Herfy Food Services
Food & Agriculture Sector
HERFY AB: Saudi Arabia
19 April 2011

الراجحي المالية
Al Rajhi Capital

US$0.571bn	51.1%	US$2.004mn
Market cap	Free float	Avg. daily volume

Target price	91.70	15.7% over current
Consensus price	90.00	13.5% over current
Current price	79.25	as at 19/4/2011

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Underweight | Neutral | **Overweight**

Herfy
Q1: solid results

Herfy released Q1 results with robust year-on-year sales growth of 17% and remarkable net profit growth of 16%. Sales in two divisions, restaurants and meats, showed very strong growth of 19% and 56% respectively; with around 6% same store sales growth in the core restaurants division. The bakery and rusk divisions showed modest growth of 4% and 1% after struggling in the last two quarters of 2010. The gross margin decreased in Q1 as a result of increasing foods commodities prices, but was offset by declining SG&A costs. Despite the declining gross margin, the overall results were solid and above our expectation. In our view, the acceleration in same store sales and the recovery in bakery segment are extremely positive news. Therefore, we upgrade our rating to Overweight and set a new target price of SAR91.7.

Strong top line well above our estimates: Herfy reported sales growth of 16.9% from SAR136mn in Q1 2010 to SAR159mn in Q1 2011; this was above our forecast of 12.4% sales growth. The discrepancy can be explained by the acceleration in restaurants like-for-like sales growth. The restaurants and meats divisions showed solid growth; bakery and rusk grew slightly by 4% and 1%. As we had expected, the meats division showed the highest sales growth of 57% driven by the plant capacity expansion and the launch of new products. Sales in the core restaurants division grew by 19%, better than our forecast of 15%. Although bakery sales grew by 4%, we need to watch Q2 bakery sales to make sure it has recovered. We expect Q2 sales growth of roughly 12.6%.

Remarkable same store sales growth: Herfy opened three new restaurants in Q3 to reach 173 restaurants (two restaurants are currently under maintenance). On this basis, we estimate Herfy's same store sales (SSS) grew by 6% during Q1, higher than the level of about 3-4% in 2010. This acceleration in SSS growth can be mainly attributed to marketing activities and consumer's spending appetite as a result of the declared two salary bonus by the government and many private entities. We believe that the impact of this bonus will boost SSS growth in Q2 as well. We expect Herfy to open 7 new stores during Q2 2011 to reach 180 stores.

Modest gross margin offset by low SG&A costs: The gross margin declined considerably from 32.6% in Q1 2010 to 31.8% in Q1 2011. However, this decline in gross margin was offset by lower than expected SG&A expenses. At this level, administrative and marketing costs comprise 11.1% of sales, lower than the level of 11.6% for the same period last year. Although we believe it will be difficult for Herfy to improve its gross margin to the 2010 level of 33.3% due to increasing food commodities prices, we think the company will be able to maintain its administrative costs as a proportion of sales close to the first quarter level.

Valuation and conclusion: Herfy reported strong sales and profit growth for Q1 2011. Although we are concerned about declining gross margin, the overall results were solid and above our expectation. In our view, the acceleration in same store sales and the recovery in bakery segment are extremely positive news. We have made slight changes to our forecasts. Therefore, we have set a new target price of SAR91.7 (old target price was SAR89.4). This implies 16% upside as the share price has recently fallen and so we rate the stock Overweight. Herfy stock is currently trading on a 2011 PE of 15.3x and an EV/EBITDA ratio of 11.9x.

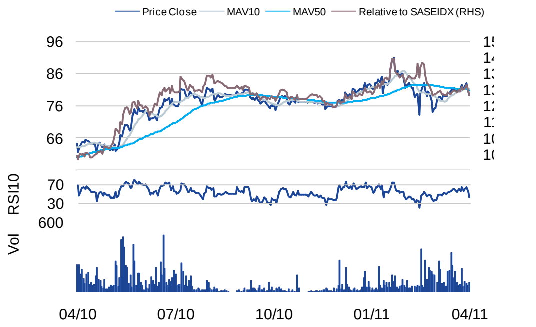
Key themes

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



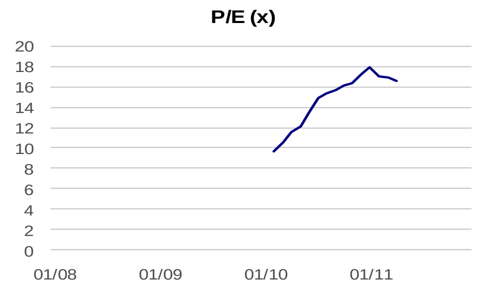
Source: Bloomberg

Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	580	658	742	824
Revenue Growth	12.0%	13.5%	12.7%	11.0%
EBITDA (mn)	160	180	205	227
EBITDA Growth	9.9%	13.1%	13.5%	11.1%
EPS	4.60	5.17	5.85	6.58
EPS Growth	-25.7%	12.4%	13.1%	12.5%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

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$)	2.140bn / 0.571bn
52-week range	61.50 - 90.75
Daily avg volume (US$)	2.004mn
Shares outstanding	27.00mn
Free float (est)	51.1%

Performance:	1M	3M	12M
Absolute	5.3%	-2.5%	25.8%
Relative to index	-2.3%	0.2%	30.4%

Major Shareholder:	
Savola group	47.6%
Ahmed Hamad Mohammed Alsaeed	20.3%

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	580	658	742	824
EBITDA (SARmn)	160	180	205	227
Net Profit (SARmn)	124	140	158	178
EPS (SAR)	4.60	5.17	5.85	6.58
DPS (SAR)	2.98	2.98	3.28	3.62
EPS Growth	-25.7%	12.4%	13.1%	12.5%
EV/EBITDA (x)	13.4	11.9	10.5	9.4
P/E (x)	17.2	15.3	13.5	12.0
P/B (x)	5.6	4.5	3.9	3.4
Dividend Yield	3.8%	3.8%	4.1%	4.6%

Source: Company data, Al Rajhi Capital

Below we summarize sales breakdown and profits for Q1 and Q2 2011 and 2010 (our estimate versus actual results).

Figure 1. Herfy: 2010Q1A vs. 2011Q1E vs. 2011Q1A & 2010Q2A vs. 2011Q2E

(SAR) mn	2010Q1A	2011Q1E	2011Q1A	YOY % chg.	2010Q2A	2011Q2E	YOY % chg.
Restaurants	104.8	120.5	124.6	18.9%	115.8	131.1	13.2%
Meats	4.0	5.0	6.3	55.9%	4.4	6.4	45.0%
Rusk	4.4	4.4	4.4	1.4%	3.4	3.5	3.9%
Bakery	23.0	23.2	23.9	4.0%	23.1	24.3	5.0%
Total Revenues	**136.2**	**153.1**	**159.2**	**16.9%**	**146.7**	**165.3**	**12.6%**
Gross Profit	44.4	50.2	50.6	14.0%	49.8	54.9	10.1%
	32.6%	32.8%	31.8%		34.0%	33.2%	
Operating Profit	**28.6**	**32.3**	**32.9**	**15.0%**	**32.0**	**35.7**	**11.6%**
Net Income	**28.1**	**31.8**	**32.5**	**15.5%**	**32.6**	**36.1**	**10.6%**

Source: Company data, Al Rajhi Capital

We expect revenues to reach SAR658mn by the end of 2011

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	**518**	**580**	**658**	**742**	**824**
Cost of Goods Sold	(348)	(387)	(443)	(498)	(552)
Gross Profit	**169**	**193**	**216**	**244**	**272**
Government Charges					
S.G. & A. Costs	(56)	(69)	(76)	(85)	(95)
Operating EBIT	**113**	**124**	**140**	**159**	**177**
Cash Operating Costs	(372)	(420)	(478)	(538)	(596)
EBITDA	145	160	180	205	227
Depreciation and Amortisation	(32)	(36)	(41)	(46)	(50)
Operating Profit	**113**	**124**	**140**	**159**	**177**
Net financing income/(costs)	(1)	(0)	(1)	(1)	1
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	5	4	4	4	4
Other Expenses					
Net Profit Before Taxes	**118**	**128**	**143**	**162**	**182**
Taxes	(3)	(3)	(4)	(4)	(5)
Minority Interests	-	-	-	-	-
Net profit available to shareholders	**115**	**124**	**140**	**158**	**178**
Dividends	(80)	(81)	(81)	(89)	(98)
Transfer to Capital Reserve					

	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	27.00	27.00	27.00	27.00	27.00
CFPS (SAR)	7.91	5.93	6.68	7.55	8.45
EPS (SAR)	6.20	4.60	5.17	5.85	6.58
DPS (SAR)	2.972	2.981	2.981	3.280	3.622

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

Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	11.0%	12.0%	13.5%	12.7%	11.0%
Gross Profit Growth	17.6%	13.9%	11.8%	13.1%	11.4%
EBITDA Growth	16.2%	9.9%	13.1%	13.5%	11.1%
Operating Profit Growth	18.5%	9.1%	12.9%	13.7%	11.5%
Net Profit Growth	25.6%	8.4%	12.4%	13.1%	12.5%
EPS Growth	-32.1%	-25.7%	12.4%	13.1%	12.5%

Gross margin should remain close to last year level despite increasing costs

Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	32.7%	33.3%	32.8%	32.9%	33.0%
EBITDA margin	28.1%	27.5%	27.4%	27.6%	27.6%
Operating Margin	21.9%	21.3%	21.2%	21.4%	21.5%
Pretax profit margin	22.8%	22.0%	21.8%	21.8%	22.1%
Net profit margin	22.1%	21.4%	21.2%	21.3%	21.6%

Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	34.8%	30.8%	28.0%	27.7%	27.0%
ROIC	40.8%	38.2%	37.4%	32.9%	31.7%
ROE	39.6%	35.7%	32.5%	30.6%	29.9%
Effective Tax Rate	2.7%	2.7%	2.5%	2.5%	2.5%
Capex/Sales	16.4%	14.3%	16.0%	14.8%	15.0%
Dividend Payout Ratio	70.0%	64.8%	57.6%	56.0%	55.0%

Herfy is trading on a P/E of 15.3x and EV/EBITDA 11.9x

Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	12.8	17.2	15.3	13.5	12.0
P/CF (x)	10.0	13.4	11.9	10.5	9.4
P/B (x)	6.8	5.6	4.5	3.9	3.4
EV/Sales (x)	2.8	3.7	3.2	2.9	2.6
EV/EBITDA (x)	10.1	13.4	11.9	10.5	9.4
EV/EBIT (x)	12.9	17.3	15.3	13.5	12.1
EV/IC (x)	6.8	5.9	4.5	3.9	3.4
Dividend Yield	3.8%	3.8%	3.8%	4.1%	4.6%

Source: Company data, Al Rajhi Capital

Herfy's balance sheet is expanding steadily

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	20	50	43	44	48
Current Receivables	20	24	26	28	30
Inventories	43	48	55	60	66
Other current assets	51	51	50	50	50
Total Current Assets	**134**	**173**	**173**	**182**	**193**
Fixed Assets	277	326	390	454	527
Investments	-	-	-	-	-
Goodwill	-	-	-	-	-
Other Intangible Assets	-	-	-	-	-
Total Other Assets	-	-	-	-	-
Total Non-current Assets	**277**	**326**	**390**	**454**	**527**
Total Assets	**411**	**499**	**564**	**636**	**721**
Short Term Debt	9	13	15	15	15
Accounts Payable	21	25	29	31	33
Accrued Expenses	-	-	-	-	-
Dividends Payable	-	-	(41)	(41)	(41)
Other Current Liabilities	29	30	30	30	30
Total Current Liabilities	**62**	**71**	**38**	**36**	**38**
Long-Term Debt	9	21	18	19	19
Other LT Payables	-	-	-	-	-
Provisions	22	26	27	27	27
Total Non-current Liabilities	**32**	**47**	**46**	**47**	**47**
Minority interests	-	-	-	-	-
Paid-up share capital	270	270	270	270	270
Total Reserves	47	110	210	283	366
Total Shareholders' Equity	**317**	**380**	**480**	**553**	**636**
Total Equity	**317**	**380**	**480**	**553**	**636**
Total Liabilities & Shareholders' Equity	**411**	**499**	**564**	**636**	**721**

Gearing measures are still at low level

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	(2)	(16)	(9)	(9)	(13)
Net Debt/EBITDA (x)	(0.01)	(0.10)	(0.05)	(0.04)	(0.06)
Net Debt to Equity	-0.6%	-4.2%	-1.9%	-1.6%	-2.0%
EBITDA Interest Cover (x)	145.6	345.3	211.4	219.0	(199.4)
BVPS (SAR)	11.73	14.08	17.77	20.50	23.55

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	**118**	**128**	**143**	**162**	**182**
Depreciation & Amortisation	32	36	41	46	50
Decrease in Working Capital	0	(3)	(3)	(10)	(5)
Other Operating Cashflow	6	1	(3)	(4)	(5)
Cashflow from Operations	**156**	**162**	**178**	**194**	**223**
Capital Expenditure	(85)	(83)	(105)	(110)	(124)
New Investments	-	-	-	-	-
Others	7	1	0	-	-
Cashflow from investing activities	**(78)**	**(82)**	**(105)**	**(110)**	**(124)**
Net Operating Cashflow	**78**	**80**	**73**	**85**	**99**
Dividends paid to ordinary shareholders	(60)	(61)	(81)	(85)	(95)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	-	(8)	-	-	-
Cashflow from financing activities	**(72)**	**(45)**	**(81)**	**(84)**	**(95)**
Total cash generated	6	35	(7)	1	4
Cash at beginning of period	21	20	50	43	44
Implied cash at end of year	**27**	**55**	**43**	**44**	**48**

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

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	16.4%	14.3%	16.0%	14.8%	15.0%

Source: Company data, Al Rajhi Capital

Disclaimer and additional disclosures for Equity Research

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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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