Famous Brands: a beacon for recovery

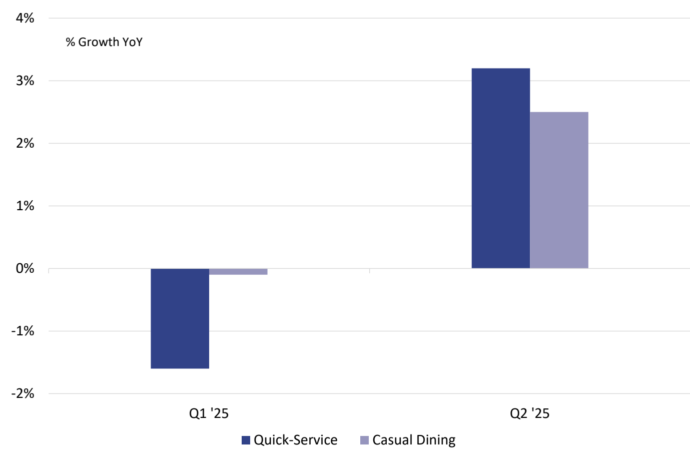
Last week, Jana used several statistics to gauge the health of the South African consumer, revealing that consumer confidence is improving in the country as we head into 2025. Subsiding inflation, lower interest rates, and improving consumer sentiment are expected to result in increased disposable income and subsequent discretionary spending. In this week's article, we review recent results from Famous Brands, South Africa's largest restaurant company, to illustrate how consumer-facing South African companies are poised to recover in the changing tide.

James Clark

Famous Brands is a leading South Arican restaurant company known for its diverse portfolio of iconic brands, including Steers, Debonairs Pizza, Wimpy, and Mugg & Bean, among others. The company employs a vertically integrated business model, which involves the ownership and management of its own manufacturing and logistics operations. Like many companies in SA, Famous Brands have experienced a strong pullback in discretionary spending as inflation and high interest rates have weighed on disposable income.

Recent interim results released by Famous Brands for the period March to August '24 were lackluster, weighed down by low sales volumes. Lower restaurant sales impacted the company's manufacturing and logistics segments, resulting in low volumes that dragged down overall topline figures. Despite a muted sales performance, we recognize the notable resilience in these results given the conditions faced and highlight the nuanced signs of recovery. Bear in mind, the first three months of the reporting period concurred with heightened uncertainty prior to our national election and suppressed disposable income due to ongoing economic pressure.

LIKE-FOR-LIKE SALES GROWTH



First quarter sales for FY25 were suppressed due to pre-election uncertainty and ongoing economic pressure on disposable income. However, a positive trend has emerged in the company's second quarter sales, aligning with consumer confidence trends in the economy.

SPEED READ

- **Despite a muted sales performance in its recent results, Famous Brands is an illustration of a South African company that has performed resiliently given the conditions, showing signs of recovery that align with improving consumer confidence in the country.**
- **Several tailwinds associated with the turning of the interest rate cycle and positive developments in South Africa are expected to result in increased fast-food spending.**
- **Key distinctions between Famous Brands and Spur Corp have helped substantiate our preference for the former in the recovery environment, including their quick-service restaurant portfolio, higher leveraged balance sheet, favourable load shedding dynamics, and liquidity considerations.**
- **While recoveries often take time, we remember that markets are forward looking. Famous Brand's share price already indicates the hopes of a gradual recovery.**

Like-for-like sales growth in the first three months of the reporting period fell by -1.6% and -0.1% for the company's quick-service and casual dining restaurants, respectively. However, the second half of the period showed an improving trend, aligning with rising consumer confidence in the economy. While green shoots of confidence are yet to result in improved economic growth, the uptick in trade in the second quarter signals emerging confidence. We expect to see continued momentum in this trend across South African consumer companies as further rate cuts and declines in the fuel price provide additional relief for consumers.

Last week, Jana highlighted several tailwinds that are expected to increase disposable income and subsequent discretionary spending, including improving consumer confidence, real-wage growth due to subsiding inflation, lower fuel costs, retirement fund withdrawals under the new two-pot system, and lower interest rates. These tailwinds will have a direct impact on Famous Brands through increased restaurant spending, lower food costs, and reduced fuel expenses related to the company's logistics operation.

A gradual resurgence in discretionary spending is also expected to be manifested through increased travel in the country, which is another integral part of the Famous Brand's business. Many of Famous Brand's stores are located on South Africa's highways, making them a beneficiary of improved domestic tourism. This highlights the positive effects associated with a turn in the economic cycle and improved consumer confidence in the country under our new government.

Undisrupted energy supply over the past 220+ days has been another positive transformation in the country, tangibly experienced across homes and businesses alike. Load shedding has impacted Famous Brands in many ways over the past few years, particularly 2023, including lost revenue on restaurants without alternative power solutions, large capital expenditure on energy independence, diesel costs for non-fleet usage, generator equipment repairs, and franchisee fee relief.

> *"We perceive liquidity risk in Spur Corp"*

To quantify the impact, Famous Brands spent R25m on diesel costs and a total of R20.6m on franchisee fee relief over their 2024 financial year, representing 0.6% of revenue. Additionally, capital expenditure spent on energy independence totaled R30m over FY22, FY23, and FY24. While it may seem like a marginal amount when contrasted with total revenue, the reversal in electricity disruptions provides significant windfall for companies like Famous Brands.

Our preference for Famous Brands over Spur

As illustrated, Famous Brands is an example of a company that is expected to recover in South Africa's improving economic environment. Evidently, the recent share price rally has already started to reflect the hopes of a turnaround. While we believe that a rising tide can lift all boats, we remain active in our investment analysis to determine whether certain companies stand to benefit more within the turning cycle. Several key factors have helped substantiate our preference for Famous Brands over its local competitor, Spur Corp, in the recovery environment:

1. Firstly, we prefer quick-service restaurants in a consumer recovery cycle as they often sell lower-priced menu options, making them more appealing to budget-conscious consumers during economic recoveries.
2. Secondly, Famous Brands has a more leveraged balance sheet. As interest rates recede, we expect Famous Brands to experience a better incremental effect on earnings growth as debt costs fall, compared with Spur Corp.
3. Thirdly, we believe that Spur Corp performed better in the load shedding environment due to their family-orientated catering style and a larger percentage of their restaurant portfolio with backup power. Many of Spur Corp's stores are located in regional malls that generally attract high footfall during load shedding hours. As a result, improved load shedding dynamics position Famous Brands to benefit more given the base effect.
4. Lastly, we perceive a liquidity risk in Spur Corp as its daily liquidity compares unfavourably with most JSE-listed shares.

The consumer recovery is underway. While improving sentiment and the tailwinds associated with an improved economic outlook may take time to translate into better results, we remember that markets are forward looking. In our opinion, Famous Brands provides a good analogy against which to compare the country as a whole – namely that a recovery is underway, green shoots are evident, but we shouldn't expect Rome to be built in a day. It will take time to build momentum. Nonetheless, markets are forward looking. The JSE as a whole, and Famous Brands in particular, are starting to price in better times ahead. It is a reminder that investors can't wait until the good news is reflected in newspaper headlines to build positions. By the times that happens, it is too late. We are confident that SA, and Famous Brands, are on a positive trajectory – the benefits of which will manifest over time.

Topic: Outlook for 2025. Is that SA Story Intact?

By the end of November, it will have been six months since our election ushered in the GNU. This presentation will focus on the outlook for 2025, and delve specifically into whether the SA story is still intact.

Natal Midlands

Date:	05 December 2024
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	04 December 2024
Venue:	Rosebank Union Church, Cnr Winne Mandela Drive and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Cape Town

Date:	2 December 2024
Venue:	SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor
Time:	7.30am
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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CONTACT DETAILS:

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HARVARD HOUSE GROUP

3 Harvard Street, Howick, 3290, South Africa
P.O. Box 235, Howick, 3290, South Africa
+27 (0) 33 330 2164
+27 (0) 33 330 2617
@ admin@hhgroup.co.za
W www.hhgroup.co.za