



US\$0.628bn Market cap
31.83% Free float
US\$0.874mn Avg. daily volume

Target price **36.00** 1.1% under current
 Current price **36.40** as at 15/1/2023

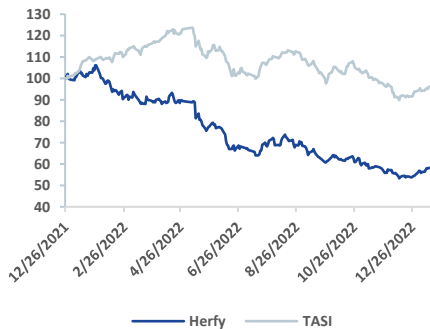
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Existing rating

Underweight **Neutral** **Overweight**

Performance



Earnings

Period End (SAR)	2021	2022E	2023E
Revenue (mn)	1,314	1,249	1,340
Revenue growth	22%	-5%	7%
EBITDA (mn)	328	244	293
EBITDA growth	31%	-26%	20%
Net Profit	161	89	128
Net Profit Margin	12%	7%	10%
EPS	2.49	1.38	1.98
EPS growth	204%	-45%	44%
DPS	0	0	1
ROE	15%	8%	11%

Source: Company data, Al Rajhi Capital

Herfy Foods

High competition coupled with higher inflation. We lower our TP to SAR36/sh with a neutral rating.

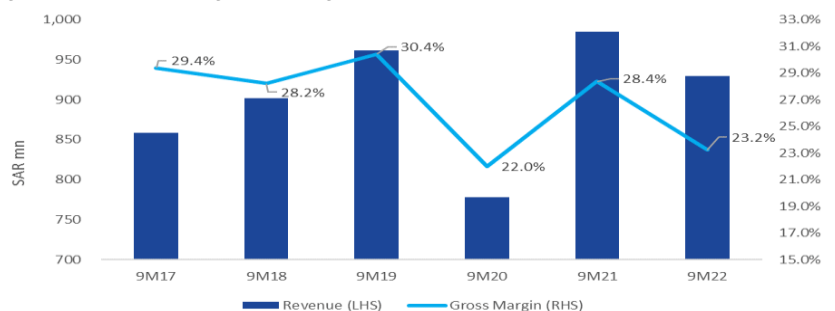
Market and Competitive landscape:

The structural changes in the restaurants sector was not in the favour of Herfy, the traditional retailer with the concept of open as many stores to reach as many customers. The recent time has been difficult for the restaurants as many of the key input prices were shooting up, pressuring the restaurants profitability. Herfy was not an exception as it also suffered the increase in prices, competition and the unfavourable structural changes. The company's sales (y-o-y) fell by -5.6% for the 9M22 period as a result of increase in competition. In the same time, gross margin dropped to 23.2% from 28.4% last year (515bps variance) mainly due to the increase in key main inputs. Until now, there is no sign of improvement in margins which we believe is a temporary until the prices of raw material starts declining. In addition, we believe it might be challenging to restore the company's historical average gross margin of around 29.5% for a number of reasons 1) indirect competition arising from delivery apps as distance is not an issue anymore and people ordering from different restaurants 2) the effect of inflation on customers purchasing power, driving customers to go for orders thus, pressuring margins 3) the competition arising as many restaurants are fighting to maintain their market share. As such, we revise our recommendation for Herfy from previous TP of SAR46/sh to SAR36/sh and maintain a neutral rating. That translates to a 1.1% downside from the current market price of SAR36.4/sh.

Herfy performance:

The company went through many cycles and were able to recover. Figure 1 below illustrates the movement of the company's revenue and gross margin for nine months period of the last 6 years. The company were able to sustain margins during 2017 to 2019. In 2020, as many companies, Herfy suffered from Covid19. In 2021, the company recovered its Margin level with strong sales recovery too. In 2022, as cost were rising margins dropped to 23.2% as at the end of 3Q22. We expect herfy to improve performance in 2023 as the company either reprice or improve its offering mix, and benefit from the expected decline in the raw material prices.

Figure 1: Revenue vs gross margin





Valuation and risks: We arrived at our target price for the company using an equal mix of DCF and P/E. The DCF target price is based on a 2% terminal growth and a WACC of 9.2%, leads to SAR38/share. The P/E is based on 17x translates to a SAR34/share. Overall, we change our target price to SAR36/share. Based on our TP, we have a neutral rating. Upside risks to our valuation are, decrease in competition, lower than expected capex spends, better than expected improvement in margins, decrease in input costs. Downside risks are Continued increase from either competition or inflation, Higher operating expense, pressuring operating profit.



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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.

"Target price": We estimate target 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.

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