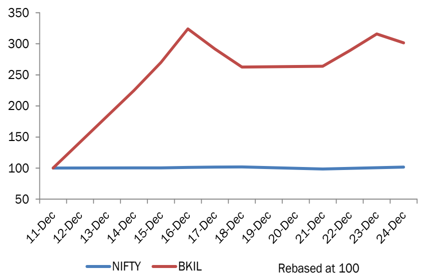
Burger King India Limited

28 December 2020

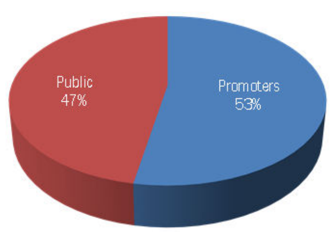
A meaty growth story! BUY

Sector	: Food Services
Target Price	: Rs 227
Current Market Price	: Rs 181
Market Cap	: Rs 5,024 crore
52-week High/Low	: Rs 214/60
Daily Avg Vol (12M)	: 5,75,88,023
Face Value	: Rs 10
Beta	: N/A
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 543248
NSE Scrip Code	: BURGERKING
Bloomberg Code	: BURGERKI IN
Reuters Code	: N/A
Nifty	: 13,749
BSE Sensex	: 46,974
Analyst	: Ritwik Bhattacharjee

Price Performance



Shareholding Pattern



Introductory Note

Investment Summary

- Burger King India Limited (BKIL) has exclusive pan-India master franchisee rights to open and operate BURGER KING restaurants in the country. It is one of the fastest-growing QSR chains in India, reaching 200 outlets in its first 5 years of operations.
- An increase in the number of dual-earner families, changing lifestyle, rising consumerism and higher internet penetration will drive eating out habits of people going forward with QSRs and fast-food restaurants expected to benefit the most.
- BKIL looks to grow its business through a combination of expansion in existing markets, entering new markets, and increasing per store revenue with the chain at an early stage of its life cycle.
- BKIL's cluster approach to penetrate and expand in geographical markets generates operating leverage by ramping up the number of restaurants in a cluster, thereby enabling per store cost reduction through expansion of operations. Its partnership with the supply chain and distribution company ColdEX enables better working capital management.
- BKIL's small-sized stores with a focus on deliveries bode well for future growth with an increasing number of customers expected to order in food not only in the near term (due to Covid-19) but also in the medium-to-longer term due to changes in lifestyle and consumer preference.
- After a weak FY21 owing to the Covid-19 outbreak, we anticipate a sharp recovery in demand in FY22 coupled with expansion of operations and a return to operating profitability. Although we have not modelled break-even at the PAT level over our forecast period, aggressive expansion of operations is expected to enable BKIL generate net profits by FY24. Assigning a target Price-to-Sales (P/S) multiple of 4.0x FY23E operating revenue, we value BKIL at Rs 227, informing a BUY rating with an upside of 26%.

Key Financial Metrics

Rs crore	FY19A	FY20A	FY21E	FY22E	FY23E
Operating revenue	632.7	841.2	436.6	1,250.4	1,579.2
Growth		*33.0%*	*-48.1%*	*186.4%*	*26.3%*
EBITDA	79.0	99.7	(62.9)	162.5	243.2
EBITDA margin	*12.5%*	*11.9%*	*-14.4%*	*13.0%*	*15.4%*
PAT	(38.3)	(76.6)	(241.9)	(32.5)	(1.6)
PAT margin	*-6.1%*	*-9.1%*	*-55.4%*	*-2.6%*	*-0.1%*
Diluted EPS (Rs)	(1.44)	(2.87)	(8.71)	(1.17)	(0.06)

Source: Company data; Khambatta Research

Company Profile

Burger King India Limited (BKIL) is one of the fastest-growing international quick-service restaurant (QSR) chains in India. It commenced business in November 2014 and had opened 200 restaurants in the first 5 years of its operations. BKIL ran 261 BURGER KING restaurants including 8 sub-franchised restaurants across 17 states and union territories and 57 cities across India as of the end of 1H FY21. The BURGER KING brand in India offers a wide range of vegetarian and non-vegetarian burgers and accompaniments through a menu customised to suit Indian tastes across price points, thereby catering to different customer segments.

BKIL runs 261 restaurants across 17 Indian states/UTs

BKIL is the national master franchisee of the international brand BURGER KING in India. Founded in 1954 in the US, BURGER KING is the world's second-largest burger chain with approximately 18,000 restaurants operating in more than 100 countries as of June 2019.

Investment Thesis

With an exclusive pan-India master franchise, BKIL is one of the fastest-growing QSR chains in the country with robust growth potential in the coming few years. One of the fastest-growing QSR chains in India, BKIL was amongst the first international QSRs to reach 200 outlets in its first 5 years of operations since opening its first restaurant in late 2014. BKIL has exclusive pan-India master franchisee rights to open and operate BURGER KING restaurants in the country under licence from the brand's parent company. With rights to operate the brand in India until December 2039, the royalty fee is capped at 5% of sales. BURGER KING is the second major international burger QSR to open in India after McDonalds. Besides McDonalds, BKIL competes with other international QSR brands such as Domino's, KFC and Subway. BURGER KING in India is positioned as a value brand alongside McDonalds, Domino's and KFC with Subway placed below these brands in terms of average ticket value (Rs 500-600 vs Rs 250-300). By virtue of its reputation as an international brand and visibility achieved over the last 6 years since its launch in India, BURGER KING already enjoys a fair degree of popularity in the country. We believe BKIL has the right price points, value proposition, positioning and reach required to generate exponential growth in the medium term.

BKIL's royalty fees are capped at 5% until 2039

The QSR segment has strong growth potential supported by demographic and socioeconomic factors. QSRs and casual dining restaurants (CDRs) comprise 74% of India's restaurant market as they continue to grow exponentially *(source: YourStory)*. The Indian QSR market is projected to grow at a CAGR of over 18% during 2021-2025 *(source: Research and Markets)*. This could be attributed to increasing urbanization, an expanding young and working-age population, rising disposable income, and a growing number of dual-income families. India's per capita GDP is expected to grow by a CAGR of 8.1% from US$ 2,172 in 2019 to US$ 3,210 in 2024 *(source: IBEF)*. An increase in the number of dual-earner families, changing lifestyle, rising

The Indian QSR market is expected to grow at a CAGR of 18% over 2021-2025 consumerism and higher internet penetration will drive eating out habits of people going forward with QSRs and fast-food restaurants expected to benefit the most as it is one of the most popular formats amongst younger people. While the standalone restaurants segment grew by a CAGR of 11% between FY16 and FY19, chain restaurants witnessed a growth rate of 23% over the same period *(source: Express Food & Hospitality)*. A majority of chain restaurants in India comprises QSRs. We expect QSRs to continue to outperform the overall sector in the medium term. On the supply side, proliferation of QSR outlets and increased online food ordering will boost the segment in the coming years. Furthermore, food services penetration in India is still lower compared to the western world and East/Southeast Asia. This coupled with an increasing share of the market for the organised segment presents robust growth opportunities for the food services sector in general and QSR in particular.

The Indian chain restaurant market witnessed a growth rate of 23% between FY16 and FY19

New store openings in existing and new cities, and increase in per store revenue will drive future growth. BKIL has a majority of its restaurants in the northern region with 131 outlets across 5 cities, accounting for 50% of the company's topline. The northern region contains India's largest urban agglomeration of the National Capital Region (NCR) as well as Tier II cities which are important commercial hubs with a large number of younger working-age people residing there. This presents further expansion opportunities for BKIL in the region. With a relatively lower presence currently, the western and southern regions (together accounting for 47% of the company's revenues) present BKIL with a significant scope to expand geographically. Basis the popularity of older international QSR chains in these regions, we believe BKIL can grow exponentially in these markets due to favourable consumer preferences. Moreover, with BKIL being a new entrant in the market, its per store revenue can grow by a high rate in the years to come. BKIL plans to increase its outlet count to 700 by December 2026 in line with its Master Franchise Development Agreement (MFDA) with the parent company. Currently, 55% of BKIL's outlets are located in malls, 25% in high streets, 15% drive-throughs, and 5% in metro and railway stations. The MFDA renders flexibility to BKIL in terms of tailoring the menu, promotions and pricing, supply chain, distribution, advertising and promotion, and rights to sub-franchise besides a royalty rate cap of 5%.

The northern region accounts for 50% of BKIL's topline

Expansion through cluster penetration will generate operating leverage and margin growth. BKIL follows a cluster approach to penetrate and expand in geographical markets. The company identifies high-traffic locations within an urban agglomeration to roll out multiple outlets within that cluster. It employs a form of the hub-and-spoke model where raw materials are sourced from multiple vendors through the third-party distributor ColdEX with BKIL using ColdEX's warehousing facilities / distribution centres (hub) and logistics network to serve the outlets in a cluster (spokes). This operational strategy generates operating leverage through ramping up the number of restaurants in a cluster, thereby enabling per store cost reduction by expanding the operations. The partnership with ColdEX also allows better working capital

The third-party distributor ColdEX plays a key role in BKIL's supply chain setup

management for BKIL as ColdEX procures the raw materials from the vendors and holds them as its own inventory until it is supplied to BKIL's restaurants.

Small-sized stores and delivery-focused expansion strategy offer stronger scalability potential. The area of BKIL's restaurants ranges from 400 sqft to 4,000 sqft. The size of an outlet depends on its format/location, i.e. high street, shopping mall, food court, drive-through and transit location. The average size a BKIL restaurant is 1,300 sqft to 1,400 sqft, which is a half of the average McDonalds store size of 2,600 sqft to 3,200 sqft. The smaller average store size will allow nimble expansion and keep lease and other overhead costs lower. Further, an expansion strategy based on smaller stores also means that BKIL will look to generate a significant proportion of sales from takeaways and deliveries. BKIL's offerings are suitable for ordering in and with social distancing norms expected to be preferred by customers for some time even after the Covid-19 pandemic comes under control and increasing internet penetration coupled with a busy lifestyle, we find BKIL's expansion strategy credible for both the near and medium terms. The growth witnessed by food delivery companies such as Zomato and Swiggy as well as their expansion plans and fundraising success validate the strong growth potential for food delivery and restaurants with a strong focus on the channel.

The average size of a BURGER KING restaurant in India at ~1,300 sqft is half that of McDonalds

Valuation

At 4.0x FY23E sales, we rate BKIL a BUY with a target price of Rs 227 and an upside of 26%. BURGER KING has grown at a brisk pace in terms of number of outlets and brand visibility in the last 6 years since its launch in India in late 2014. BKIL has an ambitious but achievable expansion plan. The company's cluster approach and penetration strategy enable it to generate operating leverage as it expands operations in a cluster. BKIL's small-sized stores with a focus on deliveries bode well for future growth with an increasing number of customers expected to order in food not only in the near term (due to Covid-driven social distancing) but also in the medium-to-longer term due to changes in lifestyle and consumer preference. BKIL is not yet profitable at the PAT level. We expect a sharp decline in revenues in FY21, leading to an operating loss in FY21 owing to the Covid-19 outbreak's impact on sales and operations of the company. We anticipate a sharp recovery in demand in FY22 coupled with expansion of operations and a return to operating profitability. Although we have not modelled break-even at the PAT level over our forecast period, aggressive expansion of operations is expected to enable BKIL generate net profits by FY24. Assigning a target Price-to-Sales (P/S) multiple of 4.0x FY23E operating revenue, we value BKIL at Rs 227, informing a BUY rating with an upside of 26%.

We anticipate a recovery in demand coupled with expansion of operations and a return to operating profitability in FY22

Abridged Profit & Loss Account

Rs crore	FY19A	FY20A	FY21E	FY22E	FY23E
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Source: ***Company data; Khambatta Research***

Key Risks

- Our forecasts for BKIL are based on the assumption of an aggressive expansion plan. Any failure to successfully and efficiently expand operations will lead to underperformance of our projections.
- BKIL's operations rely strongly an efficient supply chain. Major disruptions or inefficiencies in its supply chain will negatively affect our expectations.
- An extended economic downturn owing to / as a fallout of the COVID-19 pandemic may lead to underperformance of our forecasts.

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

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