MACRO OPS

RESEARCH

07/25/2020: Hello Fresh (HFG.F)

Business Description: HelloFresh SE delivers meal kit solutions to prepare home-cooked meals using its [proprietary] recipes. - *TIKR.com*

Thesis: Hello Fresh (HFG) is the leader in the meal delivery business and rapidly taking share in a largely underpenetrated market. COVID-19 pulled forward the likely inevitable shift from offline to online grocery shopping and meal preparation. HFG survived the hyper-competitive period between 2014 - 2017 and now dominates its market, taking 90% market share internationally and 50% in the US. The company serves over 4M hungry customers. HFG is in the *early innings* of its profitability stage. **We believe HFG can generate over 2.5B euros in FCF over the next five years and command a >10B euro market cap (80 euro/share).**

Barriers to Entry/Scale: HFG survived the 2014-2017 era for two reasons: investment in manufacturing and advertising. The company spent $130M in investment capex and over $500M in marketing/advertising investment during the last eight years. That investment is hard for competitors *just now* entering the space to challenge. This increases average order value (increased meal choices & faster delivery times) allowing them to invest **more** money in marketing, manufacturing and reducing customer acquisition costs.

Online Grocers Gaining Share: Currently a mere 6% of home-cooked dinners are purchased online in the US. It's even less in Europe (2%). According to Nielsen, online meal prep will account for 20% of home-cooked meals in the US and 10% in Europe. That's a 3x increase over the next five years.

Strong Unit Economics: HFG's unit economics are the most exciting aspect of their business. The company's first box delivered is a loss maker (roughly -10% contribution margin). This makes sense as they offer heavy discounts to incentivize customers. Discounts reduce with each additional box shipped, and the company generates positive margin on just their *second* box. **By the 11th box, the company generates 40%+ contribution margin.** HFG customers don't *churn* in the normal sense. They either opt-in or opt-out depending on the week and delivery schedule. Reactivating a customer is **much** cheaper than finding new ones (read: lower marketing spend).

Customer Flywheel: Like the unit economics suggest, more mature markets capture higher margins. This is important as HFG expands into different regions. These new regions are a drag on overall profitability for ~3 years. But every year the high-margin customer pool grows. This further reduces the need for marketing/ad spend, which increases EBIT margins. Also, the larger the customers, the more data HFG has to calculate when/how much the average customer orders. It also allows them to negotiate lower prices with suppliers, further reducing costs (raising margins).

Valuation: HFG's grown top-line revenue 40%+ over five years (66% QoQ). They generated 9% EBITDA margins last quarter and are revising revenue growth/margins up. We think they can generate 12% EBIT margins by 2024 and 30% average annual growth. This gives us 6.67B euro in revenue and ~800M in FCF. An 18x 2024 EBIT multiple gets us 14.4B EV and $14.64B shareholder value (81euro/share). Link for worksheet.

Risks: Customer retention/churn, uncertain user habits, failed growth ex-core markets, core market saturation

Chart Analysis: Hello Fresh SE (HFG.F)