

Sapphire Foods

Estimate changes



TP change



Rating change



Bloomberg	SAPPHIRE IN
Equity Shares (m)	64
M.Cap.(INRb)/(USDb)	92.5 / 1.1
52-Week Range (INR)	1573 / 910
1, 6, 12 Rel. Per (%)	-9/-5/-
12M Avg Val (INR M)	305

Financials & Valuations (INR b)

Y/E March	2022	2023E	2024E
Sales	17.2	23.7	29.7
Sales Gr. (%)	68.8	37.6	25.5
EBITDA	3.1	4.6	6.1
EBITDA Margin (%)	17.7	19.5	20.6
Adj. PAT	0.5	1.4	1.9
Adj. EPS (INR)	7.2	21.4	29.3
EPS Gr. (%)	L/P	195.2	37.3
BV/Sh.(INR)	158.5	179.9	209.2

Ratios

RoE (%)	6.2	12.6	15.1
RoCE (%)	8.0	11.7	12.8

Valuation

P/E (x)	201.1	68.1	49.6
P/BV (x)	9.2	8.1	7.0
EV/Sales (x)	5.2	3.8	2.9
EV/EBITDA (x)	29.2	19.3	14.2
Pre-IND AD 116	49.2	30.7	21.9
Ev/EBITDA (x)			

Shareholding pattern (%)

As On	Sep-22	Jun-22
Promoter	51.3	51.3
DII	16.8	12.5
FII	12.6	12.6
Others	19.3	23.7

FII Includes depository receipts

CMP: INR1,455

TP: INR1,780 (+22%)

Buy

Robust SSSG; outlook remains positive

- Aided by healthy double-digit SSSG of 15% and 23% in KFC and Pizza Hut (PH), respectively, Sapphire Foods (SAPPHIRE)'s 2QFY23 sales and gross profit were broadly in line with expectations.
- With good festive season sales, 3QFY23 outlook (the most important quarter from a full-year perspective) is positive. The company's decision to take price hikes lower than material cost increases is resulting in good operating leverage. With the Sri Lanka (SL) business outlook getting better from Sep'22 onwards, the extent of drag on EBITDA margin is likely to be lower going forward.
- We retain our **BUY** rating with a TP of INR1,780, given SAPPHIRE's healthy earnings growth trend and relatively inexpensive valuations v/s QSR peers.

Sales and gross profit in line; KFC's SSSG better than expectation

- SAPPHIRE reported consolidated sales growth of 35.9% YoY to INR5,628m (est. INR5,680m) in 2QFY23.
- SSSG: KFC at +15% (est. 7%), PH at +23% (est. 12%), and SL at +37% in LKR terms.
- Net new units (NNU): 20 for KFC, 14 for PH, and 8 for SL. Store additions were in line with our estimates and stated guidance.
- Number of stores as of 2QFY23: KFC at 301, PH at 249, and SL at 106. There were a total of 658 stores as of 2QFY23.
- Consolidated gross margin contracted 320bp YoY/150bp QoQ to 66.4%. Sequential gross margin was down 170bp for KFC and 60bp for PH.
- SAPPHIRE's EBITDA (post-IND AS) grew 82% YoY to INR1,032m (est. INR1,121m). EBITDA margin expanded 460bp YoY but contracted 190bp QoQ to 18.3% (est. 19.7%).
- EBITDA (pre-IND AS) grew 144% YoY to INR624m with a margin of 11.1%.
- Adj. PAT was at INR269m (est. INR316m) v/s a loss of INR51m in 2QFY22.
- In 1HFY23, sales/EBITDA grew 55%/136% YoY to INR11.1b/INR2.1b, respectively. Adj. PAT came in at INR650m v/s loss of INR315m in 1HFY22.

Highlights from the management commentary

- Double-digit SSSG meant that despite 300bp impact on gross margin, the restaurant EBITDA margin contracted only 80bp. The adjusted operating margin for India restaurant business was actually up 40bp YoY with the difference being the adverse impact from SL.
- Material costs are falling sequentially. Management does not see the need to take further price increases. It expects some gross margin improvement in 3QFY23 with more to come in 4Q. Higher ADS in 3Q will enable better EBITDA margin. The 3Q ADS for KFC is usually 4-8% higher than 2Q.
- SAPPHIRE's full-year EBITDA impact from SL over the last year will be around INR150-200m.
- Tax benefits will continue in the second half as well as next year because of accumulated losses.

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Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Valuation and view

- Changes to our model have led to a 5%/1% decrease in FY23/FY24 EBITDA estimates, respectively. As the company turned profitable at the net level only in FY22, the impact on PAT forecasts is higher.
- The stock has done well with over 45% return since our [initiating coverage note](#) in May'22. Despite a strong EBITDA growth outlook with a CAGR of more than 40% over FY22-24E, the stock trades at inexpensive multiples of 21.9x FY24E Pre Ind-AS EBITDA.
- We have assigned a Sep'24E EV/EBITDA (pre-Ind AS 116) multiple of 29x to the KFC business on account of its robust metrics (ADS and restaurant EBITDA margin), and 17x to the PH business. These are at a 30%/50% discount to the target multiples for DEVYANI's KFC/PH businesses (42x/35x) due to the following disadvantages that SAPPHIRE faces in terms of trade: a) its territorial rights in KFC are largely in states with a relatively higher vegetarian population, and b) DEVYANI can venture into SAPPHIRE's territories with PHD format stores, which require lower capex. While some discount to multiples are justified given the abovementioned reasons, the earnings growth opportunity for SAPPHIRE is still attractive enough to warrant an investment case. **We retain our BUY rating with a TP of INR1,780 on an SoTP basis.**

Quarterly Performance

Quarterly Performance											(INR m)	
Y/E March	FY22				FY23				FY22	FY23E	FY23	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
KFC - No. of stores	208	219	250	263	281	301	316	323	263	323	296	
PH - No. of stores	171	188	209	219	235	249	264	289	219	289	250	
KFC - SSSG (%)	149.0	8.0	29.0	15.0	65.0	15.0	11.0	12.0	31.0	13.5	7.0	
PH - SSSG (%)	-29.0	64.0	22.0	3.0	47.0	23.0	1.0	12.0	42.0	14.0	12.0	
Net Sales	3,031	4,142	5,075	4,968	5,463	5,628	6,339	6,251	17,216	23,680	5,680	-0.9
YoY change (%)	173.0	76.9	52.0	45.9	80.3	35.9	24.9	25.8	68.8	37.6	37.1	
Gross Profit	2,130	2,884	3,510	3,414	3,707	3,737	4,259	4,240	11,938	15,943	3,864	-3.3
Margin (%)	70.3	69.6	69.2	68.7	67.9	66.4	67.2	67.8	69.3	67.3	68.0	
EBITDA	341	566	1,145	998	1,104	1,032	1,216	1,256	3,050	4,609	1,121	-8.0
EBITDA growth %	L/P	70.7	93.1	78.8	223.9	82.2	6.2	25.9	145.2	51.1	98.0	
Margin (%)	11.2	13.7	22.6	20.1	20.2	18.3	19.2	20.1	17.7	19.5	19.7	
Depreciation	534	512	513	576	609	628	700	757	2,135	2,695	650	
Interest	172	190	185	233	197	206	220	238	781	861	200	
Other Income	109	95	78	98	59	71	100	112	380	343	80	
PBT	-256	-41	525	286	356	269	396	374	514	1,396	351	-23.3
Tax	8	10	16	21	-25	1	32	31	54	38	35	
Rate (%)	-	-	2.9	7.3	-7.1	0.3	8.0	8.3	10.5	2.8	10.0	
Adjusted PAT	-264	-51	510	265	381	269	365	343	460	1,358	316	-15.0
YoY change (%)	-	-	1,678.2	-	L/P	L/P	-28.5	29.4	-	195.2	L/P	

E: MOFSL Estimates

Quarterly brand-wise performance

	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23
KFC									
No. of stores	188	196	203	208	219	250	263	281	301
Net store addition	2	8	7	5	11	31	13	18	20
SSSG (%)	NA	(10)	12	149	NA	29	15	65	15
Net sales (INR m)	1,317	1,983	2,081	1,788	2,565	3,031	2,966	3,537	3,491
YoY growth (%)	NA	(4.9)	NA	245.5	94.8	52.8	42.5	97.9	36.1
ADS (INR '000)	78	115	118	105	134	144	132	144	134
Gross Margins (%)	67.0	68.1	68.6	69.3	68.7	68.0	67.9	67.3	65.6
Restaurant EBITDA Margin (%)	13.8	18.7	18.1	13.5	20.6	21.2	19.0	20.3	17.9
Channel mix (%)									
Delivery	NA	34	33	62	NA	37	40	35	36
Dine-in + Takeaway	NA	66	67	38	NA	63	60	65	64
PH									
No. of stores	159	161	162	171	188	209	219	235	249
Net store addition	(13)	2	1	9	17	21	10	16	14
SSSG (%)	NA	(19)	8	(29)	NA	22	3	47	23
Net sales (INR m)	472	751	776	660	884	1,134	1,032	1,219	1,410
YoY growth (%)	NA	(18.3)	NA	203.2	87.1	51.0	33.0	84.6	59.5
ADS (INR '000)	32	53	54	49	57	64	55	61	64
Gross Margins (%)	75.6	75.4	76.6	76.5	75.8	75.4	74.8	75.3	74.7
Restaurant EBITDA Margin (%)	4.1	11.2	11.2	5.8	10.7	14.9	11.5	14.8	15.1
Channel mix (%)									
Delivery	NA	49	45	78	NA	49	52	47	50
Dine-in + Takeaway	NA	51	55	22	NA	51	48	53	50
SL									
No. of stores	65	66	70	69	73	89	95	98	106
Net store addition	2	1	4	(1)	4	16	6	3	8
SSSG (%)	NA	3	8	56	NA	40	29	53	37
Net sales (INR m)	528	570	501	555	653	858	917	650	669
YoY growth (%)	-	6.1	-	51.7	23.6	50.5	83.1	17.1	2.5
ADS (INR '000)	92	98	97	91	105	121	112	75	73
Gross Margins (%)	-	66.8	-	66.9	66.0	67.2	64.9	58.8	55.4
Restaurant EBITDA Margin (%)	-	20.2	26.3	18.0	19.6	23.9	24.4	15.5	15.0

Source: MOFSL, Company



Highlights from the management commentary

Demand environment

- Management is happy with double-digit SSSG on both segments. 2Q is usually the weakest for Yum brand franchisee; hence, management is pleased with its performance.
- Store expansion pace has been healthy and in line with expectations.
- Vegetarian days for the quarter were higher than recent years but impact wasn't as much as feared, albeit, ADS was still down sequentially by 7% for KFC.
- Proximity to stores is enabling higher share of takeaways compared to the past.

Costs and margins

- Double-digit SSSG meant that despite 300bp impact on gross margin, the restaurant EBITDA margin contracted only 80bp. The adjusted operating margin for India restaurant business was actually up 40bp YoY with the difference being the adverse impact from SL.

- Material costs are falling sequentially. Management does not see the need to take further price increases. It expects some gross margin improvement in 3QFY23 with more to come in 4Q. Higher ADS in 3Q will enable better EBITDA margin. The 3Q ADS for KFC is usually 4-8% higher than 2Q.

Sri Lanka

- SSSG rose 37% YoY, largely led by price increases. Transaction growth was also positive during the quarter.
- Jun-Aug'22 period was tough but things at the operating level have improved since then to about 85-90% normalcy on fuel availability and material cost imports.
- Restaurant's operating margin dipped 500bp.
- INR impact of SL was INR70m in 1QFY23 and remains at similar levels in 2QFY23 as well.
- The full-year EBITDA impact of SL over last year will be around INR150-200m.

Brand highlights

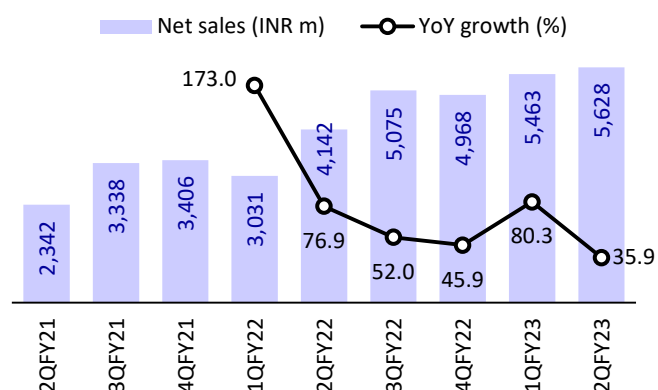
- Chicken Peri Peri launch of KFC received a good response
- There was a strong demand for Flavour Fun Pizzas but it is still early to gauge the financial impact.
- PH restaurant's EBITDA margin at 15.1% was actually shot up YoY. Newer stores are doing even better.

Other points

- KFC has 20% own delivery and PH has 10% own delivery; these are at similar levels in recent quarters.
- Tax benefits will continue in the second half as well as next year because of accumulated losses.

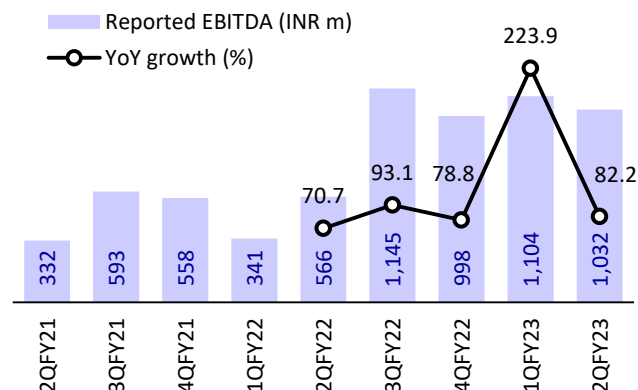
Key exhibits

Exhibit 1: Net sales grew 36% YoY to INR5.6b in 2QFY23



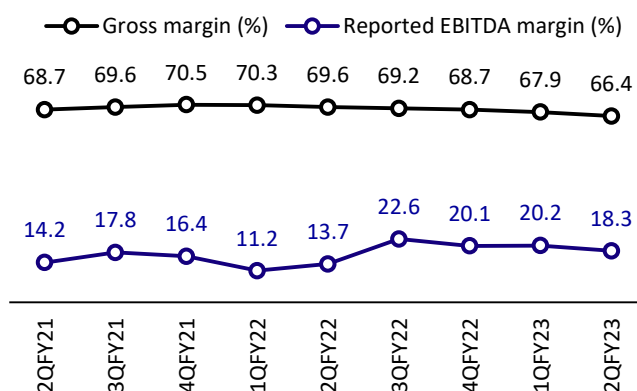
Source: Company, MOFSL

Exhibit 2: EBITDA grew 82% YoY to INR1b



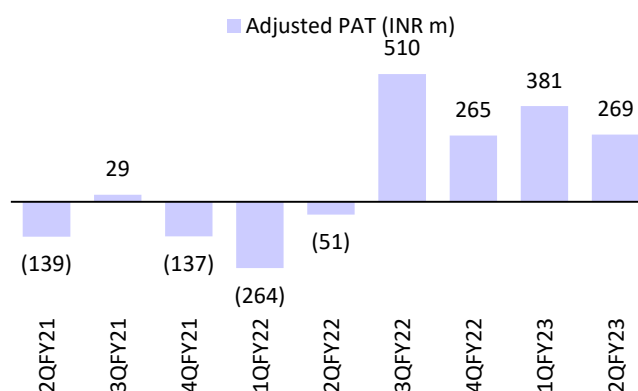
Source: Company, MOFSL

Exhibit 3: Gross/reported EBITDA margin came in at 66.4%/18.3% in 2QFY23, respectively



Source: MOFSL, Company

Exhibit 4: Adjusted PAT came in at INR269m



Source: MOFSL, Company

Valuation and view

- Changes to our model have led to a 5%/1% decrease in FY23/FY24 EBITDA estimates, respectively. As the company turned profitable at the net level only in FY22, the impact on PAT forecasts is higher.
- The stock has done well with over 45% return since our [initiating coverage note](#) in May'22. Despite a strong EBITDA growth outlook with a CAGR of more than 40% over FY22-24E, the stock trades at inexpensive multiples of 21.9x FY24E Pre Ind-AS EBITDA.
- We have assigned a Sep'24E EV/EBITDA (pre-Ind AS 116) multiple of 29x to the KFC business on account of its robust metrics (ADS and restaurant EBITDA margin), and 17x to the PH business. These are at a 30%/50% discount to the target multiples for DEVYANI's KFC/PH businesses (42x/35x) due to the following disadvantages that SAPPHIRE faces in terms of trade: a) its territorial rights in KFC are largely in states with a relatively higher vegetarian population, and b) DEVYANI can venture into SAPPHIRE's territories with PHD format stores, which require lower capex. While some discount to multiples are justified given the abovementioned reasons, the earnings growth opportunity for SAPPHIRE is still attractive enough to warrant an investment case. **We retain our BUY rating with a TP of INR1,780 on an SoTP basis.**

Exhibit 5: SoTP valuation for SAPPHIRE based on pre-Ind AS EV/EBITDA

	Sep'24E EBITDA*	Multiple	EV
KFC	3.2	29x	93.0
PH	0.7	17x	11.8
SL	0.5	5x	2.5
Others	0.0	1x	0.0
Total	4.4	26.1x	107.4
Net debt	FY24E		-5.8
Equity value			113.2
TP (INR)			1,780
Upside (%)			22%

*Pre-Ind AS 116

Source: Company, MOFSL

Exhibit 6: We change our FY23/FY24 EBITDA estimates by -9.2%/-3.5%, respectively

INR m	New		Old		Change (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Sales	23,680	29,729	24,085	30,065	-1.7	-1.1
EBITDA	4,609	6,110	4,848	6,187	-4.9	-1.2
PAT	1,358	1,864	1,495	1,932	-9.2	-3.5

Source: Company, MOFSL

Financials and valuations

Consolidated Income Statement

(INR m)

Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E
Net Sales	11,938	13,404	10,196	17,216	23,680	29,729
Change (%)		12.3	-23.9	68.8	37.6	25.5
Raw Materials	3,946	4,317	3,099	5,278	7,737	9,025
Gross Profit	7,992	9,087	7,097	11,938	15,943	20,704
Margin (%)	66.9	67.8	69.6	69.3	67.3	69.6
Operating Expenses	6,532	7,232	5,853	8,888	11,334	14,594
EBITDA	1,460	1,856	1,244	3,050	4,609	6,110
Change (%)		27.1	-33.0	145.2	51.1	32.6
Margin (%)	12.2	13.8	12.2	17.7	19.5	20.6
Depreciation	1,547	1,913	2,091	2,135	2,695	3,474
Int. and Fin. Charges	720	722	756	781	861	949
Other Income	125	113	616	380	343	455
Profit before Taxes	-683	-666	-987	514	1,396	2,142
Change (%)		-2.5	48.2	-152.1	171.7	53.5
Margin (%)	-5.7	-5.0	-9.7	3.0	5.9	7.2
Total tax	11	-17	12	54	38	279
Tax Rate (%)	-1.6	2.6	-1.2	10.5	2.8	13.0
Adjusted PAT	-694	-649	-999	460	1,358	1,864
Change (%)		-	-	L/P	195.2	37.3
Margin (%)	-5.8	-4.8	-9.8	2.7	5.7	6.3
Exceptional/Prior Period inc	0	944	0	0	0	0
Reported PAT	-694	-1,592	-985	465	1,358	1,864

Balance Sheet

(INR m)

Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E
Share Capital	431	502	528	635	635	635
Reserves	3,585	4,742	4,271	9,436	10,794	12,657
Net Worth	4,016	5,245	4,799	10,071	11,429	13,293
Loans	853	592	520	612	612	612
Other Liability	5,455	5,744	5,692	7,280	7,631	8,567
Minority Interest	11	3	-12	-17	-17	-17
Capital Employed	10,335	11,582	11,000	17,947	19,655	22,455
Gross Block	5,473	6,567	6,905	8,948	11,573	14,328
Less: Accum. Depn.	1,587	2,221	2,974	3,487	6,036	9,510
Net Fixed Assets	3,886	4,346	3,932	5,462	5,537	4,818
Capital WIP	210	215	304	327	327	327
Goodwill	2,539	1,622	1,622	1,622	1,622	1,622
Other Intangible assets	767	688	551	566	623	685
Right to Use Assets	4,859	4,953	4,739	6,249	7,925	9,058
Investments	0	155	267	1,525	2,000	2,500
Current	0	155	267	1,525	2,000	2,500
Non-current	0	0	0	0	0	0
Curr. Assets, L&A	3,414	1,828	2,074	5,890	6,201	8,876
Inventory	381	444	474	652	896	1,125
Account Receivables	224	46	78	141	194	243
Cash and Bank Balance	1,865	392	500	2,546	2,101	3,956
Others	944	947	1,022	2,551	3,010	3,552
Curr. Liab. and Prov.	5,340	2,224	2,490	3,692	4,579	5,430
Account Payables	1,142	1,307	1,440	1,991	2,739	3,438
Other Liabilities	4,051	767	887	1,525	1,647	1,779
Provisions	147	151	163	176	193	213
Net Current Assets	-1,926	-396	-416	2,198	1,621	3,446
Application of Funds	10,335	11,582	11,000	17,947	19,655	22,455

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E
Basic (INR)						
EPS	-16.1	-12.9	-18.9	7.2	21.4	29.3
Cash EPS	19.8	25.2	20.7	40.8	63.8	84.0
BV/Share	93.2	104.4	90.9	158.5	179.9	209.2

Valuation (x)

P/E	N/M	N/M	N/M	201.1	68.1	49.6
Cash P/E	73.5	57.8	70.3	35.6	22.8	17.3
EV/Sales	5.2	5.5	7.5	5.2	3.8	2.9
EV/EBITDA	42.3	39.4	61.6	29.2	19.3	14.2
P/BV	15.6	13.9	16.0	9.2	8.1	7.0

Return Ratios (%)

RoE		-14.0	-19.9	6.2	12.6	15.1
RoCE		0.5	-2.1	8.0	11.7	12.8
RoIC		-0.6	-8.1	6.5	11.5	13.0

Working Capital Ratios

Debtor (Days)	7	1	3	3	3	3
Asset Turnover (x)	1.2	1.2	0.9	1.0	1.2	1.3

Leverage Ratio

Debt/Equity (x)	0.2	0.1	0.1	0.1	0.1	0.0
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Cash Flow Statement

Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E
(INR m)						
OP/(loss) before Tax	-683	-1,610	-987	514	1,396	2,142
Depreciation	1,547	1,913	2,091	2,135	2,695	3,474
Net interest	627	620	697	677	518	494
Others	94	1,052	-378	117	0	0
Direct Taxes Paid	-38	-27	-30	-86	-38	-279
(Incr)/Decr in WC	-46	182	147	592	131	30
CF from Operations	1,501	2,130	1,541	3,949	4,701	5,862
Incr in FA	-1,744	-1,415	-734	-2,844	-2,625	-2,755
Free Cash Flow	-243	715	807	1,105	2,076	3,108
Pur of Investments	-1,585	1,313	-55	-4,078	-475	-500
Others	1,697	-1,419	-128	1,890	-1,879	-1,195
CF from Invest.	-1,632	-1,522	-917	-5,032	-4,979	-4,449
Issue of Shares	2,321	0	444	4,690	0	0
Incr in Debt	646	-218	61	-176	350	936
Dividend Paid	0	0	0	0	0	0
Net interest Paid	-709	-699	-758	-780	-518	-494
Others	-490	-1,165	-263	-604	0	0
CF from Fin. Activity	1,767	-2,081	-515	3,130	-168	442
Incr/Decr of Cash	1,636	-1,473	109	2,046	-446	1,855
Add: Opening Balance	228	1,865	392	500	2,546	2,101
Closing Balance	1,865	392	500	2,546	2,101	3,956

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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