	42.6	50.9	19.5%	49.1	169.3	192.9	13.9%
	32.8%	33.7%		33.1%	32.7%	33.3%	
Operating Profit	28.1	32.3	14.9%	32.7	113.4	123.7	9.1%
Net Income	29.6	33.1	11.8%	32.6	114.6	124.3	8.5%

Source: Company data, Al Rajhi Capital

Bakery and Rusk weak sales are questionable

Bakery and rusk divisions: not encouraging

Bakery is the second largest division in Herfy in terms of sales value. The performance of this segment was mixed during 2010. It grew modestly during H1, declined sharply in Q3, and grew slightly (by 2.3%) in Q4. Over the year, the sales growth of this segment was weak at only 2.7%. We are concerned about this figure considering the company's plans to expand bakery production and considering that a new plant, with four times the current capacity, is under construction.

We believe that the weak growth bakery stems from intensifying competition in this industry. Pain D'Or, a new large bakery brand, entered the market recently. Pain D'Or owns one of the largest plants in the region. Almarai is investing heavily in its bakery division, Lusine. We think it will be difficult for Herfy to maintain strong growth in this segment, and therefore, have cut our sales forecasts for bakery category by 4%.

The rusk division's sales declined significantly in 2010 (by 17%). However, this segment is too small to impact the company's growth. Based on our discussions with Herfy, we do not see evidence of a clear plan to improve this segment. Thus, we do not expect to see much growth in rusk sales.



Restaurants division: strong outlook but requires more improvements

Herfy opened 20 stores in 2010; we expect it to open another 20 stores in 2011

As we had expected, Herfy opened 20 restaurants during 2010. We expect the company to open 20 stores in 2011 as well and 15 to 20 stores over the next three years. This should drive this division's growth and increase Herfy's geographic reach. We think that the market is large enough to absorb such expansion considering that the outskirts of large cities and smaller cities are still underserved, and that competition in these areas is low. We expect Herfy's number of restaurants to reach 238 by 2014.

Competition in the Saudi Fast Food Hamburger Restaurants (FFHR) is intensifying. Large chains such as McDonalds, Burger King, and Hardee's have started renovating their stores. Also, in Riyadh, the largest city in Saudi Arabia, many local grilled burger chains (which rely on fresh chilled meat as their raw material) chains are opening and there is a strong trend toward such meals among young Saudis.

Renovating old stores should help Herfy maintain its position

In view of the increasing competition, in addition to marketing activities, we think Herfy needs to renovate its old restaurants and improve home delivery and drive-through services in order to maintain its position in the market and accelerate same store sales growth. Herfy may also have to improve its menu and launch new items to catch up with current trends. Same store sales growth is currently running at 3 to 4%. Although this may look respectable, we think that Herfy ought to be achieving higher organic growth considering that the Saudi fast food market is still in a strong growth phase.

We expect restaurants and meats divisions to drive growth in 2011

Looking forward: similar top line with better profits

We expect Herfy's results in 2011 to show a very similar pattern to 2010. In terms of the top line, we expect Herfy to achieve 12% sales growth driven by the restaurants and meats divisions. We expect Herfy to achieve better net profit growth of 13% to reach SAR140mn driven by strong sales and lower SG&A costs. Note: the year 2010 included some fixed administration costs associated with the company's IPO.

Figure 2. Herfy: 2009Q4A vs. 2010Q4A vs. 2010Q4E & FY2009A vs. FY2010A

(SAR) mn	2010Q1A	2011Q1E	YOY % chg.	FY2010A	FY2011E	YOY % chg.
Restaurants	104.8	120.5	15.0%	461.1	522.0	13.2%
Meats	4.0	5.0	25.0%	18.3	23.5	28.4%
Rusk	4.4	4.4	0.0%	13.0	13.3	2.1%
Bakery	23.0	23.2	1.0%	87.4	90.1	3.1%
Total Revenues	136.2	153.1	12.4%	579.9	648.9	11.9%
Gross Profit	44.4	50.2	13.1%	192.9	216.3	12.1%
	32.6%	32.8%		33.3%	33.3%	
Operating Profit	28.6	32.3	12.9%	123.7	140.8	13.8%
Net Income	28.1	31.8	12.8%	124.3	140.2	12.8%

Source: Company data, Al Rajhi Capital



Income Statement (SARmn)	12/08A	12/09A	12/10A	12/11E	12/12E
Revenue	466	518	580	649	724
Cost of Goods Sold	(323)	(348)	(387)	(433)	(483)
Gross Profit	144	169	193	216	241
Government Charges					
S.G. & A. Costs	(48)	(56)	(69)	(75)	(83)
Operating EBIT	96	113	124	141	158
Cash Operating Costs	(342)	(372)	(420)	(468)	(522)
EBITDA	125	145	160	181	203
Depreciation and Amortisation	(29)	(32)	(36)	(40)	(45)
Operating Profit	96	113	124	141	158
Net financing income/(costs)	(2)	(1)	(0)	(1)	1
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	(2)	5	4	4	4
Other Expenses					
Net Profit Before Taxes	94	118	128	144	163
Taxes	(3)	(3)	(3)	(4)	(4)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	91	115	124	140	159
Dividends	-	(80)	(81)	(81)	(89)
Transfer to Capital Reserve					
	12/08A	12/09A	12/10A	12/11E	12/12E
Adjusted Shares Out (mn)	10.00	27.00	27.00	27.00	27.00
CFPS (SAR)	12.04	7.91	5.93	6.67	7.53
EPS (SAR)	9.13	6.20	4.60	5.19	5.87
DPS (SAR)	0.000	2.972	2.981	2.981	3.280
Growth	12/08A	12/09A	12/10A	12/11E	12/12E
Revenue Growth	24.4%	11.0%	12.0%	11.9%	11.6%
Gross Profit Growth	32.2%	17.6%	13.9%	12.1%	11.5%
EBITDA Growth	39.4%	16.2%	9.9%	13.3%	12.0%
Operating Profit Growth	46.8%	18.5%	9.1%	13.8%	12.1%
Net Profit Growth	48.2%	25.6%	8.4%	12.8%	13.1%
EPS Growth	-25.9%	-32.1%	-25.7%	12.8%	13.1%
Margins	12/08A	12/09A	12/10A	12/11E	12/12E
Gross profit margin	30.9%	32.7%	33.3%	33.3%	33.3%
EBITDA margin	26.8%	28.1%	27.5%	27.9%	28.0%
Operating Margin	20.5%	21.9%	21.3%	21.7%	21.8%
Pretax profit margin	20.2%	22.8%	22.0%	22.2%	22.4%
Net profit margin	19.6%	22.1%	21.4%	21.6%	21.9%
Other Ratios	12/08A	12/09A	12/10A	12/11E	12/12E
ROCE	34.2%	34.8%	30.8%	30.6%	29.6%
ROIC	34.0%	37.8%	36.0%	33.2%	32.5%
ROE	37.0%	39.6%	35.7%	34.2%	33.3%
Effective Tax Rate	3.2%	2.7%	2.7%	2.5%	2.5%
Capex/Sales	7.2%	16.4%	14.3%	16.3%	15.0%
Dividend Payout Ratio	0.0%	70.0%	64.8%	57.4%	55.9%
Valuation Measures	12/08A	12/09A	12/10A	12/11E	12/12E
P/E (x)	9.2	13.6	18.3	16.2	14.3
P/CF (x)	7.0	10.6	14.2	12.6	11.2
P/B (x)	3.2	7.2	6.0	5.2	4.4
EV/Sales (x)	1.8	3.0	3.9	3.5	3.1
EV/EBITDA (x)	6.8	10.7	14.2	12.6	11.2
EV/EBIT (x)	8.9	13.7	18.3	16.1	14.4
EV/IC (x)	2.9	6.8	5.5	4.8	4.2
Dividend Yield	0.0%	3.5%	3.5%	3.5%	3.9%

Source: Company data, Al Rajhi Capital

We expect EPS to grow in 2011 as a result of better margins

We expect revenues growth to remain above 11% over the next three years

Gross margin should remain at last year level of 33.3%

Herfy is not cheap anymore at EV/EBITDA and P/E of 12.6x and 16.2x



Herfy's balance sheet is expanding steadily

Balance Sheet (SARmn)	12/08A	12/09A	12/10A	12/11E	12/12E
Cash and Cash Equivalents	21	20	50	35	39
Current Receivables	14	20	24	26	27
Inventories	54	43	48	55	58
Other current assets	39	51	51	51	51
Total Current Assets	128	134	173	167	175
Fixed Assets	226	277	326	392	456
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	226	277	326	392	456
Total Assets	355	411	499	558	631
Short Term Debt	12	9	13	13	13
Accounts Payable	18	21	25	29	29
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	-	-	-
Other Current Liabilities	24	29	30	30	30
Total Current Liabilities	57	62	71	71	71
Long-Term Debt	18	9	21	21	21
Other LT Payables	-	-	-	-	-
Provisions	18	22	26	26	26
Total Non-current Liabilities	36	32	47	47	47
Minority interests	-	-	-	-	-
Paid-up share capital	100	270	270	270	270
Total Reserves	162	47	110	170	242
Total Shareholders' Equity	262	317	380	440	512
Total Equity	262	317	380	440	512
Total Liabilities & Shareholders' Equity	355	411	499	558	631

Gearing measures are still at low level

Ratios	12/08A	12/09A	12/10A	12/11E	12/12E
Net Debt (SARmn)	9	(2)	(16)	(1)	(5)
Net Debt/EBITDA (x)	0.07	(0.01)	(0.10)	(0.01)	(0.03)
Net Debt to Equity	3.3%	-0.6%	-4.2%	-0.3%	-1.1%
EBITDA Interest Cover (x)	75.6	145.6	345.3	165.6	(273.4)
BVPS (SAR)	26.21	11.73	14.08	16.29	18.96

Cashflow Statement (SARmn)	12/08A	12/09A	12/10A	12/11E	12/12E
Net Income before Tax & Minority Interest	94	118	128	144	163
Depreciation & Amortisation	29	32	36	40	45
Decrease in Working Capital	(19)	0	(3)	(8)	(4)
Other Operating Cashflow	3	6	1	(4)	(4)
Cashflow from Operations	107	156	162	172	199
Capital Expenditure	(34)	(85)	(83)	(106)	(109)
New Investments	-	-	-	-	-
Others	7	7	1	-	-
Cashflow from investing activities	(27)	(78)	(82)	(106)	(109)
Net Operating Cashflow	81	78	80	66	91
Dividends paid to ordinary shareholders	(60)	(60)	(122)	(81)	(87)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	-	(1)	-	-
Cashflow from financing activities	(72)	(72)	(98)	(81)	(87)
Total cash generated	9	6	(18)	(15)	4
Cash at beginning of period	20	21	20	50	35
Implied cash at end of year	29	27	2	35	39

We expect Capex to increase as a result of bakery and restaurants expansion plans

Ratios	12/08A	12/09A	12/10A	12/11E	12/12E
Capex/Sales	7.2%	16.4%	14.3%	16.3%	15.0%

Source: Company data, Al Rajhi Capital



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Additional disclosures

1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"**Overweight**": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"**Neutral**": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"**Underweight**": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"**Time horizon**": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"**Fair value**": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"**Target price**": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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