

COMPANY UPDATE

Sphera Franchise Group

Buy

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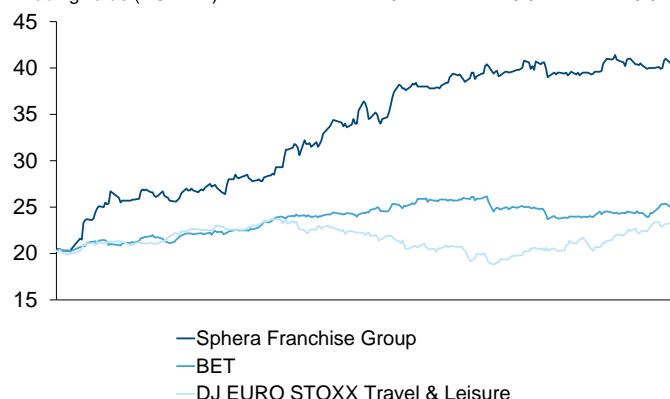
Share price (RON) close as of 19/11/2024	40.0	Reuters	ROSFG.BX	Free float	34.0%
Number of shares (mn)	38.8	Bloomberg	SFG RO	Shareholders	Tatika Inv. Ltd (28.6%)
Market capitalization (RON mn / EUR mn)	1,552 / 312	Div. Ex-date	21/10/24	Computerland Romania SRL (20.53%)	
Enterprise value (RON mn / EUR mn)	1,863 / 374	Target price	47.5	Homepage:	www.spheragroup.com

Key figures Overview

RON mn	2023	2024e	2025e	2026e
Net sales	1,469.1	1,531.9	1,679.6	1,838.0
EBITDA	212.1	237.7	269.0	319.2
EBIT	108.9	125.1	142.2	175.3
EBT	83.9	103.0	118.2	148.8
Net profit	71.7	86.5	99.3	125.0
EPS (RON)	1.85	2.23	2.56	3.22
CEPS (RON)	5.40	5.47	6.64	7.84
BVPS (RON)	3.68	4.87	6.16	7.93
Dividend/Share (RON)	0.00	1.05	1.27	1.45
EV/EBITDA (x)	6.16	7.84	7.00	5.89
P/E (x)	13.92	17.94	15.63	12.42
P/CE (x)	4.76	7.31	6.03	5.10
Dividend yield (%)	0.00	2.63	3.17	3.64
EBITDA margin (%)	14.44	15.52	16.02	17.37
Operating margin (%)	7.41	8.17	8.47	9.54
Net profit margin (%)	4.88	5.65	5.91	6.80

Trading data & Statistics

Daily averages	5 days	30 days	last year
Volume	9,467	11,479	18,903
Trading value (RON mn)	0.4	0.5	0.6



Price performance:	1M	3M	6M	12M
in EUR	-2.0%	0.5%	13.0%	96.8%

Financial Strength

	2023	2024e	2025e	2026e
ROE (%)	55.49	52.37	46.56	45.86
ROCE (%)				
Equity ratio (%)	20.34	24.48	27.23	30.57
Net debt (RON mn)	308.20	310.15	329.15	326.54
Gearing (%)	216.08	164.28	137.68	106.07

Another quarter, another record

Sphera 3Q24 results cemented our positive stance for the stock, with superior results in top line and profitability, showing remarkable cost control and superior brand management.

3Q24 was a record quarter, from several perspectives, and the optimization of the business continued, while adding another potentially valuable brand to the franchise portfolio. Albeit in the third quarter of 2024 the same-store growth of its KFC Romania flagship has declined to a level below multi-year averages, it has inched up compared to the previous quarter, and we trust the innovative, creative, and targeted marketing campaigns will help – as in the past – to ride the seasonal trends and add to top line and profitability. Moreover, we are pleased to note the persistence of a very positive development in costs of food, with management taking advantage of the current disinflationary environment and leveraging its sourcing and negotiating capabilities.

Our year-end forecasts are almost certainly going to be exceeded, if history is to be considered, however that would only reinforce our recommendation and general outlook on the stock. In the meantime, we continue to monitor same-store sales in KFC Romania for signs of weakening.

We will be revising our forecast, most likely on the upside once more clarity on the newly acquired brand is available, however our current target price is a good immediate anchor for the outlook of the shares, and our recommendation remains unchanged.

9M24 results – better profitability y-o-y and q-o-q

Sphera announced 9M24 results showed very solid y-o-y growth on the top line, together with a significant jump in profitability in both EBITDA and net profit, pointing to an better year than the last, and marked by the continuation of the management's efforts to streamline operations, combined with more subdued increase in costs. On a quarterly basis, vs 3Q23, the top line and profitability also increased significantly. Vs. the previous quarter, the results show a major increase in profitability.

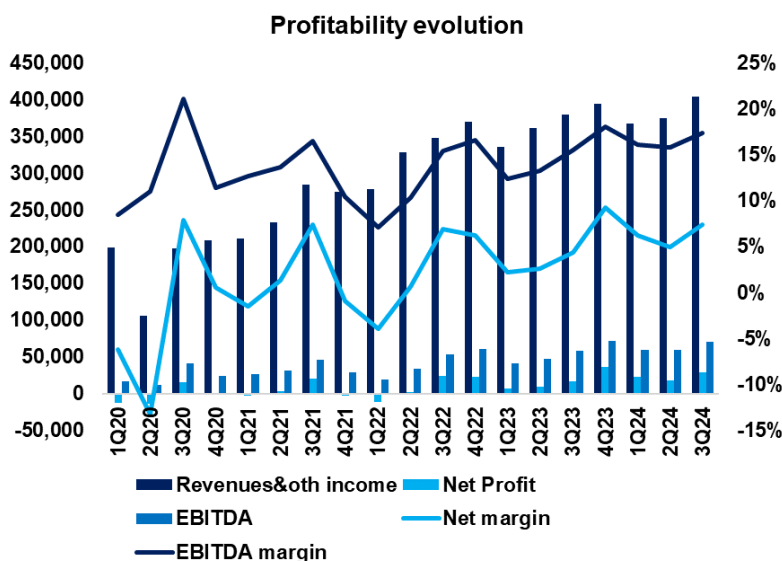
Record top line and profitability

9M24 top line advanced by more than 6.5% compared to 9M23, reaching RON1,145mn, vs. RON1,075mn. IFRS 9M24 total restaurant operating costs advanced less than revenues, growing only 2.9% y-o-y, amounting to RON994mn compared to the RON966mn of 9M23. As a result, 9M24 operating profits from restaurants increased 38% compared to the figures of the previous year. Net profit grew by 114% to RON71mn, vs RON33mn in 9M23, and EBITDA increased by 27% to RON188mn, vs RON148mn. Margins jumped as well, with net margin reaching 6.2% vs 3.1% during 9M23, and EBITDA margin 16.4% vs. 13.8% during 9M23.

(RON mn.)	3Q24	3Q23	change	2Q24	change	3Q22	change	9M24	9M23	change	9M22	change
Revenues&oth income	404	379	6.5%	374	8%	348	16%	1,144.7	1,074.7	6.5%	954.8	20%
COGS	125	122	3%	117	8%	117	7%	358.3	355.1	1%	334.7	7%
Employee costs	84	80	6%	87	-3%	71	19%	253.5	243.1	4%	212.5	19%
Rents	9	10	-2%	8	21%	9	9%	25.0	25.5	-2%	22.5	11%
Royalties	24	25	-3%	22	7%	21	17%	68.6	66.7	3%	57.0	20%
Advertising	23	21	9%	20	14%	16	41%	60.6	56.0	8%	48.6	25%
Other opex	54	49	10%	47	13%	49	10%	148.5	140.5	6%	137.7	8%
Depreciation	28	29	-5%	27	4%	24	15%	80.0	79.5	1%	71.9	11%
Operating costs restaurants	348	336	3.5%	328	6%	307	13%	994.6	966.2	2.9%	884.8	12%
Operating profit restaurants	56	43	29%	46	21%	41	37%	150.1	108.5	38%	69.9	115%
SGA	15	16	-3%	16	-1%	13	17%	46.4	45.8	1%	39.0	19%
Operating profit	41	28	48%	31	32%	28	47%	103.7	62.7	65%	31.0	235%
Financial costs	6	6	-7%	7	-13%	6	-3%	18.7	20.2	-8%	16.8	11%
Financial revenues	0	0	3%	(0)	-201%	0	1225%	0.3	1.2	-72%	0.4	-10%
Financial result	(6)	(6)	-7%	(7)	-17%	(6)	-5%	(18.4)	(19.1)	-4%	(16.5)	12%
PBT	35	21	64%	24	47%	22	61%	85.3	43.7	95%	14.5	489%
Taxes	5	5	7%	5	-2%	(2)	-341%	14.5	10.6	37%	(0.7)	-2230%
Net Profit	30	16	81%	18	61%	24	24%	70.8	33.1	114%	15.2	366%
EBITDA	70	59	19%	59	18%	54	31%	188.2	147.9	27%	107.5	75%
Net margin	7.4%	4.3%		4.9%		6.9%		6.2%	3.1%		1.6%	
EBITDA margin	17.3%	15.5%		15.8%		15.4%		16.4%	13.8%		11.3%	

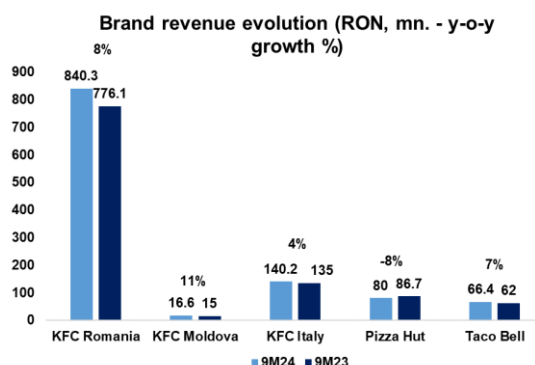
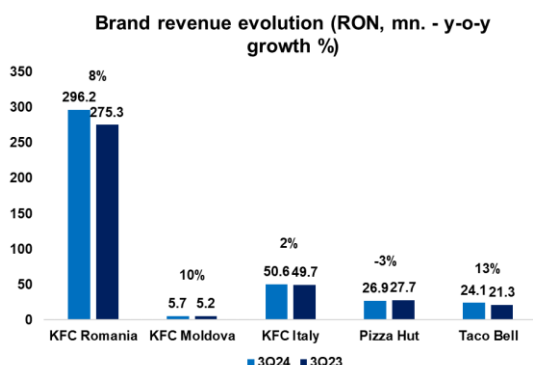
Source: Company data, Erste Group Research

On a quarterly basis, y-o-y revenues advanced by 6.5%, with COGS by 3%, leading to only a 3.5% advance in operating costs, leading to a 29% increase in operating profits from restaurants. IFRS net profits jumped by 81%, and EBITDA increased by 19% y-o-y. Profitability was also higher, with net margin reaching 7.4% vs 4.3% and EBITDA margin continued higher reaching 17.3% vs. 15.5% during 3Q23. Vs. the previous quarter, the revenue grew by 8%, Total costs increased by 6% leading to a 21% growth in operating profit, a 18% higher EBITDA and an whopping 61% hike in net profit. Margins in 3Q24 grew healthily compared to 2Q24.



Source: Company data, Erste Group Research

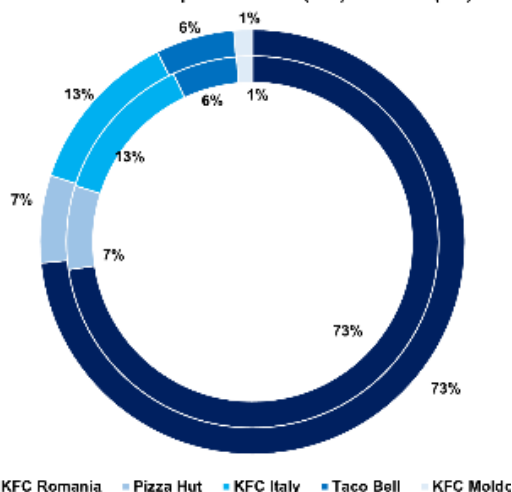
The evolution vs. the previous quarter follows the same trend as the previous years in terms of revenues and profitability. The profitability was by far the highest of any third quarter in the last five years, showing the highest sales, EBITDA and net profit.



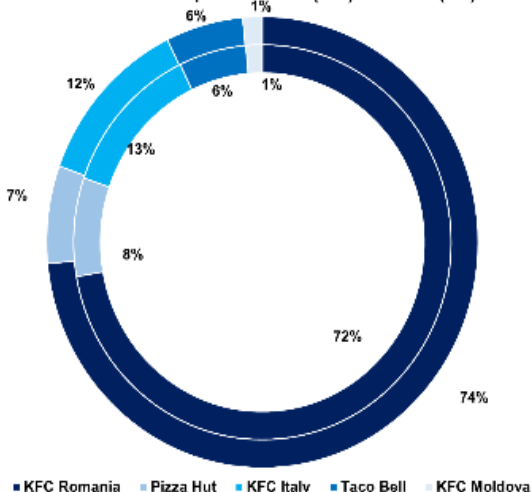
Source: Company data, Erste Group Research

In terms of brand evolution, the largest contributor by far to the company's top line remains KFC Romania with about 74% of total sales, followed by KFC Italy, with about 12%, Pizza Hut and Taco Bell. During 9M24, KFC Romania registered a 8% growth in revenues y-o-y, reaching RON840mn. With 4% growth in revenues KFC Italy contributed about RON140mn to the top line. Impressive growth rates in revenues were shown by KFC Moldova, which grew revenues by 11% and while Taco Bell grew by 7%, however both from much lower basis than the flagships of the group. It is also notable the major decline in the contribution of Pizza Hut, as a result of closings, with a y-o-y decline in revenues of about 8%. Otherwise, on a quarterly basis, KFC Romania grew y-o-y by 8% - in line compared to the 9M trend, but otherwise the trends are similar/better as those on a 9M basis showing a tapering decline for Pizza Hut and an acceleration of growth in Taco Bell.

Total sales composition 3Q24 (ext.) vs. 3Q23 (int.)



Total sales composition 9M24 (ext.) vs. 9M23 (int.)



Source: Company data, Erste Group Research

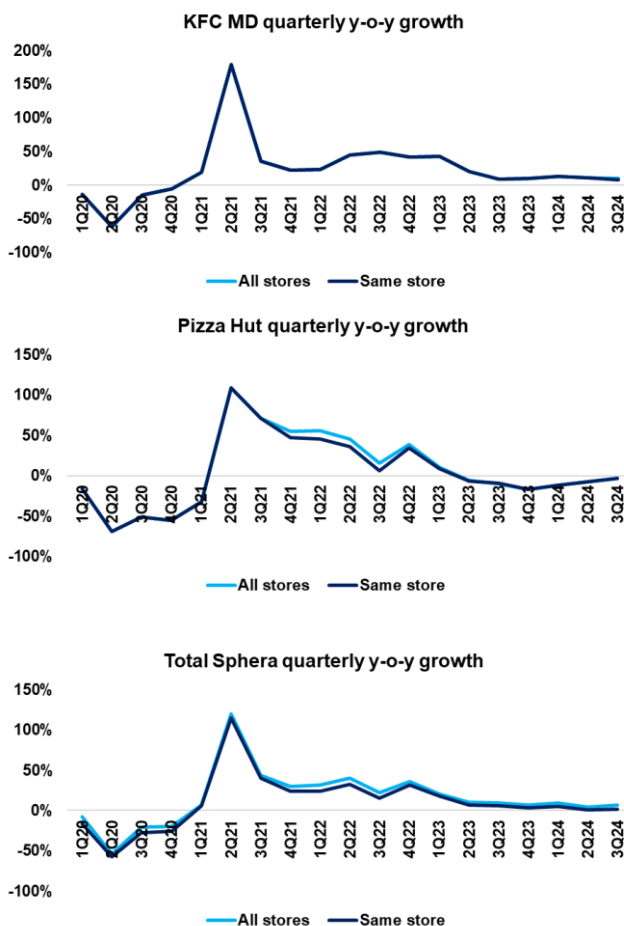
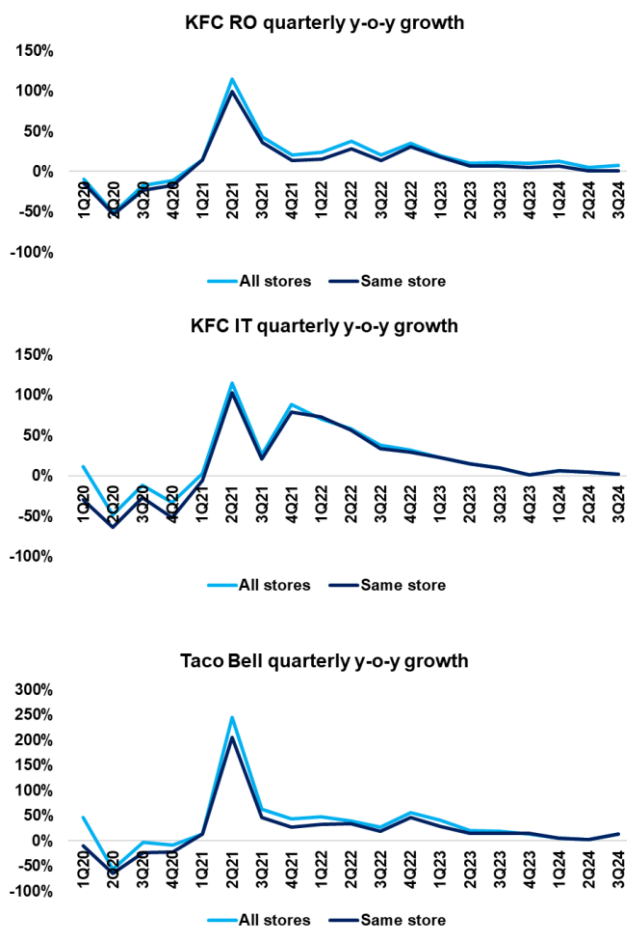
Same store performance stays solid, but tapering vs high post-pandemic growth The 3Q24 y-o-y growth delivered by the brands in the group's portfolio were still solid overall however softened overall in terms of same store sales, reaching only 1.3% in the third quarter of 2024, the second lowest compared to any quarter other than during the pandemic. When considering the impact of the new stores, the overall growth of sales overall, was 6.4%, again the second lowest in the post pandemic period.

Y-o-y growth (%)	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	
KFC RO All stores	-9.9%	-51.6%	-17.1%	-11.5%	14.3%	114.9%	42.8%	20.3%	23.6%	37.3%	20.1%	35.0%	19.6%	10.5%	10.7%	10.5%	12.8%	4.8%	7.6%	150%
Same store	-14.7%	-53.3%	-23.6%	-17.3%	14.1%	99.4%	35.9%	13.7%	15.1%	28.3%	13.3%	31.1%	18.0%	6.5%	6.9%	5.1%	7.2%	0.5%	0.6%	
KFC MD All stores	-14.4%	-62.1%	-15.4%	-5.3%	18.9%	179.3%	35.3%	22.3%	22.8%	44.8%	48.3%	42.0%	42.7%	19.7%	8.9%	9.9%	12.4%	10.8%	9.4%	100%
Same store	-14.4%	-62.1%	-15.4%	-5.3%	18.9%	179.3%	35.3%	22.3%	22.8%	44.8%	48.3%	42.0%	42.7%	19.7%	8.9%	9.9%	12.4%	10.8%	7.5%	
KFC IT All stores	11.4%	-48.4%	-11.7%	-33.5%	2.5%	114.5%	26.0%	88.0%	70.3%	58.4%	37.5%	31.6%	22.1%	14.4%	9.2%	0.6%	5.7%	4.4%	1.7%	50%
Same store	-29.5%	-64.5%	-27.0%	-52.1%	-6.0%	102.7%	20.8%	79.2%	73.0%	56.9%	33.5%	29.0%	22.1%	14.4%	9.2%	0.6%	5.7%	4.4%	1.7%	
Pizza Hu All stores	-15.8%	-68.8%	-51.4%	-55.6%	-32.6%	108.4%	71.4%	54.6%	55.3%	45.5%	15.1%	38.5%	10.0%	-6.2%	-9.8%	-16.6%	-12.0%	-7.6%	-2.9%	0%
Same store	-15.8%	-68.8%	-51.4%	-55.6%	-32.6%	108.4%	71.0%	47.5%	45.3%	35.9%	6.3%	34.4%	8.7%	-6.8%	-9.5%	-16.7%	-12.0%	-7.6%	-2.9%	
Taco Bel All stores	46.0%	-55.9%	-3.0%	-9.2%	13.1%	245.4%	62.8%	43.6%	48.2%	39.6%	27.3%	56.3%	40.6%	19.9%	19.1%	13.3%	5.4%	2.6%	13.1%	-50%
Same store	-10.3%	-64.4%	-24.1%	-22.9%	13.1%	204.4%	46.1%	26.4%	32.0%	34.2%	18.2%	46.0%	28.0%	14.5%	14.6%	14.8%	5.4%	2.6%	13.1%	
Sphera All stores	-7.7%	-54.0%	-20.4%	-20.0%	6.6%	119.4%	43.6%	30.3%	31.8%	40.5%	22.3%	35.9%	20.3%	10.1%	9.1%	6.8%	9.2%	3.8%	6.4%	-100%
Same store	-16.0%	-57.0%	-27.6%	-26.1%	5.6%	114.9%	39.9%	23.5%	23.6%	32.3%	15.6%	31.9%	18.0%	6.8%	6.2%	3.0%	5.2%	0.6%	1.3%	

Source: Company data, Erste Group Research

KFC Romania – second lowest same store growth since the pandemic.

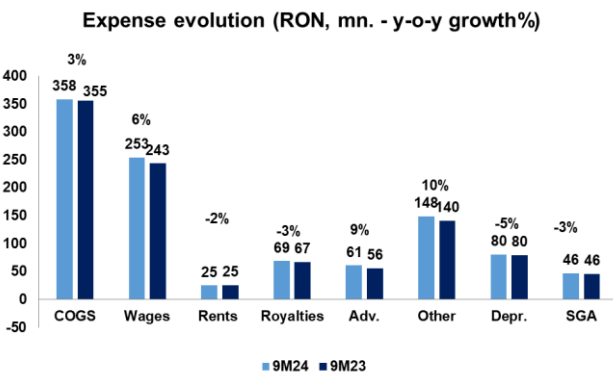
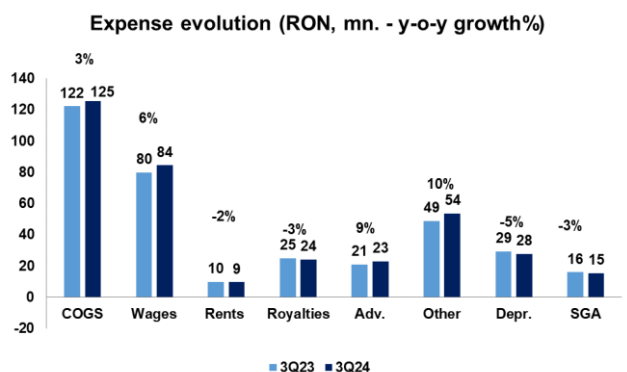
The low same store sales are mainly caused by KFC Romania, while all the other brands (except the problematic Pizza Hut brand) have registered solid same store growth. However, it is expected that the current marketing impetus to bring a renewal of growth in this segment. Thus, during 3Q24. KFC Romania grew overall y-o-y by 7.6%, considerably higher than the overall group growth, but same store sales increase below the average group growth by only 0.6%. As expected, same store sales declined in Pizza Hut, with a continuous decline for the last six quarters, which doesn't seem to end, even if the rate of decrease tapered somewhat. KFC Italy posted a 1.7% growth, Taco Bell a commendable 13.1%, with KFC Moldova second best at 7.5%.



Source: Company data, Erste Group Research

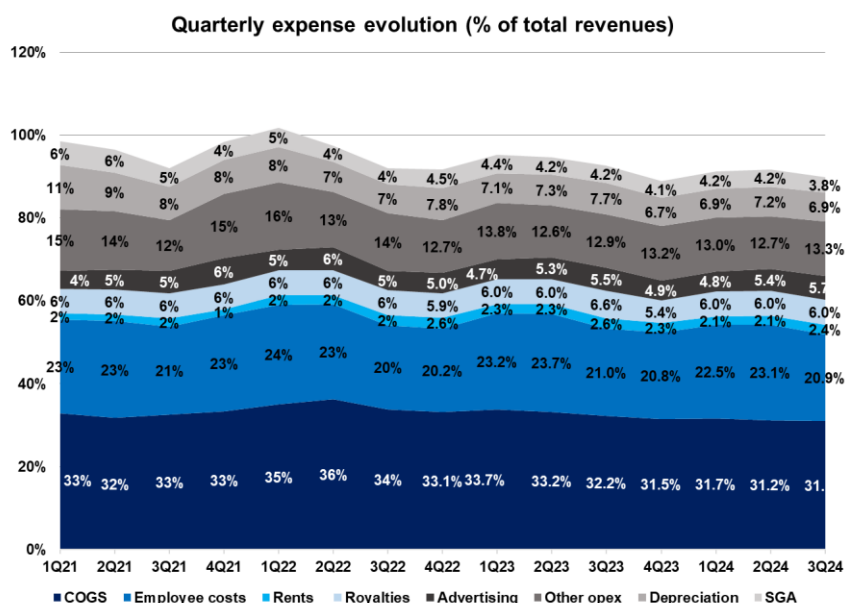
Costs improve, mainly on lower food costs

Total operating restaurant expenses grew in 9M24 by 2.9% y-o-y, less than the 6.5% increase in revenues. The cost increases were mainly caused by the general inflationary environment especially in the work force 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. 9M24 food costs remained almost flat, on the back of the purchasing policies of the company, while employee costs, grew lower than revenues, at 4%.



Source: Company data, Erste Group Research

General and administrative costs increased only by 1% and other costs also by only 6%, mainly on the back of third-party costs. Rents declined 2%, while royalties and advertising grew lower than revenues, and from a significantly lower base compared to the main cost items. On a quarterly basis, the increase in food costs y-o-y was 3%, on 6.5% higher revenues, while employee costs increased by 6% vs 3Q23. Vs the second quarter of 2024, food costs increased by 8% in line with the 8% growth in revenues, while employee costs actually declined, unexpectedly, at -3%. Advertising expenses, albeit from a smaller base, registered an increase at quarterly level as well, with 3Q24 advertising expenses increasing by 9% y-o-y and 14% q-o-q. Depreciation also generally increased, on the back of the CAPEX program.

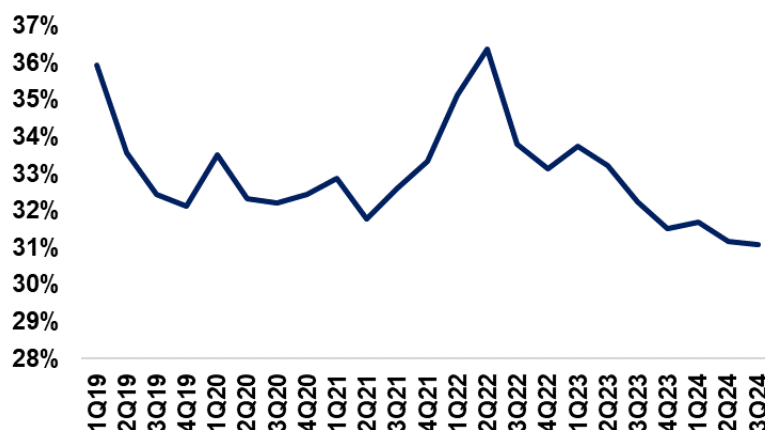


Source: Company data, Erste Group Research

As a percentage of revenues:

Most importantly, the share of food in total costs has continued to decrease as a share of revenues from 32.2% during 3Q23 to 31.1% during 3Q24, one of the main engines of profitability increase, adding to the decrease in personnel costs from 21% of total revenues to 20.9% of total revenues, a marginal amount, but a positive trend. Among other expenses, other Opex grew marginally at 13.3% of revenues from 12.9% in 3Q23, while most other items posted no major deviations.

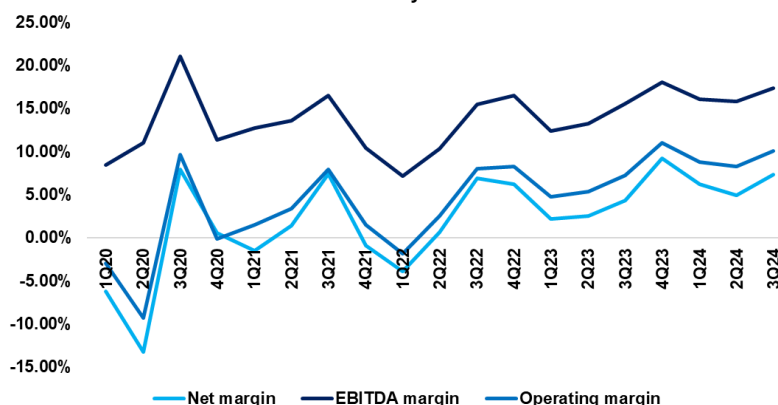
COGS evolution (% of revenues)



Source: Company data, Erste Group Research

In terms of profitability, the 17.35% 3Q24 EBITDA margin is the highest compared to the any third quarter of the last five years on a better level compared to the pre-pandemic period, and more than 3% above the average of all last 18 quarters on the same period. In terms of net margins, the 4.9% profit margin is also by far third highest among the third quarters of last five years, and about 5% higher than the average of the last 22 quarters. This is a feat, helped by the tapering of the inflation that influenced food costs, and the pricing policy success in a highly competitive market. Moreover, in the past input inflation found its way in customer pricing with a delay that eroded profitability, however it can now come as a positive in a slightly disinflationary environment specific to the company operations.

Profitability metrics



Source: Company data, Erste Group Research

No normalization required

The company also provided in the past 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 impairment for the closing of KFC restaurants in Romania, and to the temporary closing of two restaurants in Romania due to restoration work and other one-offs and provisions together with litigations and other items. During 9M24 and 3Q24 no normalization was necessary in presenting financial results.

Manageable gearing

The gearing of the company remains within manageable levels, with lower than 1.5x Net Debt/2024e EBITDA. The net debt increased only marginally since the beginning of the year to RON337mn, compared to the RON304mn at the end of 2023. Considering the expected growth in EBITDA, the gearing remains at a level in line with a median compared to the significantly lower compared to the lowest of the last four years.

(RON, mn.)	2019	2020	2021	2022	2023	1Q24	2Q24	3Q24
LT Debt + leases	263.7	280.8	348.9	313.7	303.0	303.4	325.4	328.3
ST Debt + leases	79.6	114.3	120.7	117.8	98.3	97.6	101.7	112.4
Cash&Equivalents	57.3	122.0	146.1	128.1	98.2	89.5	78.8	104.1
Net Debt	286.0	273.1	323.5	303.4	303.1	311.5	348.3	336.6
Net Debt/EBITDA	1.93	3.07	2.54	1.88	1.38	1.31	1.47	1.42

Source: Company data, Erste Group Research

Dividend payout

The company has announced a dividend payout amounting to RON1.05/share, for about 56% of 2023 net income which was paid in June. Management also submitted to October 7 GSM a proposal of an additional, extraordinary dividend of RON1.05/share, with October 21 as ex-dividend date and that was approved and was paid starting with November 7 as payment date.

Corporate action

As of the end of September 30, 2024, the group operated 107KFC restaurants in Romania, 18 in Italy and three in Moldova. It operated 28 Pizza Hut restaurants, 15 Taco Bells and one PHD (Pizza Hut Delivery) sub-franchise. During 3Q24 the company opened 2 new KFC restaurants in Romania, one KFC in Moldova, it also closed 1 Pizza hut Pizza Hut restaurant in Romania. The company has outsourced part of deliveries, while the share of deliveries out of total orders has remained relatively constant over the year.

Adding a new franchise in Italy and possibly in Romania

Post the end of the third quarter, on October 11th, the company announced the addition of a new franchise, Cioccolatitaliani, part of Gioia Group. The Group plans to develop the franchise on the Italian market, with the first unit to be opened in the first half of 2025, after an investment of approximately 500k euros. The Group estimates circa 4 new openings per year over the following 5 years, initially focusing on the northern regions of Italy, but is also considering the Romanian market, as the agreement signed with Gioia Group also covers the local market. Cioccolatitaliani currently operates a network of 43 units, most of them located in Italy, and several in the Balkans, Middle East and in North Africa. In 2023, Cioccolatitaliani catered to over 6 million customers. The Cioccolatitaliani product range includes artisanal ice cream, chocolate lingos, pralines, and alternatives as well as gourmet coffee, Italian pastries, crepes, and waffles served with chocolate-flavored ice cream and various toppings.

9M24A results vs YE forecast

The current results issued by the company are a reinforcement of our positive stance on the stock, with the rate of growth, y-o-y in all main financial indicators showing a better prospect than our conservative estimates.

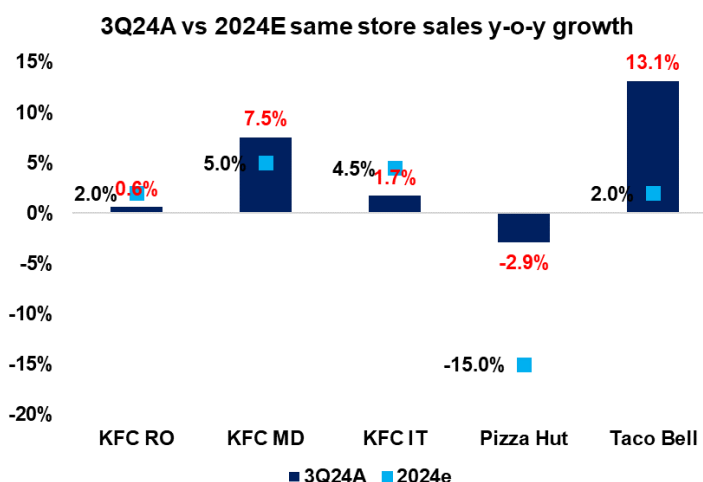
Y-o-Y growth	9M24	2024e
Revenues&oth income	6.5%	4.3%
EBITDA	27.2%	12.1%
Net Profit	114.0%	20.7%

Source: Company data, Erste Group Research

In modelling same store sales we have accounted only for a decreasing inflationary environment and the immediate transmission to the customer of any cost savings achieved by the company. This is indeed a stance that errs on the conservative side, since any disinflationary period would in fact impact positively on the costs, while prices would remain stickier.

We projected conservatively for 2024 and beyond

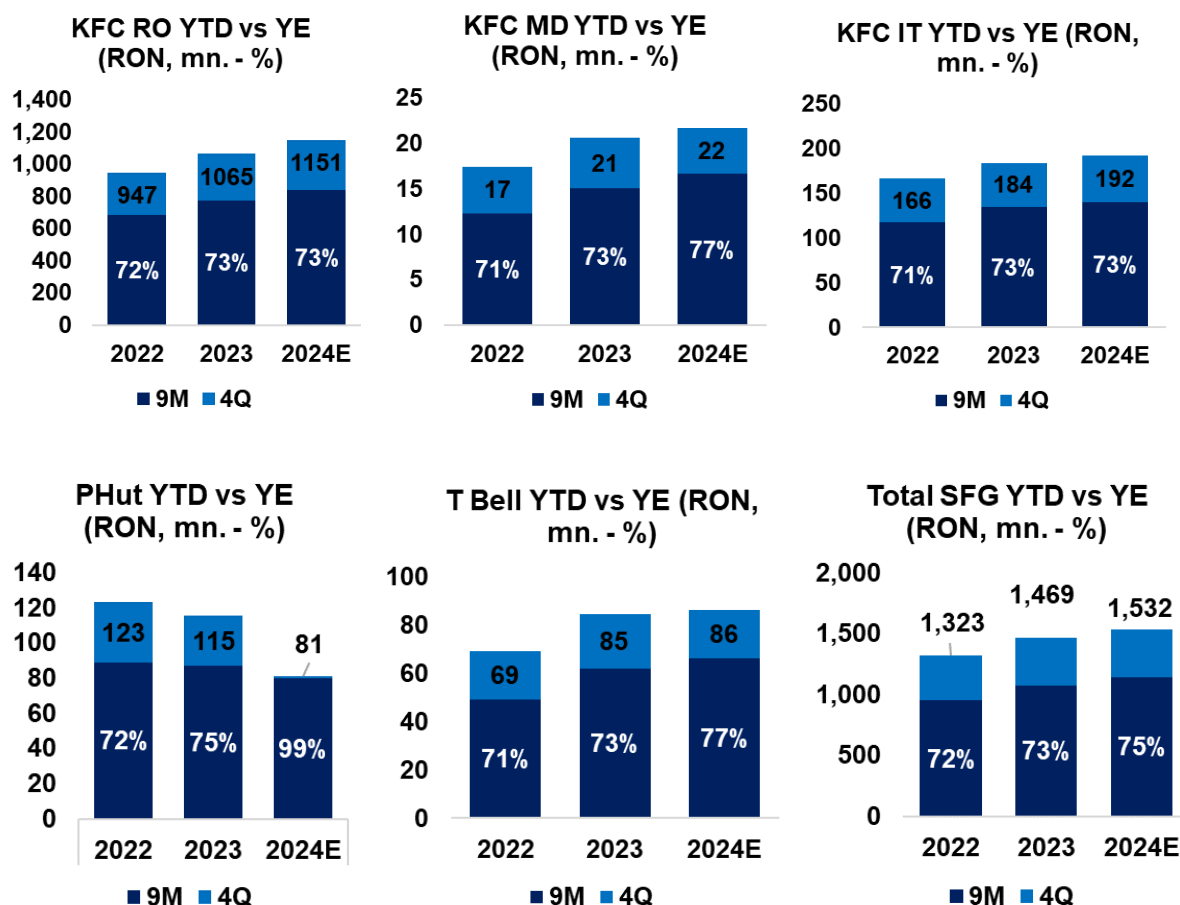
At the same time, as of our last update, we have calibrated our forecast in view of latest quarterly results, and have moderated our growth outlook for same store sales compared to our previous forecast. Thus, we decreased KFC Romania same store sales to 2% vs 4.5% previously, for KFC Italy to 4.4% from 5.7% and in Taco Bell to 2.6% from 5.4%. In Pizza Hut we maintained the rate of decline of 15%. Our last update seems overly conservative in most respects overall, despite a possible overshoot especially in the case of KFC Romania, however the last quarter of the year is seasonally the best and we trust that would show better results than 9M. This is true, especially considering the actual 9M24 financial results compared to our forecasts for the year, as seen below.



Source: Company data, Erste Group Research

YE revenues forecast perfectly 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 nine months of the year. Across the board our forecast is more conservative compared to the achievement of last years. (Note: A higher share of 9M24A in 2024E compared to that of 9M23 in 2023 figures represents a more conservative YE estimate compared to actual 9M numbers. Similar to previous years' results.)



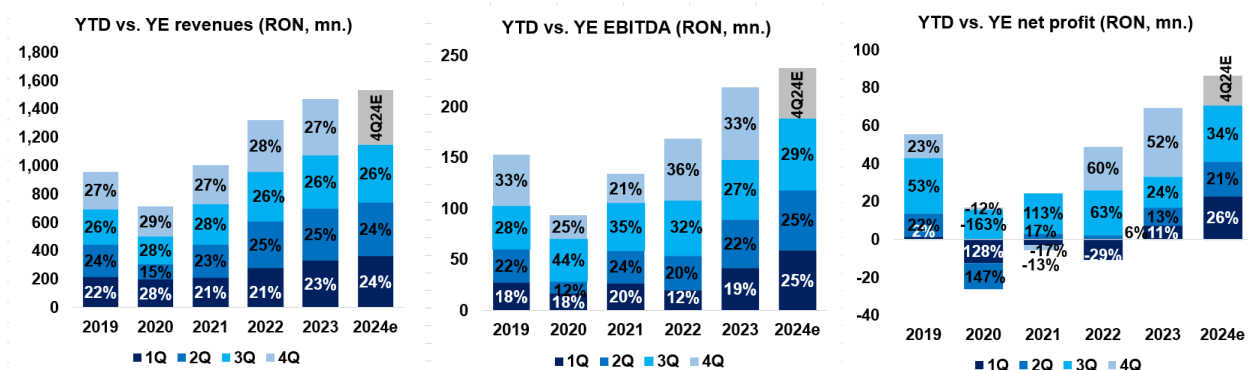
Source: Company data, Erste Group Research

YE profitability likely to overshoot our conservative forecasts.

Our YE forecast of revenues, EBITDA and Net Profit seem conservative considering the current development of sales and profitability, in the absence of any major disruptions from the macroeconomic or business side.

In terms of revenues, as mentioned above, we remain conservative 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 quarters – accounting for seasonality – and we will continue to monitor profitability in the coming quarters to ascertain the validity of the current trend.

We also consider our current forecast to be rather modest, as the first three quarters are, if taken separately, seasonally weaker in a normal environment, and – compared to our year end estimates, especially in terms of EBITDA and net profit – looks as a basis for a better YE performance.



Source: Company data, Erste Group Research

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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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