

Battling it out with fast-food brands

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A war is being waged in SA's restaurant and fast-food sector, with major players vying to attract consumers with hot brands as their weapons.



When Taste Holdings opened the doors of SA's first Starbucks store in April it demonstrated the power of brand equity, as coffee lovers happily endured lengthy queues for a fix of Starbucks' fare.

Credit goes to Taste founder and CE Carlo Gonzaga, who was also instrumental in bringing another global power brand to SA in late 2014: Domino's Pizza.

Though these were great coups, establishing two global brands is a huge financial challenge in areas such as marketing, staff training and supply chain. Adding to the financial challenge is Taste's shift to a model in which corporate stores play an increasing role.

The trend began in its luxury goods division housing jewellery retail brands NWJ and Arthur Kaplan, where 55 of 90 stores were corporate owned at the end of Taste's half-year to August 2015.

Taste is now tackling its 140- store pizza division, where at the end of August 26 of the 63 stores converted to Domino's

from Scooters and St Elmo's were corporate owned.

"Owning these stores is an essential requirement of conversion," notes Taste.

The real heavy lifting will be Starbucks stores, of which all 150-200 stores in Taste's longterm sights will be corporate.

While the cost of setting up a new Starbucks store is hard to ascertain, Eric Parker, a senior partner at Franchising Plus, comments: "I doubt you would get much change out of R4m."

Taste has positioned itself to fund its ambitious plans, raising R480m through rights issues in 2014 and 2015, and putting in place a listed R1bn note programme. At the end of August, R225m of the programme had been drawn down.

Vunani Securities analyst Anthony Clark, is not impressed.

"Taste is doing operationally dubious things," he says. "They have so far raised R700m and have nothing to show for it in earnings."

Taste is unlikely to have anything to show for its capex anytime soon.

In a recent trading update it warns of a headline earnings per share (HEPS) loss in its year to February.

Vanessa van Vuuren, manager of Sanlam Investment Management Small Cap Fund, which has a 2.3% exposure to Taste, is hanging in there. But she is under no illusions about the risks. "You will have to hold your nerve for many years," she says.

Few investors looking for exposure to the restaurant and fast-food space will be prepared to do that. They will look to stalwarts Spur and Famous Brands.

For Clark, it is Spur all the way.

"It has been my favourite for three years," he says. "There has been a change in direction. What had become a staid old company has a new spark."

From what was a group resting heavily on Spur Steak Ranches, its core brand - and to a lesser extent on Panarottis Pizza - Spur has moved to grow its brand line-up. It acquired the up-market Hussar Grill in 2014 and gourmet burger brand RocoMamas in 2015.

"They are new gems in our brand portfolio," says Spur CE Pierre van Tonder. "We have taken Hussar Grill from six to 12 stores and RocoMamas from five to 40 stores, with 50 our target by the end of the year."

Van Tonder believes RocoMamas in particular has huge potential. "Gourmet burgers are big in the US," he says. "The stores appeal to the younger generation and at only 200m² are a great franchise opportunity. It is a brand with long legs."

RocoMamas is already making its mark, contributing R5.1m to Spur's pretax profit in the six months to December. It ranked on par with Spur's John Dory's Fish, Grill & Sushi, and was almost half-way to equalling Panarottis.

While the mature Spur Steak Ranches brand continues to generate about three-quarters of pretax profit, Spur is upping the game at Panarottis, which lifted pretax profit 44% in the year to June and 30% in the six months to December.

Spur will be looking to the likes of Panarottis and RocoMamas to produce growth at a time when Spur Steak Ranches is growing pretax profit at 7%9%.

But Van Tonder is a realist and has toned down an earlier forecast of an average 15%/year HEPS growth to June 2020.

"To get 15% in the current economic climate is a stretch," says Van Tonder. "But I am still looking for double-digit growth."

While Clark is backing Spur, Hlelo Giyose, First Avenue Investment Management CIO, has his bet on the far larger Famous Brands. The group is best known for its Steers, Wimpy, Mugg & Bean and Debonairs Pizza brands.

"You have to look to how much longer their assets can generate the high levels of returns and cash flows," says Giyose. "I believe there is a lot enabling this, including the group's manufacturing and logistics operations, and efficiencies driven by its scale."

Famous Brands is also continuing to pile on the brand pressure, adding two in the past year to take its total to 24.

Spur has six brands in its line-up.

Parker is not entirely convinced that a huge proliferation of brands is a good thing. "Minor brands can waste a lot of time and energy," he says.

Giyose is unconcerned. "What Famous Brands is doing is akin to the big beer brewing companies' creation of a broad range of brands with pricing points covering all market sectors," he says.

Giyose also stresses that SA's fast-food and restaurant density is still low.

"There is room for both Famous Brands and Spur to continue adding new formats and expanding their store footprints," he says. Choosing between two great companies, Spur and Famous Brands, is not easy. Neither is cheap, with Spur on a 19 p:e and Famous Brands on a 22 p:e.

However, with both likely to show similar growth rates, Spur's somewhat less demanding rating tips the odds in its favour.

Source: Financial Mail