

AFC Enterprises, Inc.

Consumer- Restaurants

December 6, 2012

Company Description: *AFC Enterprises owns, operates and franchises over 2,000 quick-service restaurants in 44 states and 26 countries. The company operates restaurants under the Popeyes brand with a menu focused on chicken with a Louisiana taste. In addition to fried chicken, the company offers boneless chicken, seafood, sandwiches, biscuits and sides. The company is highly franchised (98%) and we expect most unit growth will come from franchisees. The company's headquarters are in Atlanta, GA.*

Updating model for restaurant acquisitions, we like AFCE, but want to buy it lower (AFCE - \$25.43) HOLD

Key Points

- **We updated our model for recent restaurant acquisitions and the Hearst/King Features settlement.**
- **AFCE closed on its acquisition of 27 former KFC restaurants in MN and CA and has begun converting those restaurants into Popeye's.** The company acquired 27 restaurants from a bankrupt KFC franchisee and will convert 26 locations into Popeye's restaurants and sell one location. The deal was closed on November 19th for \$13.8mm. All of the restaurants will be opened as franchised restaurants.
- **The company is now renovating the restaurants and expects to begin opening units over the next month and should be completed by 2Q:13.** We checked the 13 locations in MN yesterday and found that minimal work has begun on all of the restaurants while some restaurants are advanced in the renovation work (see pictures at end of this report). Signage has been removed or covered in all locations and windows have been covered for internal demolition and external painting. Four restaurants have external painting completed with an additional unit being painted during our visit. We think the currently painted restaurants may be available for opening over the next 45 days or so. We are encouraged by the progress on the work over the last two weeks. AFCE expects to spend approximately \$11.5mm renovating the restaurants.
- **We updated our model to reflect the acquisition cost, remodeling expense, rent and interest expense.** We added the 26 restaurants into our franchise base opening between the end of the year and 2Q:13. We are unsure of franchise fee impact and estimated standard rates for fees and royalty rates. Additionally, 19 of the locations are owned and the company will collect rent from franchisees, which is now in our model. We expect the company will finance approximately half of the total expenditures and adjusted our interest expense to reflect this change.
- **We updated our model to reflect the settlement with Hearst/King Productions regarding the Popeye's character.** We lowered our G&A expense to reflect the agreement.
- **AFCE had a large franchisee acquisition in Texas which could boost results.** A franchisee in Texas bought 49 restaurants from other franchisees to become the third largest franchisee in the system. We think this is encouraging as the franchisee plans an aggressive remodeling and opening schedule.

Financial Summary

Rev(mil)	2011A	2012E	2013E
Apr	\$46.8	\$52.8A	\$58.0E
July	\$35.3	\$39.6A	\$44.3E
Oct	\$35.4	\$38.9A	\$44.6E
Dec	\$36.3	\$43.3E	\$45.0E
FY	\$153.8	\$174.6E	\$191.9E
P/Sales	4.0x	3.5x	3.2x

EPS	2011A	2012E	2013E
Apr	\$0.27	\$0.35A	\$0.42E
July	\$0.23	\$0.27A	\$0.34E
Oct	\$0.25	\$0.29A	\$0.34E
Dec	\$0.24	\$0.30E	\$0.35E
FY	\$0.99	\$1.20E	\$1.45E
P/E	25.7x	21.2x	17.5x

Price:	\$25.43
52-Week Range:	\$27.89-\$13.68
Target:	\$27.50
Rating:	HOLD
Shares Outstanding:	24.0 mil
Mkt. Capitalization:	\$611 mil
Ave. Volume:	124,200
Instit. Ownership:	89%
BV / Share:	\$1.14
Debt / Tot. Cap.:	69%
Est. LT EPS Growth:	15%

- **We are raising our 2013 EPS estimate.** We now project 2013 EPS of \$1.45 compared to our prior \$1.38 estimate. We also raised our 2013 revenue estimate to \$191.9mm from \$189.1mm. Our 4Q:12 estimates are relatively unchanged. Overall we are encouraged by the recent development and the positive impact on the model.
- **We are raising our price target to \$27.50 from \$26.00.** We derive our new \$27.50 estimate by applying a 19x multiple to our new 2013 EPS estimate of \$1.45. Our valuation methodology is unchanged. We think a 19x multiple is justified given where other highly franchised restaurant concepts currently trade and AFCE's strong earnings growth
- **We like AFCE and the strong earnings growth, but would like to buy the stock at a lower price; we are maintaining our HOLD rating.** We think AFCE has turned from a story about improving results and turnaround to a growth story. We think the company's aggressive acquisition of its largest competitor's restaurants in two major markets shows the company's ability to move quickly and aggressively to expand and take market share. We think AFCE's franchisees are healthy and have an appetite for growth. We project mid-single digit net unit growth rate over the next several years and think AFCE has ample opportunity for both domestic and international expansion. We like a highly franchised restaurant base in uncertain economic times due to the reduced risk and strong cash flow and think AFCE is a good defensive investment despite being a consumer stock. We think the approximate 20% earnings growth this year and next are attractive. AFCE produces strong free cash flow and is attractive with a trailing twelve month FCF yield of 4.7%. However, we would like to buy the shares at a slightly lower price than current levels. We would turn more positive if the shares traded closer to \$24 with no change in fundamentals. We are maintaining our HOLD rating due to valuation but recommend keeping AFCE on your radar and buying on a pullback.

Brooklyn Center, MN



Crystal, MN



Brooklyn Center, MN



Bloomington, MN



St. Paul, MN



December 6, 2012

AFC Enterprises, Inc. Income Statement
(Dollars in millions, except where noted)

	F2010	Apr	Jul	Oct	Dec	F2011	AprA	JulA	OctA	Dec	F2012E	Apr	Jul	Oct	Dec	F2013E
Revenues:																
Sales by company operated restaurants	\$52.7	\$ 17.6	\$ 12.3	\$ 12.3	\$ 12.4	\$ 54.6	\$ 19.8	\$ 14.3	\$ 13.5	\$ 15.1	\$ 62.7	\$ 22.8	\$ 17.0	\$ 16.9	\$ 17.1	\$ 73.8
Franchise revenues	89.4	27.9	22.0	22.2	22.9	95.0	31.7	24.3	24.4	27.2	107.6	33.3	25.9	26.3	26.6	112.1
Other revenues	4.3	13	10	0.9	10	4.2	13	10	10	11	4.4	18	14	14	14	5.9
Total revenues	146.4	46.8	35.3	35.4	36.3	153.8	52.8	39.6	38.9	43.3	174.6	58.0	44.3	44.6	45.0	191.9
% change	-1.1%	6.8%	2.9%	3.8%	6.1%	5.1%	12.8%	12.2%	9.9%	19.4%	13.5%	9.8%	119%	14.6%	3.9%	9.9%
Expenses:																
Restaurant employee, occupancy and other expense	25.8	8.4	6.2	6.0	5.5	26.1	9.4	7.0	6.7	6.7	29.8	10.8	8.4	8.3	7.6	35.2
Restaurant food, beverages and packaging	16.8	5.8	4.1	4.2	4.2	18.3	6.6	4.8	4.6	5.0	21.0	7.6	5.7	5.7	5.7	24.7
Restaurant gross profit	103.8	32.6	25.0	25.2	26.6	109.4	36.8	27.8	27.6	31.5	123.7	39.5	30.2	30.6	31.7	132.0
Restaurant gross margin	19.2%	19.3%	16.3%	17.1%	21.8%	18.7%	19.2%	17.5%	16.3%	21.9%	18.8%	19.1%	17.3%	17.4%	21.9%	18.9%
General and administrative expense	58.5	19.3	14.2	14.8	15.7	64.0	21.3	15.2	15.3	18.2	70.0	20.7	15.4	15.5	16.4	68.0
Depreciation and amortization	3.9	13	10	0.9	10	4.2	13	11	11	11	4.6	15	11	12	12	4.9
Other expenses (income), net	0.2	(0.5)	0.2	0.3	0.5	0.5	0.0	0.1	0.1	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Total operating expenses	62.6	20.1	15.4	16.0	17.2	68.7	22.6	16.4	16.5	19.3	74.8	22.2	16.5	16.7	17.5	72.9
Operating income	41.2	12.5	9.6	9.2	9.4	40.7	14.2	11.4	11.1	12.2	48.9	17.3	13.7	14.0	14.1	59.2
Operating margin	28.1%	26.7%	27.2%	26.0%	25.9%	26.5%	26.9%	28.8%	28.5%	28.3%	28.0%	29.9%	31.0%	31.3%	31.4%	30.8%
Interest expense	8.0	11	0.9	0.8	0.9	3.7	11	0.9	0.7	0.7	3.4	12	0.9	0.8	0.8	3.7
Income before income taxes	33.2	11.4	8.7	8.4	8.5	37.0	13.1	10.5	10.4	11.5	45.5	16.2	12.9	13.1	13.3	55.5
Pretax margin	22.7%	24.4%	24.6%	23.7%	23.4%	24.1%	24.8%	26.5%	26.7%	26.5%	26.1%	27.9%	29.1%	29.4%	29.6%	28.9%
Income tax expense	10.3	4.2	3.2	2.6	2.8	12.8	4.8	3.9	3.5	4.4	16.6	6.1	4.8	4.9	5.0	20.8
% of pretax income	31.0%	36.8%	36.8%	31.0%	32.9%	34.6%	36.6%	37.1%	33.7%	38.0%	36.4%	37.5%	37.5%	37.5%	37.5%	37.5%
Income before discontinued operations	22.9	7.2	5.5	5.8	5.7	24.2	8.3	6.6	6.9	7.1	28.9	10.1	8.1	8.2	8.3	34.7
Discontinued operations, net of income taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income	22.0	6.9	5.7	6.1	6.0	24.7	8.6	6.6	6.9	7.1	29.2	10.1	8.1	8.2	8.3	34.7
Net income (GAAP)	22.9	7.2	5.5	5.8	5.7	24.2	8.3	6.6	6.9	7.1	28.9	10.1	8.1	8.2	8.3	34.7
EPS	0.86	0.27	0.23	0.25	0.24	0.99	0.35	0.27	0.29	0.30	1.20	0.42	0.34	0.34	0.35	1.45
EPS (GAAP)	0.90	0.28	0.22	0.24	0.23	0.97	0.34	0.27	0.29	0.30	1.19	0.42	0.34	0.34	0.35	1.45
EPS growth rate	17.0%	18.1%	8.3%	8.4%	27.9%	14.9%	31.3%	17.9%	13.7%	20.9%	215%	19.7%	24.0%	20.4%	17.7%	20.4%
Diluted shares	25.5	25.8	24.8	24.5	24.5	25.0	24.6	24.4	24.2	24.1	24.3	24.1	24.0	23.9	23.9	24.0
EBITDA	45.3	13.3	10.8	10.4	10.9	45.4	16.0	12.6	12.3	13.3	54.2	18.8	14.9	15.1	15.3	64.1
Number of restaurants period end:																
Domestic company owned	38	38	38	38	40	40	40	40	40	44	44	47	48	50	52	52
Domestic franchise operated	1542	1549	1557	1560	1587	1587	1589	1597	1606	1632	1632	1654	1671	1681	1704	1704
International	397	410	405	400	408	408	415	412	414	433	433	442	449	455	464	464
Total units	1977	1997	2,000	1998	2,035	2,035	2,044	2,049	2,060	2,109	2,109	2,143	2,168	2,166	2,220	2,220
Domestic same-store sales (yoy % change):	2.5%	3.9%	0.5%	1.7%	5.9%	3.0%	8.1%	8.4%	6.8%	2.2%	6.5%	0.3%	0.9%	2.0%	4.4%	1.8%
International same-store sales (yoy % change):	3.1%	4.1%	2.3%	1.8%	4.6%	3.3%	2.3%	0.9%	2.5%	0.4%	1.6%	3.1%	3.6%	2.3%	3.7%	3.2%

December 6, 2012

Analyst Certification

I, **Mark E. Smith**, certify that the views expressed in this research report accurately reflect my personal views about the subject company and its securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation related to the specific recommendations expressed in this report.

Important Disclosures:

The analyst or a member of his/her household **does not** hold a long or short position, options, warrants, rights or futures of this security in their personal account(s).

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There is **not** any actual material conflict of interest that either the analyst or Feltl and Company is aware of.

The analyst **has not** received any compensation for any investment banking business with this company in the past twelve months and **does not** expect to receive any in the next three months.

Feltl and Company **has not** been engaged for investment banking services with the subject company during the past twelve months and **does not** anticipate receiving compensation for such services in the next three months.

Feltl and Company **has not** served as a broker, either as agent or principal, buying back stock for the subject company's account as part of the company's authorized stock buy-back program in the last twelve months.

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Feltl and Company Rating System: Feltl and Company utilizes a four tier rating system for potential total returns over the next 12 months.

Strong Buy: The stock is expected to have total return potential of at least 20%. Catalysts exist to generate higher valuations, and positions should be initiated at current levels.

Buy: The stock is expected to have total return potential of at least 10%. Near term catalysts may not exist and the common stock needs further time to develop. Investors requiring time to build positions may consider current levels attractive.

Hold: The stock is expected to have total return potential between positive 10% and negative 10%. Fundamental events are not present to make it either a Buy or a Sell. The stock is an acceptable longer-term holding.

Sell: Expect a negative total return of at least 10%. Current positions may be used as a source of funds.

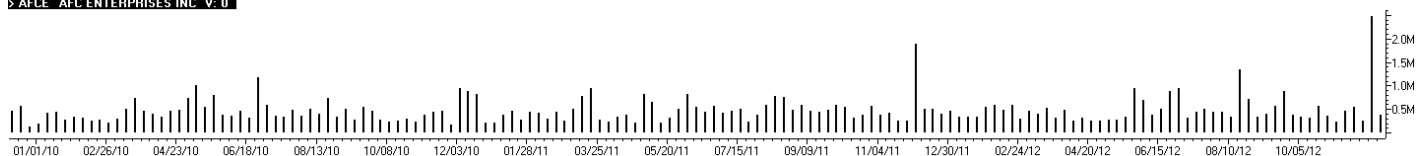
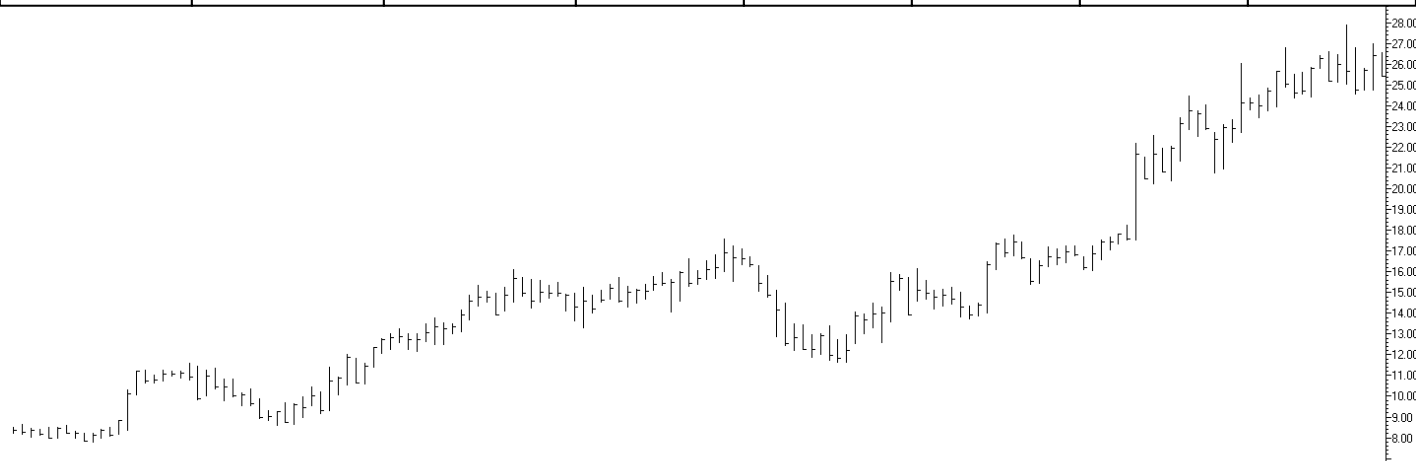
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Ratings Distribution for Feltl and Company

Rating			----- Investment Banking -----	
	Number of Stocks	Percent of Total	Number of Stocks	Percent of Rating category
SB/Buy	39	58%	0	0%
Hold	26	39%	0	0%
Sell	2	3%	0	0%
	67	100%	0	0%

The above represents our ratings distribution on the stocks in the Feltl and Company research universe, together with the number in (and percentage of) each category for which Feltl and Company provided investment-banking services in the previous twelve months.

08/19/10 Hold Target: \$11.00	01/10/11 Hold Target: \$13.00	03/10/11 Hold Target: \$15.00	11/10/11 Buy Target: \$17.00	1/26/12 Buy Target: \$18.00	5/24/12 Buy Target: \$21.50	8/16/12 Hold Target: \$26.00	12/6/12 Hold Target: \$27.50
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Date	Nature of Report	Rating	Price Target
07/22/09	Initiation @ \$7.00	Buy	\$9.00
09/28/09	Downgrade to HOLD	Hold	\$9.00
08/19/10	Raise Price Target	Hold	\$11.00
01/10/11	Raise Price Target	Hold	\$13.00
03/10/11	Raise Price Target	Hold	\$15.00
11/10/11	Upgrade to BUY, Raise Price Target	Buy	\$17.00
01/26/12	Raise Price Target	Buy	\$18.00
05/24/12	Raise Price Target	Buy	\$21.50
08/16/12	Downgrade to HOLD, Raise Price Target	Hold	\$26.00
12/06/12	Raise Price Target	Hold	\$27.50

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Valuation and Price Target Methodology:

We derive our \$27.50 price target by applying a 19x multiple to our 2013 EPS estimate of \$1.45.

Risks to Achievement of Estimates and Price Target:

- AFCE's business may be impacted by consumers' discretionary spending and confidence. Macroeconomic factors such as increasing gasoline prices, unemployment and generally tough economic times may negatively impact consumers' restaurant spending. Changing customer tastes or health trends could also have a negative impact on sales.
- Severe weather may slow sales at the restaurants as customers and staff may not be able to travel to the restaurant, or customers may choose not to eat out due to inclement weather.
- Volatile commodity prices may affect earnings. Volatile chicken prices have historically had a substantial impact on the company's operating results.
- There is no guarantee that AFCE's restaurants will be successful in new markets. Restaurants are currently operated in only 44 states, and the company will experience growth in new international markets over the next five years. In our view, this risk is lowered through growth in new markets from franchisees.
- The restaurant business is extremely competitive and competition for customers through lower prices may negatively impact AFCE's results. Discounted prices at AFCE's largest competitors may cause the company to lower prices to maintain its market share.
- Our growth projections are dependent on AFCE's ability to recruit, sign and retain competent franchisees. Lower demand for franchised restaurants could slow restaurant development and expected returns. Franchised restaurant growth may be negatively impacted by a tight credit market. We view AFCE's relationship with its franchisees as favorable.
- AFCE is leveraged with approximately \$59 million in debt. Results have been negatively impacted by high interest expense, and inability to maintain certain debt requirements could impact results. No debt maturities are immediately pending.
- Readers should recognize that the risks noted here do not represent a comprehensive list of all risk factors or potential issues, nor all factors that may preclude achievement of our forecast or price target. Additional risk factors exist and are outlined in the Company's SEC filings

Other Disclosures:

The information contained in this report is based on sources considered to be reliable, but not guaranteed, to be accurate or complete. Any opinions or estimates expressed herein reflect a judgment made as of this date, and are subject to change without notice. This report has been prepared solely for informative purposes and is not a solicitation or an offer to buy or sell any security. The securities described may not be qualified for purchase in all jurisdictions. Because of individual requirements, advice regarding securities mentioned in this report should not be construed as suitable for all accounts. This report does not take into account the investment objectives, financial situation and needs of any particular client of Feltl and Company. Some securities mentioned herein relate to small speculative companies that may not be suitable for some accounts. Feltl and Company suggests that prior to acting on any of the recommendations herein, the recipient should consider whether such a recommendation is appropriate given their investment objectives and current financial circumstances. Past performance does not guarantee future results. Additional information is available upon request.

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