Famous Brands

ANCHOR STOCKBROKERS

Load shedding impacts the margin recovery

Date: 06 June 2023

- Famous Brands achieved a robust recovery post Covid 19, HEPS up 37% to 488c, ahead of our 460c forecast. Strong cash flow generation and a healthy balance sheet facilitated an impressive 2H23 dividend of 233c, bringing the full year DPS to 363c, a 68% payout ratio with scope for it to rise further.
- Revenue growth benefited from high food inflation, recovering volumes and a normalisation in royalty fee recovery rates. Leading brands was up 17% and in line with our estimates. Signature brands has recovered strongly post Covid but short of expectations as consumer affordability is challenged. The Supply Chain performed better than expected and is running optimally whilst having to navigate load shedding challenges. Persistently high food inflation (13.6% in Feb 23) should deliver double digit growth in revenue in FY24E (+10.7%), despite anticipated increases in franchisee support due to load shedding.
- GP margins came under greater pressure than anticipated, primarily in 2H, as it became increasingly more difficult to pass on costs to franchisees. GP margins declined from 45% to 42.7% and we envisage them to remain under further pressure into FY24E. Recurring operating margins improved from 10.1% to 11.1% but have not achieved pre Covid levels of 14%. The medium-term outlook is for group margins to continue to improve but loadshedding related costs will hamper FY24E margins, with high forecast risk. At present around 90% (up from 80% in February 2023) of franchisees are able to operate during load shedding. We forecast a slight decline in margins to 11%, led by the SA operations.
- Signature brands remains under review; however, it remains a difficult operating environment to assess the true potential of the brands. Consumers spend is under pressure and finding franchise partners is difficult. The hospital brands and Paul are performing well. Net store numbers declined by 6. We forecast R20.2m of EBIT in FY24E, still below the R22.8m in FY20. Whilst expansion in AME continues, its performance is disappointing – it has circa 10% of stores but only delivers 3% of group EBIT, in part due to expansion costs. We forecast a considerable improvement in its EBIT in FY24E, up 80%, but still below FY20.
- Net debt remained flat, compared to our forecast of a decline. Inventory build up to capitalise on favourable pricing and prevent supply disruptions together with the higher dividend were the primary drivers of the outcome. Capex of R162m was lower than expected and management is guiding for R405m in FY24E, boosted by property investments.
- Management remains confident around the growth prospects for the business, despite the challenging environment. Value offerings , retail partnerships, loyalty programmes, home delivery, piloted new brands, net new store growth and ongoing marketing initiatives are areas of focus to ensure continued share of consumer wallet. We forecast HEPS growth of 10% in FY24E and 16% in FY25 as load shedding related costs are absorbed.
- In our DFCF valuation we calculate a fair value range of R71.69-R89.44, a mid-point of R80. The stock is trading on a forward 11.3x PE.

ZAR'm (to February)	FY22	FY23	FY24E	FY25E
Revenue	6,476	7,444	8,243	8,861
EBITDA	851	1,105	1,169	1,327
Headline earnings	357	489	537	624
HEPS (ZAc)	356	488	535	622
PE Ratio	20.1	12.4	11.3	9.8
Dividend (ZAc)	200	333	401	466
Dividend yield	2.8%	5.5%	6.6%	7.7%

Analyst
Sven Thordsen
+44 (0) 752 367 6780
sthordsen@anchorsb.co.za

Price (06/06/2023):	R60.71
Market cap	R6083mn
Shares in issue	100.2mn

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Price performance - ZAR

Source: FactSet

Figure 1 Financial summary

Year Ending	FY2020 A	FY2021 A	FY2022 A	FY2023 A	FY2024E	FY2025E	FY2026E
Income Statement							
Sales	6,495	4,684	6,476	7,444	8,243	8,861	9,479
Sales growth (%)	*-15.9%*	*-27.9%*	*38.3%*	*14.9%*	*10.7%*	*7.5%*	*7.0%*
EBITDA	1,079.8	481.2	850.7	1,104.6	1,168.8	1,327.3	1,432.4
EBITDA Margin (%)	*16.6%*	*10.3%*	*13.1%*	*14.8%*	*14.2%*	*15.0%*	*15.1%*
EBIT	912.1	119.2	629.5	861.1	902.7	1,016.8	1,150.6
EBIT Margin (%)	*14.0%*	*2.5%*	*9.7%*	*11.6%*	*11.0%*	*11.5%*	*12.1%*
Profit before tax	753.0	-69.6	514.0	769.4	790.7	918.2	1,086.5
Net profit	532.8	-104.9	355.4	555.4	570.9	663.9	785.6
Net profit post minorities	362.4	-1,239.1	317.6	524.3	536.6	624.1	738.4
Recurring EBITDA	1,079.8	481.2	850.7	1,029.1	1,168.8	1,327.3	1,432.4
Recurring EBITDA Margin (%)	*16.6%*	*10.3%*	*13.1%*	*13.8%*	*14.2%*	*15.0%*	*15.1%*
Recurring EBIT	912.1	294.7	654.6	826.2	902.7	1,016.8	1,150.6
Recurring EBIT Margin (%)	*14.0%*	*6.3%*	*10.1%*	*11.1%*	*11.0%*	*11.5%*	*12.1%*
Headline earnings	417.4	-86.8	356.8	488.9	536.6	624.1	738.4
Underlying Net profit margin (%)	*6.4%*	*-1.9%*	*5.5%*	*6.6%*	*6.5%*	*7.0%*	*7.8%*
Reported EPS (ZAR)	3.61	-12.34	3.17	5.23	5.35	6.22	7.34
HEPS (ZAR)	4.17	-0.87	3.56	4.88	5.35	6.22	7.34
EPS Growth	*31.9%*	*-120.8%*	*-511.0%*	*37.0%*	*9.7%*	*16.1%*	*18.1%*
DPS (ZAR)	0.90	0.00	2.00	3.33	4.01	4.66	5.87
Payout ratio (%)	*21.6%*	*0.0%*	*56.2%*	*68.3%*	*75.0%*	*75.0%*	*80.0%*
Balance Sheet							
Cash and Cash equivalents	486.3	444.4	456.2	445.5	411.1	517.3	507.7
Current asset (ex – all cash)	1,046.0	856.2	878.6	1,095.9	1,184.3	1,262.3	1,339.1
Net Fixed assets	2,226.8	667.1	640.4	904.1	1,064.1	962.3	911.9
Intangible assets	2,274.9	917.5	871.6	850.5	836.5	822.8	809.3
Investments	62.3	21.7	9.4	12.1	12.1	12.1	12.1
Other assets	77.0	86.4	103.4	124.6	130.8	137.4	144.2
Total assets	**6,173.3**	**2,993.3**	**2,959.6**	**3,432.7**	**3,639.0**	**3,714.2**	**3,724.4**
Debt excl lease liabilities	1,678.0	1,470.7	1,138.2	1,218.1	1,118.1	898.1	578.1
Lease liabilities	1,383.2	345.0	321.3	339.0	355.4	369.7	384.4
Current liabilities	993.4	700.9	698.6	810.0	920.8	973.8	1,024.8
Other liabilities	318.1	85.8	81.0	89.9	94.3	98.9	103.7
Total liabilities	**4,372.7**	**2,602.4**	**2,239.1**	**2,457.0**	**2,488.7**	**2,340.5**	**2,091.0**
Shareholders' equity	1,680.0	269.5	601.2	843.9	986.3	1,172.0	1,386.8
Minorities	120.3	121.2	119.3	131.9	166.2	206.0	253.1
Total shareholders' equity	**1,800.3**	**390.7**	**720.5**	**975.8**	**1,152.5**	**1,378.0**	**1,639.9**
BVPS (ZAR)	*18.0*	*3.9*	*7.2*	*9.7*	*11.5*	*13.7*	*16.3*
ROE (%)	*25.1%*	*-7.9%*	*64.2%*	*57.6%*	*50.4%*	*49.3%*	*48.9%*
Debt ex leases							
Debt: Ebitda	*1.6*	*3.1*	*1.3*	*1.2*	*1.0*	*0.7*	*0.4*
Interest Cover	*5.1*	*2.5*	*6.8*	*8.4*	*8.2*	*10.6*	*15.1*

Year Ending	FY2020 A	FY2021 A	FY2022 A	FY2023 A	FY2024E	FY2025E	FY2026E
Cash Flow							
Reported net profit	**362.4**	**-1,239.1**	**317.6**	**524.3**	**536.6**	**624.1**	**738.4**
Change in net working capital	111.9	41.7	-47.0	-145.2	22.4	-25.0	-25.8
Other adjustments	466.8	1,487.6	306.0	299.5	308.5	355.9	334.7
Dividends paid	-249.1	-5.5	-43.9	-355.6	-394.2	-438.4	-523.6
Cash flow from operations	**692.0**	**284.7**	**532.7**	**323.0**	**473.4**	**516.5**	**523.7**
Net Capex	-148.6	-68.8	-126.1	-150.2	-412.2	-194.9	-218.0
Capex/sales (%)	*2.3%*	*1.5%*	*1.9%*	*2.0%*	*5.0%*	*2.2%*	*2.3%*
Other investing cash flows	32.6	12.0	8.6	-204.7	0.0	0.0	0.0
Cash flow from investing	**-116.0**	**-56.8**	**-117.5**	**-354.9**	**-412.2**	**-194.9**	**-218.0**
Equity raised/(bought back)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net inc/(dec) in borrowings	-430.0	-188.3	-332.7	2.2	-100.0	-220.0	-320.0
Other financing cash flows	-123.8	-134.2	-100.2	-80.0	4.4	4.6	4.8
Cash flow from financing	**-553.8**	**-322.5**	**-432.9**	**-77.8**	**-95.6**	**-215.4**	**-315.2**
Net cash flow	**31.7**	**-94.6**	**-18.6**	**-99.9**	**-34.4**	**106.2**	**-9.5**
Free cash flow	**822.9**	**418.8**	**519.0**	**595.2**	**559.3**	**853.0**	**887.6**
Lease payments	**-123.4**	**-73.5**	**-77.8**	**-85.7**	**-90.0**	**-94.5**	**-99.2**
Net free cash flow	**699.5**	**345.3**	**441.2**	**509.5**	**469.3**	**758.5**	**788.4**
ValuationSummary							
Share Price (ZAR)	53.60	46.03	71.53	71.53	71.53	71.53	71.53
P/E (Underlying) (x)	12.9	-53.1	20.1	14.7	13.4	11.5	9.7
P/BV (x)	3.0	11.8	9.9	7.3	6.2	5.2	4.4
EV/EBITDA (x)	6.7	15.1	8.5	6.6	6.2	5.5	5.1
EV/EBIT (x)	7.9	60.8	11.5	8.4	8.0	7.1	6.3
FCF Yield (%)	11.6%	5.7%	7.3%	8.5%	7.8%	12.6%	13.1%
Dividend Yield (%)	1.7%	0.0%	2.8%	4.7%	5.6%	6.5%	8.2%
Net Debt	2,575	1,371	1,003	1,112	1,062	750	455
Debt/Equity	1.43	3.51	1.39	1.14	0.92	0.54	0.28
Net Debt (excl lease liabilities)	1,192	1,026	682	773	707	381	70
Debt/Equity (excl lease liabilities)	0.66	2.63	0.95	0.79	0.61	0.28	0.04

Source: Company data, FactSet, ASB estimates

Revenue

FY23 reported a sharp recovery in revenue post Covid, with SA operations achieving new highs. High food inflation has been a big driver as volumes still lag in certain segments. Royalty fee recovery rates are back at pre Covid 19 levels, however, they are envisaged to drop now that aid is being offered to franchisees for load shedding related costs. This will be facilitated by fee rebates during times of load shedding, commencing March 2023.

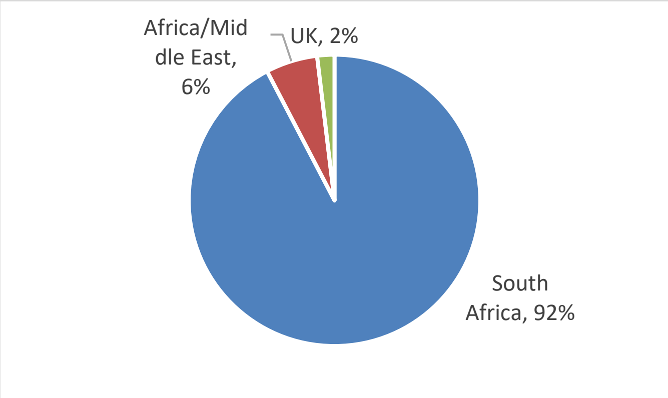
As per the table below, we forecast 10.7% revenue growth for the group in FY24E, still benefiting from persistently high food inflation of circa 13%. Revenue growth drops to 7.5% in FY25E as inflation is anticipated to fall. Retail is coming off a low base and is benefiting from a significant expansion in product offering. AME is anticipated to benefit from ongoing store rollouts in faster growing regions. AME will be negatively impacted by the closure of its Sudan stores due to conflict since the start of FY24E – there are 6 stores in total, circa 3% of total AME stores. Should hostilities end these stores are envisaged to reopen.

Fig 2 Revenue segmental breakdown

REVENUE	FY22	FY23	%	FY24E	%	FY25E	%
Leading brands	773	904	17%	990	9.5%	1059	7.0%
Signature brands	145	203	40%	225	11.0%	247	10.0%
	918	1107	21%	1215	9.8%	1307	7.6%
Supply Chain	4496	5153	15%	5712	10.8%	6133	7.4%
Manufacturing	222	175	-21%	200	14.2%	214	7.1%
Gross	2,770	3,006	9%	3,328	10.7%	3,564	7.1%
Eliminations	-2,548	-2,831	11%	-3,128	10.5%	-3,350	7.1%
Logistics	4052	4705	16%	5184	10.2%	5552	7.1%
Retail	222	273	23%	328	20.0%	367	12.0%
Marketing funds	583	612	5%	670	9.5%	717	7.0%
Corporate	1	2	69%	2	10.0%	3	7.0%
South Africa	5998	6874	15%	7599	10.6%	8160	7.4%
	478	570	19%	644	13.0%	701	8.8%
UK	133	142	7%	152	7%	160	5.0%
AME	346	428	24%	492	15%	541	10.0%
TOTAL	6476	7444	15%	8243	10.7%	8861	7.5%

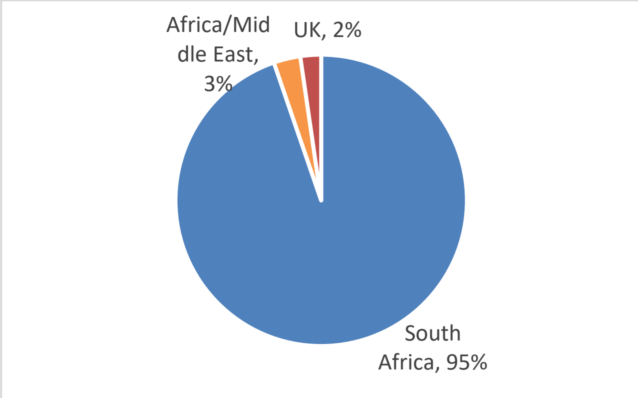
Source: Company data, ASB Research

Figure 3 FY23 – revenue mix



Source: Company data, ASB Research

Figure 4 FY23 – EBIT mix



Source: Company data, ASB Research

EBIT

Figure 5 Recurring EBIT segmental breakdown

EBIT - recurring	FY22	FY23	%	FY24E	%	FY25E	%
Leading brands	371	462	24%	495	7%	535	8%
Signature brands	-8	14	-277%	20	49%	27	34%
	363	475	31%	515	8%	562	9%
Supply Chain	361	416	15%	443	7%	495	12%
Manufacturing	299	302	1%	319	6%	356	12%
Logistics	60	114	89%	114	0%	128	12%
Retail	2	0	-88%	10	4816%	11	12%
Corporate	-121	-108	-11%	-121	12%	-130	8%
South Africa	604	784	30%	838	7%	928	11%
	51	44	-15%	65	49%	89	38%
UK	17	19	12%	21	8%	24	18%
AME	34	25	-28%	44	81%	65	47%
TOTAL	655	827	26%	903	9%	1017	13%

Source: Company data, ASB estimates

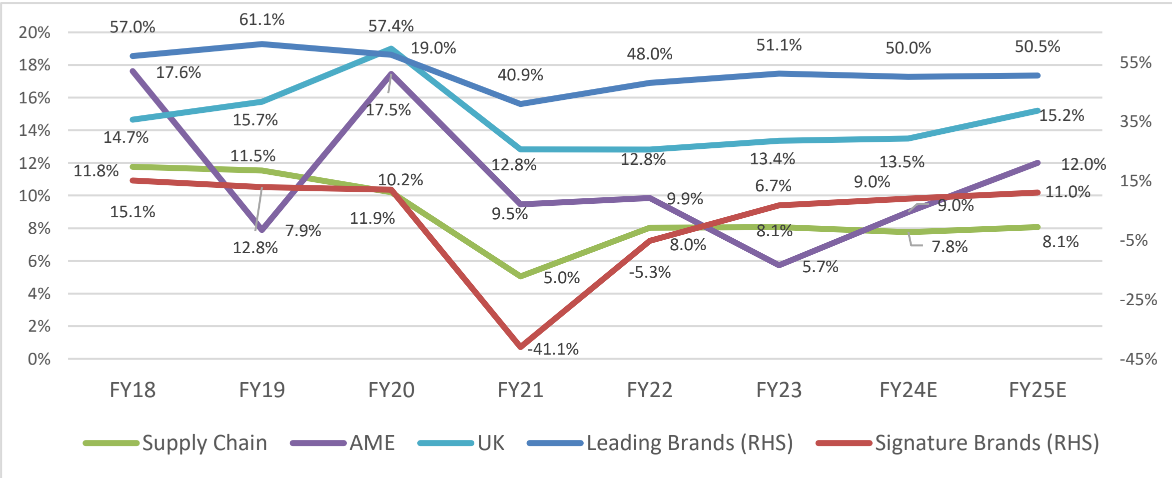
Observations:

- The above excludes the GBK liquidation dividend of R74.7m

- Leading brands margins recovered well in FY23 to 51.1%, however still well short of pre Covid levels of 57.4%. Lower royalty fee recoveries due to load shedding and the inability for consumers to absorb persistently high food inflation will place short term pressure on margins. We forecast the margin to decline to 50% in FY24E and recover gradually thereafter.
- Signature brands margins also improved significantly (to 6.7%) in FY23E and we see scope for further recovery given the low base – we forecast a 9% margin, still well short of the 11.9% in FY20. Management believes this business should deliver 15% margins. Its performance remains under review, there are however certain brands performing well.
- The supply chain will be negatively impacted by load shedding given considerable increases in diesel spend. In 1H23 circa R3m was spent on diesel, this increased to R12m in 2H23. Post February power outages have intensified and the outlook for winter remains negative – we therefore could see diesel costs nearing R35-40m in FY24E. We forecast supply chain margins to fall from 8.1% to 7.8%.
- We see Wimpy UK margins remaining relatively flat with AME rising from a low FY23 base following the continued roll out of company owned stores and some economic headwinds in certain African countries. Net new stores rose by 17 in AME, with 21 new company owned stores. Higher company owned stores as well as an expanded franchise support team in the UAE placed pressure on margins. Tourism in Botswana, Namibia and Mauritius has not returned to pre Covid levels placing further pressure on margins.

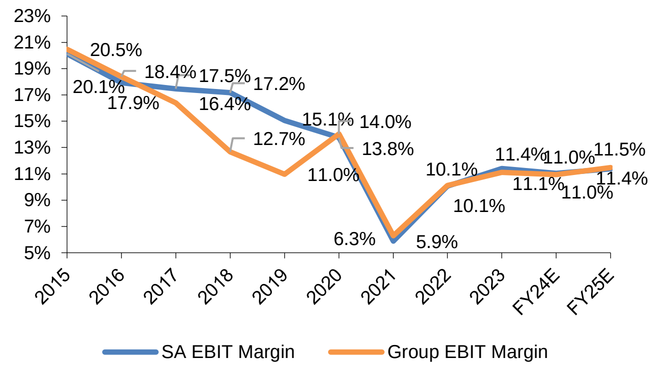
Key financial charts

Figure 6 EBIT margins segmental breakdown



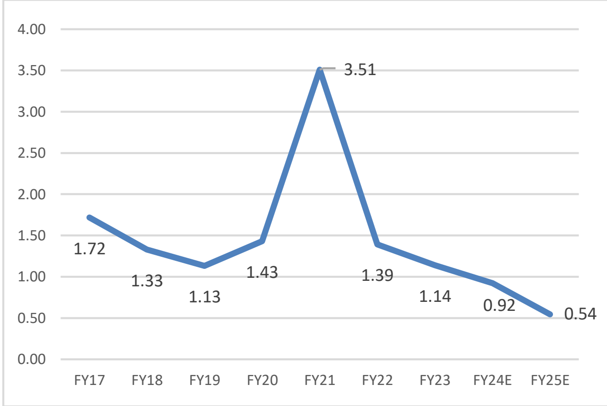
Source: Company data, ASB estimates

Figure 7 EBIT Margin – SA vs Group



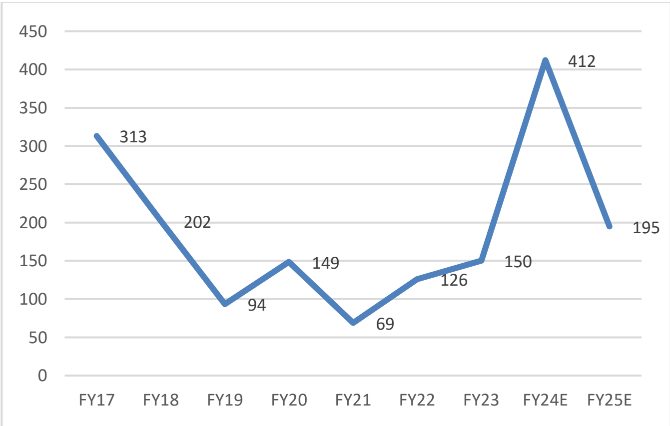
Source: Company data, ASB Research

Figure 8 Net debt/equity - x



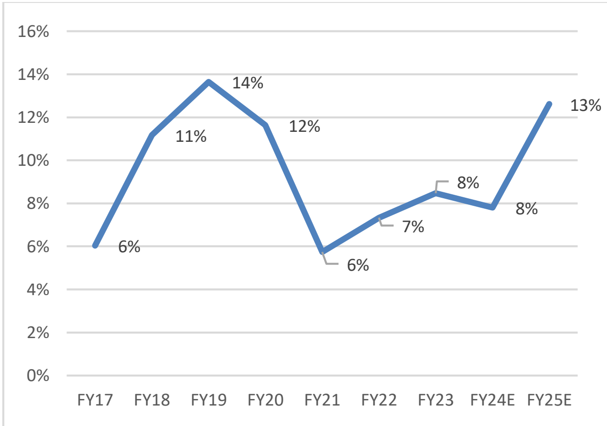
Source: Company data, ASB Research

Figure 9 Capex – R'm



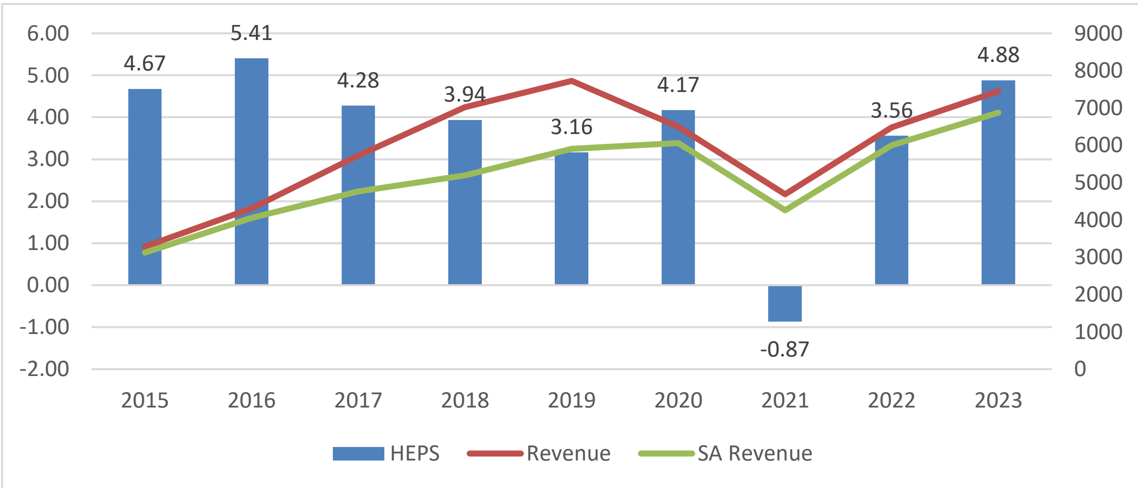
Source: Company data, ASB Research

Figure 10 Free cashflow yield



Source: Company data, ASB Research

Figure 11 HEPS vs Revenue



Source: Company data, ASB estimates

We revise our FY24E HEPS down from 548c to 535c and our FY25E HEPS from 647c to 622c. The extent of load shedding adds a considerable amount of forecast risk, particularly going into winter. We believe we have taken a conservative approach with our margin outlook.

The group is generating strong free cashflow allowing it to redeem debt as well as pay a healthy dividend in FY24E. We envisage a 75% dividend payout ratio in FY24E, taking it back to the levels pre the GBK transaction. At current levels the stock trades on an attractive 6.6% forward dividend yield.

Valuation

Figure 2 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	11%
Beta	0.9
Market risk premium	6.5%
Marginal tax rate	27.0%
Pre-tax cost of debt	9.0%
Cost of equity	16.9%
Target debt/value ratio	45%
Target equity/value ratio	55%
WACC	12.2%
Growth Rate assumption	
Sustainable long term growth rate	4.0%

Source: ASB estimates

Figure 3 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
Terminal Growth	3.0%	8557	7962	7432	6956	6256
	3.5%	8895	8250	7679	7169	6712
	4%	9279	8575	7956	7407	6917
	4.5%	9718	8944	8268	7673	7145
	5%	10227	9366	8622	7972	7401

Source: ASB estimates

We value the group on a DFCF basis, applying a WACC of 12.2%, a risk premium of 6.5%, a beta of 0.9 and a sustainable long-term growth rate of 4%, as highlighted in the table above. Applying some sensitivities to WACC and terminal growth rates leads to a valuation range of R71.69-89.44/share. Applying the midpoint of the valuation range (R79.56), values the stock on a 12-month forward P/E of 14.9x. Based on our HEPS forecasts, the stock trades on a 12M forward P/E of 11.3x. This represents a 57% discount to the 5-year average P/E prior to the GBK transaction.

Famous Brands is trading on a forward 6.3x EV/EBITDA. A substantial discount to global peers such as YUM (19x), McDonalds (18x) and RBI (18x). It's hard to argue a return to these sorts of valuations given the SA backdrop, but the discount appears excessive and could make Famous Brands a candidate for a global operator looking for strong profitable QSR brands with a growing presence across Africa and the Middle East.

Risks

- Load shedding – 90% of stores are now operating during load shedding, an improvement on FY23. Disruptions range from the manufacturing plants to the logistics given traffic disruptions, operating hours of stores and food wastage. Some positive impact is felt in consumers acquiring fast food given cooking disruptions at home.
- A further deterioration in the SA economy will impact sales further, particularly for Signature brands.
- Water disruptions – these are currently being experienced but managed. Any further deterioration may disrupt operations.
- 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.

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