

COMPANY UPDATE

Sphera Franchise Group

Buy

Analyst: Caius Rapanu +4 0373 510 441 caiusroa.rapanu@bcr.ro

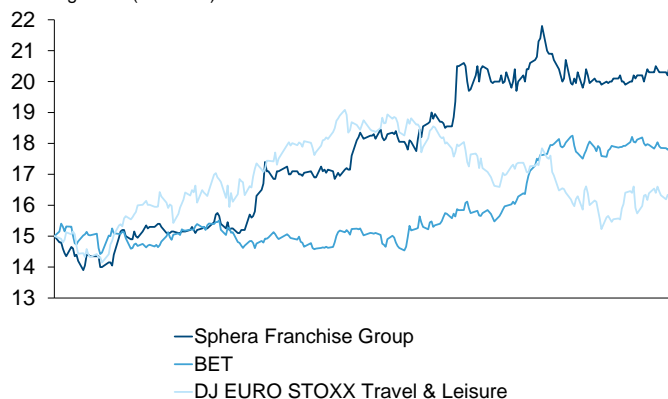
Share price (RON) close as of 01/12/2023	20.5	Reuters	ROSFG.BX	Free float	34.0%
Number of shares (mn)	38.8	Bloomberg	SFG RO	Shareholders	
Market capitalization (RON mn / EUR mn)	795 / 160	Div. Ex-date	30/03/23	Homepage:	www.spheragroup.com
Enterprise value (RON mn / EUR mn)	1,156 / 233	Target price	26.1		

Key figures Overview

RON mn	2022	2023e	2024e	2025e
Net sales	1,322.8	1,490.0	1,658.0	1,839.1
EBITDA	161.8	183.6	208.5	240.5
EBIT	61.2	77.2	88.2	101.0
EBT	38.6	53.9	65.3	75.2
Net profit	37.8	45.2	54.9	63.2
EPS (RON)	0.97	1.17	1.41	1.63
CEPS (RON)	3.95	3.48	4.86	5.64
BVPS (RON)	3.00	3.40	3.88	4.38
Dividend/Share (RON)	0.90	0.78	0.93	1.13
EV/EBITDA (x)	5.26	6.30	5.83	5.30
P/E (x)	14.39	17.58	14.50	12.59
P/CE (x)	3.54	5.88	4.22	3.64
Dividend yield (%)	6.43	3.80	4.55	5.52
EBITDA margin (%)	12.23	12.33	12.58	13.08
Operating margin (%)	4.63	5.18	5.32	5.49
Net profit margin (%)	2.85	3.04	3.31	3.44

Trading data & Statistics

Daily averages	5 days	30 days	last year
Volume	4,719	4,685	7,720
Trading value (RON mn)	0.1	0.1	0.1



Price performance:	1M	3M	6M	12M
in EUR	2.5%	2.1%	11.6%	39.3%

Financial Strength

	2022	2023e	2024e	2025e
ROE (%)	30.45	36.55	38.97	39.55
ROCE (%)				
Equity ratio (%)	16.49	18.93	19.33	19.60
Net debt (RON mn)	307.30	360.57	419.81	479.61
Gearing (%)	264.00	273.62	278.95	282.40

9M23 results – paving the way for a great year

After reviewing 9M23 results, we maintain unchanged our BUY recommendation on the stock and our target price.

The 9M23 results posted by Sphera Franchise Group validate our positive stance on the stock showing significant increase in profitability y-o-y and a better performance q-o-q. Despite one-off charges related to streamlining of operations, we consider positively that management efforts to limit the impact of the inflationary environment have been met with a measure of success, with costs largely under control, especially in the area of food costs.

Our YE estimates seem now modest, considering the already achieved profitability and would expect the last quarter of the year to validate the current positive trend in profitability. Even if restructuring would incur additional one-off charges, the same store sales and new openings paint a business-as-usual picture, after the pandemic and post-pandemic disruptions.

Sustained innovative and concentrated marketing efforts build upon a loyal and expanding customer base and should support profitability going forward, together with the ever-going efforts to contain costs and increase margins.

3Q23 results – another step on an upward trend

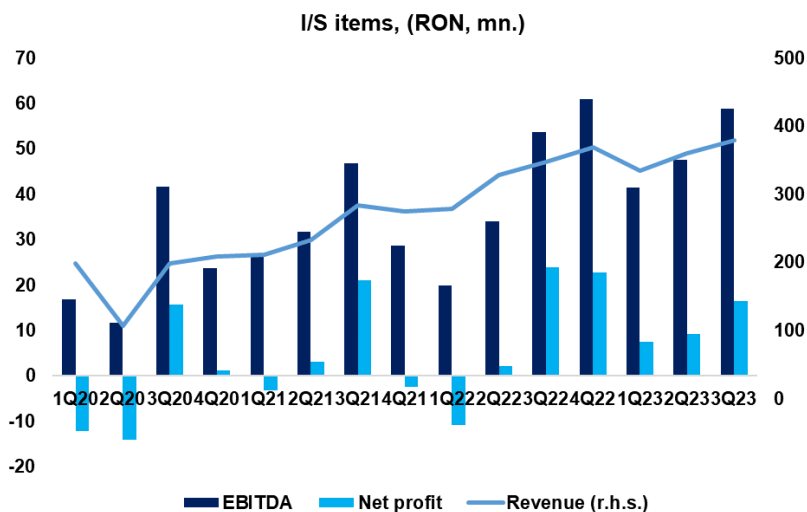
Sphera announced 9M23 results that are well on the way to indicate a year with a better profitability compared to the previous period and marked by the continuation of the management's efforts to streamline operations. The results were impacted by one-off costs related to the streamline efforts' activities and – as we detail below – paint a better picture when normalized for the effect of these corporate actions.

RON1bn 9M revenues mark surpassed first time in company history. Top line advanced by 13% compared to 9M22, reaching RON1075mn, vs. RON955. IFRS 9M23 total restaurant operating costs advanced less than revenues, growing only 9% y-o-y, amounting to RON966mn compared to the RON885mn of 9M22. As a result, 9M23 operating profits from restaurants increased more than 55% compared to the figures of the same 9M of the previous year. Net profit grew more than double, and EBITDA increased by 38%. 9M margins jumped as well, with net margin over the nine months of the year reaching 3.1% vs 1.6% during 9M22, and EBITDA margin 13.8% vs. 11.3% during 9M22.

(RON mn.)	3Q23	3Q22	change	2Q23	change	3Q21	change	9M23	9M22	change	9M21	change
Revenues	379	348	9%	361	5%	284	33%	1,075	954.77	12.6%	728.72	47%
COGS	122	117	4%	120	2%	93	32%	355.07	334.74	6%	236.24	50%
Employee costs	80	71	13%	85	-7%	60	33%	243.06	212.48	14%	162.29	50%
Rents	10	9	12%	8	19%	6	66%	25.47	22.47	13%	13.01	96%
Royalties	25	21	22%	22	15%	17	45%	66.68	56.95	17%	43.71	53%
Advertising	21	16	29%	19	10%	15	38%	55.98	48.58	15%	35.35	58%
Other opex	49	49	0%	46	7%	35	40%	140.46	137.68	2%	99.30	41%
Depreciation	29	24	21%	26	11%	23	28%	79.53	71.92	11%	67.24	18%
Operating costs restaurants	336	307	9%	326	3%	249	35%	966.24	884.82	9.2%	657.13	47%
Operating profit restaurants	43	41	6%	34	26%	35	23%	108.50	69.95	55%	71.59	52%
SGA	16	13	21%	15	5%	13	23%	45.77	38.99	17%	38.06	20%
Operating profit	28	28	-1%	19	43%	22	23%	62.73	30.96	103%	33.53	87%
Financial costs	6	6	5%	7	-14%	4	44%	20.25	16.83	20%	14.42	40%
Financial revenues	0	0	1192%	0	65%	0	87%	1.19	0.37	224%	0.13	853%
Financial result	(6)	(6)	2%	(7)	-15%	(4)	43%	(19.05)	(16.46)	16%	(14.29)	33%
PBT	21	22	-2%	12	79%	18	18%	43.67	14.50	201%	19.24	127%
Taxes	5	(2)	-325%	3	81%	(3)	-271%	10.58	(0.68)	-1652%	(1.90)	-658%
Net Profit	16	24	-31%	9	78%	21	-22%	33.09	15.18	118%	21.13	57%
EBITDA	59	54	10%	48	24%	47	26%	147.93	107.52	38%	105.32	40%
Net margin	4.3%	6.9%		2.6%		7.4%		3.1%	1.6%		2.9%	
EBITDA margin	15.5%	15.4%		13.2%		16.5%		13.8%	11.3%		14.5%	

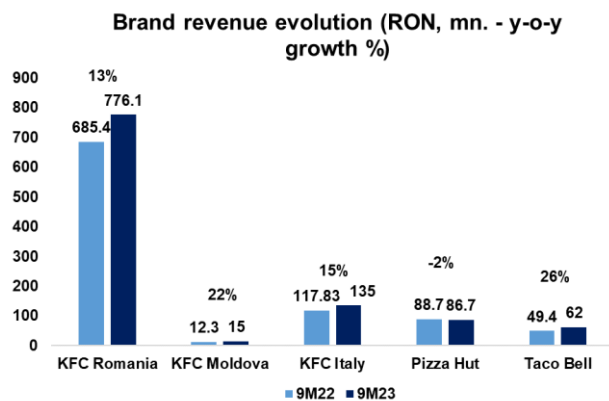
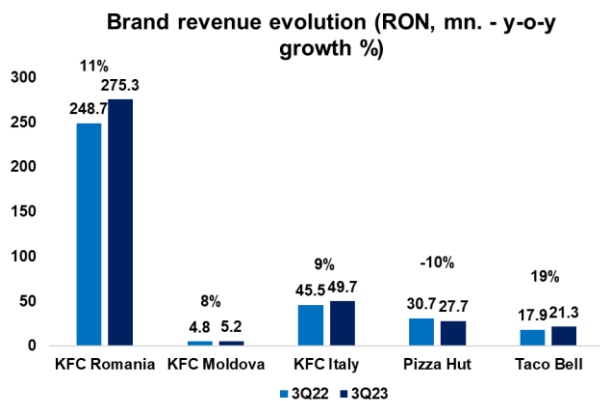
Source: Company data, Erste Group Research

On a quarterly basis, revenues jumped by 9% y-o-y, with a similar increase in costs, leading to a 6% increase in operating profits from restaurants. IFRS net profits declined by 31% y-o-y and EBITDA grew 10% y-o-y. Profitability was lower with net margin reaching 4.3% vs 6.9% and EBITDA margin inched higher reaching 15.5% vs. 15.4% during 3Q22.



Source: Company data, Erste Group Research

Even better on a q-o-q basis Most importantly, on a quarterly basis, 3Q23 evolved on a positive trend established over the last two quarters. The company recorded another positive quarter, albeit more in line with long-term historical development, with a 5% higher top line q-o-q. Vs the previous quarter, restaurant operating costs increased by only 3%, compared to the 5% growth in revenues. Vs. 2Q23, profits from restaurants increased by a significant 26% and EBITDA by 24%, leading to a quarter on quarter profit increase by 78%.

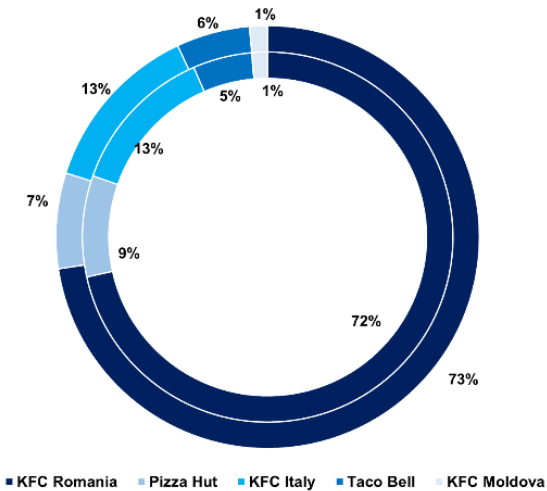


Source: Company data, Erste Group Research

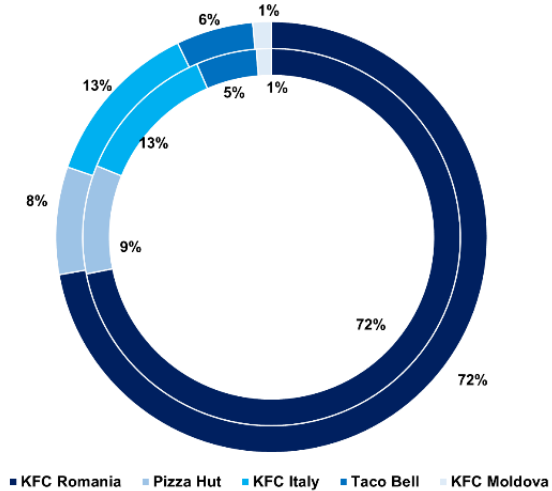
In terms of brand evolution, the largest contributor by far to the company's top line remains KFC Romania with about 72% of total sales, followed by KFC Italy, with about 13%, Pizza Hut and Taco Bell.

During 9M23, KFC Romania registered a 13% growth in revenues y-o-y, reaching RON776mn. With 15% growth in revenues KFC Italy contributed about RON135mn to the top line. Impressive growth rates in revenues were shown by Taco Bell, which grew revenues by 26% and KFC Moldova with a 22% growth, however both from much lower basis than the flagships of the group.

Total sales composition 3Q23 (ext.) vs. 3Q22 (int.)



Total sales composition 9M23 (ext.) vs. 9M22 (int.)

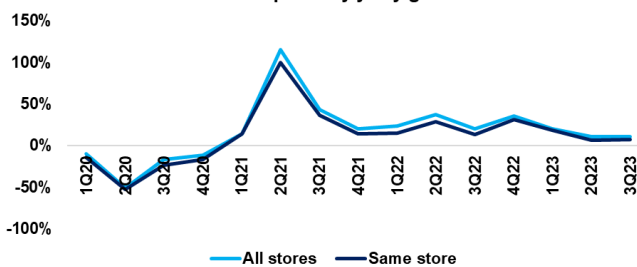


Source: Company data, Erste Group Research

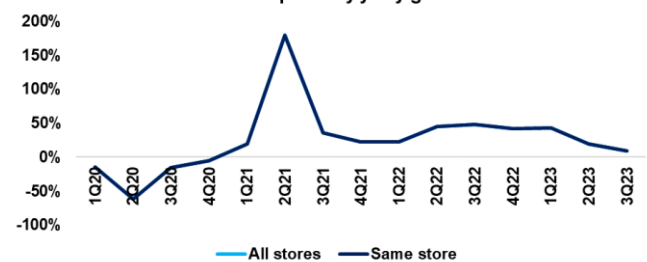
Same store performance stays solid, but reverting to L-T norms Same (I-f-I) store performance delivered by the brands in the group's portfolio were solid overall however softened y-o-y after the high growth of 2022 vs the depressed 2021, due to basis effect and aligned better with the long-term potential of the company. Overall, for the entire group the y-o-y same store growth was about 6.2% over 3Q23. (no nine months data available)

During 3Q23 KFC Romania delivered a y-o-y same store performance of 6.3%, better than the overall performance of the group and better than the growth posted during the previous quarter. A much better result came from KFC Moldova, with a very solid 9.2% same store growth and a 14.6% increase in same store growth coming from Taco Bell. KFC Italy also posted a very solid 9.2% same store growth, while Pizza Hut registered a decrease in same store sales by about 9.5%.

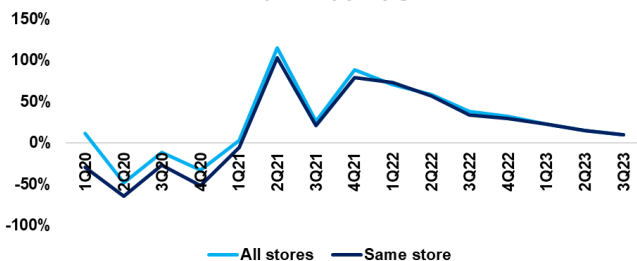
KFC RO quarterly y-o-y growth



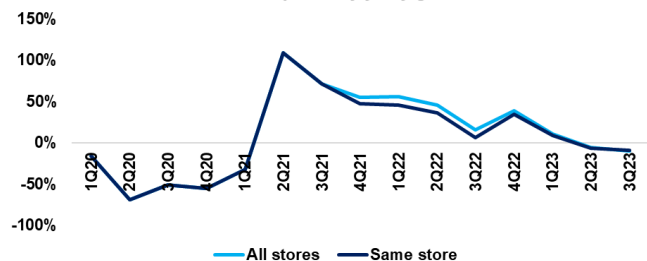
KFC MD quarterly y-o-y growth

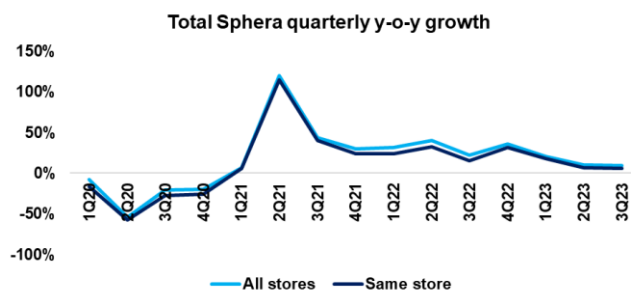
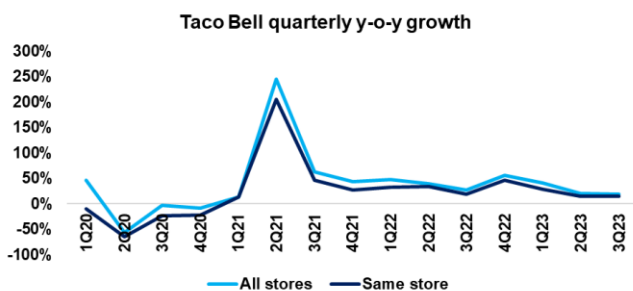


KFC IT quarterly y-o-y growth



Pizza Hut quarterly y-o-y growth



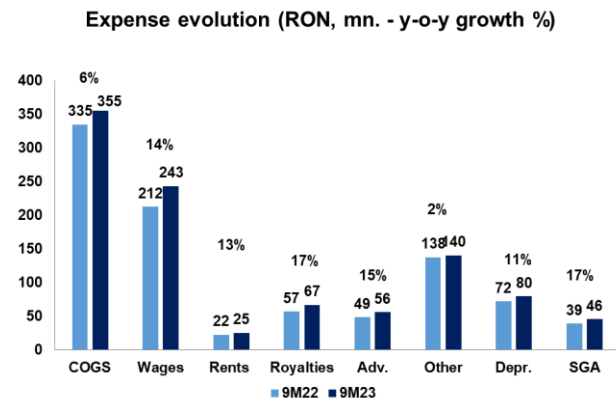
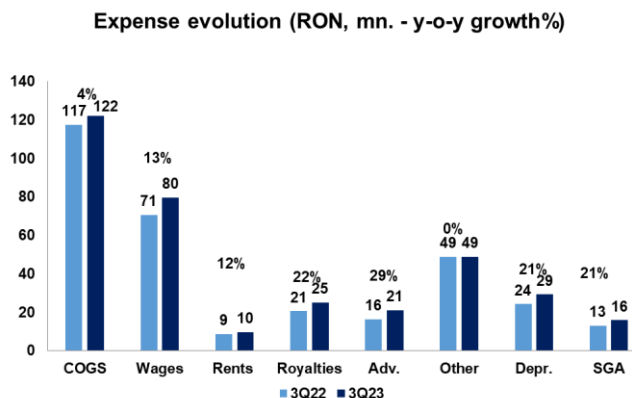


Source: Company data, Erste Group Research

Costs largely under control... Total restaurant expenses grew in 9M23 by 9.2% y-o-y, less than the 12.6% increase in revenues. The cost increases were mainly caused by the general inflationary environment and moderated by the management's effort to streamline operations and control expenses.

The largest two items on the cost structure of the company remain the cost of food and personnel related costs. 9M23 food costs grew only 6%, on the back of the purchasing policies of the company, while employee costs, grew slightly higher than revenues. General and administrative costs increased by 17% and other costs by only 2%. Rents, royalties and advertising grew slightly higher than revenues, however from a significantly lower base compared to the main cost items.

On a quarterly basis, the growth in food costs y-o-y was only 4%, and only grew 2% q-o-q, while employee costs increased vs. 3Q22 by 13%, and actually declined by 7% q-o-q. The impact of the other cost items, on the back of the softer inflation, was less significant, both y-o-y and q-o-q.

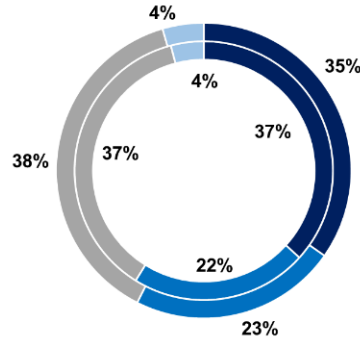


Source: Company data, Erste Group Research

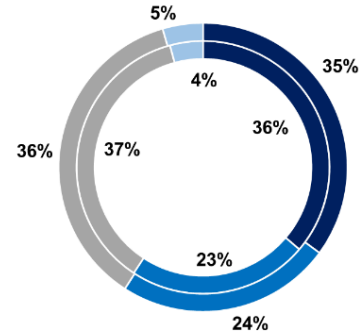
... to the extent of possible management action. The cost evolution represents – despite the mixed evolution of absolute numbers – a measure of success of the management's efforts to control expenses in a difficult, but tapering inflationary environment, especially on a comparison with 2Q23. Input inflation is a reality to cope with and largely beyond the control of management. Similarly, the cost of labour registered increases across the board and the efforts to retain personnel and attract new employees come at an increasing expense. The company provides training and increasingly attractive benefits, and has been sourcing labour from outside of Romania, however the growth in wages and benefits is an unavoidable reality. Similarly, SG&A costs, are influenced by the same trends and somewhat outside of possible management action have been kept under control and remained stable. In a similar manner, on the back the sustained

and successful advertising campaigns, costs of advertising remained stable as a percentage of revenues.

Expenses 3Q23 (ext.) vs. 3Q22 (int.)



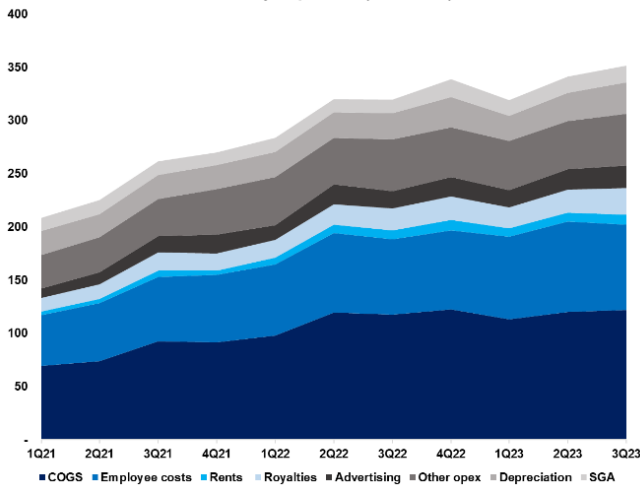
Expenses 9M23 (ext.) vs. 9M22 (int.)



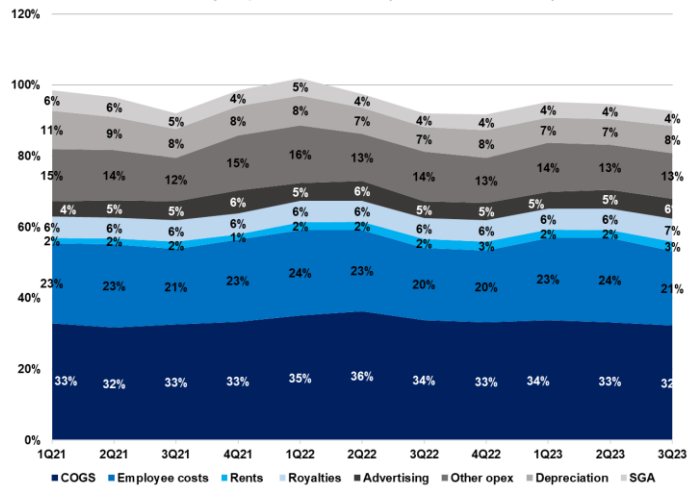
■ COGS ■ Employee costs ■ Other op. exp. ■ SGA ■ COGS ■ Employee costs ■ Other op. exp. ■ SGA
Source: Company data, Erste Group Research

Most importantly, the share of food in total costs has decreased as a share of revenues from 37% during 3Q22 to 35% during 3Q23, one of the main engines of profitability increase, balancing the relative increase in personnel costs. Other operating expenses have stayed mostly flat as a percentage of revenues, compared to previous quarter, on the back of the easing of energy costs, maintenance and consumables.

Quarterly expenses (RON, mn.)



Quarterly expense evolution (% of total revenues)

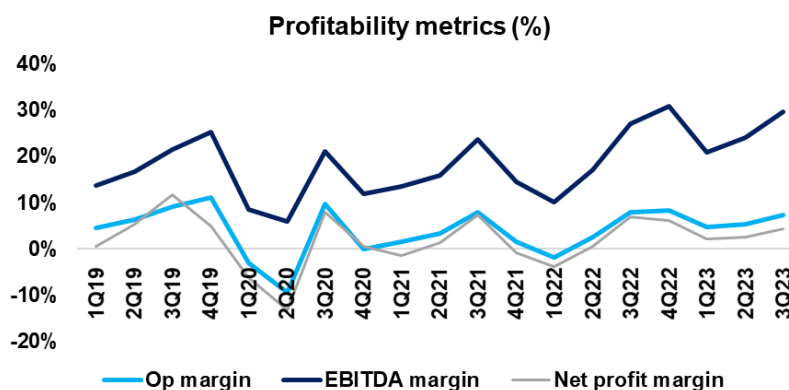


Source: Company data, Erste Group Research

Second highest quarterly EBITDA margin. In terms of profitability, the EBITDA margin is the highest compared to the any quarter of the last five years with the exception of 4Q22 pandemic and on a better level compared to the pre-pandemic period. This is a feat, helped by the tapering of the inflation and the stickiness of prices in a highly competitive market. Moreover, input inflation found its way in customer pricing with a delay that eroded profitability, however it can come as a positive in a slightly disinflationary environment.

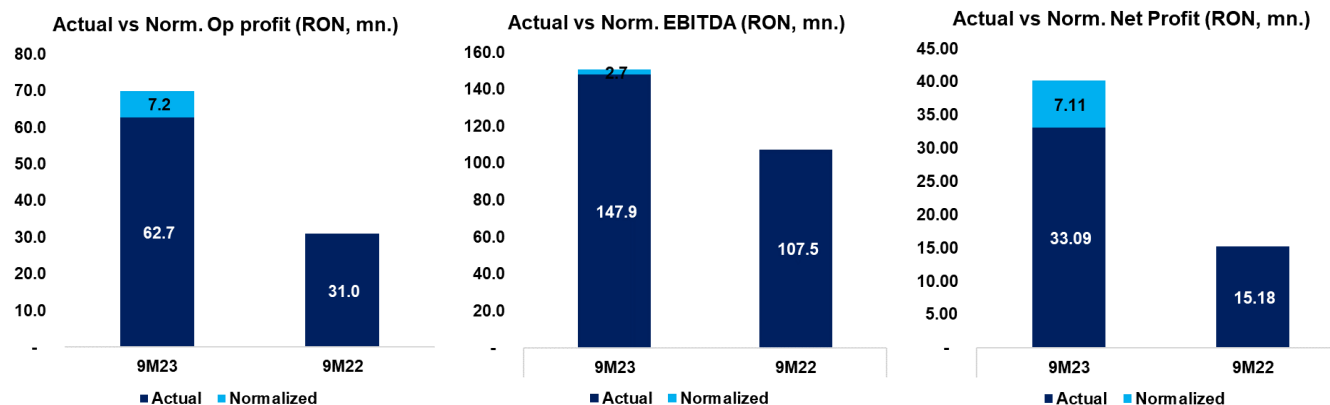
We are expecting the continuation of the reversal of the profitability trend that was established from the onset of the pandemic, with a tapering of cost increases and a bettering of margins. Further price increases may be more

difficult to implement, since consumer behaviour has been influenced by the recent erosion in purchasing power and price increases would be more an expression of brand loyalty than of actual augmentation of disposable income.



Source: Company data, Erste Group Research

Normalized figures look even better. The company also provided profitability figures normalized for one-off items such as the impairments and costs for the closing of Pizza Hut units in line with the network reorganization plan, to the temporary closing of two restaurants in Romania due to restoration work and other one offs and provisions.



Source: Company data, Erste Group Research

Balance sheet remains strong, showing marginal decline in net debt.

The gearing of the company remains within manageable levels, with lower than 2x Net Debt/2023e EBITDA. The net debt increased marginally since the beginning of the year to RON307mn, compared to the RON303mn at the end of 2022. Nevertheless, it declined compared to that of the previous two quarter of the year, and considering the expected growth in EBITDA, the gearing remains at a level marginally lower compared to the lowest of the last four years.

(RON, mn.)	2019	2020	2021	2022	1Q23	2Q23	3Q23
LT Debt + leases	263.7	280.8	348.9	313.7	322.7	321.3	316.4
ST Debt + leases	79.6	114.3	120.7	117.8	113.1	101.7	108.8
Cash&Equivalents	57.3	122.0	146.1	128.1	107.6	83.9	118.2
Net Debt	286.0	273.1	323.5	303.4	328.2	339.1	307.0
Net Debt/EBITDA	1.93	3.07	2.54	1.88	1.79	1.85	1.67

Source: Company data, Erste Group Research

Corporate action: streamlining, expansion and digitalization... As of the end of 3Q23, the group operated 101 KFC restaurants in Romania, 18 in Italy and two in Moldova. It operated 40 Pizza Hut restaurants, 15 Taco Bells and one PHD (Pizza Hut Delivery) sub-franchise and 1 Paul restaurant. During 3Q23 it opened 1 KFC and closed two PHD restaurants. The Pizza Hut and PHD reorganization continues with 5 Pizza Hut restaurants being closed in October. Further closings of Pizza Hut would include 13 Pizza Hut closings over six months with the relocation of personnel among other locations of the group. Also, it has continued the digitalization effort by deploying digital kiosks. Employee sourcing from abroad continued.

... and a sustained focus on marketing. The company continued to focus on marketing campaigns that emphasize innovation in terms of product and means of reaching the consumer. On KFC brand it concentrated on back-to-school, and value-for-money perception and launched a campaign presenting sourcing of hand-cooked chicken from local producers. Same innovation approach was used in Pizza Hut to attract new and lapsed customers and also introduction of value deals in order to increase trial. Taco Bell concentrated on core products and increasing brand campaigns.

No change to our valuation, TP and YE forecast

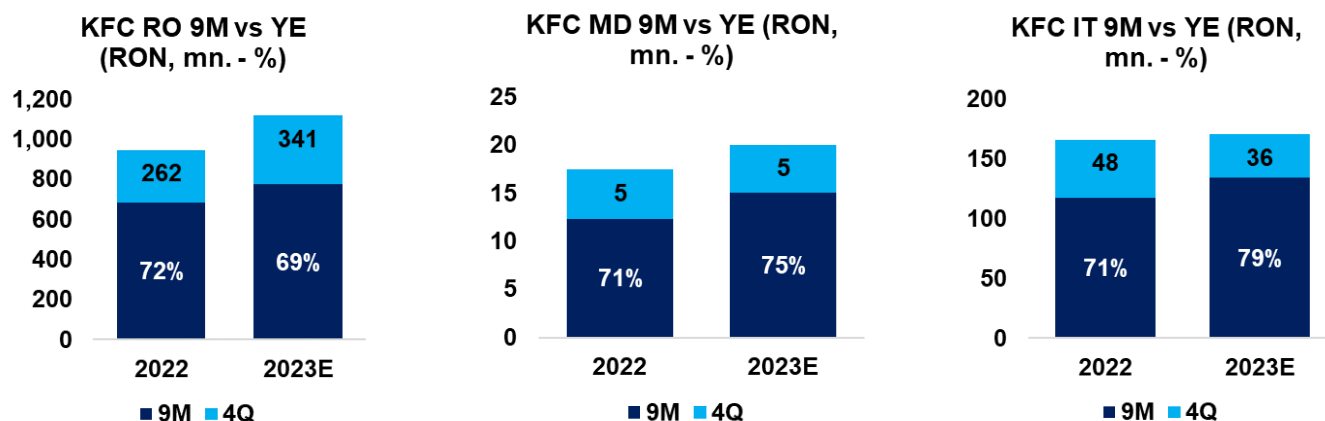
The current results issued by the company are – if anything – a reinforcement of our positive stance on the stock and we have no reason to alter YE forecasts, in view of the 9 months performance. Even so, we maintain a conservative stance, and, when considering our general estimates vs. the actual figures of the period, our growth rate y-o-y appears seriously restrained especially in terms of profitability. We expect the base effect to evanesce somewhat in the last quarter of the year, however YTD results point to an upside to our forecast.

Y-o-y forecast vs actual 9M23 y-o-y growth rates

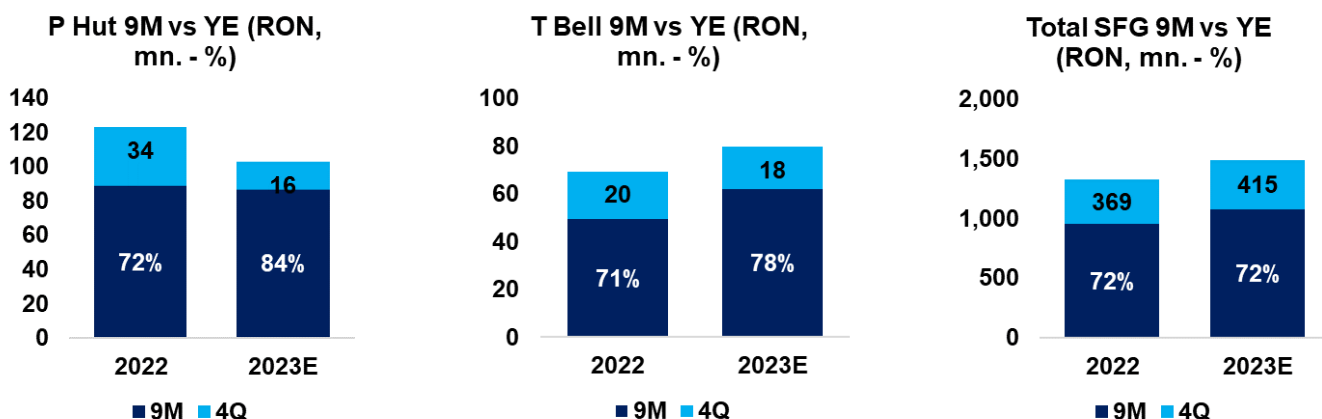
Y-o-Y growth	9M23A	2023E
Revenue	12.57%	12.64%
EBITDA	37.58%	13.50%
Net profit	117.97%	19.82%

Source: Company data, Erste Group Research

YE revenue forecast entirely achievable. We have charted the revenues of the company's brands vs the previous year, in terms of the share of YE revenues allocated to first 9M. Across the board our forecast is in line, or more conservative compared to the achievement of last year, while taking into consideration the net positive increase in KFC RO restaurants and the closings in KFC IT and Pizza Hut. On balance, our expectations for KFC RO performance in 4Q23 may be a tad optimistic, however it should be balanced by our more conservative stance in the other brands. (Note: A higher share of 9M23A in 2023E compared to that of 9M22 in 2022 figures represents a more conservative YE estimate compared to actual 9M numbers.)

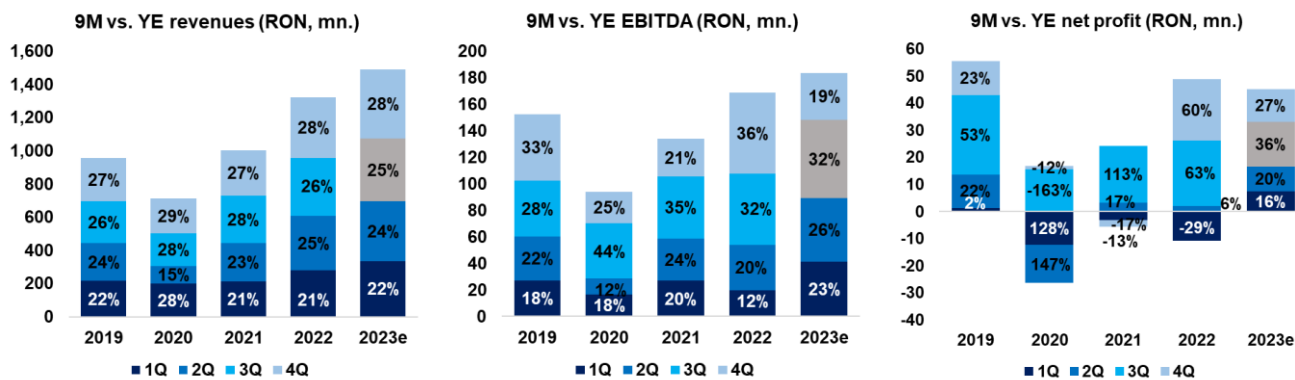


Source: Company data, Erste Group Research



Source: Company data, Erste Group Research

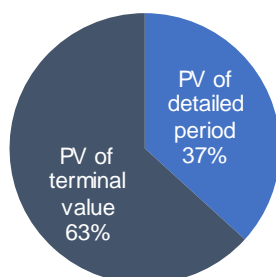
YE profitability forecast also achievable. Our YE forecast of revenues EBITDA and Net Profit are largely in line with a normal development of sales and profitability. In terms of revenues, as mentioned above, we are in line in forecasting compared to already achieved figures. In terms of profitability, i.e. EBITDA and Net Profit, the years since the beginning of the pandemic are not truly relevant since the disruptions to the whole environment were major. Thus, we expect a continuation of the positive trend born in the last three quarters – accounting for seasonality. Even so, both in terms of EBITDA and Net Profit we are confident our forecasts are modest and even under these admittedly conservative figures, the company justifies our positive stance and recommendation.



Source: Company data, Erste Group Research

DCF valuation

(RON mn)	2024e	2025e	2026e	2027e	2028e	2029e TV
<i>Sales growth</i>	11.3%	10.9%	10.6%	5.0%	5.0%	5.0%
EBIT	88	101	147	150	164	153
<i>EBIT margin</i>	5.3%	5.5%	7.2%	7.0%	7.3%	6.5%
<i>Tax rate</i>	16.0%	16.0%	16.0%	16.0%	16.0%	16.0%
Taxes on EBIT	-14.1	-16.2	-23.4	-24.0	-26.3	-24.5
NOPLAT	74.1	84.9	123.1	126.1	138.0	128.7
+ Depreciation	120	139	160	183	207	156
<i>Capital expenditures / Depreciation</i>	85.7%	81.4%	78.0%	85.1%	75.0%	100.0%
+/- Change in working capital	-17	-19	-20	-10	-11	-66
<i>Chg. working capital / chg. Sales</i>	-10.2%	-10.2%	-10.2%	-10.2%	-10.2%	-30.0%
- Capital expenditures	-103.1	-113.5	-124.9	-155.3	-155.6	-155.6
Free cash flow to the firm	74.1	92.3	138.4	142.9	178.9	62.9
<i>Terminal value growth</i>						3.0%
Terminal value						1,270.3
Discounted free cash flow - December 31 2023	68.1	78.3	108.3	103.2	119.1	821.1
Enterprise value - December 31 2023	1,298					
Minorities	0					
Non-operating assets	0					
Net debt (incl. lease liabilities)	356					
Other adjustments	0					
Equity value - (RON bn) December 31 2023	941.6					
Number of shares outstanding (mn)	1					
Cost of equity	12.7%					
Fair value, RON mn	1,040.2					
Number of shares outstanding (mn)	38.8					
Fair value per share, RON	26.81					
Share price	20.5					
<i>Upside/downside Official NAV (%)</i>	<i>30.8%</i>					

Enterprise value breakdown


Source: Erste Group Research

Sensitivity (Equity value - RON mn)

		Terminal value EBIT margin				
		5.5%	6.0%	6.5%	7.0%	7.5%
WACC	7.1%	23.36	27.94	32.51	37.08	41.65
	7.6%	21.20	25.27	29.35	33.43	37.50
	8.1%	19.46	23.13	26.81	30.49	34.16
	8.6%	18.03	21.38	24.72	28.07	31.42
	9.1%	16.83	19.91	22.98	26.05	29.13
		Terminal value growth				
		2.0%	2.5%	3.0%	3.5%	4.0%
WACC	7.1%	26.81	29.35	32.51	36.54	41.87
	7.6%	24.72	26.81	29.35	32.51	36.54
	8.1%	22.98	24.72	26.81	29.35	32.51
	8.6%	21.50	22.98	24.72	26.81	29.35
	9.1%	20.23	21.50	22.98	24.72	26.81

SFG DDM valuation

WACC calculation

	2024e	2025e	2026e	2027e	2028e	2029e TV
Risk free rate	7.5%	7.5%	7.5%	7.5%	7.5%	5.0%
Equity risk premium	7.5%	7.5%	7.5%	7.5%	7.5%	7.0%
Beta	1.1	1.1	1.1	1.1	1.1	1.1
Cost of equity	15.7%	15.7%	15.7%	15.7%	15.7%	12.70%

DDM valuation

(RON mn)	2024e	2025e	2026e	2027e	2028e	2029e TV
Net profit	54.9	63.2	98.7	98.8	103.6	109
Net profit input	54.9	63.2	98.7	98.8	103.6	109
Payout ratio	80.0%	80.0%	80.0%	80.0%	80.0%	90.0%
Gross dividends flow	43.9	50.5	79.0	79.0	82.9	98
<i>Terminal value growth</i>						3.0%
Terminal value						1,040
Discounted dividends - Dec 31 2023	43.9	43.7	59.0	51.0	46.3	652

Equity value (RON mn) - Dec 31 2023 **895.68**

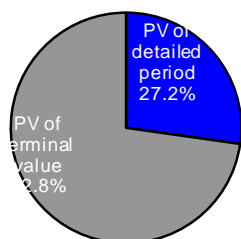
Cost of equity 15.7%

12M target value (RON) **26.1**

Current share price (RON) 20.5

Up/Downside 27.2%

Enterprise value breakdown



Source: Erste Group Research

Sensitivity

		Payout ratio				
		89.0%	89.5%	90.0%	90.5%	91.0%
COE	11.7%	28.0	28.1	28.2	28.4	28.5
	12.2%	26.9	27.0	27.1	27.2	27.3
	12.7%	25.9	26.0	26.1	26.2	26.3
	13.2%	24.9	25.0	25.1	25.2	25.3
	13.7%	24.1	24.2	24.3	24.4	24.5
		Terminal value growth				
		2.0%	2.5%	3.0%	3.5%	4.0%
COE	11.7%	26.1	27.1	28.2	29.5	31.0
	12.2%	25.1	26.1	27.1	28.2	29.5
	12.7%	24.3	25.1	26.1	27.1	28.2
	13.2%	23.5	24.3	25.1	26.1	27.1
	13.7%	22.8	23.5	24.3	25.1	26.1

Group Research

Head of Group Research Friedrich Mostböck, CEFA [®] , CESGA [®]	+43 (0)5 0100 11902	Institutional Equity Sales Czech Republic Head: Michal Rizek Pavel Krabicka Martin Havlan Jiri Feres	+420 224 995 537 +420 224 995 411 +420 224 995 551 +420 224 995 554
CEE Macro/Fixed Income Research Head: Juraj Kotian (Macro/Fl) Katarzyna Rzentarzewska (Fixed income) Jakub Cery (Fixed income)	+43 (0)5 0100 17357 +43 (0)5 0100 17356 +43 (0)5 0100 17384	Institutional Equity Sales Hungary Levente Nándori Balázs Zánkay Krisztián Kandik	+361 235 5141 +361 235 5156 +361 235 5140
Croatia/Serbia Alen Kovac (Head) Mate Jelić Ivana Rogic	+385 72 37 1383 +385 72 37 1443 +385 72 37 2419	Institutional Equity Sales Poland Jacek Jakub Langer (Head) Tomasz Galanciak Wojciech Wysocki Przemyslaw Nowosad Maciej Senderek	+48 22 257 5711 +48 22 257 5715 +48 22 257 5714 +48 22 257 5712 +48 22 257 5713
Czech Republic David Navratil (Head) Jiri Polansky Michal Skorepa	+420 956 765 439 +420 956 765 192 +420 956 765 172	Institutional Equity Sales Romania Liviu George Avram	+40 3735 16569
Hungary Orsolya Nyeste János Nagy	+361 268 4428 +361 272 5115	Group Markets Retail and Agency Business Head: Christian Reiss	+43 (0)5 0100 84012
Romania Ciprian Dascalu (Head) Eugen Sinca Dorina Ilasco Vlad Nicolae Ionita	+40 3735 10108 +40 3735 10435 +40 3735 10436 +40 7867 15618	Markets Retail Sales AT Head: Markus Kaller	+43 (0)5 0100 84239
Slovakia Maria Valachyova (Head) Matej Hornak	+421 2 4862 4185 +421 902 213 591	Group Markets Execution Head: Kurt Gerhold	+43 (0)5 0100 84232
Major Markets & Credit Research Head: Gudrun Egger, CEFA [®] Ralf Burchert, CEFA [®] (Sub-Sovereigns & Agencies) Hans Engel (Global Equities) Margarita Grushanina (Austria, Quant Analyst) Peter Kaufmann, CFA [®] (Corporate Bonds) Heiko Langer (Financials & Covered Bonds) Stephan Lingnau (Global Equities) Carmen Riefler-Kowarsch (Financials & Covered Bonds) Rainer Singer (Euro, US) Bernadett Povazsai-Römhild, CEFA [®] , CESGA [®] (Corporate Bonds) Elena Staelov, CIIA [®] (Corporate Bonds) Gerald Walek, CFA [®] (Euro, CHF)	+43 (0)5 0100 11909 +43 (0)5 0100 16314 +43 (0)5 0100 19835 +43 (0)5 0100 11957 +43 (0)5 0100 11183 +43 (0)5 0100 85509 +43 (0)5 0100 16574 +43 (0)5 0100 19632 +43 (0)5 0100 17331 +43 (0)5 0100 17203 +43 (0)5 0100 19641 +43 (0)5 0100 16360	Retail & Sparkassen Sales Head: Uwe Kolar	+43 (0)5 0100 83214
CEE Equity Research Head: Henning Eßkuchen Daniel Lion, CIIA [®] (Technology, Ind. Goods&Services) Michael Marschallinger, CFA [®] Nora Nagy (Telecom) Christoph Schultes, MBA, CIIA [®] (Real Estate) Thomas Unger, CFA [®] (Banks, Insurance) Vladimira Urbankova, MBA (Pharma) Martina Valenta, MBA	+43 (0)5 0100 19634 +43 (0)5 0100 17420 +43 (0)5 0100 17906 +43 (0)5 0100 17416 +43 (0)5 0100 11523 +43 (0)5 0100 17344 +43 (0)5 0100 17343 +43 (0)5 0100 11913	Corporate Treasury Prod. Distribution Head: Martina Kranzl-Carvell	+43 (0)5 0100 84147
Croatia/Serbia Mladen Dodig (Head) Boris Pevalek, CFA [®] Marko Plastic Matej Pretkovic Bruno Barbic Davor Spoljar, CFA [®] Magdalena Basic	+381 11 22 09178 +385 99 237 2201 +385 99 237 5191 +385 99 237 7519 +385 99 237 1041 +385 72 37 2825 +385 99 237 1407	Group Securities Markets Head: Thomas Einramhof	+43 (0)50100 84432
Czech Republic Petr Bartek (Head, Utilities) Jan Safranek	+420 956 765 227 +420 956 765 218	Institutional Distribution Core Head: Jürgen Niemeier	+49 (0)30 8105800 5503
Hungary József Miró (Head) András Nagy Tamás Pletser, CFA [®]	+361 235 5131 +361 235 5132 +361 235 5135	Institutional Distribution DACH+ Head: Marc Frieberthshäuser Bernd Bollhof Andreas Goll Mathias Gindele Ulrich Inhofner Sven Kienzle Rene Klases Christopher Lampe-Traupe Michael Schmotz Klaus Vosseler	+49 (0)711 810400 5540 +49 (0)30 8105800 5525 +49 (0)711 810400 5561 +49 (0)711 810400 5562 +43 (0)5 0100 85544 +49 (0)711 810400 5541 +49 (0)30 8105800 5521 +49 (0)30 8105800 5523 +43 (0)5 0100 85542 +49 (0)711 810400 5560
Poland Cezary Bernatek (Head) Piotr Bogusz Lukasz Jańczak Krzysztof Kawa Jakub Szkopek	+48 22 257 5751 +48 22 257 5755 +48 22 257 5754 +48 22 257 5752 +48 22 257 5753	Slovakia Šarlota Šípulová Monika Sméliková	+421 2 4862 5619 +421 2 4862 5629
Romania Caius Rapanu	+40 3735 10441	Institutional Distribution CEE & Insti AM CZ Head: Antun Burić Jaromir Malak	+385 (0)7237 2439 +43 (0)5 0100 84254
Group Institutional & Retail Sales		Czech Republic Head: Ondrej Cech Milan Bartoš Jan Porvich Pavel Zdichynec	+420 2 2499 5577 +420 2 2499 5562 +420 2 2499 5566 +420 2 2499 5590
Group Institutional Equity Sales Head: Michal Rizek	+420 224 995 537	Croatia Head: Antun Burić Zvonimir Tukač Natalija Zujic	+385 (0)7237 2439 +385 (0)7237 1787 +385 (0)7237 1638
Cash Equity Sales Werner Fuerst Viktoria Kubalцова Thomas Schneidhofer Oliver Schuster	+43 (0)5 0100 83121 +43 (0)5 0100 83124 +43 (0)5 0100 83120 +43 (0)5 0100 83119	Hungary Head: Peter Csizmadia Gábor Bálint Gergő Szabo	+36 1 237 8211 +36 1 237 8205 +36 1 237 8209
Institutional Equity Sales Croatia Matija Tkalicanac	+385 72 37 21 14	Romania Head: Octavian Florin Munteanu	+40 746128914
Group Fixed Income Securities Markets Head: Goran Hobljaj		Institutional Asset Management Czech Republic Head: Petr Holeček Petra Maděrová Martin Peřina David Petráček Blanca Weinerová Petr Valenta	+420 956 765 453 +420 956 765 178 +420 956 765 106 +420 956 765 809 +420 956 765 317 +420 956 765 140
FISM Flow Head: Gorjan Hobljaj Margit Hraschek Bernd Thaler Ciprian Mitu Christian Kienesberger Zsuzsanna Toth		Poland Pawel Kielek Michal Jarmakowicz	+43 (0)50100 84403 +43 (0)5 0100 84403 +43 (0)5 0100 84117 +43 (0)5 0100 84119 +43 (0)5 0100 85612 +43 (0)5 0100 84323 +36-1-237 8209

Company description

Sphera is the leading food operator in Romania, operating through subsidiaries in Italy and Moldova. It operates KFC, Pizza Hut and Pizza Hut Delivery, and Taco Bell branded restaurants under master franchisee agreements

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1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna
Erste Group Homepage: www.erstegroup.com