HAITONG

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Haitong Bank in a report from 25th June (08:19) initiates coverage of AmRest with a BUY recommendation and FV of PLN 515.4.

Valuation Methodology

Analysts value the stock using two methods: DCF and peer valuation, where the DCF has 75% and the peer valuation has a 25% weight. The peer valuation is based on P/E and EV/EBITDA multiples with equal weights. Based on a DCF they arrive at PLN 532.0 per share while based on peer valuation it is PLN 465.6. The final value is PLN 515.4, which offers 16.6% upside potential.

Risks to Fair Value

Vat rate

One of the most significant risks for AmRest is the change in the VAT tax rate due to the change of the Ministry of Finance's opinion about the tax on food and services.

Previously, regulations gave the option to apply a different tax rate depending upon the type of service. When classifying their services as subject to 5% VAT or 8% VAT, restaurants had to distinguish whether they deliver goods (pizza delivery) or offer a gastronomic service (traditional dine-in), taxed at a higher VAT rate of 8%. AmRest had received an individual interpretation of this law from the Polish tax office on the basis of which it can apply a 5% tax rate to its "inhouse" sales. However, in April, a new tax ordinance was proposed, which assumes that all individual interpretations will no longer be valid 6 months after the new law comes into force. If this law is imposed in unchanged form, it will result in an obligation to pay c.a. EUR 7.3m/8.4m in 2019E/2020E, respectively. The impact of a new VAT rate on our FV is marginal and accounts for PLN 0.2 per share.

Sunday trade ban

According to the company, the imposition of a Sunday sales ban will slightly impact the company's results. 40% of AmRest's activity is located in shopping malls, which according to FootFall index Polska suffered a -5.1% decline YoY in March.

AmRest was forced to abstain from Sunday sales in 30% of its fast-food restaurants. However, on Sundays some malls are opened to customers, ie who go to the cinema and on the way visit the food court. The first month of the Sunday trade ban resulted in a 20% drop in sales in restaurants that opened. As Sunday accounts for c.a. 13% of weekly sales, thus we assume the overall impact at c.a. - 5.7% on fast food restaurant sales and c.a 3.5% on overall sales.

On the other hand, limited access to food may force customers to order a meal, from which AmRest should also benefit. The company saw record rates of sales in the delivery segment which partially offset the negative impact of closed restaurants. Nevertheless, the net effect is not supportive for AmRest's results.

Franchisee dependence

As the vast majority of AmRest restaurants are franchised, there is a risk associated with the franchiser. Thus, many factors and decisions within the framework of AmRest's activity depend on the restrictions or specifications imposed by the franchiser. In every restaurant chain except Burger King, where the franchise fee is set at 5% of sales, AmRest is paying 6% of sales. Also, the marketing budget is set at 3-6% of revenues. However, the company tries to manage these costs by receiving the rights and budgets for marketing campaigns in the countries in which it has the exclusive right for development.

The duration of franchise agreements for KFC, Pizza Hut and Burger King brands is 10 years. AmRest has the option of extending this period for another 10 years provided it meets requirements that include payment of an extension fee. Irrespective of the fulfillment of the above conditions, there is no certainty that the contract will expire.

Wage rises

Higher than expected salary growth in CEE countries and unexpected wage hikes in Western Europe may put additional pressure on company margins and thus pose a risk to our valuation.

IMPORTANT DISCLOSURES