Taste, Famous Brands issue dire trading updates

Finding an analyst who sees any compelling reason to buy any of SA's fast-food stocks these days is as rare as spotting a Naspers naysayer. And that was even before two particularly grim updates last week sparked another furious wave of investors selling out.

First, Famous Brands - the granddaddy of casual dining in SA which owns Steers, Wimpy, Debonairs and Mugg & Bean - revealed its new purchase, UK-based Gourmet Burger Kitchen (GBK), had made a R15.5m loss for the half-year. This meant its earnings fell by up to 61%.

It was a stunning reversal. Famous Brands has a hard-won reputation of not disappointing investors, which is why its stock has risen 486% over the past decade. But as last week's news hit, its shares tumbled 10.7%.

Then Taste Holdings, the ambitious upstart that is rolling out Starbucks and Domino's Pizza in SA, revealed its loss for the six months to August had widened by 97%, as it ploughed more cash into its superstar brands. The value of Taste's stock has nearly halved in six months. Worse, there's no clue yet how it plans to raise more capital to finance its plans to push Starbucks and Domino's in this country.

Speaking to the *Financial Mail*, CEO Carlo Gonzaga says Taste was caught off-guard by the extent to which luxury goods declined in the first part of this year. "Apart from the lower-end consumer being under pressure (which affects brands such as Fish & Co and Maxi's), we are reasonably comfortable with Starbucks and Domino's," he says.

Gonzaga won't give away his recovery plans, but he says Taste will provide clarity about the way forward in about a month.

Taste's options are similar to those of hotel group Sun International, whose recovery bid hinges on three options: a rights issue, selling assets or taking on a third-party investor to reduce debt. But a rights issue would be tricky for Taste, especially as its last issue, to raise R120m, was taken up by only 81.4% of the shareholders this year.

"If we were in a buoyant economy we may have adopted a less conservative approach," says Gonzaga.

Analysts aren't holding their breath. Anthony Clark, a small- and medium-cap analyst at Vunani Securities, says that even before last week's results, Taste was "highly risky".

Clark questions whether Taste is in a "death spiral", having overcommitted to its two global mega-brands in a squeezed consumer market. The problem is that Taste has run out of cash. And besides funding the rollout of the two brands, Taste also has to settle debt of R225m it took to buy the local rights.

Its first plan - to sell the family jewels (including Arthur Kaplan jewellers) - ran aground. While market talk suggested the jewellery division could be worth between R400m and R600m, it seems no-one is willing to pay that sum. Says Clark: "It's not just about the fast-food segment, which continues to deteriorate. Taste and its very ambitious plans simply haven't materialised to justify the capital spend."

But Gonzaga vigorously defends Taste's plan to bet its future on the big brands. "We don't pay royalties in dollars, they're calculated in rand. The only risk we take is if we don't pay straight away, but we hedge against the risk," he says.

Gonzaga argues that if Taste can find new funding, and SA's consumers don't become much weaker, the company could reach a cash break-even point in the second half of next year. Given the recent experience of other food companies, that may be wishful thinking.

A few weeks ago, the company with the taste for life, Spur Corp, said revenue at its steak and burger ranches had fallen 2.1% for the year to June - the biggest drop in its 50-year history. In Spur's case, it wasn't just the collapse in the middle market; it also faced a social media crisis over a clash between a black woman and a white man that led many South Africans to boycott its restaurants.

Executives from these companies, who spoke to the *Financial Mail*, say the sector just isn't as resilient as many people had thought.

Darren Hele, CEO of Famous Brands, says the slowing sales, after March and April, were disappointing - but not a surprise. "There is no doubt it will get back on track. We own a great brand with a great track record. We need to make sure we capitalise on the upswing in consumer spend when it happens."

But he expects the next 18 months to be tough. "Our business is not hiding behind the Brexit effect, but one would be naive to think it is not affecting consumer behaviour."

Hele also says the short-term challenges in the UK are "overshadowing the solid and exciting business we have in the SA market".

Jean Pierre Verster, portfolio manager at Fairtree Capital, says the fragility of the fast-food companies caught everyone off guard. "Where previously people knew the sector wasn't recession-proof, many thought it was recession-resistant. Now it seems the consumer recession in SA and the UK is causing a lot of the companies indigestion," he says.

Verster sold a chunk of his Famous Brands holding - and he doesn't see a buying opportunity in the others. "I would avoid Taste because of the uncertainty of the debt."

Fast food stocks risky

12 Jun 2017

While the bitter consumer environment has hurt all these companies, there's a differentiator: some have cash, and some don't.

The most vulnerable are Taste Holdings (which owns lower-income brands such as Fish & Co, Maxi's and Zebro's Chicken) and Gold Brands (which owns ChesaNyama and Blacksteer), which are struggling for cash.

Famous Brands, Spur and Grand Parade may be struggling - but at least they have cash. Grand Parade is the other company to launch a mega-brand - Burger King - a few years ago, and it's only now starting to make profits, after years of huge investments.

Damon Buss, analyst at Electus Fund Managers, says he wouldn't buy any of the food stocks right now. But, having said that, he thinks Spur is probably the best of the lot. "[Spur is] well-run with good solid brands - it fits into relatively good niches (such as RocoMamas and Hussar Grill) and has more space growth potential than Famous Brands."

Buss agrees with Clark that Taste underestimated its capital rollout. "[It has] gone from being a franchiser to being a franchisee so it's paying away a chunk of its top line in franchise fees. The strategy of bringing Domino's in and switching Scooters to Domino's is good, but is yet to deliver."

Kevin Hedderwick, CEO of Famous Brands until a year ago, spoke frequently about avoiding the high-cost overseas brands. Yet Famous Brands now has its own headaches, thanks to a deal done shortly before Hedderwick left: the R2.1bn purchase of burger franchise GBK. It is rolling out new GBK stores at a hefty cost of 1m apiece in the UK - even though the country's prospects have darkened following the Brexit vote.

Gourmet can't beef up Famous Brands

18 Aug 2017

Alec Abraham, an analyst at Sasfin Wealth, says that with consumers under pressure, it's difficult for food companies to push up prices. "At the moment, especially given the price levels, I wouldn't pay these kind of prices for the restaurant stocks," he says.

He isn't sure Taste will survive. "I don't know if [it has] the money to roll out the Domino's and Starbucks. I wouldn't even consider this as an investment at all. I don't know if it can get [itself] out of this hole."

More worryingly, he says it seems the hype over Starbucks and Domino's may be fading. "You don't see the stores nearly as busy as they used to be. Without the flow it's very difficult to keep those stores opening. I don't know where they will get the money."

Clark says Taste is probably in the most risky position since it listed. "If there is a further, large bail-out, I question whether shareholders would support it and at what price? The liabilities on the company's balance sheet virtually match the market cap. It's looking very precarious," he says.

Source: Financial Mail