Sponsored Research

Famous Brands

ANCHOR STOCKBROKERS

A taste of normality, finally

- Famous Brands (FBR) is the largest casual dining and quick service restaurant (QSR) franchisor in Africa. Operating through 17 brands it has 2850 restaurants across SA, Africa and the Middle East (AME) and the UK. It's a vertically integrated business with its franchisees serviced by its ingredients manufacturing business and its logistics operation.
- 87% of stores are in SA, contributing 93% of revenue. Post the liquidation of GBK, the UK is 2% of revenue. AME presents an opportunity for the group given the higher growth prospects in these countries as their QSR markets are less developed, home delivery gains traction and their GDP prospects are better than SA.
- As GBK was exited, COVID-19 posed a new and greater challenge, impacting hospitality severely. A net 62 stores were closed/sold in FY21 with a net 68 added back in FY22 and 1H23. Increased franchisee support was necessary, impacting royalty revenues, and capacity utilisation of its supply chain declined. Revenues have bounced back to pre-COVID-19 levels with the support of higher food inflation, but volumes still lag behind in certain segments.
- FBR dominates the SA burger and pizza market - the latter being the fastest growing SA category. Debonairs has 165% more stores than its next competitor. However, FBR is poorly represented in the chicken segment, the dominant QSR category in SA. Attractive and appropriate acquisitions are being sought across all geographies. We estimate the balance sheet can accommodate up to a R700m acquisition.
- FBR has numerous revenue streams. It manufactures and delivers ingredients to its franchisees at market related rates and collects royalties on menu sales. It also operates 79 (only 2.8% of restaurants) company owned stores, mainly in AME. Its revenue is driven by the demand for its menus and therefore it needs to deliver a competitive, quality and well-priced product, a process it oversees. Food inflation, economic growth and store rollouts are key revenue drivers.
- Margins are expected to widen from depressed levels as the operating environment normalises and franchisee support (royalty breaks) declines – SA EBIT margins were 10.1% in FY22 vs 14% in FY20. In line with managements' outlook, we forecast a consistent recovery in margins over the medium term, albeit to levels lower than previously achieved and indicated by management.
- We anticipate a sharp recovery in HEPS, +29% in FY23E and 19% in FY24E. Our HEPS forecast of ZAR4.60 in FY23E is still below FY16 (pre GBK) of ZAR5.41, with 9% more stores, reflecting a cautious outlook given the difficult operating environment. GBK impairments resulted in the FY22 NAV per share being 54% lower than FY16. We forecast the NAV per share to double by FY25E. Strong cash generation has reduced net debt from R2.6bn in FY17 to R0.8bn in 1H23 and has facilitated the resumption of dividends.
- FBR is trading on a forward 18m P/E of 11.3x and an EV/EBITDA of 6.8x, well below its historic levels and those of global peers. In our DFCF valuation we calculate a fair value range of R73.27-R95.03, a mid-point of R82.69, implying a fwd. fair P/E of 18x.The stock is on a 18m fwd. dividend yield of 6.2%

ZAR'm (to February)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	4,684	6,476	7,453	8,034	8,602
EBITDA	481	851	1,036	1,081	1,200
Headline earnings	-87	357	461	550	649
HEPS (ZAc)	-87	356	460	548	647
PE Ratio	-53.1	17.4	13.5	11.3	9.6
Dividend (ZAc)	0	200	276	384	485
Dividend yield	0.0%	3.2%	4.5%	6.2%	7.8%

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Price (18/11/2022):	R61.90
Market cap	R6204mn
Shares in issue	100.2mn

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Price performance - ZAR

Source: FactSet

Figure 1 Financial Summary

Year Ending	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023E	FY2024E	FY2025E
Income Statement								
Sales	7,023	7,725	6,495	4,684	6,476	7,453	8,034	8,602
Sales growth (%)	*22.8%*	*10.0%*	*-15.9%*	*-27.9%*	*38.3%*	*15.1%*	*7.8%*	*7.1%*
EBITDA	1,093.1	1,069.4	1,079.8	481.2	850.7	1,036.4	1,081.2	1,200.3
EBITDA Margin (%)	*15.6%*	*13.8%*	*16.6%*	*10.3%*	*13.1%*	*13.9%*	*13.5%*	*14.0%*
EBIT	517.7	-69.7	912.1	119.2	629.5	823.0	884.8	994.5
EBIT Margin (%)	*7.4%*	*-0.9%*	*14.0%*	*2.5%*	*9.7%*	*11.0%*	*11.0%*	*11.6%*
Profit before tax	270.2	-293.2	753.0	-69.6	514.0	755.7	818.0	953.8
Net profit	63.3	-426.3	532.8	-104.9	355.4	540.3	584.9	686.7
Net profit post minorities	21.6	-483.5	362.4	-1,239.1	317.6	505.2	549.8	649.0
Recurring EBITDA	1,093.1	1,069.4	1,079.8	481.2	850.7	961.7	1,081.2	1,200.3
Recurring EBITDA Margin (%)	*15.6%*	*13.8%*	*16.6%*	*10.3%*	*13.1%*	*12.9%*	*13.5%*	*14.0%*
Recurring EBIT	890.3	846.9	912.1	294.7	654.6	778.9	884.8	994.5
Recurring EBIT Margin (%)	*12.7%*	*11.0%*	*14.0%*	*6.3%*	*10.1%*	*10.5%*	*11.0%*	*11.6%*
Headline earnings	393.0	316.1	417.4	-86.8	356.8	460.9	549.8	649.0
Underlying Net profit margin (%)	*5.6%*	*4.1%*	*6.4%*	*-1.9%*	*5.5%*	*6.2%*	*6.8%*	*7.5%*
Reported EPS (ZAR)	0.22	-4.82	3.61	-12.34	3.17	5.04	5.48	6.47
HEPS (ZAR)	3.94	3.16	4.17	-0.87	3.56	4.60	5.48	6.47
EPS Growth	*-8.0%*	*-19.7%*	*31.9%*	*-120.8%*	*-511.0%*	*29.1%*	*19.2%*	*18.0%*
DPS (ZAR)	0.00	1.00	0.90	0.00	2.00	2.76	3.84	4.85
Payout ratio (%)	*0.0%*	*31.6%*	*21.6%*	*0.0%*	*56.2%*	*60.0%*	*70.0%*	*75.0%*
Balance Sheet								
Cash and Cash equivalents	717.0	453.8	486.3	444.4	456.2	443.4	467.7	525.2
Current asset (ex – all cash)	1,205.7	1,170.8	1,046.0	856.2	878.6	1,024.4	1,072.8	1,141.6
Net Fixed assets	1,339.8	1,048.5	2,226.8	667.1	640.4	693.5	728.5	675.0
Intangible assets	2,547.8	2,179.8	2,274.9	917.5	871.6	848.7	866.5	886.1
Investments	80.9	57.2	62.3	21.7	9.4	17.3	32.7	49.6
Other assets	14.6	49.9	77.0	86.4	103.4	121.7	127.8	134.2
Total assets	**5,905.8**	**4,959.9**	**6,173.3**	**2,993.3**	**2,959.6**	**3,149.2**	**3,296.0**	**3,411.8**
Debt excl lease liabilities	2,788.3	2,116.2	1,678.0	1,470.7	1,138.2	942.8	742.8	542.8
Lease liabilities	97.5	69.0	1,383.2	345.0	321.3	334.4	347.8	361.7
Current liabilities	973.4	922.4	993.4	700.9	698.6	875.0	948.9	1,003.6
Other liabilities	414.6	324.8	318.1	85.8	81.0	81.0	85.1	89.3
Total liabilities	**4,273.8**	**3,432.4**	**4,372.7**	**2,602.4**	**2,239.1**	**2,233.3**	**2,124.6**	**1,997.4**
Shareholders' equity	1,505.6	1,413.8	1,680.0	269.5	601.2	781.0	1,004.2	1,212.3
Minorities	126.4	113.7	120.3	121.2	119.3	137.0	172.1	209.9
Total shareholders' equity	**1,632.0**	**1,527.5**	**1,800.3**	**390.7**	**720.5**	**918.0**	**1,176.4**	**1,422.2**
BVPS (ZAR)	*16.3*	*15.3*	*18.0*	*3.9*	*7.2*	*9.2*	*11.7*	*14.1*
ROE (%)	*25.2%*	*20.0%*	*25.1%*	*-7.9%*	*64.2%*	*56.3%*	*52.5%*	*49.9%*
Debt ex leases								
Debt: Ebitda	*2.6*	*2.0*	*1.6*	*3.1*	*1.3*	*1.0*	*0.7*	*0.5*
Interest Cover	*3.6*	*3.7*	*5.1*	*2.5*	*6.8*	*8.2*	*10.6*	*15.7*

Year Ending	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023E	FY2024E	FY2025E
Cash Flow								
Reported net profit	**21.6**	**-483.5**	**362.4**	**-1,239.1**	**317.6**	**505.2**	**549.8**	**649.0**
Change in net working capital	-12.2	-22.3	111.9	41.7	-47.0	21.4	25.5	-14.1
Other adjustments	631.7	1,143.6	466.8	1,487.6	306.0	246.9	220.6	231.3
Dividends paid	-17.2	-73.4	-249.1	-5.5	-43.9	-350.9	-326.6	-440.9
Cash flow from operations	**623.9**	**564.4**	**692.0**	**284.7**	**532.7**	**422.6**	**469.3**	**425.2**
Net Capex	-201.9	-93.5	-148.6	-68.8	-126.1	-193.8	-249.1	-172.0
Capex/sales (%)	*2.9%*	*1.2%*	*2.3%*	*1.5%*	*1.9%*	*2.6%*	*3.1%*	*2.0%*
Other investing cash flows	0.6	4.3	32.6	12.0	8.6	-9.7	0.0	0.0
Cash flow from investing	**-201.4**	**-89.2**	**-116.0**	**-56.8**	**-117.5**	**-203.5**	**-249.1**	**-172.0**
Equity raised/(bought back)	13.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net inc/(dec) in borrowings	-106.7	-732.8	-430.0	-188.3	-332.7	-200.0	-200.0	-200.0
Other financing cash flows	-14.6	-27.4	-123.8	-134.2	-100.2	-33.7	4.1	4.3
Cash flow from financing	**-107.7**	**-760.2**	**-553.8**	**-322.5**	**-432.9**	**-233.7**	**-196.0**	**-195.7**
Net cash flow	**311.6**	**-264.8**	**31.7**	**-94.6**	**-18.6**	**-15.0**	**24.3**	**57.4**
Free cash flow	**672.0**	**820.5**	**822.9**	**418.8**	**519.0**	**648.7**	**624.5**	**747.1**
Lease payments	**0.0**	**0.0**	**-123.4**	**-73.5**	**-77.8**	**-81.7**	**-85.8**	**-90.1**
Net free cash flow	**672.0**	**820.5**	**699.5**	**345.3**	**441.2**	**567.0**	**538.7**	**657.0**
ValuationSummary								
Share Price (ZAR)	122.50	87.10	53.60	46.03	61.90	61.90	61.90	61.90
P/E (Underlying) (x)	31.1	17.0	12.9	-53.1	17.4	13.5	11.3	9.6
P/BV (x)	7.5	5.7	3.0	11.8	8.6	6.8	5.3	4.4
EV/EBITDA (x)	7.2	7.3	7.2	16.3	8.6	7.1	6.8	6.5
EV/EBIT (x)	15.1	-112.2	8.6	65.6	11.6	8.9	8.3	7.3
Dividend Yield (%)	0.0%	1.1%	1.7%	0.0%	3.2%	4.5%	6.2%	10.6%
FCF Yield (%)	10.2%	12.5%	10.6%	5.3%	7.1%	9.1%	8.7%	7.8%
Net Debt	2,169	1,731	2,575	1,371	1,003	834	623	379
Debt/Equity	1.33	1.13	1.43	3.51	1.39	0.91	0.53	0.27
Net Debt (excl lease liabilities)	2,071	1,662	1,192	1,026	682	499	275	18
Debt/Equity (excl lease liabilities)	1.27	1.09	0.66	2.63	0.95	0.54	0.23	0.01

Notes:

GBK treated as a discontinued operation in FY21 and FY20 but included in HEPS

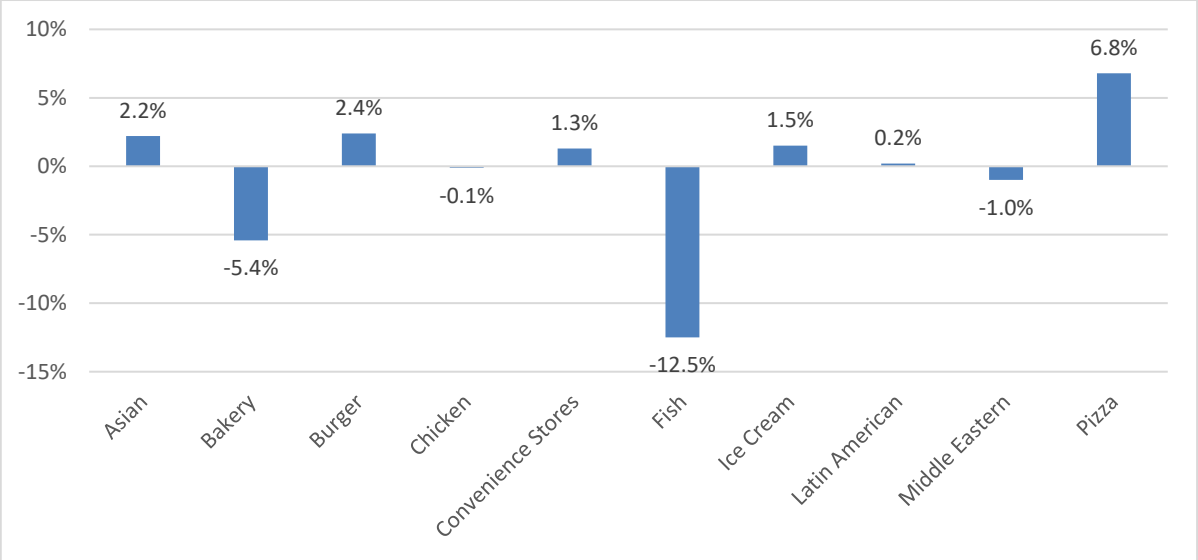
Source: Company data, FactSet, ASB Research

Overview of the SA casual dining and fast food industry

While Famous Brands (FBR) also operates bespoke casual dining offerings, through its Signature Brands portfolio, the bulk of its stores/restaurants (95%) and revenue originates from Casual Dining Restaurants (CDR) and Quick Service Restaurants (QSR), in its Leading Brands portfolio. This is a very competitive market dominated by local and global franchise chains with FBR being the largest franchisor by store size in SA. Within the space, chicken outlets dominate (Euromonitor estimates a 45% market share based on sales), followed by burgers (circa 27%) and pizza. FBR has its dominance in the latter two categories, chicken presenting an opportunity for future growth, however, it will require an acquisition of a well-established sizeable operator.

Research by Euromonitor in 2019 estimated the industry sales at R42.5bn, a level we believe it is currently still likely to be at given COVID-19 disruptions. Independent operators account for approximately 25% of the market, the rest belonging to franchise chains. Euromonitor segments the market into Asian, Bakery products, Burger, Chicken, Convenience Store, Fish, Ice Cream, Latin American, Middle Eastern, Pizza and other.

Figure 2 5-yr CAGR revenue growth rates to 2019 – 0.3% on average

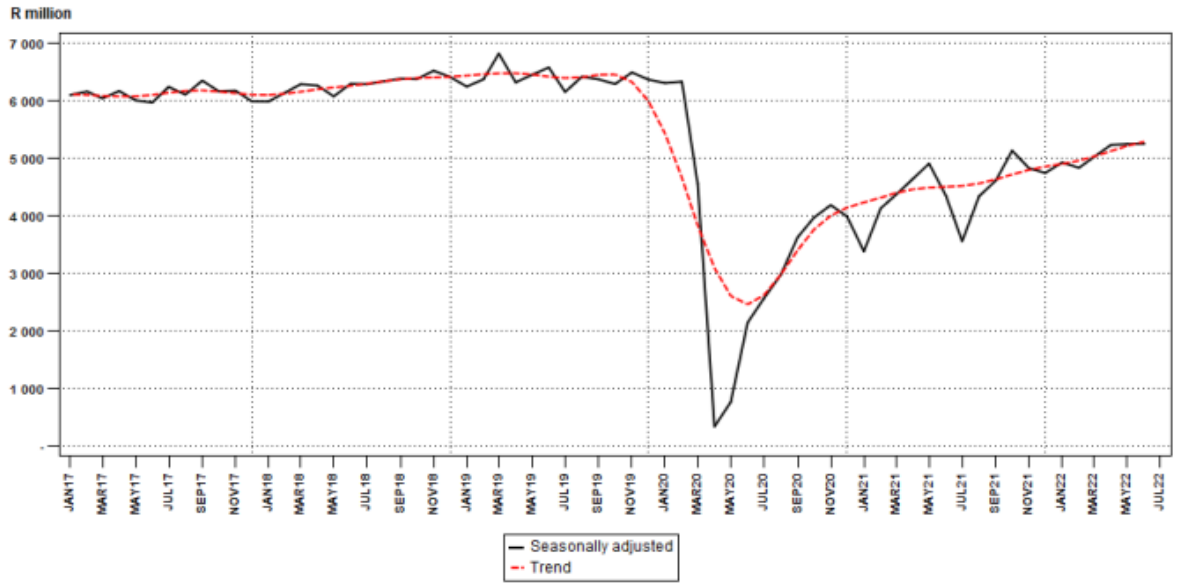


Source: Euromonitor, ASB Research

Research by Euromonitor shows that in SA the strongest growth food sector in QSR is Pizza, a 5 yr. CAGR of 6.8%, whilst the Fish sector has declined the most at 12.5%. There remains positive growth in Burgers, but Chicken has remained relatively flat. FBR has been better positioned as it dominates Pizza and Burgers. Debonairs has the biggest store roll out within the FBR group confirming the growth prospects for pizza.

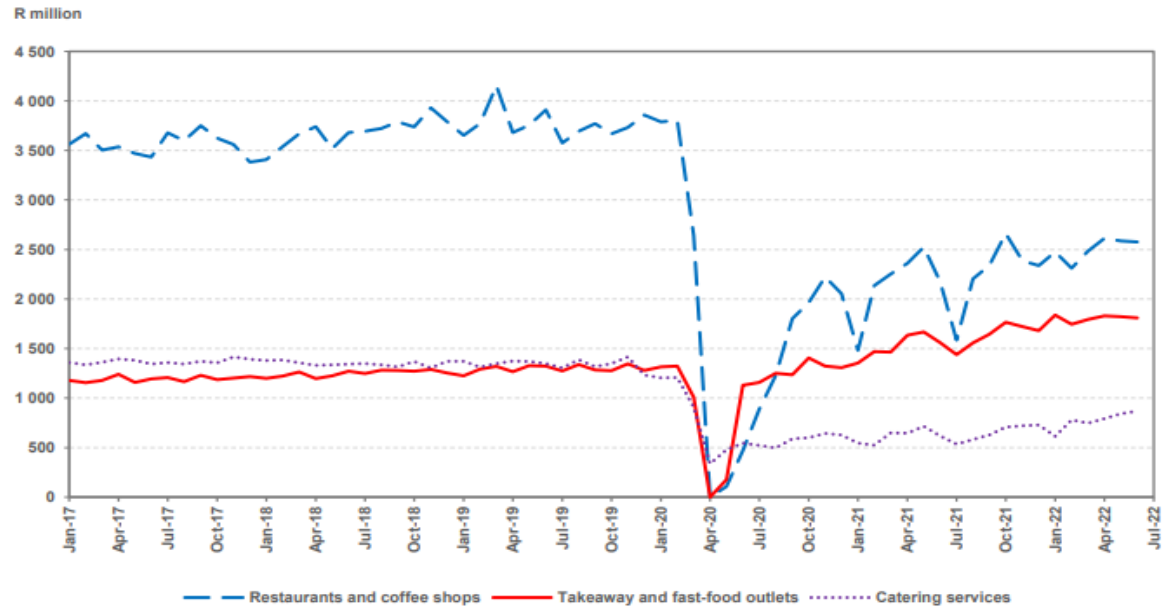
The market is extremely competitive with numerous providers vying for wallet share. More recently it's the supermarkets that are competing via ready meals and fresh food offerings in-store (sit down or take away). Asian and plant-based food are growing segments.

Figure 3 SA Food and beverages income at constant 2019 prices



Source: StatsSA, ASB Research

Figure 4 SA Food and beverages income at constant 2019 prices – by enterprise type



Source: StatsSA, ASB Research

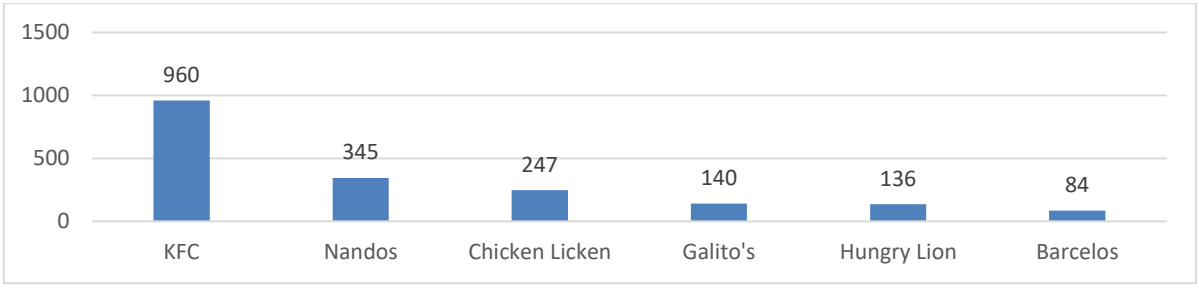
While in nominal terms revenue growth is likely to be back above pre-Covid -19 levels (as confirmed by FBR and Spur Corporation's latest results), revenue is structurally lower with lower trading volumes. In Figure 3 and 4 above, we highlight the food and beverage income at 2019 constant prices. In real terms the industry is approximately 17% below 2019 levels. Takeaway and fast food outlets have recovered and surpassed 2019 levels but not restaurants and coffee shops. This is confirmed in the weaker performance of Signature and Specialty brands at FBR and Spur Corporation respectively. This can be attributed to Covid-19 restrictions only being fully eased in June 2022, affordability pressure on consumers and lower travel volumes.

In SA, the weak economic growth combined with rising operating costs such as rentals, utilities and fuel, have placed pressure on profits. The industry has seen its fair share of failures in the past few years with the exit of Taste Holdings and the exit of brands by Grand Parade. Taste exited Domino's Pizza after no buyers were found; it sold the Starbucks license for R7m and it sold Maxi's and the Fish & Chips Co to Fiamme. Grand Parade announced the discontinuation of Dunkin Donuts and Baskin Robbin brands from SA. FBR has rationalised some of its own brands including Bread Basket, Thrupps, Juicy Lucy, Wakaberry and O' Hagans.

The largest franchise in SA is KFC, managed by Yum! Brands. Its estimated to have 960 stores in SA, ahead of Steers, Debonairs and Wimpy which fill spots two, three and four. McDonalds comes in at fifth followed by Spur. The key players by dominant category in SA are as follows (store information based on the latest reporting by brand):

Chicken

Figure 5 Chicken brands in SA – number of stores

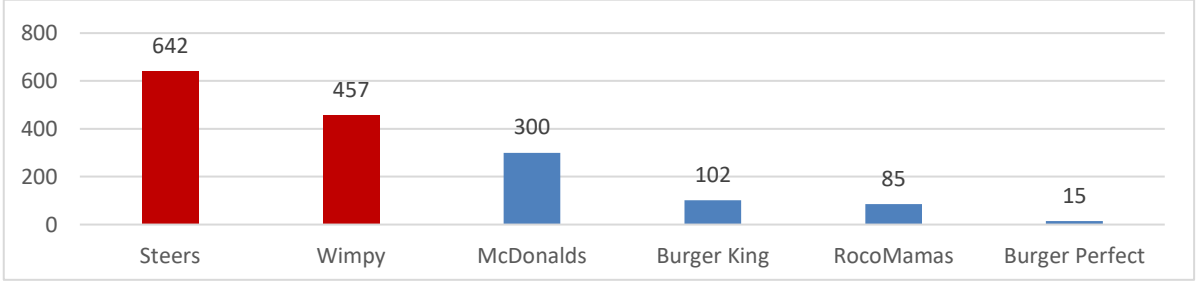


Source: ASB Research, based on latest company published data

- KFC dominates by a significant margin with 960 stores
- Nandos is in second place with 345 stores. Its recognised as one of the Top 10 most valuable brands in SA (Brandz survey 2020), the only fast food outlet in the Top 10
- Chicken Licken - 247 stores
- Hungry Lion – 136 stores in SA. Approx. 200 across Africa
- Galito's – 140 stores in SA. It has 210 stores in over 17 countries
- Barcelos – 84 stores
- Other names include Mochachos, Chicken Xpress, Popeyes, Afro's Chicken Shop, Pedro's and Zebro's.

Burgers

Figure 6 Burger brands in SA – number of stores

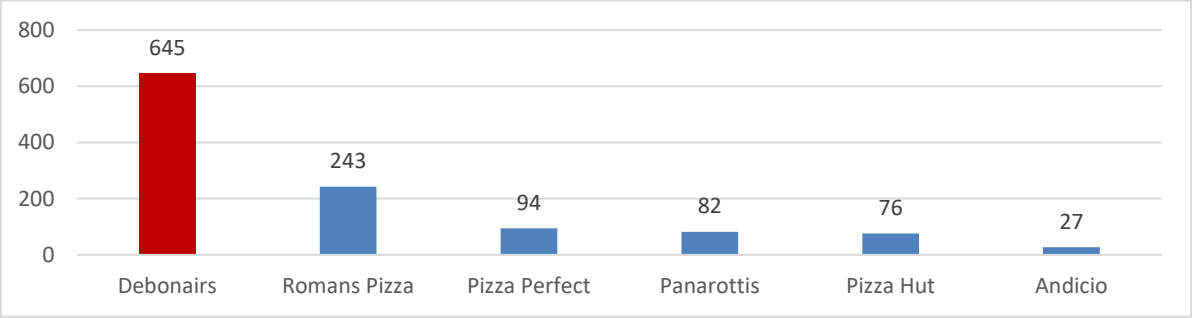


Source: ASB Research, based on latest company published data and FBR FY22 numbers

- Steers dominates with 642 stores
- Wimpy has 457 stores
- McDonalds is the biggest foreign player with around 300 stores
- Burger King – 102 stores
- RocoMamas - owned by Spur Corporation, it has 85 stores
- Burger Perfect – 15 stores

Pizza

Figure 7 Pizza brands in SA – number of stores



Source: ASB Research, based on latest company published data and FBR FY22 numbers

- Debonairs dominates with 645 stores
- Romans Pizza – established in 2002 it has amassed 243 stores in SA, and it claims to have the highest sales per square metre
- Pizza Perfect – established in 1989 and part of Eclectic Brands (which also owns Burger Perfect) has 94 stores
- Panarottis – owned by Spur Corporation, it has 82 stores
- Pizza Hut – managed by Yum! Brands, it has 76 stores.
- Andiccio – it operates 27 stores that open 24hrs 7 days a week

These are the dominant categories in the fast food/casual dining industry in SA. Other large store footprints serving different markets include:

- Fishaways – a seafood focused restaurant with 248 stores (part of FBR)
- Mugg & Bean - primarily a sit down restaurant, it also offers take-aways with 236 stores (part of FBR)
- Sausage Saloon – 101 stores
- Spur – whilst mainly a sit down restaurant it offers take aways and added Spur Grill & Go outlets which are quicker and more convenient for take aways. There are 297 stores
- The Fish & Chip Co – 130 stores
- Ocean Basket – primarily a sit down restaurant it also offers take-aways with an approximate 166 stores
- John Dorys – part of Spur Corporation - primarily a sit down restaurant, it also offers take-aways with an approximate 47 stores

Outlook for the industry

The QSR market in SA is fairly mature as evidenced by high levels of competition, modest growth rates and declining growth rates in annual store rollouts. Weak economic growth and pressure on household affordability will continue to hamper growth prospects. However, the economic outlook is no worse than that experienced over the past 5 years, with GDP growth averaging 0.2% p.a over this period. The challenge is to be in the growth segments of the QSR market, such as pizza and plant-based eateries, while increasing share of wallet in the more mature segments like chicken and burgers.

We identify the following key characteristics for growth, and how FBR is positioned:

- Scale - larger franchise companies have an advantage in these difficult times through economies of scale, the ability to offer financial assistance to franchisees and greater leverage on landlords. With approximately 25% of the industry in the hands of independents, these operators face a greater challenge and may become acquisition targets or more importantly free up key retail sites for the likes of FBR.
- Home delivery - placing full reliance on third party distribution like Mr D, Uber Eats, OrderIn and Bolt Food is making the end product more costly for the consumer. Opting for a blend of cheaper in-house delivery is key to remaining competitive. FBR has a significant in-house delivery platform that commenced in the 1990's.
- Convenience – this is a function of national footprint, delivery options, self service kiosks, ordering Apps etc. The establishment of mobile "container" stores and partnering with petrol stations are cheaper options of expanding footprint and providing convenience. FBR is well positioned in this regard through long established partnerships with fuel companies, several container stores and multiple ordering platforms including click and collect and self-service terminals.
- Marketing – advertising, promotions and loyalty programmes are key to remaining relevant, competitive and growing wallet share. FBR levies franchisees with a marketing fee on turnover which is exclusively used for marketing purposes ensuring a healthy budget.
- Pizza - it is the segment of the QSR market that is anticipated to grow the most in the medium term given it is a calorie rich, affordable and sharing occasion meal. This is positive for FBR as Debonairs is the largest player in the space by a considerable margin.
- Dark kitchens – these kitchens prepare food only, there is no interaction with the public as food is ordered online and delivered. It's a more cost-effective solution. FBR participates in this market but in a limited manner as it has concerns over its growth trajectory given low levels of volumes. Spur Corporation has embraced virtual kitchens (VK) and developed its own VK brands.
- Tourism – a sharp recovery in local and foreign tourism is expected post COVID-19. Its impact on the industry is best observed by the largest decline in sales emanating from the Western Cape for FBR during COVID-19. Travel volumes in SA are still down considerably on pre COVID-19 levels.

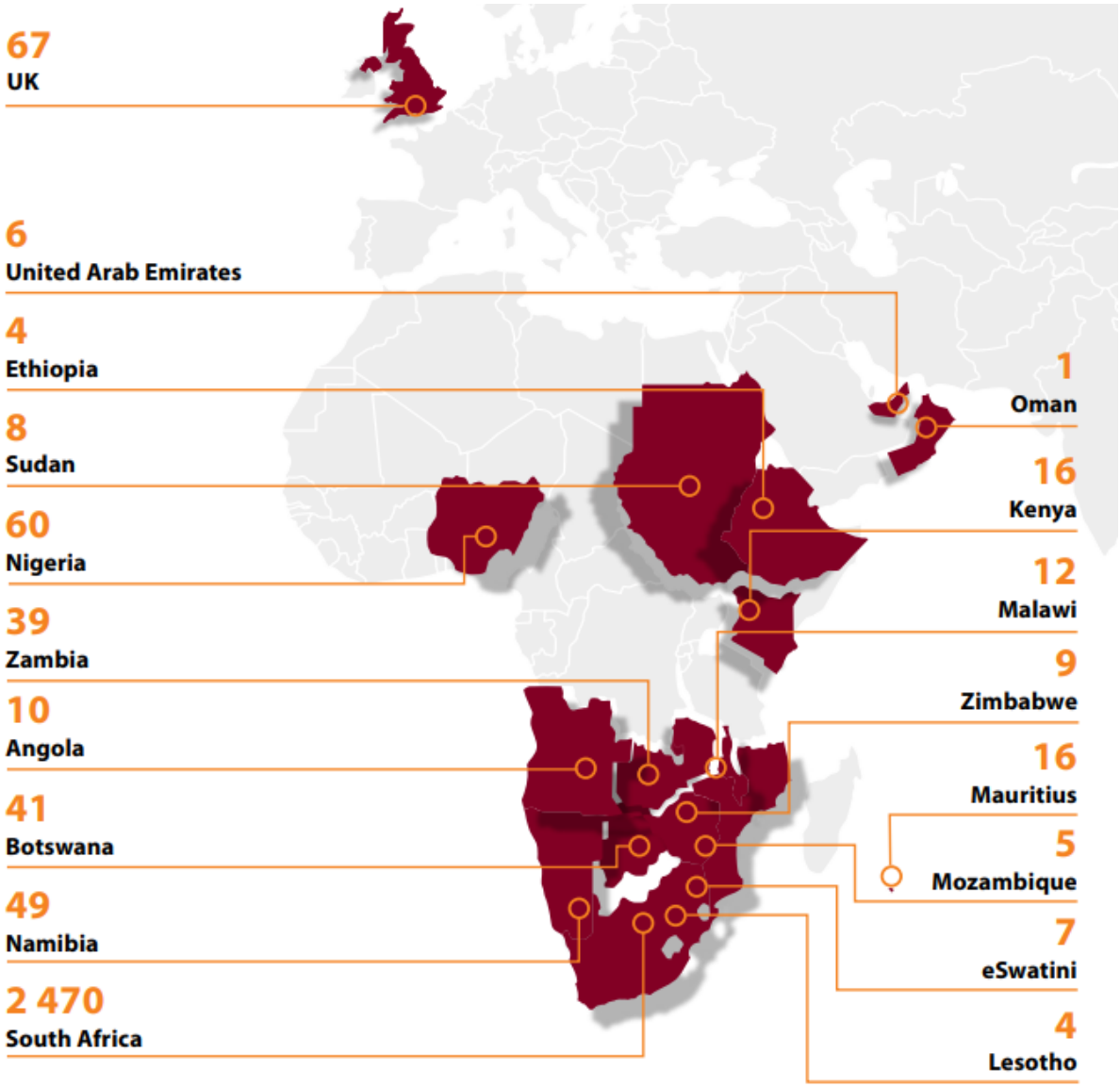
We see the following challenges facing the industry:

- Affordability - menu prices rise with food inflation (which over the past 10 years has on average exceeded CPI by approximately 1%) so consumers that are being squeezed by lower wage inflation and rising interest rates will feel the pinch. Larger operators like FBR are best positioned to remain competitive given cost efficiencies through scale, brand power, greater leverage over landlords and greater marketing spend. FBR also benefits from its inhouse manufacturing and logistics which can be optimised further to ensure pricing remains competitive. Menu sizes, its offering and pricing is under constant review and loyalty programmes have been rolled out at Wimpy and Mugg & Bean to attract repeat business.
- Health conscious consumers – menus need to evolve as the trend towards Vegetarian, Vegan, Gluten Free etc. grows. FBR has been very proactive in ensuring its various menus are relevant to its target market and it publishes dietary information for many of its brands. In April 2022 it acquired 51% of Lexis's Health Eatery which offers a plant-based menu as well as Retail products.

- Environmental – packaging needs to be environmentally friendly, stores need to be energy efficient and food waste must be minimised. There are consumers that hold these criteria in high regard, and would pay a premium for it, when choosing which brand to eat at. FBR has numerous initiatives on the go including all its brand packaging being 100% recyclable and all operations using cage-free eggs. Where possible near expiry date stock is donated to charities by Logistics.
- Innovation – ease of ordering and payment, collection, delivery and menu. FBR has been on the front foot regarding delivery and has built a good blend between click and collect, in house delivery and third-party deliveries. It does not disclose the mix for competitive reasons. Innovation includes embracing social media whilst being cognizant that it is a growing format for complaints and therefore reputational risk needs to be closely monitored and managed. FBR has been increasing its roll-out of digital menu boards, digital payment options and self-ordering terminals. Certain stores now also offer free Wi-fi.
- Changing dining trends – with many still working from home, mealtimes have become more flexible and spread across the day. All day breakfasts, snacking and sandwiches are growing offerings to fulfil this demand. Menu innovation and home delivery needs to reflect these changing trends. FBR is constantly reviewing its menu and promotes some of its dinner options to shift trading activity to later in the day.
- Disintermediation – supermarkets have been establishing in-house eateries for years, competing with FBR's casual dining. Convenience meals are also on offer which infringe on the QSR's. Pricing and menus need to remain competitive. Through its Retail offering, FBR is making its unique product items available in supermarkets, and its enhancing its product range considerably.
- Load and water shedding – this impacts access to stores, disrupts manufacturing facilities and delays deliveries. Apart from these costs it also attracts additional capex like solar and generators and the cost of running them. Where possible, generators are being placed in FBR stores and solar is considered on long term leased or owned properties. Where landlords don't provide a solution, it will attract additional costs for franchisees which may require financial support from the group.

Famous Brands - Overview of the business

Figure 8 Global footprint – number of restaurants – FY22



SA statistics

2 470 restaurants (2021: 2 436)
9 logistics sites (2021: 9)
10 manufacturing sites (2021: 12)
2 865 employees (2021: 2 056)

UK statistics

67 restaurants (2021: 71)
14 employees (2021: 14)

AME statistics

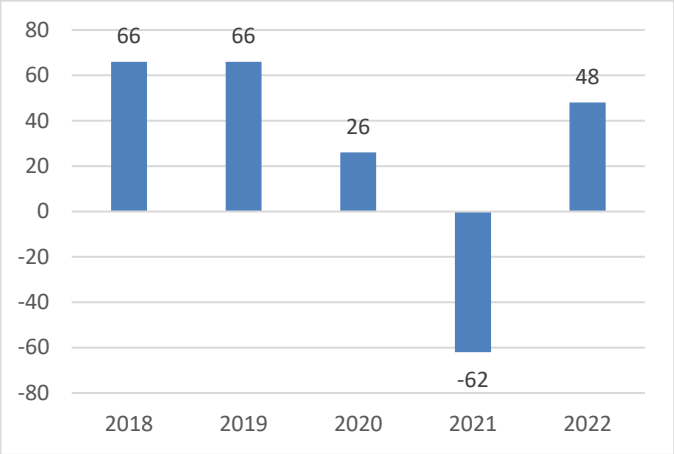
287 restaurants (2021: 266)
1 089 employees (2021: 930)

* *Employee number excludes Associates.*

Source: Company data

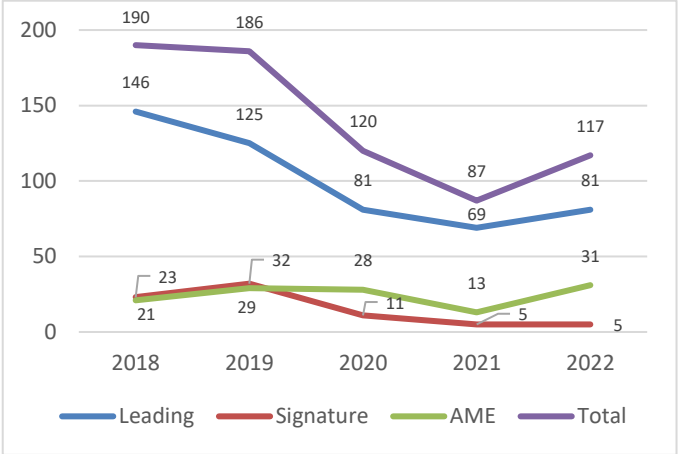
FBR is Africa's leading quick service and casual dining restaurant franchisor. It's a vertically integrated business model with its franchisees serviced by its substantial Logistics and Manufacturing operations. At 1H23 it has a portfolio of 17 brands represented by a network of 2 850 (2 771 franchised and 79 company owned) restaurants across SA, the Rest of Africa and Middle East (AME), and the UK. Apart from FY21 it has shown consistent growth in store numbers (see Figure 9 and 10 below) across all categories with the number now at all-time highs. FY21 net closures is distorted by the sale of Tasha's which had 18 stores. It operates franchised, master license and company-owned restaurants. There are four pillars to the business, namely Brands, Manufacturing, Logistics and Retail. Each pillar is managed and measured independently.

Figure 9 Net new stores gained per year



Source: Company data, ASB Research

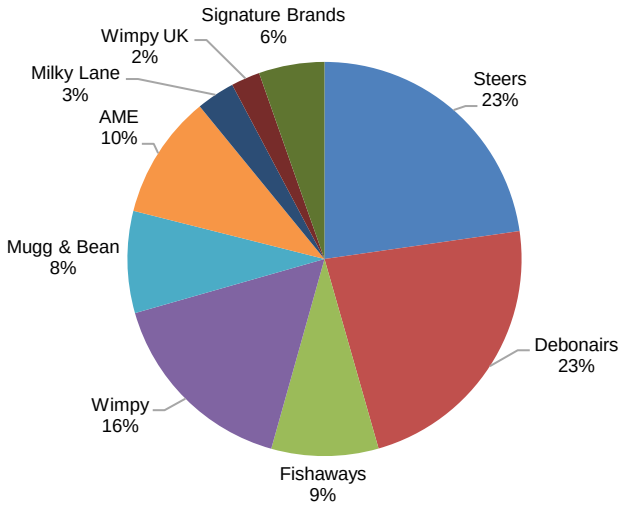
Figure 10 Number of new stores opened



Source: Company data, ASB Research

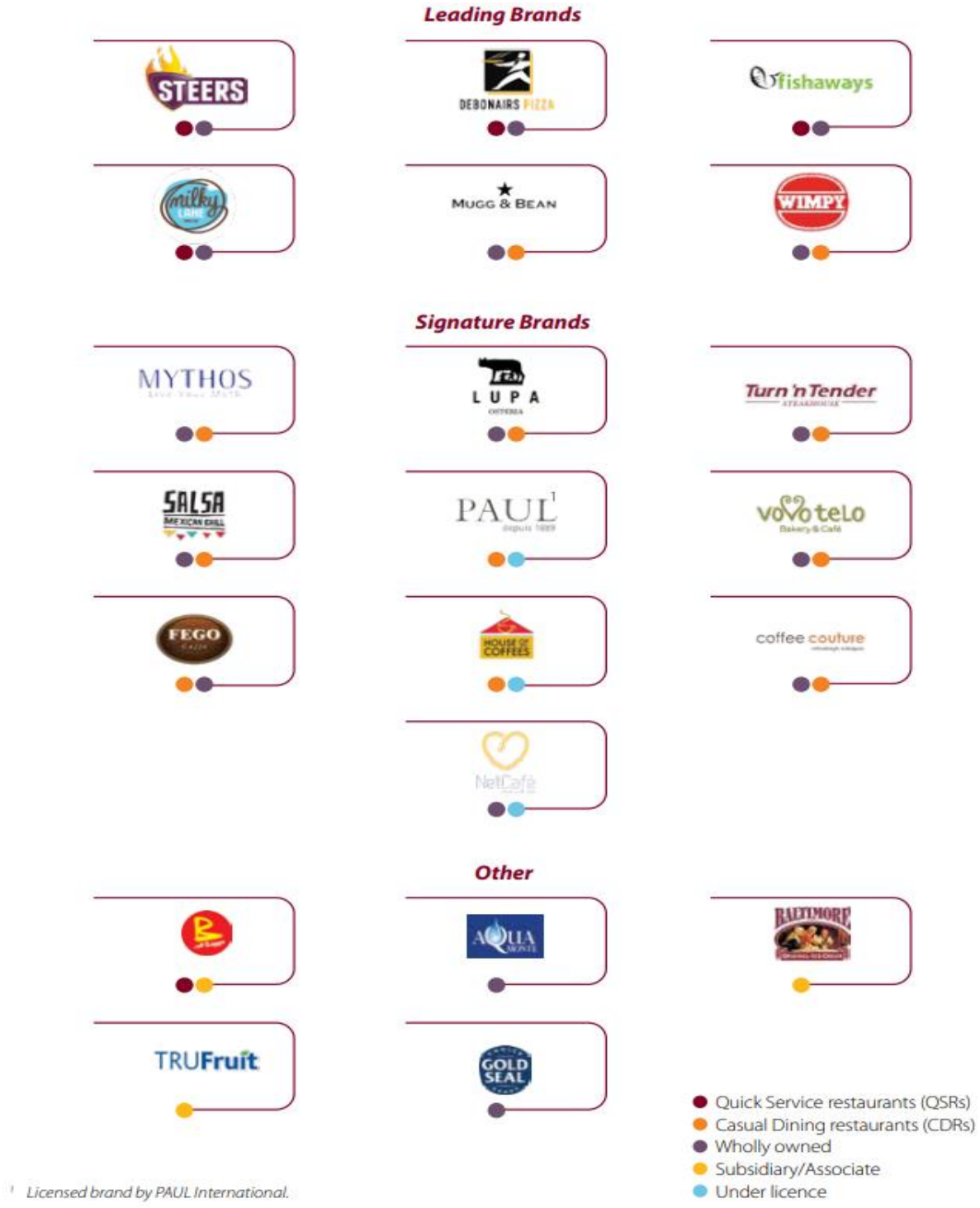
Brands

Figure 11 – Restaurant composition by brand (SA based) and region – FY22



Source: Company data, ASB Research

Figure 12 Brands within the Famous Brands Group – FY22



Source: Company data

The Brands portfolio is segmented into Leading (or mainstream) Brands and Signature (or niche) Brands. Leading Brands are also located in AME. Leading Brands are further categorised as Quick Service and Casual Dining. Quick Service prioritises take away and delivery offerings and have small sit down areas with the focus on quick service. Casual Dining offers customers a full-service sit down experience with a take away option. Signature Brands has a wide range of bespoke casual dining offerings and is generally limited to SA, with 8 company owned stores (at 1H23) as the brands are less established and more niche making it more challenging to attract franchisees.

Leading Brands

Wimpy – Casual Dining, wholly owned
A leading Casual Dining restaurant and family favourite. The brand is renowned for its famous Wimpy coffee, all day breakfasts, burgers, and grills, complemented by a wide selection of shakes and desserts.

Steers - Quick Service, wholly owned
Launched in SA in the 60's, Steers is an iconic hamburger brand, enjoyed for its 100% pure flame-grilled burgers and hand cut chips.

Debonairs - Quick Service, wholly owned
It's a market leading Quick Service pizza brand that is popular due to its pizza innovation, customer interactive technology and free home delivery, which it pioneered in 1996.

Fishaways - Quick Service, wholly owned
SA's leading Quick Service seafood brand, offering fresh and nutritious seafood based meals.

Milky Lane - Quick Service, wholly owned
Since the late 50's it has been a household name in SA, serving ice cream treats and desserts. This brand is a leader in the indulgence category.

Mugg & Bean – Casual Dining, wholly owned
Opened in 1996, it offers legendary bottomless coffee, giant muffins and substantial portion sizes. It is also accessible through various convenient formats including On The Move, OTM Limited Service and OTM Express.

Signature Brands

Turn 'n Tender – Casual Dining, wholly owned
Opened in 1977, a traditional South African steakhouse, its evolved to become a destination for lovers of steaks, ribs, burgers and fine wine in a contemporary setting.

Vovo telo – Casual Dining, wholly owned
A specialist artisan bakery, synonymous with craft baking, breakfasts and lunches and brewed coffee.

Coffee couture – Casual Dining, wholly owned
A specialised hospital coffee shop, situated in Mediclinic hospitals nationwide. It offers meals, coffee, a range of gifts and other convenience retail items.

House of Coffees – Casual Dining, under licence
Established in 1965, it's a specialist coffee shop serving premium coffee and meals. The bespoke coffee blends are also available in leading retailers nationwide.

NetCafe – Casual Dining, under licence
A bespoke brand to cater to the Netcare groups hospital staff, patients and their visitors. It comprises a combination of a full sit-down menu, a deli section and a retail convenience outlet. Netcare operate the largest private hospital network in SA.

Fego Caffe – Casual Dining, wholly owned
Café style dining, serving light meals and coffee. Coffee is sourced from South America and Africa proving an extraordinary coffee experience.

Lexi's – Casual Dining, joint venture/associate
Its slogan is "Eat more plants". It's a casual dining restaurant, offering a full service, sit down, plant based dining experience from breakfast through to dinner. The menu is almost entirely vegan, gluten-free and refined sugar free. It's the latest addition to the group.

Lupa Osteria – Casual Dining, wholly owned
It offers modern, yet traditional artisanal Italian food. Homemade pasta and wood fired pizzas are complemented by a wider range of other meals and alcoholic beverages.

Mythos – Casual Dining, wholly owned
A contemporary Greek restaurant with a traditional spirit, serving time-honoured dishes in a Mediterranean setting.

PAUL – Casual Dining, under licence
The internationally renowned bakery-café chain, with an authentic French offering in restaurants or take-away. Famous Brands holds the licence agreement for PAUL in SA.

SALSA Mexican Grill – Casual Dining, wholly owned
Mexican food prepared traditionally with a modern inspired twist. Food is complemented by craft tequilas and beers in a vibrant and festive environment

Other brands

Mr Biggs – Quick Service, associate
Dating back to the 60's, it's a popular restaurant chain in Nigeria catering for takeaways and sit down dining, offering traditional and international menu items.

Manufacturing

FBR has 10 manufacturing plants, 5 wholly and 5 partly owned. Manufacturing of key food ingredients or licensed products is the focus of this unit. This includes potato chips, bakery products, meat, spices, fruit juices, coffee, sauces, ice cream, serviettes, cheese etc.

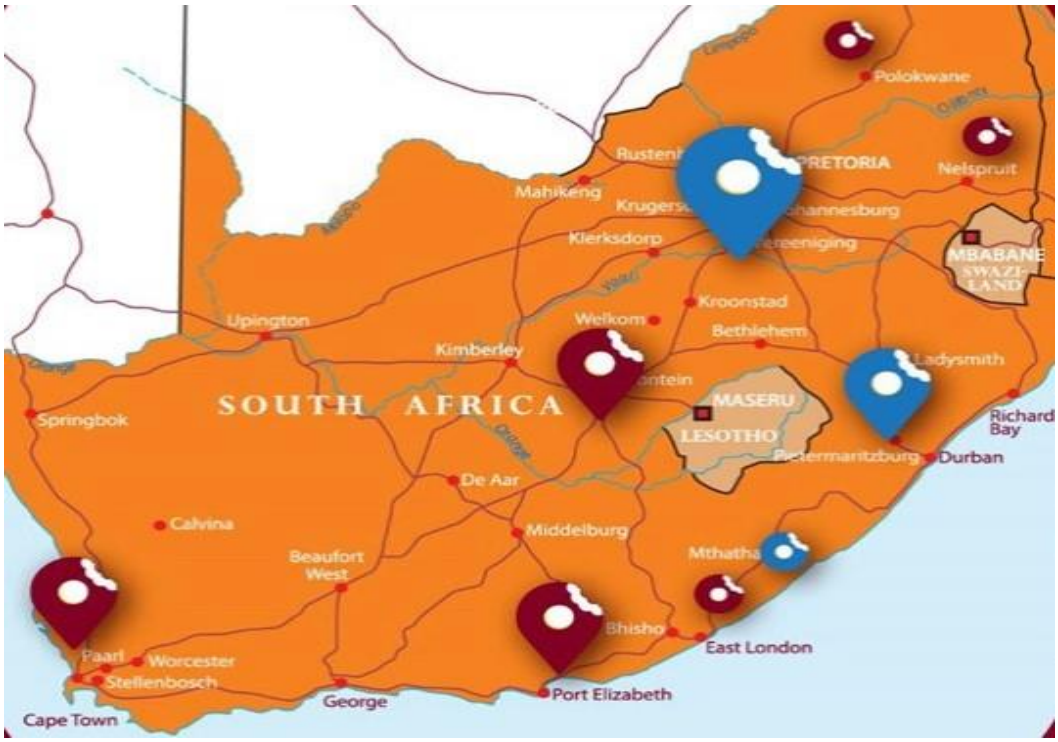
These ingredients are key to standardising the final product. However, it doesn't mean that FBR has pricing power over these products as franchisees can substitute the product should they find one of equal quality and standards. Extensive research is done to ensure the ingredients are competitively priced.

Approximately 65% of ingredients comes from within the group, the rest being sourced from 3rd parties. Around 85% is locally sourced. Imports include coffee and milk whey powder for ice cream. AME operations are not dependent on the Manufacturing division, rather sourcing ingredients locally. Only around 3% of Manufacturing's sales is exported.

All manufactured products are distributed to franchisees, restaurants or retail stores (for its licensed products) by the Logistics division.

Logistics

Figure 13 – Five depots and four cross docks



Source: Company data

The Logistics operation is the route to market that ensures the delivery of the necessary products that cater for brand-specific menus. Only 1.7% of its revenue is from exports. There are nine distribution centres in SA. The vehicles (104 of them) are owned with 28 operated on an owner driver basis, supporting B-BBEE operators. As part of Project Decade, the logistics operation is continually being optimised. A new KZN depot will be occupied in November 2022 and the Frozen Crown Mines DC will be relocated to the Midrand Campus which is being expanded following the proposed successful acquisition of the property.

Once again Logistics pricing is market related. While this function could be outsourced it does provide the following benefits to the group:

- It supports B-BBEE
- Drivers interact with the restaurant, and it therefore provides some intelligence on activity levels of its franchisees.
- There is greater control of the process ensuring better reliability – this played out well during COVID-19.
- It simplifies the procurement process for franchisees.

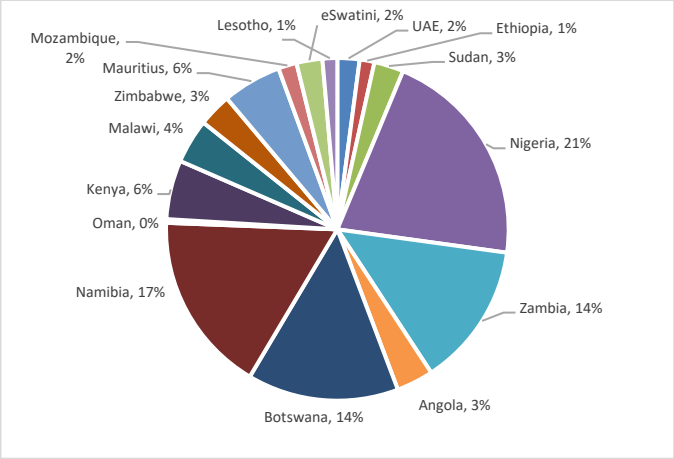
Retail

This is a stand alone business unit. Associated brand retail products are stocked in supermarket chains such as Pick n Pay, Makro, SPAR and Checkers. Some of the brands include, Steers, Wimpy, Mugg & Bean, TruFruit, Aqua Monte and Baltimore. Products include sauces, dressings, spices, frozen meat, coffee, frozen chips, fruit juice. This is a growing market for those seeking convenience of dining at home while consuming their favoured brands.

The AME and UK operations fall largely within the Leading Brands segment. These are, however, disclosed separately in segmental reporting given less reliance on the Supply Chain. We cover each separately below:

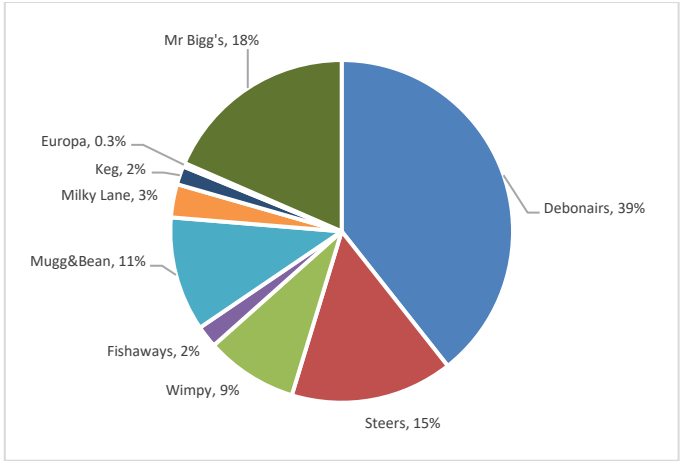
AME

Figure 14 Representation by store numbers – FY22



Source: Company data, ASB Research

Figure 15 Representation by brand - FY22



Source: Company data, ASB Research

The expansion into AME continues within the Leading Brands as per Figure 15 above. Mr. Biggs is a part of the listed UAC Restaurants group in Nigeria, FBR owns a 49% shareholding. Debonairs dominates the AME footprint with 39% of the stores. FBR is currently the QSR market leader in Zambia and Botswana, its intention is to achieve this status in other countries with ongoing investment as consumption rises. Debonairs opened its first restaurants in Oman and the Kingdom of Saudi Arabia in 1H23.

There is a presence in 16 countries, the largest being Nigeria followed by Namibia, Botswana and Zambia – the four making up 66% of stores. The AME store footprint has declined since FY15, from 359 to 287 in FY22, with a large contraction from Nigeria. This is due to an exit of underperforming franchise stores. AME will, however, continue to expand its presence in existing and new markets going forward - on a net basis its gained stores in FY22 and 1H23.

Of the 287 stores in AME, 60 or 16% are company owned. These company stores drive scalability faster and set a benchmark for franchisees – the intention is to exit to franchisees where possible. There is therefore an element of risk taking in these regions but with higher economic growth rates forecast and less mature QSR markets, management believes in the strategy and revenue growth should surpass that of the SA operations. Given the tepid SA growth and its more mature QSR market, we believe the strategy has merit and gain comfort from the fact that it has always delivered a positive financial return. We do, however, believe that profitability needs to improve in the medium term or else the strategy needs to be reassessed.

UK

Its failed expansion into the UK through the GBK acquisition in October 2016 has destroyed considerable value for the group. Apart from the full impairment of the R2.1bn investment, the debt required to fund the acquisition also diluted earnings. But that chapter has been closed and an interim liquidation dividend of R75m was recently received.

The remaining UK business is Wimpy, a mature but profitable business. Store numbers have been rationalised from 83 in FY16 to 67 in FY22 and stores have been revamped to improve their curb appeal. Management remains committed to this business as evidenced by new store openings and ongoing refurbishment. It is profitable even though margins have contracted given the challenges facing the UK since Brexit. It is totally independent from the SA Wimpy operation with a different menu.

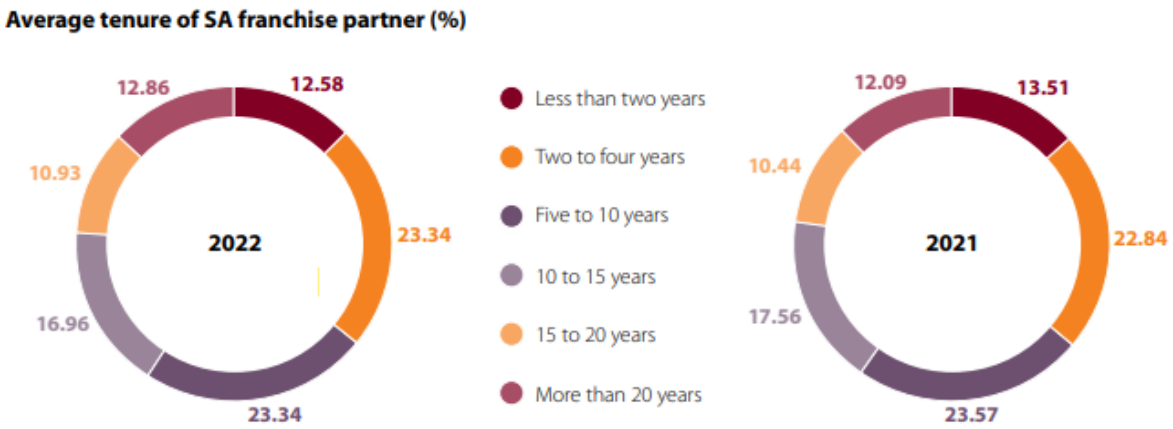
The role of the franchisee

The success to FBR's growth and expansion is the extent to which it attracts franchisees to its model. Franchisees are the interface to its customers and are brand ambassadors playing a key role in upholding the reputation of the group. Selection of franchisees as well as support of them is key. Support is offered in the management of a successful restaurant, including finance, marketing, design and development, training and procurement. Some practical examples of support include:

- Start up and ongoing training of staff
- Develop and manage brand plans and provide tools and support for local store marketing
- Manage new and revamp projects including equipment procurement
- Assist with site selection, negotiation and management of leases. For key sites FBR may negotiate and enter the lease with a sub-lease to the franchisee.
- Procurement, reliable and efficient delivery of product
- Margin management – input prices are generally only revised bi-annually
- Provision of financial assistance in difficult times such as COVID-19. This will be in the form of rebates on royalty and marketing fees, with no recourse.

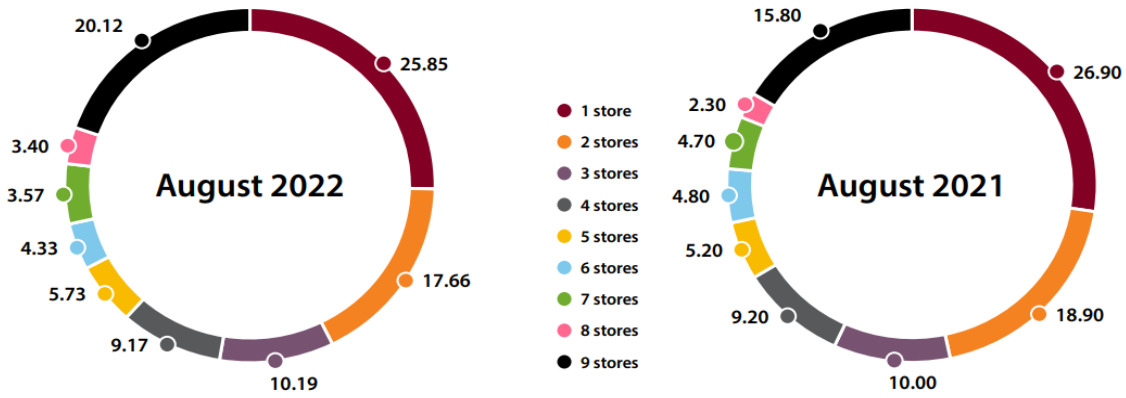
There are regular reviews and audits of stores to ensure standards are maintained. Stores are on average revamped between 5-7 years, pushing it out in difficult times such as those experienced during COVID-19. There is a national call centre to manage consumer queries and complaints.

Figure 16 Average tenure of SA franchise partners – FY22 and FY21



Source: Company data, ASB Research

Figure 17 Franchisee ratio to stores – 1H23 and 1H22



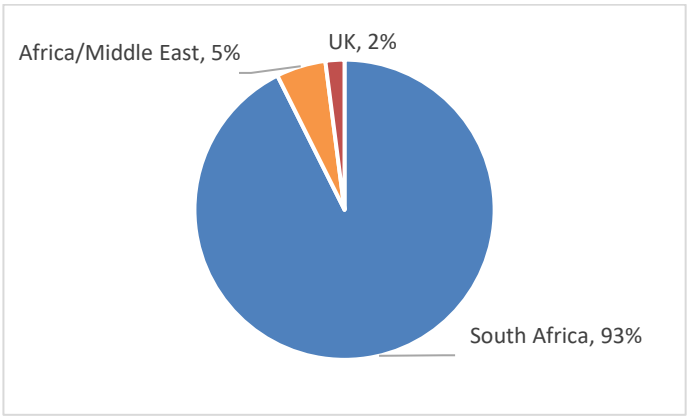
Source: Company data, ASB Research

Its success as a franchisor is best highlighted by Figure 16 above, which shows that circa 41% of franchise partners have been with the group for longer than 10 years. Less than two years has declined modestly from 2021 but still reflecting growth and support. Figure 17 shows that >56% of franchisees own more than 2 stores. There is a sharp increase in franchise partners owning 9 stores in the past year, suggesting the larger franchisees are optimistic on the outlook from current levels.

National Franchise Forums are held in which franchisees participate in brand decision making.

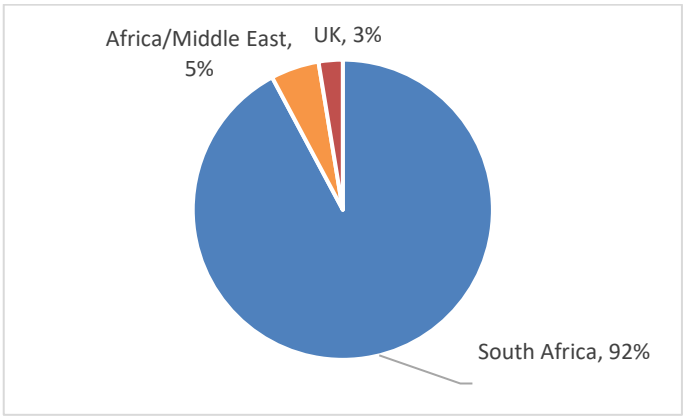
Financial

Figure 18 Revenue split – FY22



Source: Company data, ASB Research

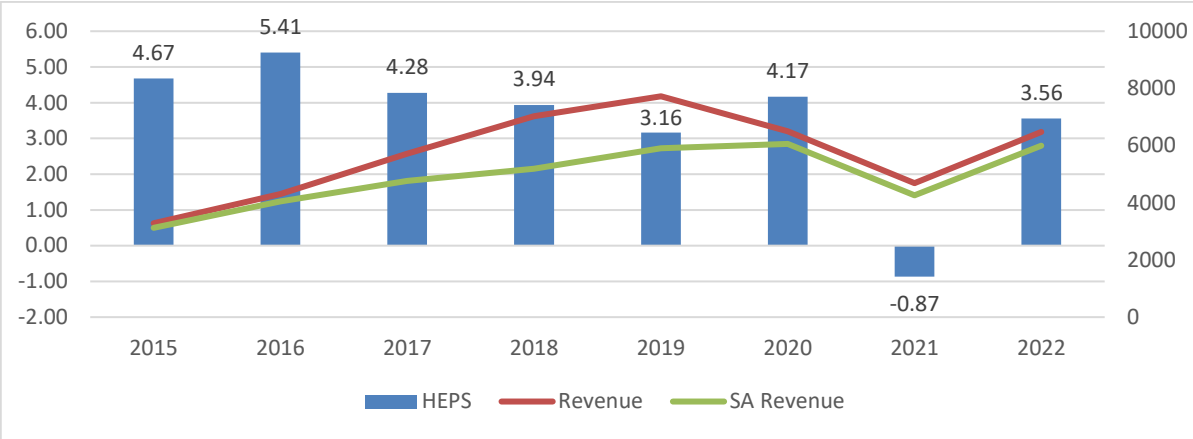
Figure 19 EBIT split - FY22



Source: Company data, ASB Research

Despite ongoing geographic diversification over the past decade, SA remains the dominant revenue and EBIT contributor at 93% and 92% respectively.

Figure 20 – HEPS in ZAR (LHS), SA revenue and Group revenue in R'm – FY22

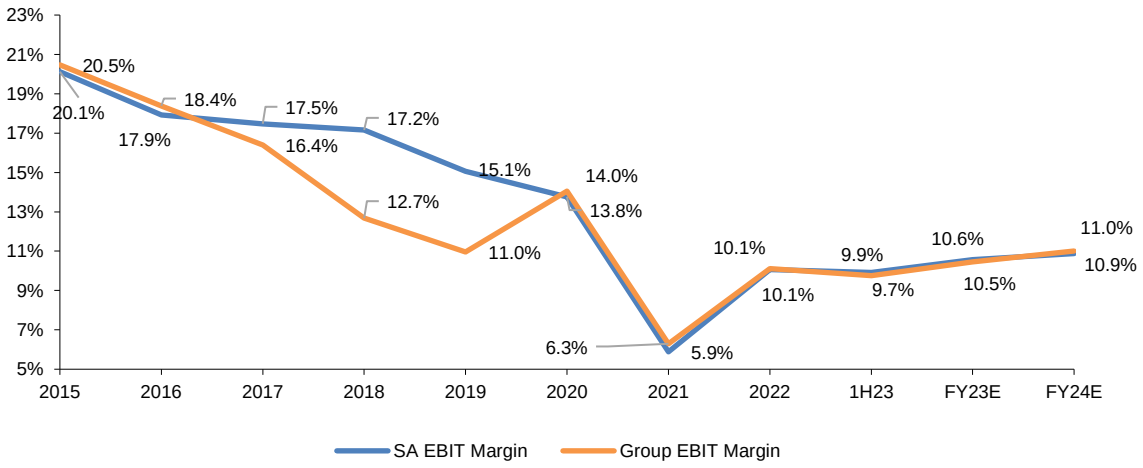


Source: Company data, ASB Research

At a HEPS level the group's FY22 result was lower than that achieved in FY15, a disappointing performance. GBK in the UK was acquired in FY17 for R2.1bn and attracted significant debt. It contributed positively to EBIT in FY17 but saw losses thereafter, compounded with higher finance costs and a full subsequent impairment. FY20 and FY21 include GBK as a discontinued operation whilst FY22 excludes GBK. FY20 and FY21 continuing operations delivered HEPS of 53c and 470c. COVID-19 had a major impact on FY21 as the best part of the year incurred some form of lockdown. COVID-19 continued to hamper FY22 but to a lesser degree.

Throughout this period the SA business has progressed with consistent revenue growth until FY21 with COVID-19. FY22 saw revenue broadly in line with that pre COVID-19 (FY20).

Figure 21 – Group and SA operations EBIT margins



Source: Company data, ASB Research

As per Figure 21 margins are down considerably on FY20 and should recover from these levels as the operating environment normalises. Volumes in the industry are not where they were projected to be at this time prior to COVID-19. SA has performed better on revenue growth and margins over the period. Had FY22E achieved the same EBIT margins as FY20 (14% instead of 10%) it would result in R907m EBIT compared to R655m, a 38% uplift.

Gross debt (excluding lease liabilities) has declined significantly from R2.9bn in FY17 (when the market was concerned about a potential rights issue) to R1.1bn in FY22 and will continue to decline given strong cash generation and measured capex.

We look at the relevant financial categories in more detail:

Revenue

Figure 22 – Net revenue split by source – FY22

R'm	2022	2021	% change
Royalty income	1501.5	969.2	55%
Franchise fees	918.2	644.2	43%
Marketing fees	583.3	325	79%
Manufacturing revenue	221.9	203.8	9%
Gross revenue	2770	2117.7	31%
Intersegmental	-2548.1	-1913.9	33%
Logistics revenue	4051.5	2994.1	35%
Retail revenue	222.1	151.2	47%
Company owned stores	446.9	328.4	36%
Other	32.4	37.2	-13%
	6476.3	4683.9	38%
Cost of sales	-3564.3	-2677.8	33%
Net revenue	2912.0	2006.1	45%

Source: Company data, ASB Research

Revenue sources are diverse in the business and include the following:

- Royalty income – this is turnover based and paid by franchisees to the group. There are two components:
  - Franchise fee revenue – this covers the support given by the group to the franchisees. The average fee is 5-7% depending on the brand.
  - Marketing fee – these are fees paid by the franchisees to the group for purposes of brand marketing. The fee ranges from 3-5% depending on the brand. These proceeds are ringfenced for marketing purposes only, resulting in a restricted cash category on the balance sheet. This currently amounts to R125m and is elevated due to the lack of spend during COVID-19.
- Manufacturing revenue – manufactured goods are largely for inter-divisional sales to Logistics and the cost thereof is billed to the Logistics division, which in turn invoices the franchisee for the delivered product (or ingredient). The bulk of its revenue (R2.77bn) is therefore intersegmental and eliminated on consolidation (it's recognised under Logistics). What remains is manufacturing sales to third parties amounting to R222m.
- Logistics revenue – this is the revenue earned from franchisees for the delivery of manufactured goods as well as other third party ingredients. Approximately 60% of volumes is from the Manufacturing division. It is the most significant component of revenue (it includes manufacturing) and attracts a cost of sales. It runs at a margin of 2-3%.
- Retail revenue – revenue from the sale of products through retailers. The dominant products are salad dressings and sauces, but growth is coming from coffee and frozen products such as chips. Pre FY21 part of Retails revenue was recognised in Manufacturing as it sold products directly. Disclosed revenue is net of internal eliminations.
- Company owned store revenue – revenue from the Leading and Signature brands that have not been franchised within the group. The bulk of these would be in AME. Once again it attracts cost of sales.

The primary driver of all revenue is the turnover within the franchisees. This determines the royalty income, the level of production in the manufacturing plants as well as the extent of deliveries. It is the key

line item we focus on in our forecasts. Signature brands are less reliant on the Supply Chain as they are not scale businesses.

We model revenue on a more simplistic segmental basis, which is SA, AME and UK. Within SA we have Leading and Signature brands revenue, the Supply Chain, Marketing funds and Retail.

Figure 23 – Net revenue split by geography – FY22

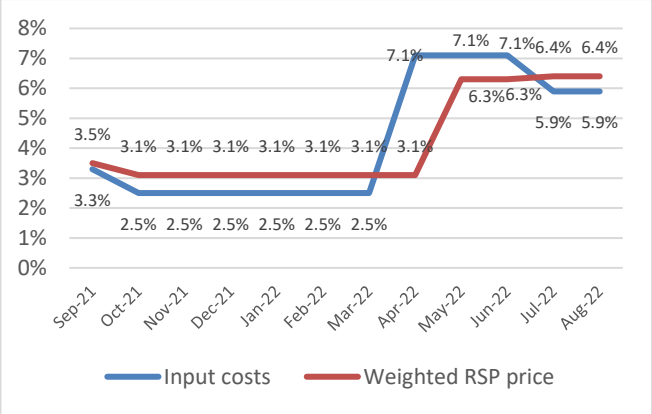
R'm	2022	2021	% change
Leading brands	772.6	490.5	58%
Signature brands	145.3	76.0	91%
	917.9	566.5	62%
Supply Chain	931.2	671.3	39%
	4495.5	3349.1	34%
Manufacturing	221.9	203.8	9%
Logistics	4051.5	2994.1	35%
Retail	222.1	151.2	47%
Cost of sales	-3564.3	-2677.8	
Marketing funds	583.3	325.0	79%
Corporate	1.3	14.9	-91%
South Africa	2433.7	1577.7	54%
	478.4	428.3	12%
UK	132.6	112.3	18%
AME	345.8	316.0	9%
TOTAL	2912.1	2006.0	45%

Source: Company data, ASB Research

Leading Brands

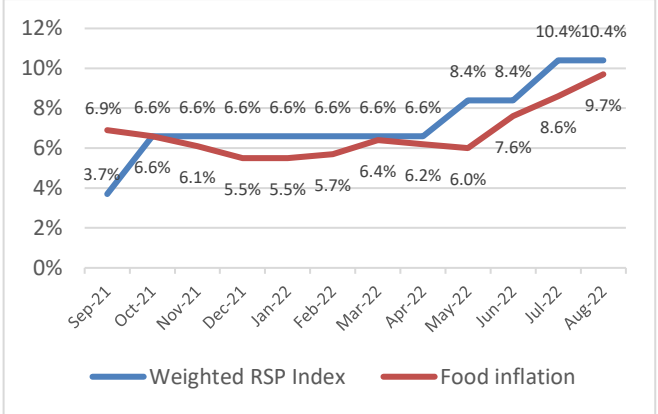
Franchise revenue is a function of volume increases (organic and through store rollouts/closures) as well as menu price increases. Twice a year (April/May and October/November) input prices for franchisees are fixed and menu prices revised to adequately adjust for food inflation/input costs. As an exception, prices can be adjusted more regularly where a particular ingredient is seeing significant price inflation (e.g., fish). Input costs would move in line with food inflation trends but are not directly comparable as input costs include logistic costs which would have a different inflationary profile.

Figure 24 Input costs vs RSP - % change



Source: Company data, ASB Research

Figure 25 RSP Index vs food inflation

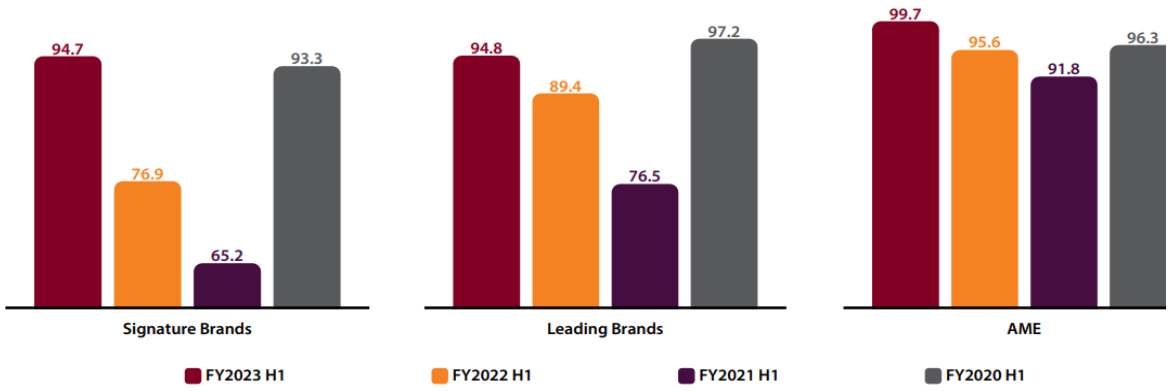


Source: Company data, ASB Research

In Figure 24 above, we look at Leading Brands input costs and retail selling prices (RSP) for the 12-months to 31 August 2022. Internal input costs were adjusted in October with a resultant change to menu prices in the same month. Input costs were adjusted higher in April due to rising food inflation with menu prices adjusted in May. In Figure 25 we highlight the impact of the menu price adjustments, as measured as an index compared to food inflation. In FY21 the index tracked well below food inflation for the first eight months, only beginning to exceed it from October 2021. This will have negatively impacted group margins. It continues to track above food inflation allowing some flexibility for franchisees to deal with other cost pressures such as rentals, utilities and load shedding.

High food inflation is positive for the group as menu prices are unlikely to drop when inflation falls, widening the margins. It's more likely that menu prices stay flat with some promotional activity and menu changes initiated to pass on the benefits to customers – these remain discretionary and flexible.

Figure 26 – Royalty fee recovery rates

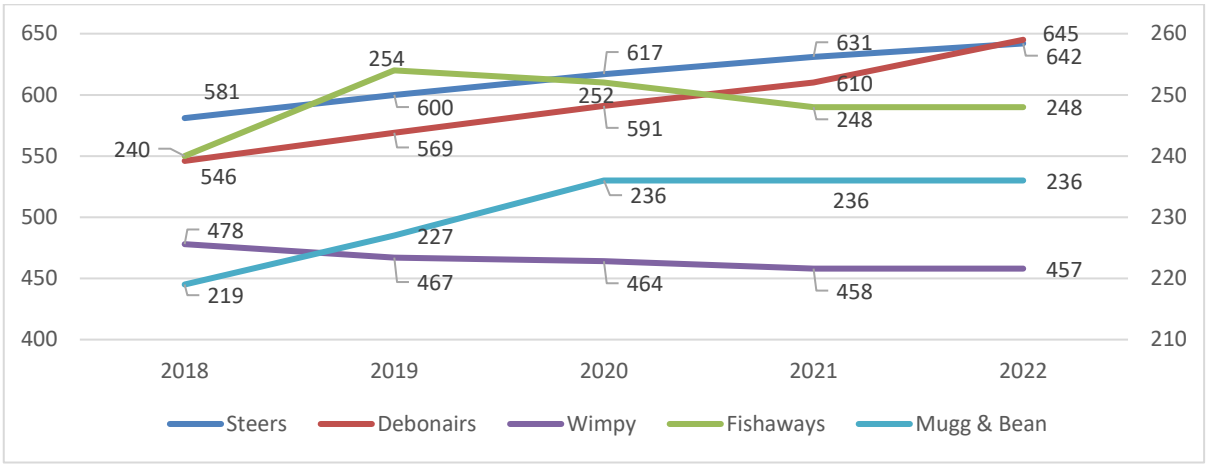


Source: Company data

Revenue in the past two financial years has been negatively impacted by financial assistance to franchisees in the form of reduced royalties. There is no recourse to this lost revenue. Consequently, its rebound will reflect more than price and volume changes to revenue growth. As per the above chart, royalty revenue support was very prevalent in Signature brands with only 65% of billable royalties received in 1H21. This has recovered strongly to 94.7% in 1H23. Leading brands was less impacted but also suffered considerably with almost 25% of billed income not received in 1H21. AME has been significantly more resilient and

almost has 100% recovery rates in 1H23. There is further scope for recovery in 2H23E from Leading and Signature brands.

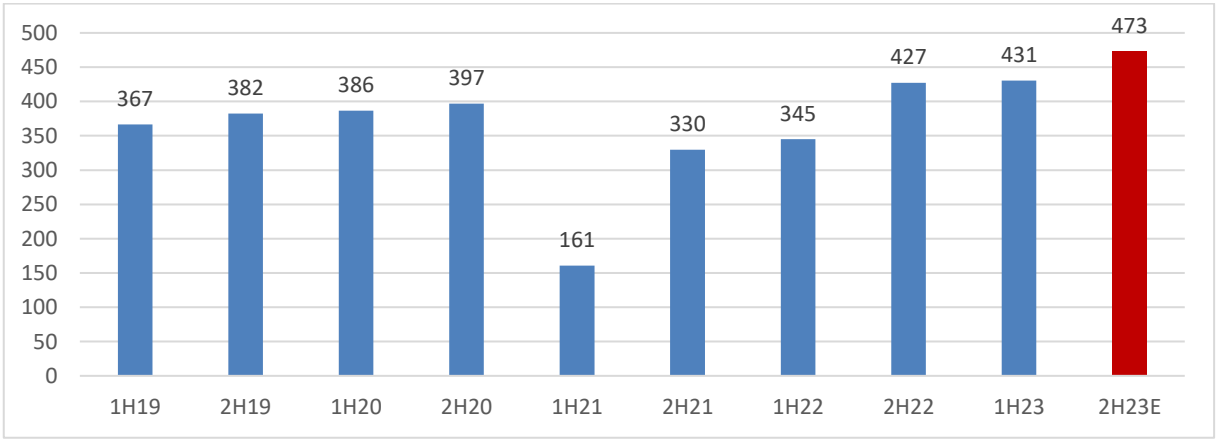
Figure 27 Number of stores by major brand – South Africa



Source: Company data, ASB Research

Franchise revenue is also impacted by store rollouts. As per the chart above, store numbers have been rising considerably in Steers and Debonairs in SA. Mugg & Bean is no longer showing store growth, like Fishaways. Wimpy's seeing numbers decline. On a portfolio basis, however, Leading Brands store numbers are rising considerably each year, supporting revenue growth.

Figure 28 Leading Brands revenue by reporting half – R'm

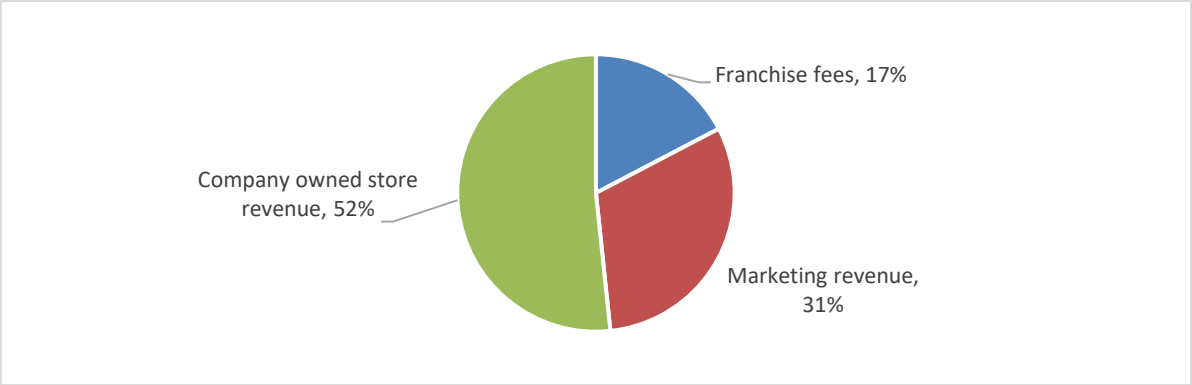


Source: Company data, ASB Research

Latest data has food inflation averaging 7.1% for 2022. This is likely to rise further. We anticipate average food inflation for FY23 to be 7.5%. Volume growth is anticipated to rebound sharply off a depressed base, and we expect 7% growth, implying royalty revenue growth of approximately 15%. Case volumes in the Logistics business was up 8.6% in 1H23 with Leading Brands revenue up 24.7%. Growth rates for the full year will be lower due to a higher 2H23 base (2H22 was 24% higher than 1H22)– we forecast 17% growth including store roll out benefits and further improvements in royalty fee recovery rates. We anticipate a more normalised operating environment in FY24E with lower food inflation and lower volume growth – we anticipate 7% revenue growth off the FY23E recovered base.

Signature Brands

Figure 29 Signature Brands revenue split – FY22

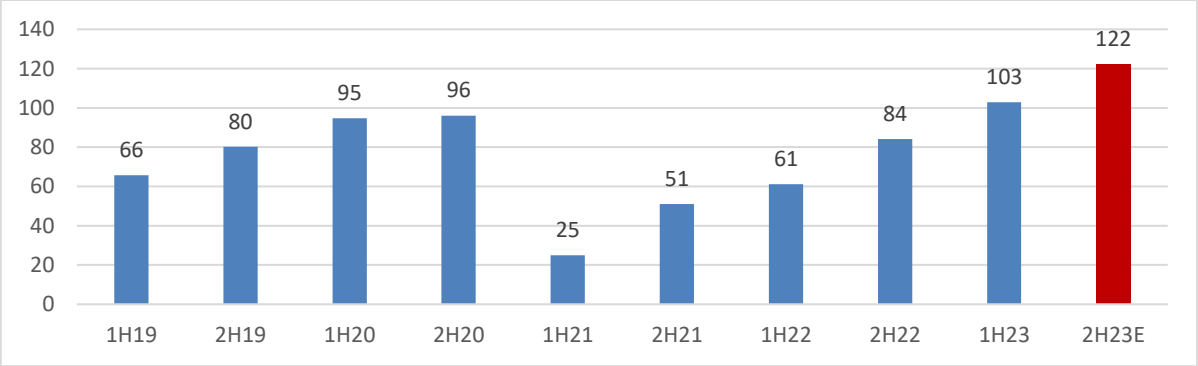


Source: Company data, ASB Research

This business has been rationalised and refocused to improve its growth prospects. Unfortunately, COVID-19 had a huge impact on its trading as sit down dining was prohibited for a lengthy period followed by alcohol restrictions and social distancing restrictions. This has eased in 1H23 but still lags behind pre COVID-19 levels. Consequently, some franchisees have been unable to continue operating with 8 restaurants closed in 1H23 and more likely to follow as rental arrears are hampering progress. These events have been headwinds for franchisee interest in these brands. There are 8 company owned stores in Signature Brands, however, 5 are Paul restaurants in which FBR is obligated to own the restaurant.

Signature Brands has been an underperformer primarily because it lacks scale, and its target market has been impacted hard by weak economic growth and COVID-19. It's not a growth engine like Leading Brands but does offer potential from current levels. Management has indicated that ongoing underperformance from these brands could result in an exit strategy, but it's too early to call given that the changes implemented have had little time to be realised.

Figure 30 Signature Brands revenue by reporting half – R'm

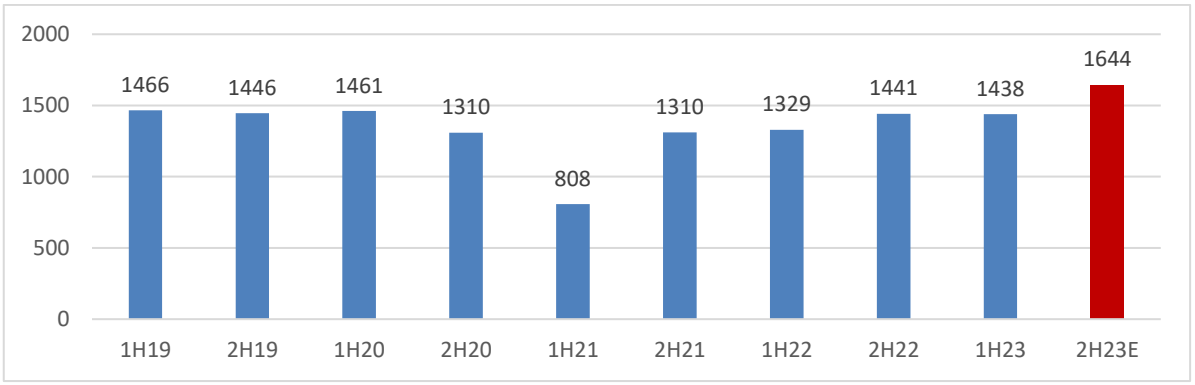


Source: Company data, ASB Research

Given a low base, FY22 revenue is 24% lower than FY20 with only 5% less restaurants, we anticipate stronger revenue growth than Leading Brands. Volume recovery has lagged in sit down dining. We believe FY23E revenue will exceed FY20 and assume growth of 55% and 8% p.a in FY23E and FY24E. Growth was 68% in 1H23 off a depressed base. 1H23 revenue equated to R102.9m, we anticipate a stronger 2H given a more normalised operating environment and higher royalty fee recovery rates, equating to R225m for the full year. Forecast risk is high given its sensitivity to economic growth which is very uncertain.

Manufacturing

Figure 31 Manufacturing revenue by reporting half – R'm

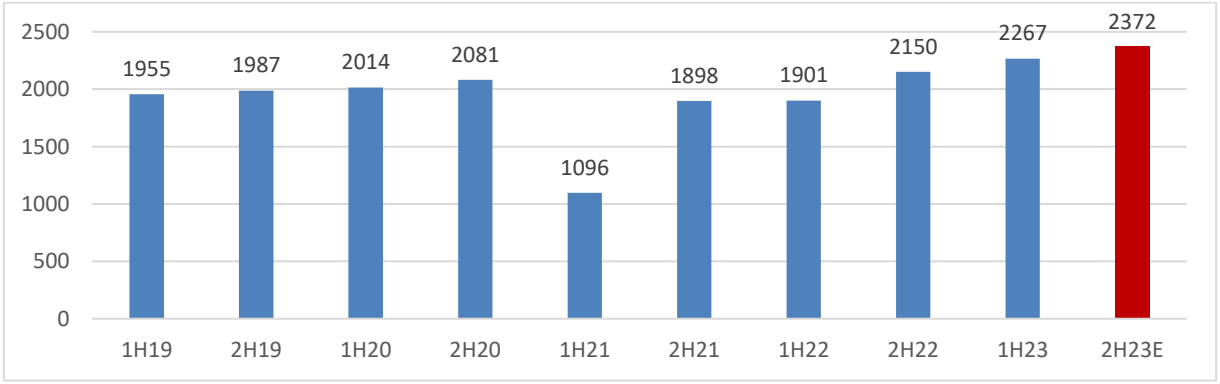


Source: Company data, ASB Research

The above revenue is prior to internal eliminations due to Logistics accounting for the revenue to franchisees. This is a true reflection of the divisions output. We assume growth in FY23E at the rate of food inflation and 4% volume growth. In FY24E we apply 5.5% and 2.5% volume growth. This equates to 11.3% and 8.1% growth in FY23E and FY24E. Intergroup eliminations amounted to 94.4% of revenue at 1H23, we apply 94% for the full year. Net Manufacturing revenue (or revenue from third parties) is therefore R183m.

Logistics

Figure 32 Logistics revenue by reporting half – R'm

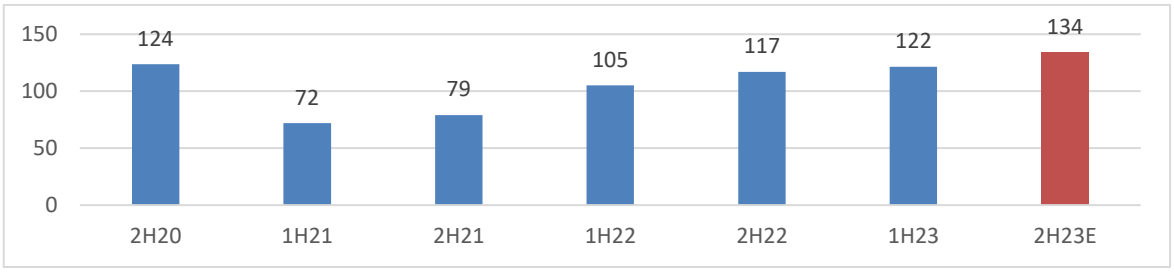


Source: Company data, ASB Research

As indicated previously this should move in line with franchise revenue on a see-through basis. This has not been the trend over COVID-19 given unique circumstances to both divisions. However, if we compare growth in Logistics to that of Leading Brands from FY18 to FY22, they are up 7.2% and 7% respectively. We therefore forecast Logistics Revenue in line with Leading Brands in the medium term. However, for FY23E, growth will be lower as Leading brands is benefiting from the sharp drop in franchisee financial support. Growth at 1H23 was 19.2%. We anticipate growth of 14.5% for FY23E, representing 7% volume growth and 7% inflation growth. We have this declining to 8.1% in FY24E.

Retail

Figure 33 Retail revenue by reporting half – R'm

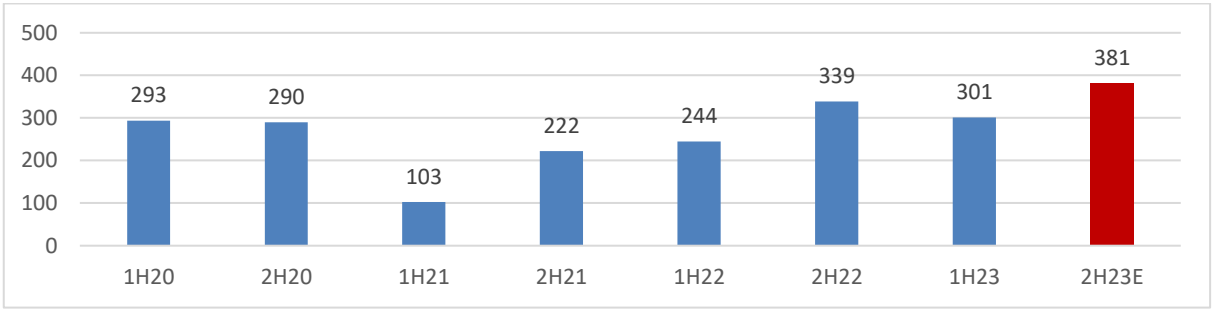


Source: Company data, ASB Research

Growth was up 47% in FY22. There were 16 new product lines introduced in FY22 and a further 12 envisaged for FY23, 4 already rolled out in 1H23. Demand for the products remains strong given the trends towards home consumption, particularly with affordability under pressure. Growth was 15.5% in 1H23. We maintain this growth rate for FY23E and forecast 13% growth in FY24E given ongoing product rollout. In the medium term, this category should show the strongest revenue growth of all divisions given its low base and growing product offering.

Marketing

Figure 34 Marketing revenue by reporting half – R'm

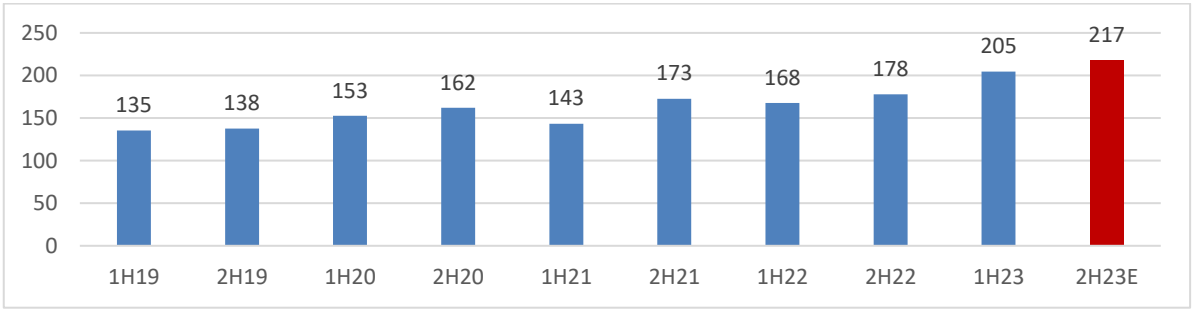


Source: Company data, ASB Research

As with royalties, marketing fee revenue is also earned as a % of franchisee revenue. We therefore model its growth at the same levels as Leading Brands – 17% in FY23E and 7% in FY24E. At 1H23 its revenue was up 23.3% compared to Leading Brands at 24.7%.

AME

Figure 35 AME revenue by reporting half – R'm



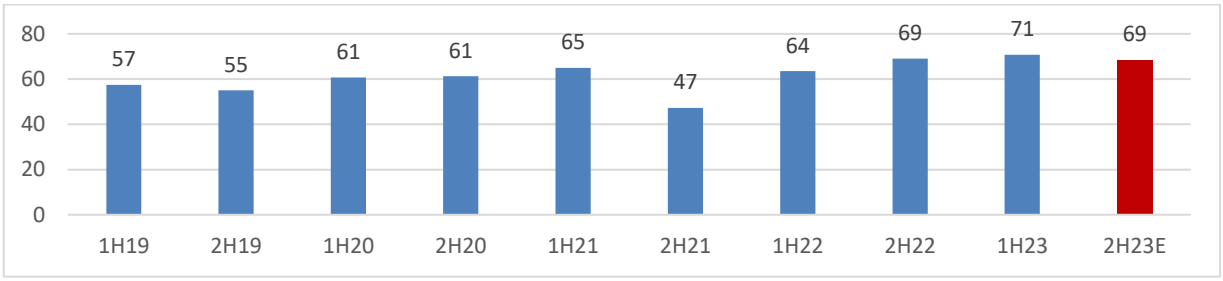
Source: Company data, ASB Research

AME represents an area of opportunity for the group. To date its performance has been below expectations. However, management continues to roll out new stores - a net gain of 7 restaurants in 1H23. The 1H23 result included some breakdown of the AME revenue, albeit its limited and misleading. Botswana comprised R166.4m of revenue, 81% of revenue. This is significant as it only accounts for 14% of stores. This is because these are largely company owned stores (as it also accounts for the bulk of non-current assets) skewing the numbers considerably.

Revenue from AME is anticipated to rise considerably higher than SA in the medium term given the rate of expansion and higher growth prospects. 1H23E saw revenue up 21.9% and we anticipate the same growth rate for the full year. We forecast 9% growth in FY24E.

UK

Figure 36 UK revenue by reporting half – R'm



Source: Company data, ASB Research

There was a strong recovery in restaurant spend in the UK post COVID-19. This has, however, been negated by high inflation, higher interest rates and spiraling energy costs. 1H23 saw 3 restaurants open and 3 close. Revenue was up 11% in 1H23, however, we anticipate a more challenging 2H with revenue up 5% for the year. We forecast 3% growth in FY24E given the strained operating environment.

Figure 37 Divisional revenue forecast – R'm

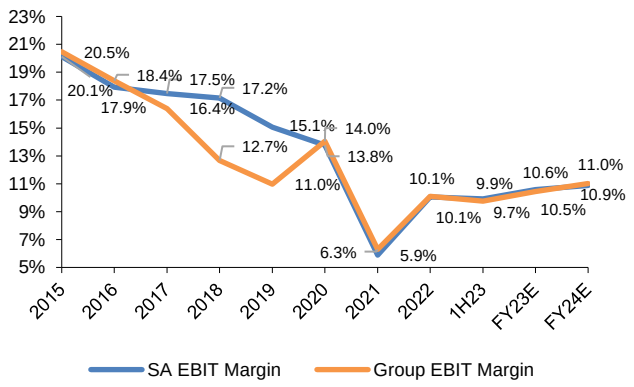
REVENUE	FY22	1H23	2H23E	FY23E	%	FY24E	%
Leading brands	773	431	473	904	17%	967	7%
Signature brands	145	103	122	225	55%	243	8%
	918	533	596	1129	23%	1210	7%
Supply Chain	4496	2468	2611	5079	13%	5488	8%
Manufacturing	222	80	105	185	-17%	183	-1%
Gross	2,770	1,438	1,644	3,082	11%	3,333	8%
Eliminations	-2,548	-1,359	-1,539	-2,898	14%	-3,150	9%
Logistics	4052	2267	2372	4639	14%	5016	8%
Retail	222	122	134	255	15%	289	13%
Marketing funds	583	301	381	682	17%	730	7%
Corporate	1	1	1	2	40%	2	10%
South Africa	5998	3304	3588	6892	15%	7431	8%
	478	275	286	561	17%	603	8%
UK	133	71	69	139	5%	143	3%
AME	346	205	217	422	22%	460	9%
TOTAL	6476	3579	3874	7453	15%	8034	8%

Source: Company data, ASB Research

In total we forecast 15% and 8% growth in group revenue for FY23E and FY24E respectively.

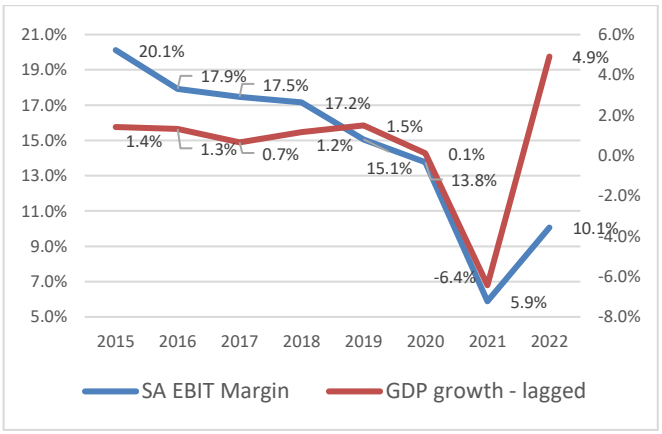
EBIT

Figure 38 SA vs Group EBIT margins – 1H23



Source: Company data, ASB Research

Figure 39 Margins vs GDP growth – FY22



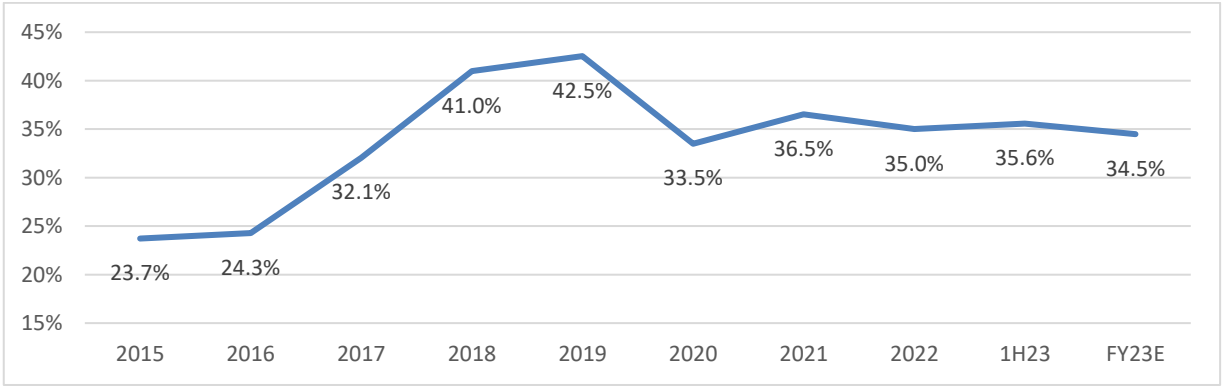
Source: Company data, ASB Research

EBIT margins have been declining since FY15, both at a group and SA level. Despite the recovery in FY22, margins are at depressed levels. This is a function of intensified competition in QSR and the operating environment which has included COVID-19, KZN unrest and floods as well as weak GDP growth. GDP growth impacts affordability as well as capacity utilisation of the supply chain. In Figure 39 we find a strong visual correlation between GDP growth and margins.

If the SA economy can produce 1.5% GDP growth p.a over the next three years, despite being weak, it's an improvement on the average growth rates since 2015. Margins should therefore expand as a result but high inflation, rising interest rates impacting affordability and electricity supply issues are headwinds. Further efficiencies from the Supply Chain and higher recovery rates on royalty fees will provide tailwinds to margins. We take a cautious view on our margin expansion assumptions given the aforementioned risks.

Operating costs

Figure 40 Operating costs as a % of revenue



Source: Company data, ASB Research

In the chart above we plot operating costs as a % of revenue. GBK adds noise to the numbers in FY17 to FY19. The more recent data points are more stable. There are, however, many moving parts that makes this analysis prone to error, namely revenue mix, company stores owned and franchisee royalty rebates. Some improvement is anticipated as royalty fee rebates decline and operating efficiencies in the Supply Chain are unlocked.

For the first time in 1H23, management provided a breakdown of its operating expenses, although FY22 full year comparatives were not disclosed. Prior to this it has been disclosed as a single line item. The revised breakdown is still fairly limited as its across three broad groups, namely administration, marketing and operations:

- Administration – these costs include professional fees.
- Marketing costs – these costs grow in line with marketing revenue collected from franchisees. Funds received are ringfenced and are for marketing purposes only. In 1H23 marketing costs and marketing revenue grew in line with each other.
- Operations – the primary cost would be salaries and head office costs. Costs would rise as the number of company owned stores rises which was the case in 1H23. Depreciation and amortization of intangibles is also included.

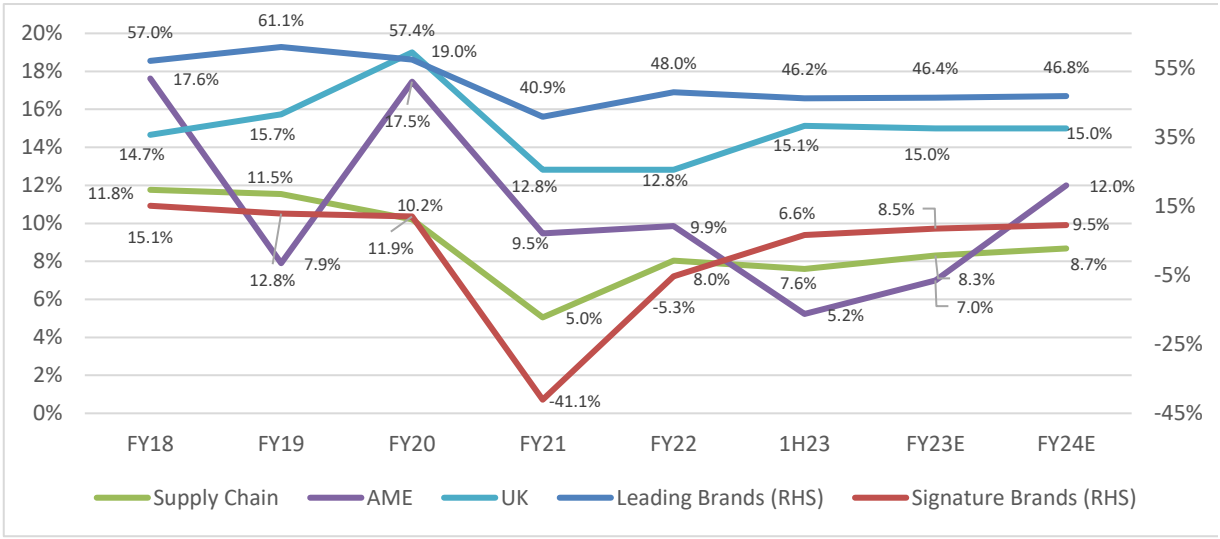
Total costs were up 13.2% in 1H23. Excluding marketing costs (matched by revenue), depreciation and amortization, the remaining costs were up 12.9% in 1H23. Salary increases were negotiated at 4.5% while staff numbers increased due to new stores and interns being onboarded.

We have costs growing at 13.4% for FY23E (34.5% of revenue), broadly in line with the 1H23E growth rate, impacted by rising inflation, higher marketing costs in line with marketing revenue, load shedding related costs and elevated fuel costs. Where landlords do not provide a load shedding solution, operating costs will rise given the need for generators and diesel. This will ensure stores remain open and productive. Whilst these are franchisee costs, they may see some relief in royalties to fund the costs as its important for the group and the brand that these stores remain open.

We model revenue and EBIT for each segment, deriving group numbers. Our cost estimates are therefore both top down and bottom up driven.

Outlook for margins

Figure 41 EBIT Margins



Source: Company data, ASB Research

Whilst the margins between the different divisions and brands can't be compared (given the revenue recognition differentials), the trend is important to note. There is scope for improvement in all categories but particularly in Signature brands and AME. AME is down from 18% to 5.2% and Signature brands is down from 15.1% to 6.6%. These divisions are anticipated to recover from current levels (or potentially face closure as was the case with GBK) providing margin expansion.

Leading Brands SA's margin peaked at 61.1% in FY19 and has declined to 46.2% in 1H23. The environment is unlikely to improve much in the short term. We envisage margins to widen slightly in 2H23E as financial assistance to franchisees has largely come to an end and menu prices are tracking food inflation more closely – menu price increases were constrained during COVID-19. Costs to manage the franchisees are largely fixed. Management has indicated a recovery in margins, however, we believe returning to FY20 levels of 57.4% will be very challenging given the environment. Given poor visibility, our assumptions are conservative, and we model for a gradual margin expansion - 46.4% in FY23E and 46.8% in FY24E. With the highest margins across the group, Leading Brands attracts the highest forecast risk to EBIT.

Signature Brand SA's margin recovered nicely in 1H23 to 6.6% but remains well off its peak of 15.1% in FY18. A normalised hospitality operating environment will see margins recover. We envisage margins to track back towards 12% (level seen in FY20) over the next three years. We forecast 8.5% in FY23E and 9.5% in FY24E.

Supply Chain's margin remained under pressure in 1H23 at 7.6%, after peaking at 11.8% in FY18. Manufacturing was hard hit in FY21 when menu price hikes were delayed resulting in margins declining to a low of 8.6%. These have risen to 9.9% in 1H23 and we anticipate a further widening given increasing volumes and high food inflation. We forecast 10.4% and 10.8% in FY23E and FY24E. We are conservative in our estimates as management is targeting a return to 15%. Logistics operates on tiny margins, between 1.5-2.5%. These have risen to 2.1% in 1H23, in line with FY19, on the back of increased volumes and efficiency gains in the distribution network. There is scope for a further widening if fuel costs normalise. We envisage margins to rise to 2.3% by FY25E.

Retail – Retail incurred a loss in 1H23 due to the write down of inventory, particularly coffee. In prior years it has made a negligible contribution to the group. We forecast an EBIT margin of 1.5% in FY23E, rising to 2% in FY24E, a level we believe is sustainable.

UK's 1H23 operating profit declined from R8m to a loss of R20m due to an asset impairment of R31m. Excluding the impairment in 1H23, the operating profit rose 38% with higher margins of 15% vs 13%. The margin is well off the high of 19% in FY20. Given the challenging operating environment, we model for margins to stay broadly in line with 1H23 for FY23E and FY24E.

AME's 1H23 margin is at lows of 5.2%. The margin is misleading as it depends on the mix of company owned stores and franchisees. The former having risen in 1H23. As company owned stores are converted to franchisees margins will rise. This is the medium-term strategy for AME. Franchisee financial support has also largely been removed. Certain projects have been delayed in 1H23 due to equipment shortages and shipping challenges, thereby impacting the results, however, this should unwind in 2H23E. We anticipate these margins to rise from these levels and would anticipate a 7% margin in FY23E and 12% by FY24E.

Figure 42 Recurring EBIT outlook

EBIT	FY22	1H23	2H23E	FY23E	%	FY24E	%
Leading brands	371	199	221	419	13%	453	8%
Signature brands	-8	7	12	19	>100%	23	21%
	363	206	233	439	21%	476	8%
Supply Chain	361	188	234	422	17%	476	13%
Manufacturing	299	143	178	321	7%	360	12%
Logistics	60	47	51	97	61%	110	13%
Retail	2	-2	6	4	139%	6	51%
Corporate	-121	-66	-66	-132	9%	-144	9%
South Africa	604	328	401	728	21%	808	11%
	51	21	29	50	-1%	77	52%
UK	17	11	10	21	23%	22	3%
AME	34	11	19	30	-13%	55	87%
TOTAL	655	349	430	779	19%	885	14%

Notes: 1H23 excludes the GBK dividend. 1H23 and FY22 exclude the impairment of goodwill. There are rounding differences in the schedule

Source: Company data, ASB Research

Debt and capex

After peaking post the GBK transaction, net debt levels (incl lease liabilities) have declined from R2.6bn in FY17 to R0.8bn in 1H23. Debt has been redeemed through internal cash generation and the suspension of dividends in particular years. Debt is very manageable at current levels with a 1.4x net debt /equity, 7x interest cover and 1.3x net debt/EBITDA in FY22.

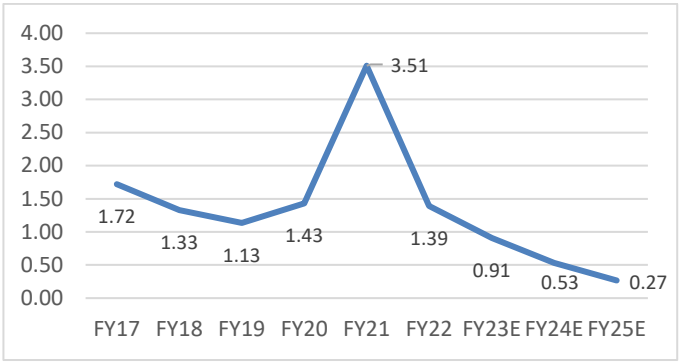
Debt of R150m was voluntarily repaid in 1H23 and we see scope for further redemption of debt whilst investing in the business and resuming dividends. We forecast net debt of R623m in FY24E.

Management continues to assess potential acquisitions across all geographies, the chicken segment in SA being an obvious target. A meaningful transaction could be financed with debt given the low gearing levels. Debt covenants with banks are generally at 3x interest cover and 2.25x net debt/EBITDA. On the latter it implies appetite for additional debt of approximately R700m.

Debt is largely variable based and around 1.75% above JIBAR, currently 8.25%. We have the interest expense declining from R125m to R117m in FY23E, benefitting from debt redemption and improved bank financing rates. We have it declining further to R102m in FY24E.

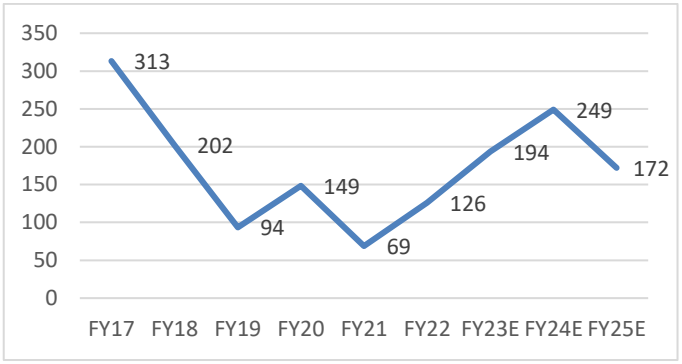
Capex of R60m was incurred in 1H23, down from R69m in 1H22. There is ongoing investment in company owned stores in AME as well as customer facing technology in Leading Brands and improvements in Manufacturing infrastructure. Logistics will require some additional spend in 2H23E. The proposed acquisition of the Midrand Campus from the founding shareholders will result in higher capex in FY24E as the Supply Chain activities are consolidated in Midrand. This includes a new cold storage facility. Guidance is for Capex to rise to approximately R190m in FY23E. We estimate capex to rise to circa R250m in FY24E with normalised levels of around R170m achievable in FY25E.

Figure 43 Net debt/equity (incl. lease liabilities)



Source: Company data, ASB Research

Figure 44 Net capex – R'm



Source: Company data, ASB Research

Headline earnings

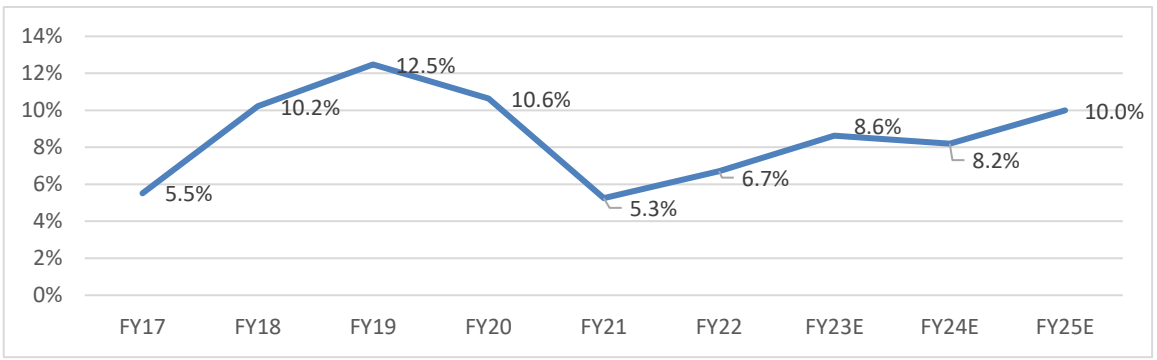
1H23 saw HEPS up 121% to 215c. This reflects a normalising environment post COVID-19. However, the first three months still featured some COVID-19 restrictions and the KZN floods had a considerable impact on trading in that province, particularly as it disrupted the tourism season. September and October have been subdued months according to management but there is optimism around Black Friday and the summer holiday season. Franchisee support will also be lower in 2H, as well as debt levels. Therefore, we forecast a stronger 2H, with FY23E HEPS at 460c. We have a 46.5%: 53.5% split between 1H23 and 2H23E.

Our FY23E HEPS forecast is broadly in line with FY15 HEPS, despite having approximately 300 more restaurants. This is s simplistic indication of the potential for strong earnings growth from the current base. We forecast 19% growth in FY24E, equating to 548c. This will reflect a full year of normalised operating conditions. FY24E benefits from lower finance costs, with recurring EBIT up 14%. We forecast 18% HEPS growth in FY25E.

A 56% and 60% dividend payout ratio was implemented in FY22 and 1H23. We forecast a 60% payout for FY23 and 70% for FY24E. Payout ratios were above 70% pre the GBK acquisition.

Valuation

Figure 45 Free Cash Flow Yield



Source: Company data, ASB Research

FBR generates strong cash flows, as shown by its ability to pay down the significant debt it incurred for GBK while expanding the business with new store rollouts. Even during the height of COVID-19 it continued to generate a positive free cash flow yield. We have the yield rising in FY23E, dropping in FY24E due to the additional capex required for the Midrand campus and rising again thereafter to 10%.

Figure 46 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	10.4%
Beta	0.9
Market risk premium	6.5%
Marginal tax rate	28.0%
Pre-tax cost of debt	8.5%
Cost of equity	16.3%
Forecast debt/value ratio	50%
Forecast equity/value ratio	50%
WACC	11.2%
Growth Rate assumption	
Sustainable long term growth rate	4%

Source: ASB estimates, FactSet

Figure 47 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
Terminal Growth	3.0%	8908	8211	7600	7061	6581
	3.5%	9352	8582	7913	7327	6809
	4%	9868	9008	8269	7627	7064
	4.5%	10474	9503	8678	7969	7353
	5%	11198	10086	9154	8362	7681

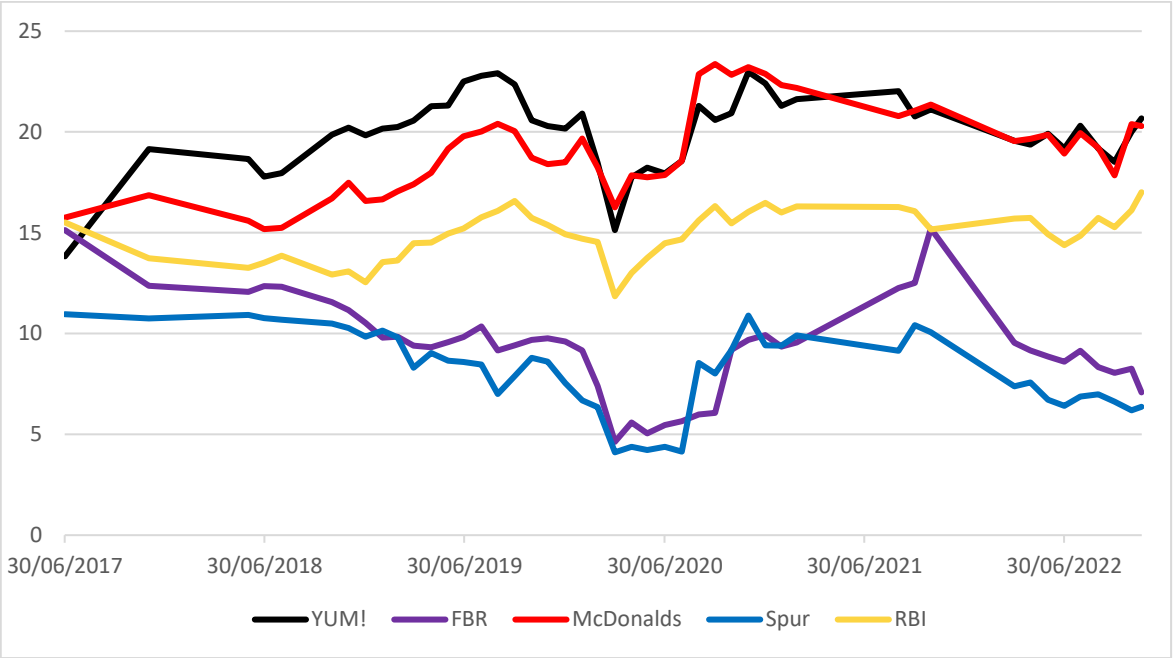
Source: ASB estimates

We apply the prevailing risk-free rate of 10.4%, a long-term growth rate of 4%, Beta of 0.9 (as per Bloomberg) and a debt/equity of 50:50 including lease liabilities. This results in a revised WACC of 11.2%. Our valuation range equates to R73.27-R95.03/share, a mid-point valuation of R82.69.

Based on our HEPS forecasts, the stock trades on a 18m forward P/E of 11.3x, a 6.8x EV/EBITDA. In the five years leading up to the GBK transaction it traded at an average 26x P/E. Achieving that sort of multiple in today's market seems very ambitious given the more competitive operating landscape, the weak economic growth and the more frequent occurrence of business interruptions, primarily load shedding. However, a 57% P/E discount to this historic P/E average seems overdone particularly as the balance sheet health improves significantly, we forecast a three-year CAGR in HEPS of 22% and free cash flow yields rise. Our fair DCF valuation mid-point values the group on a 6m forward P/E of 18x which we don't believe is demanding given its HEPS growth outlook. The stock trades on an attractive 18m forward 6.2% dividend yield.

As per FactSet, on a trailing 12m P/E, FBR trades at 12.9x compared to 15.3x for Spur Corporation. Yum! Brands, McDonalds and Restaurant Brands International (Burger King, Popeyes) trade on 32x, 34x and 22x historic P/E's respectively.

Figure 48 EV/EBITDA – FBR vs. local and global peers



Source: FactSet, ASB Research

In the chart above we plot the EV/EBITDA of FBR, Spur, McDonalds, Yum! Brands and RBI over the past 10 years. Up until 2017 the SA stocks were more highly rated than their global peers! Of interest is the derating of Spur in line with FBR post 2017, despite FBR occurring all the issues with the GBK acquisition. This suggests a considerable component of the derating is the SA landscape which has become more competitive but also the lack of economic growth that has impacted these stocks given their reliance on growing consumer spend. Its hard to argue a return to superior valuations given the SA backdrop, but we believe a rerating of the SA counters is justified, with particular reference to FBR and its strong earnings growth outlook as per our forecasts. Unlike the global peers, the SA counters have not rerated back to pre-COVID-19 levels.

As per Figure 50, FBR has underperformed the ALSI by 53% over the past 5-years, made worse by the fact that it was outperforming by 30% after the GBK transaction was announced.

Figure 49 Famous Brands share price – 5yrs

Source: FactSet, ASB Research

Figure 50 Share price rel to ALSI – 5yrs

Source: FactSet, ASB Research

Risks

- Affordability pressure on SA consumers from rising inflation, rising interest rates and an economy that is struggling to improve. Its AME strategy mitigates some of this risk, but it remains small in the context of the group.
- Tourism – the decline in local and foreign tourists in SA as a consequence of COVID-19 had a negative impact on sales. Whilst recovering, it's not back at pre COVID-19 levels, particularly given local airline capacity declines.
- Load shedding – this is impacting the operations of its franchisees, particularly those that are in premises where landlords have not put alternative energy sources in place. Where possible alternatives will be sought with the potential assistance of the group.
- Business interruptions from events like COVID-19, unrest and adverse weather. This can't be predicted but the management team has firsthand knowledge on how to deal with it. Insurance cover was in place for the KZN unrest.
- Reputational damage – social media, whilst beneficial from a marketing perspective, can have negative consequences. This is closely monitored with plans to address any adverse media.
- Regulation such as a health promotion levy which has been previously discussed.

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